

**MUSIC LICENSING PART ONE:
LEGISLATION IN THE 112TH CONGRESS**

HEARING
BEFORE THE
SUBCOMMITTEE ON
INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET
OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES
ONE HUNDRED TWELFTH CONGRESS
SECOND SESSION

NOVEMBER 28, 2012

Serial No. 112-158

Printed for the use of the Committee on the Judiciary



Available via the World Wide Web: <http://judiciary.house.gov>

U.S. GOVERNMENT PRINTING OFFICE

77-042 PDF

WASHINGTON : 2013

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
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MUSIC LICENSING PART ONE: LEGISLATION IN THE 112TH CONGRESS

WEDNESDAY, NOVEMBER 28, 2012

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 11:30 a.m., in room 2141, Rayburn House Office Building, the Honorable Bob Goodlatte (Chairman of the Subcommittee) presiding.

Present: Representatives Goodlatte, Smith, Sensenbrenner, Coble, Chabot, Issa, Jordan, Chaffetz, Griffin, Amodei, Watt, Conyers, Berman, Chu, Deutch, Sánchez, Nadler, Lofgren, Jackson Lee, and Johnson.

Staff Present: (Majority) David Whitney, Counsel; Olivia Lee, Clerk; and (Minority) Stephanie Moore, Subcommittee Chief Counsel.

Mr. GOODLATTE. Good morning. This hearing of the Subcommittee on Intellectual Property, Competition, and the Internet on the Internet Radio Freedom Act will come to order. The title of today's hearing is "Music Licensing Part One: Legislation in the 112th Congress." The focus of the discussion today will be legislation introduced by Congressman Jason Chaffetz, H.R. 6480, the "Internet Radio Freedom Act." Today's hearing is the first in what I hope will be a series of hearings examining the nuances of music licensing. The Merriam-Webster Dictionary defines the word "system" in a number of ways.

One of those is a harmonious arrangement or pattern. I'm not sure that definition is the one most suitable to describe the accumulation of laws and customs that govern the music licensing apparatus in the United States today. The complexity of our music licensing system is a result of a number of sometimes independent but often interdependent factors. For instance, there are distinctions that are based on one, the type of work, whether the work is a musical composition or sound recording; two, the type of right someone wishes to license, whether they want to distribute, reproduce or publicly perform the work; and even three, the type of technology they plan to use, whether they want to publicly perform the work by means of an analog radio or Internet radio broadcast. To be sure, there is often a need for fine distinctions in a subject area as complex and far reaching as copyright law.

And much of our work in this area is frequently devoted to examining how best to calibrate the law to ensure it achieves the right balance in a particular area. But from time to time, we need to step back from the pieces and look at how they fit into the whole. Music licensing is an area where it would benefit us to take a broader look. To their credit, under the leadership of Chairman Sensenbrenner, Conyers and Smith, this Committee began the process of seeking to modernize and bring some order to aspects of our music licensing system that have been slow to adapt. Indeed, four laws that originated in the Subcommittee that relate principally to or profoundly affect aspects of our music licensing system were enacted during the last decade. And the Committee and the Subcommittee devoted considerable effort to attempt to both resolve the longstanding debate over whether the United States should recognize a full performance right in sound recordings and modernize provisions in the Copyright Act that relate to the collective licensing of musical works.

But there are many interconnected issues that have been raised by stakeholders on all sides that the Subcommittee needs to begin to carefully review and consider. These include the following: First, Representative Chaffetz and webcasters have raised the issues of rate standard parity in the sound recording compulsory license, section 114, and reform the adjudicatory and rate-setting processes.

Second, sound recording stakeholders have raised the issue of applying the sound recording statutory license to terrestrial radio stations. This Committee reported a bill on that issue in 2009.

Third, music publishers and webcasters have raised the issue of the rate standard in the musical work statutory license, section 115, and suggested a need for parity of that standard across licenses. They have also raised the issue of reforming the musical works license, especially as it applies to use by digital services directly.

Fourth, performing rights organizations that represent songwriters and publishers, such as ASCAP, have asked the Committee to examine broadly issues of music licensing, including current decisions by the rate court in New York and the continued utility of the consent decree.

Fifth, some broadcasters have suggested that performing rights organizations that currently operate in the free market, such as SESAC, should be bound by a consent decree or legislation in a manner similar to that which binds their competitors, ASCAP and BMI.

All of these issues need to be carefully examined as they all affect both the incentive to create new works for consumers to enjoy and innovation in the music and Internet industries. However, today we focus our attention on the Internet Radio Freedom Act. This legislation seeks to harmonize the rate-setting standard among Internet radio broadcasters and satellite and cable radio broadcasters by changing the rate-setting standard from the willing buyer/willing seller standard to a modified 801(b) standard, similar to what cable and satellite radio broadcasters currently operate under. It is worth noting that this legislation does not attempt to address the question of whether terrestrial radio should pay performance royalties.

In addition to harmonizing the rate standard, H.R. 6480 also contains numerous other provisions amending the procedures governing the music licensing, including changing the method by which copyright royalty judges are chosen. I am open to the idea of harmonizing the rate-setting standard to create more parity across music delivery platforms, but I am also concerned about ensuring that those who create and perform music are fairly compensated for their creative works. I hope today we will have a productive conversation about the issues, including; one, whether we should harmonize the rate standard at all; two, if so, whether the 801(b) standard, the willing buyer/willing seller standard, or something in between is the right balance; and three, how adjusting the standard would affect innovation in the Internet radio market and compensation for artists in the long term.

The need to protect intellectual property and the imperative to foster innovation are not mutually exclusive goals. We can and will promote both interests going forward. When we succeed, hopefully more of us will also agree that the copyright law, in general, and the music licensing system in particular, resemble that harmonious arrangement or pattern defined in Merriam-Webster's Dictionary.

I look forward to hearing the testimony of all of our expert witnesses today. And before we proceed to swear them in, I want to acknowledge and thank several members of our Committee for their service on this Subcommittee since they are leaving the Congress. And I don't see any of them with me here today, so maybe they've already left. But I still think it is worth noting their contribution to this Subcommittee.

And I first want to mention Representative Howard Berman, next Representative Dan Lungren, Representative Mike Pence, Representative Ben Quayle and Representative Sandy Adams. And in their absence, let's give them all a round of applause for their service to this great Subcommittee.

[The bill, H.R. 6480, follows:]

112TH CONGRESS
2D SESSION

H. R. 6480

To adopt fair standards and procedures by which determinations of Copyright Royalty Judges are made with respect to webcasting, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 21, 2012

Mr. CHAFFETZ (for himself, Mr. POLIS, Mr. ISSA, and Ms. ZOE LOPGREN of California) introduced the following bill; which was referred to the Committee on the Judiciary

A BILL

To adopt fair standards and procedures by which determinations of Copyright Royalty Judges are made with respect to webcasting, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Internet Radio Fair-
5 ness Act of 2012”.

6 **SEC. 2. APPOINTMENT OF COPYRIGHT ROYALTY JUDGES**
7 **AND QUALIFICATIONS.**

8 Chapter 8 of title 17, United States Code, is amend-
9 ed—

1 (1) in section 801(a)—

2 (A) in the first sentence, by striking “Li-
3 brarian of Congress” and inserting “President
4 of the United States, by and with the advice
5 and consent of the Senate,”; and

6 (B) by striking the second sentence; and

7 (2) in section 802—

8 (A) in subsection (a)(1), by striking
9 “Each” and all that follows through “econom-
10 ics.” and inserting the following: “Each Copy-
11 right Royalty Judge shall be an attorney who
12 has not fewer than 10 years of legal experience
13 and has significant experience in adjudicating
14 arbitrations or court trials. The Chief Copyright
15 Royalty Judge shall have not fewer than 7
16 years of experience in adjudicating court trials
17 in civil cases.”; and

18 (B) in subsection (d)—

19 (i) in paragraph (1), in the first sen-
20 tence, by striking “Librarian” and all that
21 follows through “section.” and inserting
22 “President of the United States shall act
23 expeditiously to fill the vacancy.”; and

24 (ii) in paragraph (2), by striking “Li-
25 brarian of Congress” and inserting “Presi-

1 dent of the United States, by and with the
2 advise and consent of the Senate.”.

3 **SEC. 3. COMPUTATION OF ROYALTY FEES FOR INTERNET**
4 **RADIO SERVICES OFFERING DIGITAL PER-**
5 **FORMANCES OF SOUND RECORDINGS AND**
6 **REPORTING OBLIGATIONS.**

7 (a) STANDARD FOR DETERMINING RATES AND
8 TERMS; BURDEN OF PROOF.—

9 (1) EPHEMERAL RECORDINGS.—Section 112(e)
10 of title 17, United States Code, is amended—

11 (A) in paragraph (3), by striking the sec-
12 ond sentence and inserting the following: “Such
13 rates may include a minimum annual fee for
14 each type of service offered by the transmitting
15 organization.”;

16 (B) in paragraph (4), by striking “Such
17 rates shall” and all that follows through “para-
18 graphs (2) and (3).” and inserting the fol-
19 lowing: “In establishing rates and terms under
20 this paragraph, the Copyright Royalty Judges
21 shall apply the objectives set forth in section
22 801(b)(1), in accordance with subparagraphs
23 (C) and (D) of section 114(f)(1). In any pro-
24 ceeding under this paragraph, the burden of
25 proof shall be on the copyright owners of sound

1 recordings to establish that the fees and terms
2 that they seek satisfy the requirements of this
3 paragraph, and do not exceed the fees to which
4 most copyright owners and users would agree
5 under competitive market circumstances. To the
6 extent the Copyright Royalty Judges consider
7 marketplace benchmarks to be relevant, they
8 shall limit those benchmarks to benchmarks re-
9 flecting the rates and terms that have been
10 agreed under competitive market circumstances
11 by most copyright users.”; and

12 (C) in paragraph (5), by striking “in lieu
13 of any” and all that follows and inserting the
14 following: “and be binding upon the parties to
15 any such agreements in lieu of any determina-
16 tion by the Copyright Royalty Judges.”.

17 (2) DIGITAL SOUND RECORDING PERFORM-
18 ANCES.—Section 114(f) of title 17, United States
19 Code, is amended—

20 (A) in paragraph (1)—

21 (i) in subparagraph (A)—

22 (I) in the first sentence—

23 (aa) by striking “subscrip-
24 tion transmissions by preexisting
25 subscription services and trans-

1 missions by preexisting satellite
2 digital audio radio”; and

3 (bb) by striking “, except in
4 the case of a different transi-
5 tional period provided under sec-
6 tion 6(b)(3) of the Copyright
7 Royalty and Distribution Reform
8 Act of 2004,”; and

9 (II) by striking “Such terms and
10 rates” and all that follows and insert-
11 ing the following: “Such terms and
12 rates shall distinguish among the dif-
13 ferent types of digital audio trans-
14 mission services then in operation and
15 may take into account the different
16 characteristics of such services, and
17 may include a minimum annual fee of
18 not more than \$500 for each provider
19 of services that is subject to such
20 rates and terms, which may be the
21 only minimum fee for such provider
22 and may be assessed only once annu-
23 ally to that provider. Any copyright
24 owners of sound recordings or any en-
25 tities performing sound recordings af-

1 fected by this paragraph may submit
2 to the Copyright Royalty Judges for
3 consideration in such rate-setting pro-
4 ceedings licenses covering such non-
5 interactive sound recording perform-
6 ances. The parties to each proceeding
7 shall bear their own costs.”;

8 (ii) in subparagraph (B)—

9 (I) in the first sentence—

10 (aa) by striking “paragraph
11 (3)” and inserting “paragraph
12 (2)”; and

13 (bb) by striking “, a transi-
14 tional period provided under sec-
15 tion 6(b)(3) of the Copyright
16 Royalty and Distribution Reform
17 Act of 2004,”; and

18 (II) by striking the second sen-
19 tence and inserting the following: “In
20 establishing rates and terms under
21 this paragraph, the Copyright Royalty
22 Judges shall apply the objectives set
23 forth in section 801(b)(1) and may
24 also consider the rates and terms for
25 noninteractive digital audio trans-

1 mission services under voluntary li-
2 cense agreements described in sub-
3 paragraph (A) that were entered into
4 under competitive market cir-
5 cumstances. In any proceeding under
6 this subsection, the burden of proof
7 shall be on the copyright owners of
8 sound recordings to establish that the
9 fees and terms that they seek satisfy
10 the requirements of this subsection,
11 and do not exceed the fees to which
12 most copyright owners and users
13 would agree under competitive market
14 circumstances.”;

15 (iii) by redesignating subparagraph
16 (C) as subparagraph (E);

17 (iv) by inserting after subparagraph
18 (B) the following:

19 “(C)(i) In construing the objectives set
20 forth in section 801(b)(1), the Copyright Roy-
21 alty Judges shall take into consideration—

22 “(I) the public’s interest in both the
23 creation of new sound recordings of musi-
24 cal works and in fostering online and other

1 digital performances of sound recordings;
2 and

3 “(II) the income necessary to provide
4 a reasonable return on all relevant invest-
5 ments, including investments in prior peri-
6 ods for which returns have not been
7 earned.

8 “(ii) To the extent the Copyright Royalty
9 Judges consider marketplace benchmarks to be
10 relevant, the Copyright Royalty Judges shall
11 limit those benchmarks to benchmarks reflect-
12 ing the rates and terms that have been agreed
13 under competitive market circumstances by
14 most copyright users.

15 “(D) In applying the objectives set forth in
16 section 801(b)(1), the Copyright Royalty
17 Judges—

18 “(i) shall not disfavor percentage of
19 revenue-based fees;

20 “(ii) shall establish license fee struc-
21 tures that foster competition among the
22 licensors of sound recording performances
23 and between sound recording performances
24 and other programming, including per-use
25 or per-program fees, or percentage of rev-

1 enue or other fees that include carve-outs
2 on a pro-rata basis for sound recordings
3 the performance of which have been li-
4 censed either directly with the copyright
5 owner or at the source, or for which a li-
6 cense is not necessary;

7 “(iii) shall give full consideration for
8 the value of any promotional benefit or
9 other non-monetary benefit conferred on
10 the copyright owner by the performance;

11 “(iv) shall give full consideration to
12 the contributions made by the digital audio
13 transmission service to the content and
14 value of its programming; and

15 “(v) shall not take into account either
16 the rates and terms provided in licenses for
17 interactive services or the determinations
18 rendered by the Copyright Royalty Judges
19 prior to the enactment of the Internet
20 Radio Fairness Act of 2012.”; and

21 (v) by amending subparagraph (E), as
22 so redesignated, to read as follows:

23 “(E) The procedures under subparagraph
24 (A) may also be initiated pursuant to a petition
25 filed by any copyright owners of sound record-

1 ings, or any entity performing sound recordings
2 affected by this paragraph, indicating that a
3 new type of digital audio transmission service
4 engaged in the public performance of sound re-
5 cordings is or is about to become operational,
6 for the purpose of determining reasonable terms
7 and rates of royalty payments with respect to
8 such new type of transmission service for the
9 period beginning with the inception of such new
10 type of service and ending on the date on which
11 the royalty rates and terms for the most com-
12 parable digital audio transmission services most
13 recently determined under subparagraph (A)
14 and chapter 8 expire, or such other period as
15 the parties may agree.”;

16 (B) by striking paragraph (2);

17 (C) by redesignating paragraphs (3), (4),
18 and (5) as paragraphs (2), (3), and (4), respec-
19 tively; and

20 (D) in paragraph (2), as so redesignated—

21 (i) by inserting “or their authorized
22 representatives” after “owners of sound re-
23 cordings”; and

24 (ii) by striking “in lieu of any” and
25 all that follows and inserting the following:

1 “and be binding upon the parties to any
2 such agreements in lieu of any determina-
3 tion by the Copyright Royalty Judges.”.

4 (3) DEFINITION.—Section 114(j) of title 17,
5 United States Code, is amended—

6 (A) by redesignating paragraphs (4)
7 through (15) as paragraphs (5) through (16),
8 respectively; and

9 (B) by inserting after paragraph (3) the
10 following:

11 “(4) ‘Competitive market circumstances’ are
12 circumstances in which a licensee enters into a li-
13 cense for the noninteractive performance of sound
14 recordings with a licensor that does not possess mar-
15 ket power resulting from the aggregation of copy-
16 rights, either by a licensing collective or individual
17 copyright owners.”.

18 (b) PRECEDENTIAL VALUE OF SETTLEMENTS.—Sec-
19 tion 114(f)(4) of title 17, United States Code, as so redes-
20 ignated by subsection (a)(2), is amended—

21 (1) in subparagraph (B), by striking the second
22 sentence;

23 (2) by striking subparagraphs (C) and (F);

24 (3) by redesignating subparagraphs (D) and
25 (E) as subparagraphs (C) and (D), respectively; and

1 (4) by adding at the end the following:

2 “(E) The rates and terms of any settle-
3 ments made pursuant to the amendments made
4 by the Webcaster Settlement Act of 2009 (Pub-
5 lic Law 111–36; 123 Stat. 1926) that were to
6 expire before December 31, 2015, shall be ex-
7 tended through December 31, 2015, according
8 to the rates and terms applicable to 2014.”.

9 (e) TECHNICAL AND CONFORMING AMENDMENTS.—
10 Chapter 8 of title 17, United States Code, is amended—

11 (1) in section 801(b)(7)(B), by striking
12 “114(f)(3)” and inserting “114(f)(2)”;

13 (2) in section 803(e)(2)(E)(i)(II)—

14 (A) by striking “section 114(f)(1)(C) or
15 114(f)(2)(C)” and inserting “section
16 114(f)(1)(E)”; and

17 (B) by striking “section 114(f)(4)(B)” and
18 inserting “section 114(f)(3)(B)”; and

19 (3) in section 804(b)(3)(C)—

20 (A) in clause (i), by striking “section
21 114(f)(1)(C) and 114(f)(2)(C)” and inserting
22 “section 114(f)(1)(E)”;

23 (B) in clause (iii)(II), by striking “section
24 114(f)(4)(B)(ii) and (C)” and inserting “sub-

1 paragraphs (B)(ii) and (C) of section
2 114(f)(3)”; and

3 (C) in clause (iv), by striking “section
4 114(f)(1)(C) or 114(f)(2)(C)” and inserting
5 “section 114(f)(1)(E)”.

6 **SEC. 4. MODERNIZATION OF CONDITIONS GOVERNING**
7 **EPHEMERAL RECORDING EXEMPTION AND**
8 **STATUTORY LICENSES.**

9 (a) EPHEMERAL RECORDING EXEMPTION.—Section
10 112(a)(1) of title 17, United States Code, is amended by
11 striking “no more than” and all that follows and inserting
12 the following: “1 or more copies or phonorecords embody-
13 ing the performance or display, if—

14 “(A) the copies or phonorecords are re-
15 tained and used solely by the transmitting orga-
16 nization that made them, and no further copies
17 or phonorecords are reproduced from them, ex-
18 cept as may be incidental to the operation of
19 the transmission technology used by the trans-
20 mitting organization; and

21 “(B) the copies or phonorecords are used
22 solely for the transmitting organization’s own
23 transmissions originating in the United States,
24 or for purposes of archival preservation or secu-
25 rity.”.

1 (b) EPHEMERAL RECORDING STATUTORY LI-
2 CENSE.—Section 112(e)(1) of title 17, United States
3 Code, is amended—

4 (1) in the matter preceding subparagraph (A)—

5 (A) by striking “or under a statutory li-
6 cense in accordance with section 114(f)”; and

7 (B) by striking “if the following conditions
8 are satisfied.” and inserting “if—”;

9 (2) in subparagraph (A)—

10 (A) by striking “The” and inserting “the”;
11 and

12 (B) by striking the period at the end and
13 inserting “, except as may be incidental to the
14 operation of the transmission technology used
15 by the transmitting organization;”;

16 (3) in subparagraph (B)—

17 (A) by striking “The” and inserting “the”;

18 (B) by striking “a statutory license in ac-
19 cordance with section 114(f) or”; and

20 (C) by striking the period at the end and
21 inserting “, or for purposes of archival preser-
22 vation or security; and”;

23 (4) by striking subparagraph (C);

24 (5) by redesignating subparagraph (D) as sub-
25 paragraph (C); and

1 (6) in subparagraph (C), as so redesignated, by
2 striking “Phonorecords” and inserting “phonorec-
3 ords”.

4 (e) SOUND RECORDING PERFORMANCE STATUTORY
5 LICENSE.—Section 114(d)(2)(C) of title 17, United
6 States Code, is amended—

7 (1) in clause (i), by striking “of a broadcast
8 transmission” and all that follows and inserting the
9 following: “or simultaneous transmission of a broad-
10 cast transmission in any medium, which may include
11 programming substituted for programming con-
12 tained in the broadcast transmission with respect to
13 which the transmitting entity lacks the requisite li-
14 censes or clearances to make the transmission in the
15 medium, or for advertisements contained in the
16 broadcast transmission, or the transmission of any
17 programming previously included in a broadcast
18 transmission as an archived program in conformance
19 with clause (iii);”;

20 (2) by striking clause (ii) and inserting the fol-
21 lowing:

22 “(ii) the transmitting entity
23 does not cause to be published in
24 writing by means of an advance
25 program schedule the titles of the

16

1 specific sound recordings or
2 phonorecords embodying such
3 sound recordings to be trans-
4 mitted at particular times, except
5 that this clause does not dis-
6 qualify a transmitting entity that
7 publishes in writing—

8 “(AA) such a program
9 schedule that identifies
10 sound recordings, phonorec-
11 ords or artists that will be
12 featured within a period of
13 time greater than 3 hours or
14 within an unspecified future
15 time period; or

16 “(BB) an advance pro-
17 gram schedule that is a
18 schedule of classical music
19 programming to be per-
20 formed as part of a retrans-
21 mission or simultaneous
22 transmission of a broadcast
23 transmission, which may in-
24 clude programming sub-
25 stituted for programming

1 contained in the broadcast
2 transmission with respect to
3 which the transmitting enti-
4 ty lacks the requisite li-
5 censes or clearances to make
6 the transmission in the me-
7 dium, or for advertisements
8 contained in the broadcast
9 transmission;”;

10 (3) in clause (iii)—

11 (A) in subclause (II), by adding “or” at
12 the end; and

13 (B) beginning in subclause (III), by strik-
14 ing “or” and all that follows through “require-
15 ment;”;

16 (4) in clause (vii)—

17 (A) by striking “and the transmitting enti-
18 ty” through “of the copyright owner;” and

19 (B) by striking “of a broadcast trans-
20 mission” and all that follows and inserting “or
21 simultaneous transmission of a broadcast trans-
22 mission, which may include programming sub-
23 stituted for programming contained in the
24 broadcast transmission with respect to which
25 the transmitting entity lacks the requisite li-

1 censes or clearances to make the transmission
 2 in the medium, or for advertisements contained
 3 in the broadcast transmission;” and

4 (5) by amending clause (ix) to read as follows:

5 “(ix) the transmitting entity identifies
 6 in textual data the sound recording during,
 7 but not before, the time it is performed, in-
 8 cluding the title of the sound recording
 9 and the featured recording artist, in a
 10 manner to permit it to be displayed to the
 11 transmission recipient by the device or
 12 technology intended for receiving the serv-
 13 ice provided by the transmitting entity, ex-
 14 cept that the obligation in this clause shall
 15 not apply to the extent that the transmit-
 16 ting entity does not have the technology or
 17 information necessary to provide such tex-
 18 tual data.”.

19 **SEC. 5. PROMOTION OF A COMPETITIVE MARKETPLACE.**

20 (a) LIMITATION OF ANTITRUST EXEMPTIONS.—

21 (1) EPHEMERAL RECORDINGS.—Section
 22 112(e)(2) of title 17, United States Code, is amend-
 23 ed—

24 (A) by inserting “, on a nonexclusive
 25 basis,” after “common agents”; and

1 (B) by adding at the end the following:
2 “Nothing in this paragraph shall be construed
3 to permit any copyright owners of sound re-
4 cordings acting jointly, or any common agent or
5 collective representing such copyright owners, to
6 take any action that would prohibit, interfere
7 with, or impede direct licensing by copyright
8 owners of sound recordings in competition with
9 licensing by any common agent or collective,
10 and any such action that affects interstate com-
11 merce shall be deemed a contract, combination
12 or conspiracy in restraint of trade in violation
13 of section 1 of the Sherman Act (15 U.S.C.
14 1).”.

15 (2) DIGITAL SOUND RECORDING PERFORM-
16 ANCES.—Section 114(c) of title 17, United States
17 Code, is amended by adding at the end the fol-
18 lowing:

19 “(3) Nothing in this subsection shall be con-
20 strued to permit any copyright owners of sound re-
21 cordings acting jointly, or any common agent or col-
22 lective representing such copyright owners, to take
23 any action that would prohibit, interfere with, or im-
24 pede direct licensing by copyright owners of sound
25 recordings in competition with licensing by any com-

1 mon agent or collective, and any such action that af-
 2 fects interstate commerce shall be deemed a con-
 3 tract, combination or conspiracy in restraint of trade
 4 in violation of section 1 of the Sherman Act (15
 5 U.S.C. 1).

6 “(4) In order to obtain the benefits of para-
 7 graph (1), a common agent or collective representing
 8 copyright owners of sound recordings must make
 9 available at no charge through publicly accessible
 10 computer access through the Internet the most cur-
 11 rent available list of sound recording copyright own-
 12 ers represented by the organization and the most
 13 current list of sound recordings licensed by the orga-
 14 nization.”.

15 **SEC. 6. PROCEEDINGS OF THE COPYRIGHT ROYALTY**
 16 **JUDGES AND JUDICIAL REVIEW.**

17 (a) PROCEEDINGS AND PRECEDENTIAL VALUE.—
 18 Section 803(a)(1) of title 17, United States Code, is
 19 amended—

20 (1) by striking the first sentence and inserting
 21 the following: “‘In carrying out the purposes set
 22 forth in section 801, all proceedings of the Copyright
 23 Royalty Judges shall be conducted in accordance
 24 with this title and, unless contrary to a procedure
 25 set forth in subsection (b), according to the Federal

1 Rules of Civil Procedure and the Federal Rules of
2 Evidence.”; and

3 (2) by adding at the end the following: “Not-
4 withstanding the preceding sentence, in any rate-set-
5 ting proceeding under section 112(e)(4) or section
6 114(f)(2)(B), the Copyright Royalty Judges may
7 only consider as precedent and act in accordance
8 with determinations and interpretations that are
9 made under the objectives set forth in section 801(b)
10 for the statutory licenses under sections 112(e) and
11 114(d)(2).”.

12 (b) REGULATIONS.—Section 803(b)(6) of title 17,
13 United States Code, is amended—

14 (1) in subparagraph (C), by striking “RE-
15 QUIREMENTS.—Regulations” and inserting “RE-
16 QUIREMENTS IN CASES NOT INVOLVING DIGITAL
17 PERFORMANCES OF SOUND RECORDINGS.—In pro-
18 ceedings other than proceedings to determine terms
19 and rates of royalty payments under section 112 or
20 114, regulations”; and

21 (2) by adding at the end the following:

22 “(D) REQUIREMENTS IN PROCEEDINGS IN-
23 VOLVING DIGITAL PERFORMANCES OF SOUND
24 RECORDINGS.—In proceedings to determine

1 terms and rates of royalty payments under sec-
2 tion 112 or 114, the following shall apply:

3 “(i) INITIAL DISCLOSURES.—Not later
4 than 30 days after the date on which the
5 voluntary negotiation period is initiated
6 pursuant to paragraph (3)(A)(i), each par-
7 ticipant shall make an initial disclosure to
8 the other participants by providing cop-
9 ies—

10 “(I) of all license agreements en-
11 tered into by that participant, its
12 members, or any licensor or licensee
13 represented in the proceeding by that
14 participant during the applicable 5-
15 year period or covering any portion of
16 the period for which the rates are to
17 be set, relating to—

18 “(aa) in a proceeding under
19 section 112, the making of
20 ephemeral recordings; or

21 “(bb) in a proceeding under
22 section 114, the public perform-
23 ance of musical works, sound re-
24 cordings, or audiovisual works in-

1 incorporating recorded musical
2 works; or

3 “(II) of any other license agree-
4 ment or document upon which the
5 participant intends to rely, in whole or
6 in part, in its ratemaking proposal, as
7 well as all license agreements entered
8 into by the participant, its members,
9 or any licensor or licensee represented
10 in the proceeding by that participant
11 for the same or similar rights during
12 the applicable 5-year period or cov-
13 ering any portion of the period for
14 which the rates are to be set.

15 “(ii) PROTECTIVE ORDER; SANC-
16 TIONS.—Disclosures under clause (i) and
17 other confidential information produced by
18 a participant or third party during dis-
19 covery, or used during the proceeding,
20 shall be subject to a protective order, en-
21 tered by the Copyright Royalty Judges in
22 the proceeding, that prohibits use of the
23 disclosures and the confidential informa-
24 tion for any purpose other than the pro-
25 ceeding and that prohibits disclosure of the

1 licenses or other documents included in the
2 disclosure or of other confidential informa-
3 tion to any person that is not counsel of
4 record in the proceeding. The Copyright
5 Royalty Judges may impose appropriate
6 sanctions for failure to comply in a timely
7 manner with the matters required to be
8 disclosed under clause (i).

9 “(iii) STATEMENTS OF THE CASE.—
10 Statements of the case shall be filed by a
11 date specified by the Copyright Royalty
12 Judges, which for licensor participants
13 shall be no earlier than the end of the 90-
14 day period beginning on the date on which
15 the voluntary negotiation period concludes,
16 and for licensee participants shall be no
17 earlier than the end of the 60-day period
18 beginning on the date on which the state-
19 ments of the case are required to be sub-
20 mitted by licensor participants.

21 “(iv) SUBPOENA POWER.—The Copy-
22 right Royalty Judges shall have the power
23 to issue subpoenas at the request of a par-
24 ticipant to non-participants, subject to the
25 Federal Rules of Civil Procedure. Orders

1 by the Copyright Royalty Judges to en-
2 force such subpoenas may be enforced by
3 the requesting participant in an action in
4 the district court in which the subpoenaed
5 party resides.

6 “(v) SCHEDULING CONFERENCE.—
7 The Copyright Royalty Judges shall order
8 a scheduling conference no sooner than 45
9 days following the submission to the Copy-
10 right Royalty Judges of the statement of
11 the case of the licensee participants. Par-
12 ticipants shall submit jointly a proposed
13 discovery plan no later than 21 days before
14 the conference. Following the conference,
15 the Copyright Royalty Judges shall issue
16 an initial scheduling order governing pre-
17 trial procedures, and permitting discovery
18 that is reasonable and sufficient, giving
19 due consideration to the proposals of the
20 participants and the magnitude of the po-
21 tential royalty payments at issue during
22 the license period covered by the pro-
23 ceeding. The period to conduct discovery
24 shall be no shorter than 90 days, plus the
25 time needed to complete discovery ordered

1 by the Copyright Royalty Judges in con-
2 nection with the resolution of motions, or-
3 ders, and disputes pending at the end of
4 such period.

5 “(vi) SETTLEMENT CONFERENCE.—
6 The Copyright Royalty Judges shall order
7 a settlement conference among the partici-
8 pants in the proceeding to facilitate the
9 presentation of offers of settlement among
10 the participants. The settlement conference
11 shall be held during the 21-day period be-
12 ginning on the day after the last day of the
13 discovery period ordered pursuant to clause
14 (iv) and shall take place outside the pres-
15 ence of the Copyright Royalty Judges.

16 “(vii) JOINT PRETRIAL ORDER.—If
17 the conference required in clause (v) does
18 not result in a settlement among all par-
19 ties, not later than 60 days after the last
20 day of the settlement conference, the re-
21 maining participants shall propose a joint
22 pretrial order—

23 “(I) stating the rates and terms
24 proposed by each participant and set-

1 ting forth, in detail, the grounds for
2 such proposals;

3 “**(II)** setting forth admissions
4 and stipulations about facts and docu-
5 ments;

6 “**(III)** avoiding unnecessary proof
7 and cumulative evidence and limiting
8 the use of testimony under rule 702 of
9 the Federal Rules of Evidence;

10 “**(IV)** identifying the witnesses to
11 be offered by each party, and attach-
12 ing all witness statements, testimony,
13 and exhibits to be presented in the
14 proceeding and such other information
15 that is necessary to establish terms
16 and rates;

17 “**(V)** listing the evidence to be of-
18 fered by each party, and identifying
19 any objections to any such evidence;

20 “**(VI)** identifying any pending
21 motions, including motions in limine
22 and attaching any such motions that
23 have not yet been filed;

1 “(VII) proposing a reasonable
2 limit on the time allowed to present
3 evidence; and

4 “(VIII) proposing other ways to
5 facilitate the just, speedy, and inex-
6 pensive disposition of the proceeding.

7 “(viii) PRETRIAL ORDER.—The Copy-
8 right Royalty Judges shall hold a pre-
9 hearing conference to address the issues
10 set forth in the proposed joint pretrial
11 order, and shall issue an order reciting the
12 action taken. The order shall allocate to
13 the licensor participants and licensee par-
14 ticipants sufficient, reasonable, and equal
15 time in which to present their respective
16 cases, and shall afford each set of partici-
17 pants an opportunity for rebuttal. The
18 order issued by the Copyright Royalty
19 Judges under this clause shall control the
20 course of the action unless the Judges
21 modify it.

22 “(ix) DEFINITIONS.—In this subpara-
23 graph:

1 “(I) APPLICABLE 5-YEAR PE-
2 RIOD.—The term ‘applicable 5-year
3 period’ means—

4 “(aa) the period of 5 cal-
5 endar years preceding the year in
6 which the applicable voluntary
7 negotiation period begins; and

8 “(bb) the period of the cur-
9 rent calendar year through the
10 date on which the initial dislo-
11 sure under clause (i) is made.

12 “(II) LICENSEE.—The term ‘li-
13 censee’ means a person or entity that
14 exercises rights under a statutory li-
15 cense under section 112 or 114.

16 “(III) LICENSEE PARTICIPANT.—
17 The term ‘licensee participant’ means
18 a participant that is, or is an author-
19 ized representative of, a licensee.

20 “(IV) LICENSOR.—The term ‘li-
21 censor’ means a person or entity enti-
22 tled to receive royalty payments under
23 section 112 or 114.

24 “(V) LICENSOR PARTICIPANT.—
25 The term ‘licensor participant’ means

1 a participant that is, or that is an au-
2 thorized representative of, a licensor.

3 “(VI) STATEMENT OF THE
4 CASE.—The term ‘statement of the
5 case’ means a short and plain state-
6 ment that—

7 “(aa) identifies all partici-
8 pants and licensors or licensees
9 on whose behalf the statement is
10 being submitted;

11 “(bb) states the proposed
12 rate or rates and terms of the
13 participants for each right at
14 issue in the proceeding and sets
15 forth in detail the basis of each
16 such proposed rate and term;

17 “(cc) identifies each witness
18 that the participant intends to
19 call in support of its rate and
20 terms proposal and summarizes
21 the anticipated testimony of each
22 witness; and

23 “(dd) includes any reports,
24 including expert reports, and any

1 documents upon which the par-
2 ticipant relies.”.

3 (e) TIMING OF DETERMINATION.—Section 803(e)(1)
4 of title 17, United States Code, is amended by striking
5 “subsection (b)(6)(C)(x)” and inserting “subparagraph
6 (C)(x) or (D)(v) of subsection (b)(6) (as the case may
7 be)”.

8 (d) JUDICIAL REVIEW.—Section 803(d)(3) of title
9 17, United States Code, is amended by striking the first
10 sentence and inserting the following: “Conclusions of law,
11 and determinations of rates in which the Copyright Roy-
12 alty Judges are required to apply the facts of record to
13 the objectives set forth in section 801(b) shall be subject
14 to de novo review. Findings of fact by the Copyright Roy-
15 alty Judges shall be subject to review for clear error. All
16 other actions by the Copyright Royalty Judges shall be
17 subject to review for abuse of discretion.”.

18 **SEC. 7. GLOBAL MUSIC RIGHTS DATABASE.**

19 For purposes of facilitating compensation to artists
20 of musical works and combating copyright infringement,
21 not later than 180 days after the date of enactment of
22 this Act, the Librarian of Congress, in consultation with
23 the Intellectual Property Enforcement Coordinate and the
24 United States Patent and Trademark Office, shall submit
25 to Congress a report that provides a set of recommenda-

1 tions about how the Federal Government can facilitate,
2 and possibly establish, a global music registry that is
3 sustainably financed and consistent with World Intellec-
4 tual Property Organization obligations. Such registry
5 should, to the extent practicable, include all known or
6 copyrighted musical works, the writers of the work, the
7 owners of the rights, the entity on behalf of those owners
8 who can license such rights on a territory-by-territory
9 basis, and all known sound recording data.

10 **SEC. 8. EFFECTIVE DATE AND TRANSITIONAL RULES.**

11 (a) IN GENERAL.—Except as provided in subsection
12 (e), the amendments made by this Act shall take effect
13 on the date of enactment of this Act and shall apply to
14 any proceeding that is pending on, or that begins on or
15 after the date of enactment. The Copyright Royalty
16 Judges in office as of the date of enactment shall have
17 only such continuing authority as is provided in para-
18 graphs (1) and (2) of subsection (e).

19 (b) REGULATIONS.—Not later than 60 days after the
20 date on which not less than 2 Copyright Royalty Judges
21 are appointed and confirmed pursuant to section 2, the
22 Copyright Royalty Judges shall propose regulations imple-
23 menting the amendments set forth in section 6(b), by no-
24 tice in the Federal Register, providing 30 days for com-
25 ments and 15 days for reply comments. Not later than

1 45 days after the date on which the 15-day period for
2 reply comments ends, the Copyright Royalty Judges shall
3 promulgate final regulations.

4 (c) APPLICABILITY TO PENDING PROCEEDINGS.—

5 (1) PROCEEDINGS IN WHICH THE HEARING ON
6 THE MERITS HAS CONCLUDED.—The Copyright Roy-
7 alty Judges sitting on the date of enactment shall
8 have authority to decide any pending proceeding in
9 which the hearing on the merits has concluded,
10 under the standards, procedures, and regulations in
11 effect prior to the enactment of this Act. This au-
12 thority shall include the authority to decide any mo-
13 tion for rehearing under section 803(c)(2) of title
14 17, United States Code, in any such proceeding.

15 (2) PROCEEDINGS IN WHICH THE HEARING ON
16 THE MERITS HAS COMMENCED BUT NOT CON-
17 CLUDED.—The Copyright Royalty Judges sitting on
18 the date of enactment shall have authority to decide
19 any pending proceeding in which the hearing on the
20 merits has commenced but not concluded, under the
21 standards, procedures, and regulations in effect
22 prior to the enactment of this Act, except that this
23 authority may only be exercised with the consent of
24 all participants in any proceeding to determine
25 terms and rates of royalty payments under section

1 112 or 114 of title 17, United States Code. This au-
2 thority shall include the authority to decide any mo-
3 tion for rehearing under section 803(c)(2) of title
4 17, United States Code, in any such proceeding.

5 (3) ALL OTHER PENDING PROCEEDINGS.—The
6 Copyright Royalty Judges appointed pursuant to
7 section 2 shall assume authority over any pending
8 proceeding in which the hearing on the merits has
9 not commenced. The Copyright Royalty Judges shall
10 recommence any pending proceeding to determine
11 terms and rates of royalty payments under section
12 112 or 114 of title 17, United States Code, under
13 the procedures, standards and regulations set forth
14 in this Act, and the requirement set forth in section
15 803(c)(1) of title 17, United States Code, that the
16 proceeding be concluded no later than 15 days be-
17 fore the expiration of the then current statutory
18 rates and terms, shall not apply. The Copyright
19 Royalty Judges shall set a reasonable schedule for
20 the continuation of any pending proceeding other
21 than a proceeding to determine the terms and rates
22 of royalty payments under section 112 or 114 of
23 title 17, United States Code.

○

Mr. GOODLATTE. And now it's my pleasure to recognize the Ranking Member of the Subcommittee, the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. And thank you for a very outstanding opening statement. And I understand Mr. Berman is in the back waiting to make a grand entrance, so we will chide him later. I also want to thank the Chairman on his, what I understand to be his imminent ascension to the chairmanship of the full Judiciary Committee. And he's outlined a robust agenda in this opening statement just in the music area. So I'll be looking forward to working with him. And I want to thank him for scheduling this first in a series of anticipated hearings on music licensing.

Music is, of course, ubiquitous. It's everywhere. The proliferation of reality talent shows like American Idol, X Factor, The Voice, America's Got Talent, all evidence of our affection and affinity for music. iPods and iPads and other portable devices further illustrate our near, insatiable appetite for music. It's impossible for me to imagine a day where we don't encounter music. Despite our love of music and our admiration for artists, including the singers, songwriters and musicians whose creative talents provide us a wide diversity of entertainment, the complex licensing scheme for the delivery of music like stability and parity across platforms.

Over the past 15 years, Congress has been called upon to intervene following each rate-setting proceeding before the copyright judges. We've created a compulsory license, established new standards for new technologies and retooled the structural framework for the setting of rates all in response to complaints that industry participants could not reach agreements or that the rates set by the authorizing body were too high or too low. This is not a healthy process for artists, delivery platforms or consumers and it's not a healthy process for Congress.

Although today's hearing focuses on the Internet Radio Fairness Act, that focus is itself probably very shortsighted. Many of the supporters of H.R. 6480 highlight the longstanding inequity associated with the disparate standards governing the rate-setting process for the delivery of music by digital transmission. Specifically, they argue that while preexisting cable and satellite services pay lower rates determined under the 501(b) standard, newer and increasingly popular Internet music providers pay substantially higher rates determined under the willing buyer/willing seller standard. But an even longer standing inequity exists in the U.S. copyright law in that U.S. copyright law fails to recognize a performance right for vocalists and musicians when their work is played over terrestrial AM and FM radio.

Today when you turn on your favorite AM or FM radio station, the artists who perform that music, vocalists and members of the band don't get paid a dime. But when you listen to the same song on Internet, cable or satellite radio, the artists are compensated for their work. The differences don't stop there. The composer or songwriter is paid for the performance of their work across all platforms while sound recording artists are only paid when their work is delivered by digital means. And both the songwriter and the recording artists, when they are paid, are paid at different rates depending upon the method of delivery.

The reasons for these disparities in treatment are largely historical, but also rooted in legitimate concerns surrounding the threat that high quality media poses to record sales and other forms of revenue for artists. This concern, however, may no longer justify the exemption enjoyed by broadcast radio, and I think it is incumbent on us to address that disparity if we are to bring any sense of rationality to this area of our economy. That's about 90 percent of the problem. Yet H.R. 6480 fails to address it at all and, at best, nibbles around the edges of the challenge.

I believe that we all realize that in some sense digital transmission of music over the Internet has given birth to an even wider degree of exposure and promotional value for musical performers and genres that might otherwise receive little or no airplay. In short, Internet radio has expanded choices for consumers and provided alternate means for independent artists to showcase their talents. But I believe that a fair licensing regime must, first and foremost, adequately compensate the artist who create and perform the musical content upon which all delivery platforms are based.

We must get beyond the point where the shelf life of our legislative solutions in this vital industry is only as long as the next rate-setting proceeding. A comprehensive examination of music licensing requires that we examine the existing standards and rationales underlying our copyright system with the goal of establishing a long-term competitive environment with competitive rates for artists under a license which, after all, is a compulsory license.

Mr. Chairman, there are several other components of the Internet Radio Fairness Act, including the method of selecting judges, expansion of discovery, modification of evidentiary standards, anti-trust provisions and the establishment of a global database that I have not addressed here, but that also cause me varying degrees of concern.

We have a distinguished panel of industry experts who no doubt have very passionate views on all those issues in addition to the rate standard. I look forward to their testimony. Before I yield back, Mr. Chairman, I do want to acknowledge a true champion of the rights of creative arts and a pioneer on performance rights, Howard Berman.

Mr. Berman has jealously guarded intellectual property rights throughout his distinguished career and has been a valuable resource to me personally and to this Committee. I want to express my gratitude for the work he has done on behalf of the content community, as well as all other players in the IP area and wish him well. I know that he will continue to serve the public interest in some important next endeavor. And with that, Mr. Chairman, I yield back and thank the Chairman. [Applause.]

Mr. GOODLATTE. The gentleman from North Carolina's timing is better than mine.

Mr. WATT. I knew he was waiting on his grand entrance.

Mr. GOODLATTE. We do thank the gentleman from California for his long and very capable service on this Subcommittee and the full Committee, and we will miss you, Howard.

Mr. COBLE. Mr. Chairman.

Mr. GOODLATTE. For what purpose does that the gentleman from North Carolina wish to be recognized?

Mr. COBLE. May I speak out of order for 1 minute?

Mr. GOODLATTE. The gentleman is recognized without objection.

Mr. COBLE. I think I would be remiss if I did not echo what has been said about the distinguished gentleman from California. He served as my Ranking Member, I served as his Ranking Member on this Subcommittee. And Howard, as has been said earlier, you will indeed be sorely missed. Thank you, Mr. Chairman. I appreciate that.

Mr. GOODLATTE. I thank the gentleman. And now it's my opportunity to recognize the Chairman of the full Committee, who I want to also congratulate for the recommendation of the House Republican Steering Committee that he Chairs, the Science, Space and Technology Committee, in the new Congress, and to thank him for his outstanding work as the Chairman of the Judiciary Committee.

Mr. SMITH. Thank you for that, Mr. Chairman. I am very delighted that you will be succeeding me. And the Committee will be in good hands, and look forward to continue to work with you there. Also, it was appropriate that we applaud Howard Berman a minute ago for his many contributions to this Committee. And Howard, you should know that's actually the second round of applause you have gotten today because the Chairman, Bob Goodlatte, recognized you before you came into the room. And so even the second round of applause was well deserved as well.

Mr. GOODLATTE. He doesn't represent the entertainment industry for nothing. He understands how this works.

Mr. SMITH. Again, thank you, Mr. Chairman, for calling this hearing on issues affecting music licensing. This is a topic that we have debated for many years and deserves this Committee's attention in light of changes that have occurred in the music industry. Twenty years ago when you wanted to listen to a song, you either purchased it on a CD or you tuned your radio to your favorite station and hoped that they would play it. Today, you can simply type Pandora in your browser and select an entire online radio station that plays your favorite artists' sound recordings.

The relationship among artists, consumers, composers and publishers is a delicate one. The Constitution affords Congress the exclusive right to make copyright law that protects creators while simultaneously ensuring that artists and composers are compensated. This Committee has continually addressed the issues that surround music licensing and royalty structures. This includes the section 115 Reform Act, the Performance Right Act, the enactment of three webcasting bills, and the passage of the Copyright Royalty and Distribution Reform Act.

Today we continue our ongoing examination of this compensation scheme. This hearing will explore the state of the law as it affects music creators, consumers and users of musical works and sound recordings. Government dictated compulsory licenses deprive creators of their ability to negotiate for the use of their works. Rather than increasing our reliance on these compulsory licenses, we should consider moving in the direction of free market discussions and negotiated resolutions.

The expansion and strengthening of stringent compulsory licensing terms undermines the ability to develop healthy markets. It

leads to below market compensation for creators and invites constant petitions for government to place its thumb on the economic scale, commandeering the force of government to choose winners and losers.

I do not believe the copyright law is perfect and should remain unchanged. Any change, however, should reflect a balanced approach with input from creators, presenters and listeners of music. It is my hope that this hearing will begin a process that will carry into the next Congress. And I look forward to more opportunities to examine the laws and policies that underlie our music licensing system and our compulsory licensing regime. Balance, fairness and equality requires to move with deliberation. Justice and prudence require that our process be one that is inclusive of all legitimate interest and perspectives if all results are to achieve lasting and meaningful reforms. Thank you, Mr. Chairman. I yield back.

Mr. GOODLATTE. I thank the Chairman. And it's now my pleasure to recognize the Ranking Member of the full Committee, the gentleman from Michigan, Mr. Conyers.

Mr. CONYERS. Thank you, Mr. Chairman. And to all of those who are being celebrated for leaving, for serving and for their continued interest, of course, Mr. Berman. And I want to include the former Chairman, Mr. Smith, who I worked with for more years than I thought was appropriate. But we've had a great time, and this Committee is very important to me. I'm going to just edit my own remarks and put the rest in the record, but might I be the first to suggest the misleading title of this measure, the Internet Radio Fairness Act. A more appropriate title might be the Paycheck Reduction Act, because what we're doing here is lowering the royalties that Internet webcasters would pay to artists by more than 85 percent.

This isn't the first time I've persuaded the Committee to redraft the title. I remember the Frederick Douglass and Susan B. Anthony Prenatal Nondiscriminatory Act also. We had to do a little work on that as well.

Now, what's the basic issue that brings us here today? Well, it's the fairness issue in terms of people being rewarded for their skill and talent, musicians and singers across all musical genres. I've tried to figure out a way to get Miles Davis and John Coltrane into this discussion without success. But this is their only compensation. They depend on royalties. And their careers aren't always that long either. As a matter of fact, some never have that big hit that separates them.

And so here we have the leading supporter of this bill, a publicly traded company valued at \$1.4 billion at the end of last month, essentially urging that we consider a measure that would cut royalties and deprive artists of the fair market value of their work. Not surprisingly, this explains why artists who don't often join in expressing public opposition to political matters, some 125 have signed on in opposition to H.R. 6480. As a matter of fact, today, and I'll ask unanimous consent to put in the record the letter that also adds opposition to the measure from the Center for Individual Freedom, the Harbour League, the Hispanic Leadership Fund, the Institute for Liberty, the Institute for Politic Policy Innovation and the Tea Party Nation.

All of these quite diverse, as you can detect, are expressing strong reservations about the measure that is being examined here this afternoon. It can't be disputed that now we understand Internet radio to be the future and that the Internet has dramatically changed the way music is produced, marketed and distributed. In particular, Internet radio has become a major source of music for many listeners. Even Apple and Clear Channel, and XM/Sirius have all moved into the Internet radio space.

And I know that there are broadcasters, medium-sized and small, that have some resistance to the idea of performance rights. But I want to make a prediction today. This bill may well be the catalyst to advancing and to formulating an AM-FM performance right. That's what people are beginning to think about, because outside of the experts here, most people assume that people listening to a song or a performance on the radio, that they were getting some kind of compensation all the time. And now it's becoming clear that when former Chairman Conyers starts working with Grover Norquist, the American Conservative Union, the Citizens Against Government Waste and the Taxpayer's Protective Alliance, there's something going on.

Now, on our side we have the American Federation of Labor, AFL-CIO, we have the NAACP, the Screen Actors Guild, the American Federation of Television and Radio Artists, the American Association of Independent Music. And so I want all of us to remember that it was in 1998 with Henry Hyde that we introduced the Digital Millennium Copyright Act. It was signed into law by President Clinton, and it granted Internet radio services permission to take advantage of the compulsory license, but established that a market oriented by a willing buyer/willing seller rate would be put forth.

So that's what this is all about. It's been expanded. We've had the Digital Performance Right in Sound Recordings Act of 1995, and we have moved along in a very fair way.

So I just wanted to conclude by thanking and congratulating you, Chairman Goodlatte. We have a very important and increasing role in the Judiciary Committee with reference to intellectual property. And I think this is an excellent way to start that examination. I thank you very much.

Mr. GOODLATTE. I thank Chairman Conyers. And the Chair would advise Members of the Committee and our panel and our guests here today that because the Republican Conference will convene at 2 p.m. For very important business, we do want to announce that we must conclude this hearing by 2 p.m. So we will proceed expeditiously. But we first want to recognize two more Members, the gentleman from Utah to say a word about his legislation for 1 minute, and then the gentleman from California, Mr. Berman, for 1 minute. And then all other Members' opening statements will be made a part of the record.

So the Chair now recognizes the gentleman from Utah, Mr. Chaffetz, for 1 minute.

Mr. CHAFFETZ. Thank you, Chairman Goodlatte. I appreciate your holding this hearing. And today, due to advances in technology, innovation and risk-taking companies consumers are able to listen to the radio on numerous different devices delivered

through a wide variety of digital services. Internet radio should be a boon to the entire audio market, from creators to distributors and, of course, to consumers, but instead it's barely hanging on. MTV, Microsoft, Rolling Stone, AOL, Yahoo, all tried to get in the space, all had to exit because it doesn't work financially.

All forms of digital radio, whether satellite, cable or Internet should compete against each other on a level playing field. Unfortunately, that's not the case. The Internet Radio Fairness Act legislation levels the playing field for Internet radio services by putting them under the same market base standard used to establish rates for other digital services, including cable and satellite radio. Congress enacted the royalty rate standard for Internet radio 14 years ago when Internet radio was barely a concept and long before today's prominent Internet radio companies even existed.

It's well past time to correct the mistakes with the new understanding we have today of how the world works and stop discriminating against Internet radio.

Mr. Chairman, I ask unanimous consent to insert in the record three letters, one from the Internet Radio Fairness Coalition, the Digital Media Association and an independent artist, Patrick Laird, into the record.

Mr. GOODLATTE. Without objection, so ordered.
[The information referred to follows:]



November 27, 2012

The Honorable Bob Goodlatte
 Chairman, Subcommittee on Intellectual Property,
 Competition and the Internet
 Committee on the Judiciary
 U.S. House of Representatives
 Room B-352 Rayburn HOB
 Washington, D.C. 20515

The Honorable Melvin Watt
 Ranking Member, Subcommittee on Intellectual Property,
 Competition and the Internet
 Committee on the Judiciary
 U.S. House of Representatives
 Room B-351 Rayburn HOB
 Washington, D.C. 20515

Dear Chairman Goodlatte and Ranking Member Watt,

We, the members of the Internet Radio Fairness Coalition, are writing to ask you to support H.R. 6480, the Internet Radio Fairness Act, introduced by Reps. Jason Chaffetz (R-UT), Jared Polis (D-CO), Darrell Issa (R-CA), and Zoe Lofgren (D-CA).

This legislation will bring the royalty licensing system for Internet radio into the 21st century.

H.R. 6480 helps create a sustainable Internet radio business model that will benefit your constituents:

- **CONSUMERS:** A sustainable Internet radio industry will give consumers more choices and more products for listening to the music they love.
- **MUSICIANS:** A sustainable Internet radio industry will enable artists to earn more money as Internet radio grows.
- **ENTREPRENEURS:** A sustainable business model will create a marketplace that will enable entrepreneurs to invest in new, innovative ways to deliver music to the public – and will create jobs in the process.

The current royalty rate-setting system for digital radio, including Internet radio, is the product of piecemeal legislation that was enacted as new technologies were developed. The result is a system that is significantly out of date – and, critically, out of sync with the realities of the 21st century marketplace. The current system hobbles the growth and economic health of Internet radio, and limits the financial rewards for singers and songwriters, record labels and the Internet radio industry. Even though Internet radio has been widely – and increasingly – embraced by consumers, the current rate-setting standard



for Internet radio has driven many of the early innovators out of the business and many innovators and investors have remained on the sidelines

The Internet Radio Fairness Act calls for all digital music to be judged by the same rate-setting standard – 801(b) – bringing Internet radio under the same standard that’s been used successfully for over 30 years in most other Copyright Office proceedings. The 801(b) standard is balanced to encourage both the creation and promotion of creative works and encourages the growth of robust and sustainable markets for these works.

The bill doesn’t set or change royalty rates for Internet radio. It simply encourages the Copyright Royalty Board (CRB) to have access to, and take into account, more relevant information when they make their decisions about royalty rates – e.g., maximizing the availability of creative works to the public and generating a fair return for copyright owners and a fair income for copyright users.

An updated royalty rate standard for Internet radio will create enormous benefits for artists, providing them with more ways for their music to be played and new and exciting ways to connect with their audiences, creating new revenue streams and further monetizing their work (selling CDs, MP3s, promoting their tours, selling merchandise, and more).

Passage of the IRFA will mean more jobs in a sustainable industry, more choices for listeners, and more opportunities and revenue for working artists and their record labels. When the digital music sector is allowed to grow and innovate, everybody wins.

For the benefit of the consumers, musicians, and entrepreneurs in your district, we urge you to support the Internet Radio Fairness Act. Thank you.

Sincerely,

Members of the Internet Radio Fairness Coalition

977 Music
AccuRadio
Clear Channel Media and Entertainment
Computer and Communications Industry Association (CCIA)
Consumer Electronics Association (CEA)
Digital Media Association (DiMA)
Digital Sound & Video
Digitally Imported
Engine Advocacy
HD103.com
Musera Radio

Mark Ramsey Media
National Religious Broadcasters Music License Committee (NRBLMC)
Pandora
Peardio
Radio Paradise
Salem Communications
Senzari
Small Webcasters Alliance
Triton Digital
TruLocal Media

cc: Members of the House Judiciary Committee



November 28, 2012

Honorable Bob Goodlatte
 Chairman of the Subcommittee on
 Intellectual Property, Competition, and
 the Internet
 U.S. House Committee on the Judiciary
 2240 Rayburn HOB
 Washington, DC 20515

Honorable Mel Watt
 Ranking Member of the Subcommittee on
 Intellectual Property, Competition, and
 the Internet
 U.S. House Committee on the Judiciary
 2304 Rayburn HOB
 Washington, DC 20515

Dear Chairman Goodlatte and Ranking Member Watt:

As the leading national trade association dedicated to representing the interests of legitimate online distributors of digital music, movies and books, the Digital Media Association ("DiMA") writes to express its support for H.R. 6480, the "Internet Radio Fairness Act of 2012."

Introduced just a few months ago, H.R. 6480 seeks to eliminate a longstanding inequity found in the rate-setting process associated with the public performance of sound recordings by Internet radio service providers. Under current law, performance royalties for Internet radio are established under the "willing buyer-willing seller" standard¹; while rates for cable and satellite are determined under the more widely used "801(b)" standard². This difference in treatment makes it virtually impossible for Internet radio service providers to effectively compete against their two leading rivals in the digital music industry.

Fortunately, H.R. 6480 proposes to eliminate the existing imbalance in federal law by extending the same set of rules that currently apply to cable and satellite radio to cover Internet

¹ Section 114(f)(2)(B) of title 17 USC, ("In establishing rates and terms for transmissions by eligible nonsubscription services and new subscription services, the Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a *willing buyer and a willing seller*). (emphasis added)

² Section 114(f)(1)(B) of title 17 USC, ("In establishing rates and terms for preexisting subscription services and preexisting satellite digital audio radio services, *in addition to the objectives set forth in section 801(b)(1)*, the Copyright Royalty Judges may consider...). (emphasis added)

Letter to Hon. Goodlatte and Hon. Watt, November 28, 2012.

radio. By placing Internet radio under the same rate-setting standard afforded to cable and satellite radio, Congress will have not only taken a significant step towards creating a level playing field with regard to the licensing of sound recordings; it also will have promoted greater harmony with respect to the manner by which musical compositions are licensed under section 115 of the Copyright Act.

Some have recently endorsed the idea of harmonizing the rate-setting process under sections 114 and 115 of the Copyright Act, but suggested that any newly imposed standard should mirror the market-based approach embodied in the “willing buyer-willing seller” standard. This suggestion flouts the experience that webcasters – the only licensee currently operating under the “willing buyer-willing seller” standard – have had over course of the past few years.

The rate-setting proceedings that have ensued since enactment of the “willing buyer-willing seller” standard can be characterized as nothing short of a dismal failure. The first rate-setting proceeding resulted in the disbandment of the Copyright Arbitration Royalty Panel and the adoption of the Copyright Royalty Board which still operates today. The second rate-setting proceeding, in comparison, engendered such large and widespread protests by religious, educational and commercial webcasters over unsustainable royalties that Congress ultimately decided to pass the “Webcaster Settlement Act of 2008” and the “Webcaster Settlement Act of 2009” as a way providing temporary relief.

The aforementioned experiences stand in stark contrast to those of licensees operating under the “801(b)” standard. Since the latter part of the 1970’s, record labels have relied on the “801(b)” standard to license musical compositions and not once has Congress had to intervene to provide relief from exorbitant rates. Similarly, satellite and cable radio have operated under the “801(b)” for nearly two decades now with no need for congressional intervention. The difference lies solely in the standard and the fact that under this unique standard, Internet radio service providers are currently being treated unfairly.

H.R. 6480 eliminates this inequity by proposing a series of limited, yet important, improvements to the section 114 rate-setting standard as well as its accompanying procedures. These changes are narrow in scope; and as such, we would respectfully urge you to support this thoughtful piece of legislation.

If you have any questions regarding this correspondence or need any additional information, please do not hesitate to contact me at (202) 639-9502.

Sincerely,

/s/ Gregory Alan Barnes
General Counsel, DiMA

cc: Members of the Subcommittee on Intellectual Property, Competition, and the Internet

BREAK OF REALITY

November 26, 2012

Dear Chairman Goodlatte and Representative Watt,

As a musician with Break of Reality, an independent music group, I would very much like to have my voice heard with regard to the Internet Radio Fairness Act. Internet radio has provided tremendous exposure for my band. I would like to share how important it is to help create fair legislation so that companies like Pandora can flourish and expand, creating more opportunities and revenue for us as musicians.

Break of Reality has been performing for almost a decade now, and next to performing live, internet radio has proved to be the greatest asset to the growth of our group. Our exposure on Pandora and Spotify has led directly to a huge increase in music sales through digital music stores such as iTunes and Amazon.com, and has created great performance opportunities by exposing our music to concert presenters around the country who hire us to perform. Furthermore, these concerts are being filled largely by fans who find our music exclusively through companies like Pandora.

To be more precise, in the first twelve months of being included in Pandora's music library, our digital album sales increased by 290% from the year prior. In the subsequent 12 months, sales rose 406% from our pre-Pandora days. The day before submitting this letter, Break of Reality asked its Facebook fans, in an objective manner, how they discovered our music for the first time. With an overwhelming response from our fans, the results were staggering: 44% of fans polled discovered our music through internet radio, 31% through live performance, 15% from a friend, and 9% through Youtube and other internet outlets. It is clear that the effectiveness of internet radio with regard to both product sales and promotional power is overwhelming, and the success and expansion of these companies are of the utmost importance for the future of our

As musicians who have decided not to work with a record label, my band does not have the capital to invest in large traditional media promotional campaigns and is instead focused on finding more viable promotional opportunities. Internet radio creates an unparalleled opportunity for us to reach millions of people who otherwise might not discover music like ours. On a larger scale, internet radio helps listeners discover new artists, enriching the musical landscape of our country.

It is disappointing to me to see that some well-known artists have been enlisted in the campaign against the bill. They don't speak for all working artists. I would imagine that a vast number of independent musicians are largely unrepresented in this debate, perhaps because they don't have the financial or legal resources to voice their opinion.

I hope you allow me and the many other working musicians who support this act the opportunity to help create more appropriate legislation to help innovative companies like Pandora flourish, and great artists find more exposure in this changing musical world.

I can be reached at Patrick.Laird@gmail.com or (347) 766-9464. Please let me know if you would like my voice to be heard on behalf of independent artists.

Sincerely,

A handwritten signature in black ink, appearing to read 'Patrick Laird', with a long, sweeping flourish extending to the right.

Patrick Laird

Mr. GOODLATTE. And the Chair would observe that he doubts that this will be Howard Berman's last words. But today the gentleman from California gets the last word on these opening statements and is recognized.

Mr. BERMAN. Well, thank you very much, Mr. Chairman. And I thank all my colleagues for their very kind words. It's really been a great honor to serve on this Committee for 30 years now. I was reminded of when John Conyers was Chairman of the Criminal Justice Subcommittee trying to reform the RICO laws. That was awhile ago. But just—I don't have an opening statement on the subject, I have some points I'll make later on—but just generally, I think at the end of the day this isn't about content versus technology. Musicians and artists need to get adequately compensated

to continue to create and share their art and the services need to thrive in order to ensure that the music continues to be heard.

And I think there's really more of a symbiotic relationship here. We have to just find that sweet spot that maximizes the ability of musicians and composers and songwriters to make the music and the songs and the technologies to thrive and to play that music for the benefit in the end of not just the people of this country, but of the world. Thank you very much.

Mr. GOODLATTE. I thank the gentleman. We have a very distinguished panel of witnesses today. Their written statements will be entered into the record in their entirety. And I ask that the witnesses summarize their testimony in 5 minutes or less. To help you stay within that time, there is a timing light on your table. When the light switches from green to yellow, you will have 1 minute to conclude your testimony. When the light turns red, it signals the witness' 5 minutes have expired. And before I introduce the witnesses, as is the custom of the Committee, I would ask that they rise and be sworn in.

Do you and each of you swear that the testimony you are about to give will be the truth, the whole truth and nothing but the truth, so help you God? Thank you. And please be seated.

We appreciate the personal efforts that each of you have made to arrange your schedules to accommodate our request that you appear and testify before the Subcommittee on this important subject. Our first witness is Joseph J. Kennedy, the Chief Executive Officer and President of Pandora. Pandora is the Nation's leading Internet radio service. Since launching its app and its mobile service in 2008, Pandora has been recognized by both consumers and industry experts as the premier application on the iPhone and other mobile devices. A public company since 2011, Pandora has a market capitalization in the neighborhood of \$1.3 billion, has more than 150 million registered users and serves more than 55 million individual consumers each month.

Mr. Kennedy joined Pandora in 2004 immediately following previous positions as a Senior Executive with E-Loan and Saturn Corporation. He earned his MBA from Harvard Business School and possesses a Bachelor of Science in Engineering and Computer Science from Princeton University.

Our second witness is Bruce Reese who appears today on behalf of the National Association of Broadcasters. Mr. Reese is President and Chief Executive Officer of Hubbard Radio, LLC. Hubbard operates 21 radio stations in five major media markets in the U.S., all of which stream their broadcasts over the Internet. Mr. Reese has spent nearly three decades in radio. Prior to becoming CEO of Hubbard in 2011, he served as president and CEO, Executive Vice President and General Counsel at various times at Bonneville International Corporation.

Mr. Reese began his legal career with the U.S. Department of Justice's antitrust division. He earned his Bachelor of Arts degree and his J.D. from Brigham Young University.

Our third witness is David Pakman. Mr. Pakman is a partner in Venrock, a venture capital firm he joined in 2008 that has offices in Palo Alto, New York, Cambridge and Israel. An Internet entrepreneur, Mr. Pakman previously served as the Chief Executive Of-

ficer of eMusic, a leading digital retailer of independent music that is second only to iTunes in the number of downloads sold. Mr. Pakman is credited with being a co-creator of Apple Computer's music group. Mr. Pakman earned his degree in Computer Science Engineering from the University of Pennsylvania's School of Engineering and Applied Sciences.

Our fourth witness is an accomplished record producer, songwriter, recording artist and the chairman emeritus of the National Academy of Recording Arts and Sciences, Mr. Jimmy Jam. A five-time Grammy award winner, Jimmy and his business and creative partner Terry Lewis have worked together for more than 30 years. They've written and/or produced more than 100 albums and singles that have achieved gold, platinum, multi-platinum or diamond status. Their collaboration has resulted in at least 26 number one R&B hits and 16 number one pop hits which gives the pair more billboard number one hits than any duo in chart history. Raised in Minneapolis, Jimmy and his family now live in Hidden Hills, California.

Our fifth witness is Dr. Jeffrey Eisenach. Dr. Eisenach is a professional economist who served in senior positions at the Federal Trade Commission and the Office of Management and Budget during the administration of President Reagan. A visiting scholar at the American Enterprise Institute, Dr. Eisenach focuses on policies that affect the information technology sector, innovation and entrepreneurship. He is a Managing Director and Principal at Navigant Economics and an adjunct professor at the George Mason University School of Law where he teaches regulated industries. Dr. Eisenach has been published on a wide range of issues, including industrial organization, communications policy and the Internet government regulations, labor economics and public finance.

He has also taught at Harvard University's Kennedy School of Government and at Virginia Tech. A member of the board of advisors of the Pew Project on the Internet and American Life for more than a decade and the former president of the Progress and Freedom Foundation, Dr. Eisenach received his Ph.D. in Economics from the University of Virginia and his Bachelor of Arts in Economics from Claremont McKenna College.

Michael J. Huppe is our final witness. Since 2011 Mr. Huppe has served as the President of SoundExchange, the nonprofit organization that collects digital music royalties paid by Internet radio, satellite radio and other digital media services on behalf of recording artists and record labels. Prior to being appointed to serve as President, Mr. Huppe served as the organization's Executive Vice President and General Counsel. Mr. Huppe earned his J.D. from Harvard Law School and his Bachelor of Arts from the University of Virginia. In addition to his duties at SoundExchange, Mr. Huppe also serves as an adjunct professor at the Georgetown University Law Center.

Welcome to you all. And we will begin with Mr. Kennedy. And Mr. Kennedy I will tell you that I am one of those 150 million Pandora users who enjoys your service, and welcome.

**TESTIMONY OF JOSEPH J. KENNEDY, CHAIRMAN AND
CHIEF EXECUTIVE OFFICER, PANDORA MEDIA, INC.**

Mr. KENNEDY. Thank you, sir. Chairman Goodlatte, Ranking Member Watt, Members of the Subcommittee—

Mr. GOODLATTE. Mr. Kennedy, you may want to push the button on your microphone so we can all hear you.

Mr. KENNEDY. Forgive me. Chairman Goodlatte, Ranking Member Watt, Members of the Subcommittee, I am Joe Kennedy, the CEO of Pandora, America's largest Internet radio service, which more than 60 million Americans have listened to in just the last 30 days. America's embrace of Pandora reflects the potential of Internet radio. We play all of the great music created and enjoyed by Americans, not just the most popular genres and hits, but bluegrass, big band, gospel, New Orleans jazz, et cetera, over 400 genres and subgenres. It is the most inclusive form of radio playing the music of over 100,000 different artists every month.

I'm here to ask you to support the Internet Radio Fairness Act sponsored by your Judiciary Committee colleagues, Representative Chaffetz, Polis, Issa and Lofgren. This important legislation will address two extraordinary inequities in the Copyright Act. First, the unfair rate-setting standard that applies only to Internet radio, not to cable radio or satellite radio or to record companies when they obtain licenses from musical works and songwriters; and second, an unfair process that deviates in many important ways from how our Federal Court system works, one that actually prevents royalty judges from reviewing all relevant evidence when determining Internet radio rates. The source of these inequities is massed by complex legalese, but the consequence is simple. In 2012 Pandora will account for only 7 percent of U.S. radio listening, yet we will pay SoundExchange almost a quarter of a billion dollars, more than 50 percent of revenue. By contrast, satellite radio will pay 7½ percent and cable radio 15 percent. Pandora pays more in absolute dollars than any other company, including SiriusXM, a company with eight times our revenue.

In fact, Pandora pays more sound recording performance royalties than all of the radio industries in the UK, France, Canada and Australia combined. And although Pandora's payments are extraordinarily high they would have been even higher had Congress not intervened to undo the Copyright Royalty Board's disastrous 2007 decision, so high, in fact, that they would have forced Pandora to shut down. In 14 months, the CRB will begin another rate setting. To avoid yet another congressional intervention, we urge your support of the Internet Radio Fairness Act to ensure an outcome that is fair to all parties.

How is it possible that Internet radio rates can be so unfair by any U.S. or global standard? The answer is twofold. First, the so-called willing buyer/willing-seller rate standard which applies only to Internet radio has not proven effective in practice. It forces the judges to set a rate based solely on marketplace benchmarks, yet there is no market for radio rates. Not only is there no market for these rates, but since this is also the Subcommittee on Competition, you may be interested to hear that there is also evidence that the recording industry has actively sought to prevent any such

market from developing. This is a highly concentrated industry with an HHI of over 2,500.

SoundExchange is today defending itself in Federal Court against charges that it conspired to impede SiriusXM's effort to develop a market for radio rates. In contrast, the rate-setting standard for cable and satellite radio and for record companies when they obtain licenses for musical works from songwriters, utilizes a widely accepted fairness test that directs the judges to assure fairness to all sides. The recording industry simply cannot defend that the standard it has embraced for over 30 years for use when it is the one obtaining rights is not the right standard when the roles are reversed and it is the licensor, not the licensee.

The second inequity violates a most basic American principle of fairness. The CRB proceedings as structured under current law actually permit the recording industry to cherry-pick the agreements entered into evidence in order to keep Internet radio rates artificially high. This is just one example of how the CRB process is unfair and what the Internet Radio Fairness Act will fix.

In summary, Internet radio is enjoyed by over 100 million Americans, and we embrace that this new form of radio compensates performing artists. Absent the repeated congressional interventions detailed on the screen, today's Internet radio would not exist. The law which produced such disastrous results will be relied upon again in a rate-setting process that begins in just 14 months. The time to fix that law is now. It will benefit artists, innovators and the millions of Americans who cherish Internet radio. Thank you.

Mr. GOODLATTE. Thank you, Mr. Kennedy.

[The prepared statement of Mr. Kennedy follows:]

Statement of
Joe Kennedy
Chief Executive Officer
Pandora
before the
Subcommittee on Intellectual Property, Competition and the Internet
Committee on the Judiciary
U.S. House of Representatives
“Music Licensing Part One: Legislation in the 112th Congress”
November 28, 2012

Chairman Goodlatte, Ranking Member Watt, Members of the Subcommittee,

I am Joe Kennedy, the CEO of Pandora, America’s largest Internet radio service, which more than 60 million Americans have listened to in just the last 30 days. Pandora is headquartered in an enterprise zone in Oakland, CA, where it has created over 400 new jobs in the last five years.

Pandora’s Popularity Reflects the Potential of Internet Radio

Americans’ embrace of Pandora reflects the potential of Internet radio. We play ALL of the great music created and enjoyed by Americans -- not just the hits in the most popular genres but Blues, Classical, Christian, Bluegrass, Big Band, Classic Country, Baroque, Klezmer, a Cappella, New Orleans jazz, Zydeco, etc.—over 400 genres and sub-genres.

It is the most democratic and inclusive form of radio, playing the music of over 100,000 different artists (70% of them independent), represented by a catalogue of over a million songs. And over 95% of these songs play every month--over 950,000 unique songs play every month on Pandora. For most of these artists, Pandora is the only radio play they’ve ever enjoyed. It is conceivable that this new vehicle for connecting artists with people who enjoy their particular kind of music, if it continues to grow, may eventually lead to the emergence of a musician’s middle class.

Listeners can access Pandora the same way they listen to other forms of radio. Eight of the world’s largest automakers now include Pandora in new models. We are embedded in over 650 consumer electronics devices that enable Pandora to be enjoyed throughout people’s homes. We are the second most downloaded iPhone app. Pandora is even built into refrigerators. Long gone are the days when customers accessed Internet radio only through their PCs or laptops. In fact, over 75% of our listening now takes place off the computer.

The Playing Field for Internet Radio Is Anything But Level

While Pandora and other Internet radio services compete directly with all of the other forms of radio for listeners in every place you find music – the home, the car, the office, on the go - we are subject to an astonishingly high royalty burden that is unique to Internet radio.

There are enormous differences in how performing artists and labels are compensated by digital radio services. This lack of a level playing field is fundamentally unfair and indefensible. The inequity arises from the fact that Congress has made decisions about radio and copyright law in a piecemeal and isolated manner; as each new form of radio transmission was invented, new legislation was passed but only to address the new form. The effect has been to penalize innovation when setting the rules for music royalties. The current ratesetting structure is a clear case of discrimination against the Internet and innovative services.

The Internet Radio Fairness Act Corrects Two Extraordinary Inequities in the Copyright Act

I am here to ask you to support the Internet Radio Fairness Act, sponsored by your Judiciary Committee colleagues, Representatives Chaffetz, Pollis, Issa and Lofgren. This important legislation will address two extraordinary inequities in the Copyright Act:

First, the unfair rate-setting standard that applies only to Internet radio – not to cable radio or satellite radio, or to record companies when they obtain licenses for musical works from songwriters; and,

Second, an unfair process that deviates in many important ways from how our Federal court system works, one that actually prevents royalty judges from reviewing all relevant evidence when determining Internet radio rates.

The source of these inequities is masked by complex legalese—but the consequence is simple and indisputable:

In 2012 Pandora will account for only 7% of U.S. radio listening, yet we will pay SoundExchange almost a quarter of a billion dollars—more than 50% of our revenue. By contrast, satellite radio will pay 7.5% of their revenue, and cable radio will pay 15% of their revenue.

Pandora pays more in absolute dollars than any other company, including Sirius XM – a company with eight times our revenue.

In fact, Pandora pays more sound recording performance royalties in absolute dollars than all of the AM/FM, satellite and Internet radio industries in the UK, France, Canada, and Australia – combined.

For years the recording industry has pointed to the rest of the developed world as the model the U.S. should follow in terms of sound recording performance rights. How many times have you heard the head of the RIAA start a sentence on this topic with the following words “The U.S. is the only country in the developed world.....”? Yet the rates paid today by Internet radio in the U.S. are astonishingly out of step with radio rates in every other country in the world.

For example, in the U.K., where all forms of radio (including AM/FM) must pay sound recording performance royalties and which has a population one-fifth that of the U.S, the total amount of such royalties paid by all forms of radio last year was less than \$100 million.¹ By comparison the

¹ PPL Annual Review 2011, http://issuu.com/ppi_uk/docs/ppi_ar2011; Note that the figures in this report include television usage of sound recordings as well as radio usage.

approximately \$250 million currently being paid by Pandora to serve 7% of U.S. radio listening is exorbitantly high.

And although Pandora's payments are extraordinarily high, they would have been even higher if Congress had not intervened to undo the Copyright Royalty Board's disastrous 2007 decision. So high in fact, that they would have forced Pandora to shut down.

This was not the first time that Congress intervened to save Internet radio from a disastrous royalty rate decision under the Willing Buyer-Willing Seller standard. Although Pandora had not yet launched our service, in 2002 Congress stepped in to pass a law to allow the parties to reject the rates set by the panel and enter into an economically sustainable settlement. Two major rate setting decisions and two congressional interventions to undo those decisions – clearly we are dealing with a broken system that needs to be fixed.

How Did We Get Here?

1995: Digital Performance Rights Act

First time a sound recording performance right was recognized by US law

1998: DMCA

Two fledgling webcasters forced to accept the RIAA's proposed legislation and "willing buyer/willing seller", under threat of 'ephemeral copy' lawsuits

2000-2002: Webcasting Hearing (CARP)

Congressional intervention required: Small Webcaster Settlement Act of 2002

2005-2007: Webcasting Hearing (CRB)

Congressional intervention required: Webcaster Settlement Acts of 2008 and 2009

2014-2015: Webcasting Hearing (CRB)

Flawed standard and process could result in need for third Congressional intervention

In 14 months the CRB will begin another rate-setting proceeding. To avoid the need for yet another Congressional intervention, we urge your support of the Internet Radio Fairness Act to ensure an outcome that is fair to all parties.

How is it possible that Internet radio rates can be so unfair by any U.S. or global standard? The answer is twofold:

The "Willing Buyer-Willing Seller" Rate Standard Has Failed Repeatedly

First, the "willing buyer-willing seller" rate standard – which applies only to Internet radio—has not proven effective in practice. It forces the judges to set a rate based solely on marketplace benchmarks, yet there is no market for radio rates.

The current hearing to set rates for Satellite radio illustrates the absurdity of any standard that directs the judges to set rates based solely on marketplace benchmarks: Five years ago, SoundExchange argued that a complicated set of adjustments appropriately discounted the rates paid by subscription on-demand services to make them applicable to radio. Now, five years later, the rates paid by subscription on-demand services have decreased by 20%—yet SoundExchange is arguing that radio rates should nonetheless be *increased*.²

Common sense would say that if this other market were a good benchmark for radio then a decrease in rates in that market would yield a decrease in rates for radio. But that's not what SoundExchange is arguing—which *really is just an admission that there is no market for radio rates* and telling the CRB to set rates based on a non-existent market makes it very difficult for them to do their job well.

Not only is there no market for these rates, there is also evidence that the recording industry has actively sought to prevent any such market from developing.

SoundExchange is today defending itself in Federal court against charges that it conspired to impede Sirius XM's effort to directly license music.

According to a recent CRB transcript, the content of emails among recording industry principals discussing Sirius XM's direct licensing initiative has been paraphrased by SiriusXM's counsel as follows: "We've got to stop it, it's bad....It will bring rates down. It will destroy the collective."³

The 801(b)(1) Standard Has Proven to Be Fair Over 30+ Years of Use

In contrast, the so-called "801(b)" rate-setting standard for cable and satellite radio, and for record companies when they obtain licenses for musical works from songwriters, utilizes a widely accepted fairness test that directs the judges to assure fairness to all sides.

The rate standard set forth in the Copyright Act at 17 U.S.C. §801(b)(1) was first introduced in the Copyright Act of 1975 and has been used since that time to guide the setting of rates that music labels must pay to songwriters and publishers for the use of their musical works.

This standard directs rate setting panels:

(1) To make determinations concerning the adjustment of reasonable copyright royalty rates—[which] shall be calculated to achieve the following objectives:

(A) To maximize the availability of creative works to the public;

(B) To afford the copyright owner a fair return for his creative work and the copyright user a fair income under existing economic conditions;

² U.S. Copyright Royalty Judges, Docket No.: 2011-1 CRB PSS/Satellite II, Determination of Rates and Terms 10-16-2012 - Vol. XIX, p. 4865, line 14-p. 4866, line 11

³ U.S. Copyright Royalty Judges, Docket No.: 2011-1 CRB PSS/Satellite II, Determination of Rates and Terms 10-16-2012 - Vol. XIX, p. 4893, lines 11-16

(C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication;

(D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

This rate standard has had the support of the recording industry since its introduction. The recording industry simply cannot defend that as a licensee of compositions it should have the benefit of the 801(b) “fairness” standard (which sets its royalties at about 10% of revenue), but as a licensor to Internet radio it deserves a different standard, one that under the 2007 CRB, would have captured over 100% of Pandora’s revenue if Congress had not intervened.

When Congress passed the very first law granting sound recording right holders a performance right in the Digital Performance Right in Sound Recordings Act of 1995, the standard selected was the 801(b) standard, with the support of the recording industry.

When this Committee approved the Performance Rights Act in the last session of Congress, the standard selected was the 801(b) standard, modified to exclude the (D) factor, with the support of the recording industry.

In the 37 years since the introduction of the 801(b) rate standard, its application has never required Congressional intervention.

Deviations from the Federal Court System Limit Transparency and Create Abuse Potential

The second inequity violates a most basic American principle of fairness: the CRB proceedings as structured under current law actually permit the recording industry to prevent evidence from being presented, even when the judges would consider it relevant.

In federal courts, judges determine what evidence is admissible, and then they decide how much weight to give to various evidentiary submissions. Moreover, the Federal Rules of Evidence and Civil Procedure tend to undermine efforts by one party to hide relevant evidence.

In contrast, royalty rate procedures empower parties to hide evidence and do not give the other party or the judges the authority to stop such shenanigans.

One example occurred with an inflated royalty rate that the recording industry agreed to with SiriusXM several years ago that covered just SiriusXM’s Internet radio performances, which are a tiny portion of SiriusXM’s usage. By its terms, the recording industry was permitted to submit the license into evidence in Internet radio proceedings (for example, against Pandora), but not to submit it into evidence in satellite rate proceedings.⁴ This manipulation by the recording industry was clearly intended to keep

⁴ U.S. Copyright Royalty Judges, Docket No.: 2011-1 CRB PSS/Satellite II, Rebuttal Testimony of Janusz Ordovery 7-02-2012, pp. 8-9, footnote 16

Internet radio rates artificially high and current law allows them to keep the judges from even knowing that they are being hoodwinked.

This is just one example of how the CRB process is unfair and what the Internet Radio Fairness Act will fix.

Summary: The Time to Fix the Law Is Now

In summary:

Internet radio is enjoyed by over a hundred million Americans, and we embrace that this new form of radio compensates performing artists.

Absent repeated Congressional interventions, today's Internet radio would not exist.

The law which produced such disastrous results will be relied upon again in the rate setting process that begins in just 14 months.

The time to fix that law is now. It will benefit artists, innovators, and the millions of Americans who cherish internet radio.

Thank you.

Mr. GOODLATTE. Mr. Reese, we are pleased to have your testimony.

TESTIMONY OF BRUCE T. REESE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HUBBARD RADIO, LLC, ON BEHALF OF THE NATIONAL ASSOCIATION OF BROADCASTERS

Mr. REESE. Thank you Chairman Goodlatte, Ranking Member Watt, and Members of the Committee for hearing us today. My name is Bruce Reese. I'm president of Hubbard Radio. We operate 20 radio stations in major markets around the country, including WTOP here in Washington. I've been in the industry for 30 years, and I'm testifying today on behalf of the National Association of Broadcasters and its members.

Local broadcast radio is unique among music delivery platforms because it is always on, it is always free and it is accessible to listeners in every local community across the country. There are now more than 14,000 local radio stations in the United States. With a growing audience, over 240 million people listen to radio every week, including those in communities that are underserved by other communications platforms. Local radio is responsible for hundreds of thousands of American jobs and has been shown time and time again to be a lifeline during times of emergency. What makes broadcast radio so successful is the local flavor of our programming, which forges a unique collection with listeners in a way that other media do not. In a constant cycle of new technology, broadcast AM and FM radio has remained part of the fabric of American culture for more than 90 years.

The Internet presents an enormous opportunity for broadcasters to expand both the reach and scope of locally-based services, including access to archive station materials, information about artists, and the ability to buy albums or concert tickets. Unfortunately, today many radio stations still do not stream their music over the web which does not help broadcasters or artists. There is one primary reason for the low adoption of Internet streaming by broadcasters: unaffordable royalty rates. For music-based radio stations the advertising revenue simply does not cover the streaming costs. Further, no matter how popular your Internet service becomes, the cost curve never bends in a favorable direction. At Hubbard, we've chosen to pay these high rates to stream our stations over the web because we believe our listeners expect us to be there. But even in our best years, we do no better than break even in our music webcasting business.

We're fortunate to operate in large markets and to have the financial ability to make that long-term investment. This is either a luxury that many of my industry peers do not have or a risk they are unwilling to take. Whatever the reason the majority of broadcast radio stations and the local services they provide remain outside the reach of Internet listeners. How did we get here? When initially set in 2007, and then built upon in 2009, the rates set by the Copyright Royalty Board were universally decried as being outrageously high. Four problems at the CRB contribute most significantly to these high royalties. First, the willing buyer/willing seller rate standard provides the judges with no explicit guidance on how to determine a fair market value. Second, the process by which the

parties present evidence of a fair market rate to the CRB is insufficient. Third, the CRB appointment and rate-setting processes do not afford adequate congressional oversight allowing these rate decisions to proceed essentially unchecked. And fourth, the CRB process itself is riddled with uncertainty. It's telling that when NAB made our last offer to the musicFIRST Coalition during the last Congress, our members' top priority was to escape the total unpredictability of the CRB proceedings.

We're here today to begin a dialogue with this Subcommittee on how best to address these problems. NAB has members who are very supportive of the bill introduced by Congressman Chaffetz and Polis. Other members are still seeking better understanding of how the bill would impact their businesses. So while NAB has not yet endorsed any specific legislative approach, it is fair to say that NAB supports congressional efforts to ensure fair webcasting rates and needed CRB process reforms.

This important discussion over how best to encourage the growth of Internet radio must not be bogged down by past fights over the controversial performance rights bills. Recent deals between individual broadcasters and record labels have included fees for AM/FM airplay. This reinforces our belief that this is an issue best addressed through private marketplace agreements. NAB continues to oppose an industry wide government mandate. Regardless of your position however on the performance fee issue, Congress can and should act to resolve the important webcasting rate making problems. The alternative inaction risks stifling the growth of Internet radio to the detriment of broadcasters, listeners and artists. Thank you, and I look forward to answering your questions.

Mr. COBLE [presiding]. Thank you, Mr. Reese.

[The prepared statement of Mr. Reese follows:]



**Hearing on
“Music Licensing Part One: Legislation in the
112th Congress”**

**United States House of Representatives
Committee on the Judiciary**

***Subcommittee on Intellectual
Property, Competition, and the Internet***

November 28, 2012

**Statement of Bruce Reese
Hubbard Radio, LLC**

**On behalf of the National Association of
Broadcasters**

Good afternoon, Chairman Goodlatte, Ranking Member Watt and members of the Subcommittee on Intellectual Property, Competition, and the Internet. Thank you for inviting me to testify today. My name is Bruce Reese, and I am President and CEO of Hubbard Radio, LLC, which operates 20 radio stations in five national markets. Before Hubbard made its April 2011 purchase of certain Bonneville International stations in Chicago, Washington, D.C., St. Louis, and Cincinnati, I was President and CEO of Bonneville International Corporation. I also chaired the Joint Radio and Television Boards of the National Association of Broadcasters (NAB) from 2004 through 2006. I am testifying today on behalf of the free, local, over-the-air radio members of the NAB.

Introduction

For over ninety years, broadcast radio has impacted the lives of Americans in many beneficial and significant ways. Radio broadcasters inform, educate, and alert our listeners to important events, topics, and emergencies. We introduce them to new music. We entertain them with sports, talk, and interviews. We are local, involved in our communities and proud to serve the public interest.

Technological changes over the past decade have led to exciting new developments in the radio industry. Streaming, podcasting, HD radio, mobile devices, and other new digital platforms present both opportunities and challenges for radio broadcasters. Digital distribution is still only a small part of overall audio consumption, but it is providing innovative ways for us to reach and serve our listeners.

I am here today to talk to you about a significant ongoing impediment to broadcasters' ability to innovate in the digital arena – namely, the current rate – setting standard and procedures used at the Copyright Royalty Board (CRB) under the statutory license for streaming.

The Standard and Procedures Used To Set Streaming Rates Discourage Streaming and Should Be Changed

In the broadcast community, there is a wide array of opinions as to the viability and value of streaming. Some broadcasters see streaming as an essential, burgeoning revenue stream. Others regard it as tangential but also important to their core business of over-the-air broadcasting. Still others consider it as being not worth the investment, since it is nearly impossible for broadcasters' streaming revenue to exceed the associated costs and royalty payments. Regardless of the camp, every broadcaster's expansion into Internet radio is impeded by the unreasonable costs of webcasting royalties. Whether you are a large broadcaster or small broadcaster, or your station is based in Washington DC or Charlotte or Casper, the revenue that can be generated from streaming simply does not offset the costs. This imbalance is impeding the growth of Internet radio among broadcasters.

Hubbard Radio streams our stations primarily as a service to our over-the-air listeners. We stream all our stations in all our markets. We believe that listeners expect to be able to access our stations through the Internet in addition to listening to their radios, and in a way we consider the cost of streaming a promotional expense. Nevertheless, we work very hard to monetize the streams.

Generally speaking, on a cumulative fiscal basis, we break even, with modest profits from the revenue from streaming our non-music stations offsetting the losses from streaming the music stations. Each year we revisit our streaming strategy and consider anew whether it's worthwhile to continue the service.

Since webcasting began, the chief obstacle to developing a profitable streaming model has been the egregiously high royalty rates for sound recordings. The streaming rates that have resulted from proceedings by the Copyright Royalty Board (CRB) under the so-called "willing buyer/willing seller" standard have been artificially inflated, to the detriment of both services that wish to stream and the songwriters and performers who would benefit, in the form of increased exposure and royalties, from increased streaming. The "willing buyer/willing seller" standard has increased royalty rates to levels that are suffocating radio streaming services. This is likely true because absent any specific rate setting guidance, the theoretical "free market" in which willing buyers and willing sellers can freely negotiate does not actually exist.

Broadcasters favor abandoning the "willing buyer/willing seller" standard and transitioning to the "801(b)(1)" standard for setting sound recording performance royalty rates. The 801(b)(1) standard (so named because it is found in that section of the Copyright Act) has effectively, efficiently, and equitably balanced the interests of copyright owners, copyright users, and the public for decades, in various contexts and proceedings.¹

¹ Instead of determining rates for a statutory license through a hypothetical marketplace, 17 U.S.C. § 801(b)(1) sets forth four objectives to be considered: "(A) To maximize the availability of creative works to the public; (B) To afford the copyright owner a fair return on his or her creative work and the copyright user a fair income under

As currently codified, this standard considers the interests of all stakeholders and the public, recognizes the value of all contributions of licensors and licensees, and has long been accepted and ratified by Congress. It reflects a Congressional intent not to set rates so onerous that they would stifle new businesses and uses of creative works. The 801(b)(1) criteria are particularly appropriate where, as now, there are essentially three companies controlling the majority of the distribution of sound recordings. Despite their recent disapproval of the standard in the context of this statutory license, now that they are in the position of licensor, the recording industry does not complain about the 801(b)(1) standard in the context of another statutory license, when they are acting as a licensee.

The "willing buyer/willing seller" standard was perhaps most obviously inadequate when it led to rates for the 2006-2010 license period (set by the CRB) that were so egregious that webcasters were forced to directly appeal to Congress. Passage of the Webcaster Settlement Acts of 2008 and 2009 provided an opportunity to negotiate more appropriate arrangements with the recording industry.

But the flaws in the CRB rate-setting process go beyond the excessively high royalty fees themselves. Broadcasters cannot create predictable business plans for streaming if we don't know with any reasonable degree of certainty

existing economic conditions; (C) To reflect the relative roles of the copyright owners and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communications; (D) To minimize any disruptive effect on the structure of the industries involved and on generally prevailing industry practices."

what future rates will be. Further, the broadcasting business has been one built on fixed costs. It costs a radio station very little more to reach its millionth simultaneous listeners than it costs to reach its first. The statutory streaming fees, which increase on a per person, per listener basis, with none of the advantages that scale brings to most business models, are difficult to reconcile with the standard business practices of the broadcast industry.

There is also a clear need to improve and update some of the CRB rules and procedures. This includes how stations report their music usage and how evidence is presented in CRB rate-setting proceedings. Another significant concern is the lack of Congressional oversight in the appointment process of the judges.

Recent developments have further illustrated the dysfunction of the current rate-setting procedures. The constitutionality of the appointment of the CRB itself was recently called into question with an appeal before the D.C. Circuit Court of Appeals. And an additional complication to the broken CRB system came earlier this year when SiriusXM filed a lawsuit against the CRB's chosen collective, SoundExchange, and A2IM (the American Association of Independent Music) claiming antitrust violations. This suit alleges that SoundExchange and A2IM conspired to prevent SiriusXM from negotiating direct licenses (which would take music out of the statutory royalty scheme administered by the CRB and SoundExchange).

If anything, efforts should be made to facilitate and encourage direct licensing between the recording industry and those streaming music. Certain

performers have recently argued that direct licensing would reduce their compensation. However, I would respectfully submit that, to the extent this Subcommittee might consider this to be a significant issue, it is imperative to evaluate performers' royalty payments in the larger context of their various streams of income, including how they are compensated by record labels.

Congress Should Not Impose a Performance Tax on Broadcasters

In beginning this important dialogue over how best to encourage the growth of Internet radio, Congress should not allow this debate to be bogged down by past fights over the performance tax, to which NAB remains staunchly opposed. For eighty years, American radio broadcasters and the music and recording industries have enjoyed a well-balanced relationship that has benefited all the parties. Record labels and performing artists profit from the free exposure provided by radio airplay, while local radio stations receive revenues from advertisers that purchase airtime to sell their products and services.

Despite the many dramatic changes that have occurred in the digital music industry over the past decade, this interdependent relationship between radio and the music and recording industries remains fundamentally the same.

Despite technological improvements, radio broadcasting retains the same basic character that it has had for decades. It is local. It is free to listeners. It is supported by commercial advertising. Local stations use on-air personalities and DJs to differentiate their programming, including by commenting on the music they play. While increasing, there is not an unlimited number of radio stations in the U.S., and listeners cannot choose what songs they will hear next, with the

exception of call-in and request lines. In addition, radio is characterized by its public service to local communities and is subject to numerous Federal Communications Commission (FCC) restrictions and obligations.

Many digital audio transmission services are eager to associate themselves with radio's rich history and consumer familiarity and affection, styling themselves as offering "radio" services. But simply marketing digital audio transmission services as "radio" does not make them so.

In 1995 and 1998, Congress recognized the vast differences between digital audio transmission services and local radio when it created a limited digital sound recording performance right for those new services that diverged so dramatically from the nature of traditional radio.

Now challenged by the economic downturn and financial threats posed by the rapidly changing digital environment, the recording industry is in search of additional revenue streams. But it is important to recognize that broadcasters are not responsible for the recording industry's financial woes. Broadcasters have continued to do their part in presenting music to the public in the same manner that they have done for decades. Particularly in the current highly competitive environment, where broadcasters are struggling to adapt their own business models to address the realities implicit in new media, it makes little sense to siphon revenues from local broadcasters for record labels to prop up the recording industry's past failings and ill-advised business decisions.

Conclusion

The relationship between the radio industry and the recording industry in the U.S. is one of mutual collaboration, with a long history of positive economic benefits for both. Without the airplay provided by thousands of local radio stations across America, the recording industry would suffer immense economic harm. Local radio stations in the U.S. have been the primary promotional vehicle for music for decades; it is still the primary place where listeners are exposed to music and where the desire on the part of the consumer to acquire the music begins.

The radio industry looks forward to a robust future that embraces the fundamental nature of broadcasting, as well as new opportunities arising from evolving digital technologies. But as we seek to develop business models that include streaming, we are continually thwarted by one consistent problem – statutory royalty rates and the dysfunctional rate-setting system and procedures.

In short, the royalty rate setting process has become a royal mess, and an opportunity to remedy that situation would be embraced by all who stream music. Broadcasters welcome the opportunity to discuss reform of this dysfunctional process in greater detail.

Mr. COBLE. Mr. Pakman you're recognized for 5 minutes.

TESTIMONY OF DAVID B. PAKMAN, PARTNER, VENROCK

Mr. PAKMAN. Thank you, Chairman Goodlatte, Ranking Member Watt and Members of the Subcommittee. Thank you for inviting me here today to testify regarding the state of Internet music radio licensing. I'm a venture capitalist with the firm Venrock. We invest in early stage Internet health care and energy companies and work to build them into successful standalone high growth businesses. We look to invest in outstanding entrepreneurs intending to bring exciting new products to very large and vibrant markets. Our firm has invested more than \$2.6 billion into more than 450 companies over the past 40 years. These investments include Apple, Athenahealth, Check Point Software, Intel and DoubleClick. Although I was previously a multi-time entrepreneur in the digital music business, we are not currently investors in any digital music or Internet radio companies. As venture capitalists we evaluate new companies largely based on three criteria: The abilities of the team, the size and conditions of the market the company aims to enter, and the quality of the product. Although we've met many great entrepreneurs with great product ideas, we have resisted investing in digital music largely for one reason: The complications and conditions of the state of music licensing. The digital music business is one of the most perilous of all Internet businesses. We are skeptical under the current licensing regime that profitable standalone digital music companies can be built. In fact, hundreds of millions of dollars of venture capital have been lost in failed attempts to launch sustainable companies in this market. While our industry is used to failure, the failure rate of digital music companies is among the highest of any industry we have evaluated. This is solely due to the overburdensome royalty requirements imposed upon digital music licensees by record companies under both voluntary and compulsory rate structures. The compulsory royalty rates imposed upon Internet radio companies render them noninvestible businesses from the perspective of many VCs.

The Internet has delivered unprecedented innovation to the music community and allowed more and more artists to be heard unfiltered by the incumbent major record labels and terrestrial radio stations. I believe more people listen to a more diverse set of music today than ever before in our time. However, the companies trying to deliver these innovative services are unsustainable under the current rates and frequently shut down once their investors grow tired of subsidizing these high rates and illusive profits fail to arrive at any scale. Pandora is a company that's done an amazing job of trying to make their business work at the incredibly high rates under which it currently operates.

But their quarterly earnings reports make abundantly clear why they are virtually alone in this category. Regretfully I cannot point to a single stand-alone business that operates profitably in Internet radio. In fact, in all of digital music, only very large companies who subsidize their digital music efforts with profits from elsewhere in their business currently survive as distributors or retailers of music.

There was a time when record companies were part of conglomerate media companies which also distributed the music they controlled. These joint owners and users of music appreciated the need for healthy economics on both sides of a license. Once the Internet emerged, new distributors or users of music grew outside of major label ownership. Perhaps in response to their failure to prosper as Internet distributors of music, the major labels took a short-term approach and refused to license their music on terms that would allow the music users to enjoy healthy businesses.

To this day, more than 15 years since I first entered the digital music business, I remain baffled by this practice. In my opinion, it is in the long-term best interests of music rights holders to encourage a healthy, profitable digital music business that attracts investment capital, encourages innovation, and indeed celebrates the successes of the licensees of its music. A healthy future for the recorded music business demands an ecosystem of hundreds or even thousands of successful music licensees, prospering by delivering innovative music services to the global Internet. Yet the actions of the RIAA seem counter to this very goal. They have appeared on the opposite side of every issue facing digital music innovators, opposed to sensible licensing rates meant to achieve a healthy market. Regretfully, and, perhaps most upsetting to all of us, the artists are the ones who suffer most. They depend on the actions of their labels to encourage a healthy market to grow, and have little influence on the decisions of the RIAA.

I am a believer in the value of open and unfettered markets and generally prefer market-based solutions. Unfortunately the music industry is controlled by a mere three major labels, two of them controlling about two-thirds of all record sales. That amount of concentrated monopoly power has prevented a free market from operating and letting a healthy group of music licensees thrive.

That said, I do believe there has been great value in compulsory licensing regimes such as the one governing Internet radio. This structure has allowed Internet radio companies to license the catalogs of all record labels and tens of thousands of independent artists, not just the dominant majors.

The problem is simply that the rates available to Internet radio companies under this compulsory license are too high. They frighten off investment capital, prevent great entrepreneurs from innovating, and they kill off exciting attempts to bring their music services to consumers.

I would like nothing more than to invest in the many entrepreneurs we have met with great ideas about the future of music, but without a sensible rate structure in place, our focus on this market won't be able to return.

Thank you.

Mr. COBLE. Thank you, Mr. Pakman.

[The prepared statement of Mr. Pakman follows:]

Testimony of David B. Pakman
Partner
Venrock

U.S. House of Representatives Committee on the Judiciary
Subcommittee on Intellectual Property, Competition and the Internet
Hearing on “Music Licensing Part One: Legislation in the 112th Congress”
November 28, 2012

Chairman Goodlatte, Congressman Watt, and Members of the Subcommittee:

Thank you for inviting me to testify today regarding the state of internet music radio licensing. I am a venture capitalist with the firm Venrock. We invest in early stage internet, healthcare and energy companies and work to build them into successful, stand-alone, high-growth businesses. We look to invest in outstanding entrepreneurs intending to bring exciting new products to very large and vibrant markets. Our firm has invested more than \$2.6 billion in more than 450 companies over the past 40 years. These investments include Apple, Athenahealth, Check Point Software, Intel and DoubleClick.

Although I was previously a multi-time entrepreneur in the digital music business, we are not currently investors in any digital music or internet radio companies.

As venture capitalists, we evaluate new companies largely based on three criteria: the abilities of the team, the size and conditions of the market the company aims to enter, and the quality of the product. Although we have met many great entrepreneurs with great product ideas, we have resisted investing in digital music largely for one reason — the complications and conditions of the state of music licensing. The digital music business is one of the most perilous of all internet businesses. We are skeptical, under the current licensing regime, that profitable stand-alone digital music companies can be built. In fact, hundreds of millions of dollars of venture capital have been lost in failed attempts to launch sustainable companies in this market. While our industry is used to failure, the failure rate of digital music companies is among the highest of any industry we have evaluated. This is solely due to the over-burdensome royalty requirements imposed upon digital music licensees by record companies under both voluntary and compulsory rate structures. The compulsory royalty rates imposed upon internet radio companies render them non-investible businesses from the perspective of many VCs.

The internet has delivered unprecedented innovation to the music community and allowed more and more artists to be heard unfiltered by the incumbent major record labels and terrestrial radio stations. I believe more people listen to a more diverse set of music today than ever before in our time. However the companies trying to deliver these innovative services are unsustainable under the current rates and frequently shut down once their investors grow tired of subsidizing these high rates and elusive profits fail to arrive at any scale. Pandora is a company that has done an amazing job of trying to make their business work at the incredibly high rates under which it currently operates — but their quarterly earnings reports make abundantly clear why they are

virtually alone in this category. Regretfully, I cannot point to a single stand-alone business that operates profitably in internet radio. In fact, in all of digital music, only very large companies who subsidize their music efforts with profits from elsewhere in their business currently survive as distributors or retailers of music.

There was a time when the record companies were part of conglomerate media companies which also distributed and licensed the music they controlled. These joint “owners” and “users” of music appreciated the need for healthy economics on both sides of a license. Once the internet emerged, new distributors or “users” of music grew outside of major label ownership. Perhaps in response to their failure to prosper as internet distributors of music, the major labels took a short-term approach and refused to license their music on terms that would allow the “music users” to enjoy healthy businesses. To this day, more than 15 years since I first entered the digital music business, I remain baffled by this practice. In my opinion, it is in the long-term best interest of music rights holders to encourage a healthy, profitable digital music business that attracts investment capital, encourages innovation, and indeed celebrates the successes of the licensees of its music. A healthy future for the recorded music business demands an ecosystem of hundreds or even thousands of successful music licensees, prospering by delivering innovative music services to the global internet. Yet the actions of the RIAA seem counter to this very goal. They have appeared on the opposite side of every issue facing digital music innovators, opposed to sensible licensing rates meant to achieve a healthy market. Regretfully, and perhaps most upsetting to all of us, the artists are the ones who suffer most. They depend on the actions of their labels to encourage a healthy market to grow and have little influence on the decisions of the RIAA.

I am a believer in the value of open and unfettered markets and generally prefer market-based solutions. Unfortunately, the music industry is controlled by a mere three major labels, two of them controlling about two-thirds of all record sales. That amount of concentrated monopoly power has prevented a free market from operating and letting a healthy group of music licensees thrive. That said, I do believe there has been great value in compulsory licensing regimes such as the one governing internet radio. This structure has allowed internet radio companies to license the catalogs of all record labels and tens of thousands of independent artists, not just the dominant majors, bringing unprecedented exposure and revenue to the vibrant long tail of indie music — often where music innovation itself gestates.

The problem is simply that the rates available to internet radio companies under this compulsory license are too high. They frighten off investment capital, prevent great entrepreneurs from innovating, and kill off exciting attempts to bring great new music services to consumers. American entrepreneurship and innovation require vibrant markets unburdened by artificially high rate structures. I am hopeful you will see through the rhetoric often employed in this debate and make sensible policy based on sound economics. I would like nothing more than to invest in the many entrepreneurs we have met who have great ideas about the future of music. With a sensible rate structure in place, our focus on this market could return.

Please note: the views expressed herein are my own and are not necessarily those held by Venrock or other individual partners at the firm.

Mr. COBLE. Mr. Jam.

TESTIMONY OF JIMMY JAM, CHAIR EMERITUS, THE RECORDING ACADEMY, RECORD PRODUCER, SONGWRITER, RECORDING ARTIST

Mr. JAM. Thank you, Chairman Goodlatte, Ranking Member Watt and Members of the Subcommittee. My name is Jimmy Jam. I am a record producer, recording artist, songwriter and small business owner. I am also the chair emeritus of the Board of The Re-

Recording Academy, known for producing the Grammy Awards. The Recording Academy is the trade association that represents the individual performers, songwriters and studio professionals who create the music enjoyed around the country and around world. I am also a member of the American Federation of Musicians, SAG-AFTRA, and ASCAP. I am honored and grateful for the opportunity to present the music creators' viewpoint at this important hearing.

Now, as a record producer I have had the privilege of working with some of the finest recording artists, including Usher, Mariah Carey, the Isley Brothers, Willie Nelson, Yolanda Adams and many others. And while their names are well known, if you came to my studio on any given day, you would see dozens of people who you have never heard of employed as session musicians, background singers, songwriters, engineers and other professionals who all derive their income from creating music. The majority of Recording Academy members are middle-class artists; music is not just their lives, but their livelihood.

As a small business owner, I know firsthand that bringing music to the American public takes time, investment, talent, and the passion of many remarkable individuals, but while music is our passion, it is also our job, and, like any job, we hope to be paid fairly for our work. So let us compare two of the ways creators get paid in the digital era.

If a consumer downloads a song from Amazon, they pay the rights holders and creators about 70 cents. If a consumer streams that same song on Pandora radio, Pandora pays SoundExchange about one-tenth of 1 penny; or, put another way, the listener would have to hear that song on Pandora every single day for nearly 2 years to equal the payments earned from the one download on Amazon.

So when Pandora tells you it is paying too much, think about that tenth of a penny, and then remember that small amount is shared by the copyright owners, featured artists, session musicians, singers and producers. That is why the Recording Academy opposes H.R. 6480, the Internet Radio Fairness Act, which would lower these already small payments by as much as 85 percent. And while Pandora is trying to lower the earnings of artists through legislation, it is also seeking to lower its payments to songwriters in rate court. We oppose both efforts.

The Internet Radio Fairness Act is ironically named. First, it is hardly fair to ask the very people who enable Pandora's business to work for below-market payments. But even worse it fails to mention the most unfair aspect of the music royalty debate.

Now, if I told you, the congressional leaders responsible for IP policy, that one business in America is allowed to take and use another's intellectual property without permission or compensation, I think you would say, that is crazy. Well, one such business does exist: the radio broadcast industry.

Through unbelievable exemption in the law, terrestrial radio is allowed to take and profit from any sound recording without paying a single penny to those that create the track. Now, this is the only industry in America that is allowed to do this, and the United States is the only developed country in the world that provides such an exemption for its broadcasters. We believe that before

there can be any discussion of rates or rate standards, Congress should close the corporate radio loophole.

Chairman Goodlatte, the Internet Radio Fairness Act is anything but fair, but by all means it is time to have a real conversation about fairness. For example, is it fair for Pandora, which already enjoys the benefit of a compulsory license, to also enjoy a government-imposed, below-market rate? Is it fair for songwriters who provide the very DNA of the music industry to have to fight Pandora in court just to keep their already small payments? And finally, is it fair for terrestrial broadcasters to pay nothing for using the sound recordings because they, not we, have decided that it is good for us?

The answer to all these questions is clearly no. Members of the Subcommittee, if you agree that music creators should be paid fairly for their work, then I ask that you oppose H.R. 6480, and that we all work together to support fair-market royalties paid by all who use music as the foundation of their business.

Thank you.

Mr. COBLE. Thank you, Mr. Jam.

[The prepared statement of Mr. Jam follows:]

**Testimony of
Jimmy Jam
Chair Emeritus, Board of Trustees
The Recording Academy
and
Record Producer, Songwriter, Recording Artist**

**Before the U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Intellectual Property, Competition, and the Internet
Washington, DC**

**"Music Licensing Part One: Legislation in the 112th Congress"
November 28, 2012**

Chairman Goodlatte, Ranking Member Watt, and members of the Subcommittee: My name is Jimmy Jam. I'm a record producer, recording artist, songwriter, and small business owner. I am also Chair Emeritus of the Board of The Recording Academy. Known for producing the GRAMMY Awards, The Recording Academy is the trade association that represents the individual performers, songwriters and studio professionals who create the music enjoyed around the country and around the world. I am also a member of the American Federation of Musicians, SAG-AFTRA and ASCAP. I am honored and grateful for the opportunity to present the music creator's viewpoint at this important hearing.

As a record producer, I've had the privilege of working with some of the finest recording artists, including Usher, Mariah Carey, The Isley Brothers, Sting and Yolanda Adams. And while their names are well known, if you came to my studio on any given day, you would see dozens of people you've never heard of employed as session musicians, background singers, songwriters, engineers and others professionals who derive their income from creating music.

The majority of Recording Academy members are middle class artists. Music is not just their lives, but their livelihoods.

As a small business owner, I know first-hand that bringing music to the American public takes investment, time, and the talents and passion of many remarkable individuals.

But while music is our passion, it's also our job. And as with any job, we hope to be paid fairly for our work.

So let's compare two ways creators get paid in the digital era.

If a consumer downloads a song from Amazon's mp3 store for 99 cents, Amazon pays the rights holders and creators about 70 cents. If a consumer streams that same song on Pandora radio, Pandora pays SoundExchange about one tenth of one penny. Or put another way, the listener would have to hear that song on Pandora every single day for nearly two years to equal the payments earned from that one download.

So when Pandora tells you it's paying too much to the creators who are the backbone of its business, think about that tenth of a penny—and remember that small amount is shared by copyright owners, featured artists, session musicians, singers, and producers. We're talking about very little money per play.

That's why the Recording Academy opposes H.R. 6480, which would lower these already small payments by as much as 85 percent.

It's also important to note that while Pandora is trying to lower the earnings of artists through legislation, it is simultaneously seeking to lower its payments to songwriters in rate court. As an organization that represents both artists and songwriters, The Recording Academy opposes both the Internet Radio Fairness Act as well as any attempts to lower payments to songwriters.

The Internet Radio Fairness Act is ironically named. First, it's hardly fair to ask the very people who enable Pandora's business to work for below-market payments. But perhaps even worse, it neglects to mention the most unfair aspect of all in the music royalty debate. So while we discuss these digital platforms, we must also address an important inequity in the analog world.

If I told you – the Congressional leaders responsible for I.P. policy – that one business in America is allowed to take and use another's intellectual property without permission or compensation, I think you would find that patently unjust. Well, one such business does exist – the radio broadcast industry. Through an inexplicable exemption in the law, terrestrial radio is allowed to take – and profit from – any sound recording without paying a single penny to those who created the track. This is the only industry in America allowed such a taking, and the United States is the only developed country in the world that provides such an exemption to its broadcasters.

The NAB will tell you, on the basis of a few deals with independent record labels, that the marketplace will solve this problem. But we need Congress to provide an industry-wide solution that covers all broadcasters and all artists. And if you don't believe me, take it from the architect of the first of these private market deals. Scott Borchetta, the CEO of Big Machine Records who made the first private deal that includes a terrestrial royalty, sent a letter to Congress noting the reasons why private deals are not a substitute for legislation. And I would ask that his letter be submitted into the record.

Private deals between a few labels and broadcasters cannot create a performance right – only Congress can. And until this important right is established in law, the United States will continue to lose tens of millions of dollars each year as money is collected for American music played in foreign countries – revenue rightly belonging to American creators and businesses – but not shared with us because we lack a performance right.

We believe that before there can be any discussion of rates or rate standards, Congress should address this anomaly in the law and close the corporate radio loophole. I want to thank the members of this Committee who have supported and favorably reported the Performance Rights Act, and also thank Mr. Nadler for his draft legislation, the Interim FIRST Act, which ensures a level playing field for all participants.

Chairman Goodlatte, the Internet Radio Fairness Act is anything but fair. But by all means, it's time to have a *real* conversation about fairness.

Is it fair for Pandora – which already enjoys the benefits of a compulsory license – to also enjoy a government-imposed below-market rate so it can increase its profit margins at the expense of artists? Is it fair for songwriters, who provide the very DNA of the music industry, to be asked to fight to maintain their already meager payments from Pandora? And finally, is it fair for terrestrial broadcasters to pay nothing for using sound recordings because they – not we – have decided it's good for us?

The answer to all of these questions is clearly no.

Those of us who make music are happy to share our gifts with the world, and we only ask that we be paid a fair wage in return. Members of the subcommittee, if you agree that music creators should be paid fairly for their work, then I ask that you oppose H.R. 6480 and that we work together to support fair-market royalties paid by *all* who use music as the foundation of their business.

Thank you.

Mr. COBLE. Dr. Eisenach.

**TESTIMONY OF JEFFREY A. EISENACH, MANAGING DIRECTOR
AND PRINCIPAL, NAVIGANT ECONOMICS**

Mr. EISENACH. Mr. Chairman and Mr. Ranking Member, Members of the Subcommittee, thank you for the opportunity to testify

before you today. I thank Mr. Goodlatte for his kind introduction and note that while the research upon which my testimony is based was partially supported by the musicFIRST Coalition, I am appearing solely on my own behalf, and the views I will express are exclusively my own.

I have submitted written testimony, and I would like to briefly summarize it.

Beginning with the Digital Performance Right in Sound Recordings Act of 1995, and continuing with the Digital Millennium Copyright Act in 1998, Congress has adopted an increasingly market-oriented approach to sound performance recording rights.

Under DMCA, license terms and royalty rates for nearly all parties are either negotiated directly between the parties or, in the case of rights subject to a compulsory license, are set so as to, quote, “represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.” Twice in recent years this Subcommittee has passed legislation that would have extended this market-based approach to over-the-air broadcasting.

My central point today is that Congress is on the right track and should not turn back by passing legislation designed to subsidize a particular class of copyright users. I am referring, of course, to the proposed Internet Radio Fairness Act, or IRFA, and especially to the proposal to replace the market-oriented willing buyer/willing seller standard with the uneconomic four-part standard under section 801(b) of the Copyright Act of 1976. Doing so would distort the marketplace and harm consumers for four primary reasons.

First, market-based rates maximize consumer welfare by ensuring that society’s resources are directed to their highest-valued uses. In a market-based economy like ours, prices serve as the key signaling mechanism telling economic actors how capital and labor should be directed to produce products and services valued most highly by consumers at the lowest possible cost. Replacing the market-based willing buyer/willing seller standard with the downward-biased 801(b) standard would result in the misallocation of economic resources and ultimately make consumers worse off.

Second, there is no valid economic or public policy basis for forcing content providers to subsidize webcasters by charging them the below-market rates that would almost surely result from IRFA. The market for online music is intensely vibrant and growing rapidly. Online advertising revenues are growing 30 percent per year. New firms are entering the market, existing firms are garnering billion-dollar valuations, and the mobile marketplace, as Pandora notes prominently in its most recent financial reports, is getting ready to take off and explode.

Pandora makes much of the fact that content acquisition accounts for half or more of its revenues, but in reality its content costs as a proportion of revenues are comparable to other similar firms. Moreover, the ratio of Pandora’s content costs to its revenues is within Pandora’s control. As The New York Times put it recently, throughout the music industry there is a wide belief that Pandora could solve its financial problems by simply selling more ads.

Third, the fourth prong of section 801(b), the nondisruption standard, would grant copyright users a de facto right to perpetual profitability based on their current business models. In fact, copyright users are arguing in the current SDARS II proceeding that the nondisruption standard guarantees them a profit not only on their past investments, but on future investments as well.

In the dynamic world of online content delivery, the creation of what amounts to a right of eternal life for market incumbents is a recipe for technological and marketplace stagnation.

Fourth and finally, passage of IRFA would risk politicizing the rate-setting process for sound recording performance rights. The changes it would make to the appointment process and qualifications of the copyright royalty judges would reduce the objectivity and independence of the CRB.

More broadly, as you all know, all firms would prefer to pay lower prices for their inputs. Car manufacturers would like to pay less for steel, filling stations less for gasoline, aluminum plants less for electricity. In general, markets ensure that the prices paid for such inputs are, to paraphrase Goldilocks, neither too high nor too low, but just right.

The politicization of pricing decisions, on the other hand, favors those with the greatest capacities for political influence. In this case Congress should not allow the fact that webcasters have the demonstrated capacity to generate a large volume of emails from their listeners to lead to a result that would in the end harm those very same consumers by retarding innovation and destroying incentives for content creation.

Mr. Chairman and Members of the Subcommittee, that completes my testimony. I look forward to your questions.

Mr. COBLE. Thank you, Doctor.

[The prepared statement of Mr. Eisenach follows:]

**TESTIMONY
OF
JEFFREY A. EISENACH, PH.D.
BEFORE THE SUBCOMMITTEE ON
INTELLECTUAL PROPERTY, COMPETITION AND THE INTERNET
COMMITTEE THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES**

November 28, 2012

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear before you today to testify on issues relating to music licensing.

I currently serve as a Managing Director at Navigant Economics, a Visiting Scholar at the American Enterprise Institute and an adjunct professor at George Mason University Law School, where I teach the course on Regulated Industries. In all of these capacities, and for much of the past two decades, I have written about and taught on topics relevant to the subject of today's hearing. While some of the research upon which my testimony today is based was supported in part by the musicFIRST coalition, I am appearing today solely on my own behalf, and the views I will express are exclusively my own.

My testimony today focuses on the sound recording performance right and, in particular, on what is commonly referred to as the digital performance right.¹ As the Subcommittee knows well, until recently, owners of sound recording performance rights were granted reproduction and distribution rights, but – unlike the holders of musical work rights – were not granted a performance right. Thus, copyright holders of sound recordings could monetize the copying and distribution of their recordings, but could not charge for “performances,” such as when radio stations (or webcasters) played copyrighted music. In the absence of such a property right, naturally, there was no market for sound recording performances.

Beginning with passage of the Digital Performance Right in Sound Recordings Act (DPRA) in 1995,² Congress has moved gradually in the direction of both creating performance rights and putting in place the conditions to allow such rights to be traded at market (that is, economically efficient) rates. The DPRA established the first sound recording performance right in the form of the digital performance right. Then, in the 1998 Digital Millennium Copyright Act (DMCA), Congress established the principle that license terms and royalty rates would either be negotiated directly between the parties or, in the case of rights subject to a compulsory license, would “represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.”³ Twice in recent years, this subcommittee has passed

¹ I have recently authored a study on the sound performance recording right which addresses many of the issues discussed herein. It is included in this written statement as Attachment A.

² *Digital Performance Right in Sound Recordings Act of 1995*, Pub. L. No. 104–39.

³ 17 U.S.C. § 114(f)(2)(B).

legislation that would have further advanced market-based principles by extending the sound performance right to the over-the-air broadcasts of terrestrial broadcasters.⁴

The central point of my testimony today is that Congress should continue to move in the direction of using market-based mechanisms for setting the terms and rates by which sound recording performance rights are licensed among rights holders and users. Equally important, it should resist entreaties to backslide by passing legislation that would replace the current market-based standard for royalty rates with one designed to tilt the playing field in such a way as to subsidize a particular class of copyright users.

I am referring, of course, to the proposed Internet Radio Fairness Act (IRFA, H.R. 6480/S. 3609). While the IRFA contains a number of provisions designed to tilt the rate-setting process in favor of copyright users and against copyright holders, at its core is its proposal to replace the market-oriented willing buyer/willing seller standard with the uneconomic, four-part standard under Section 801(b)(1) of the Copyright Act of 1976 (the “801(b) standard”). To do so would represent a significant step in the wrong direction, both because the rates likely to emerge from the rate setting process would be below those that would emerge from a competitive market, and thus reduce economic welfare, and because the “non-disruption” standard contained in Section 801(b)(1)(D) would create perverse incentives that are fundamentally at odds with the innovative, dynamic nature of the market for online music.

Specifically, replacing the willing buyer/willing seller standard with the 801(b) standard and making the other changes proposed by the IRFA would harm consumers for four primary reasons.

- (1) Market-based rates result in the efficient – i.e., consumer-welfare-maximizing – allocation of society’s resources, and the willing buyer/willing seller standard embodies the principle of market-based rates.
- (2) The lower rates that would result from the IRFA are not necessary to preserve a vibrant, growing market for online music, and would harm the market for content creation.
- (3) The non-disruption standard contained in Section 801(b)(1)(D) is fundamentally inconsistent market-based incentives for efficiency and innovation, especially in a dynamic market such as the market for digital music.
- (4) Adoption of the IRFA would distort the rate setting process and likely result in the further politicization of rate setting for sound performance rights.

Let me expand briefly on each reason.

First, market-based rates maximize consumer welfare by ensuring that society’s resources are directed to their highest valued uses. In a market-based economy like ours, prices serve as the key signaling mechanism telling economic actors how capital and labor should be directed to

⁴ See The Performance Rights Act of 2007 (H.R. 4789/S. 2500) and its successor, The Performance Rights Act of 2009 (H.R. 848/S. 379).

produce the products and services valued most highly by consumers at the lowest possible cost. Prices set above market-clearing levels result in too many resources being directed towards production, while at the same time too little of the resulting output is demanded by consumers. Prices set below market clearing levels have the opposite effect – too little is produced, and consumers are unable to procure the amount, or the quality, of products they desire.

As I detail in Attachment A, the willing buyer/willing seller standard has been implemented in such a way as to produce royalty rates consistent with those that would likely result from a freely functioning market. In particular, the arbitration bodies that have set rates in the major Webcaster proceedings have based their determinations on freely negotiated rates for analogous products, e.g., the rates for interactive services, which are not subject to a compulsory license. While no rate setting process is perfect, the procedures followed by the Copyright Arbitration Royalty Panel (in *Webcaster I*) and by the Copyright Royalty Board (in *Webcaster II* and *Webcaster III*) – which include opportunities for all sides to fully present their positions, supported by expert economic and industry testimony, as well as both administrative and judicial review – have likely yielded rates that reasonably approximate those that would have resulted from voluntary negotiations in a freely operating market, and thus are presumptively consumer-welfare-maximizing.

Second, while IRFA would almost certainly produce the lower royalty rates its supporters seek, there is no valid economic or public policy basis for forcing content providers to subsidize webcasters by charging them below-market rates. The market for online music is intensely vibrant and growing rapidly. Tens of thousands of new listeners are signing up to services like Pandora and Spotify every week, and existing listeners are using the services more and more intensely every year. Online advertising revenues are growing 30 percent per year, new firms are entering the market at a rapid pace, and existing firms are garnering billion dollar market valuations.

IRFA's leading supporter, Pandora, makes much of the fact that content acquisition accounts for a large proportion of its revenues, but in fact its content costs as a proportion of revenues are comparable to other, similar firms. For example, as I detail in the attachment, the proportion of revenues accounted for by content costs for Netflix and Pandora have been nearly identical over the last three years (2009-2011) for which data is available from both firms; indeed, for each of the last two years, Netflix has paid a higher proportion of its revenues for content acquisition than has Pandora.

Moreover, and crucially, the ratio of Pandora's content costs to its revenues is well within Pandora's control: To raise its revenues, it need only choose to sell additional advertising. As *The New York Times* reported recently, "Throughout the music industry there is a wide belief that Pandora could solve its financial problems ... by simply selling more ads."⁵

⁵ See Ben Sisario, "Proposed Bill Could Change Royalty Rates for Internet Radio," *The New York Times* (September 23, 2012) (available at <http://www.nytimes.com/2012/09/24/business/media/proposed-bill-could-change-royalty-rates-for-internet-radio.html>). See also Richard Greenfield, "Congress Should be Working to Raise Royalty Rates on Pandora, Not Lower Them," *BTIG Research* (September 24, 2012) (available at <http://www.btigresearch.com/2012/09/24/congress-should-be-working-to-raise-royalty-rates-on-pandora-not-lower-them/>) ("[T]he reason why companies such as Pandora pay such high royalty rates as a percentage of revenues is because they severely limit audio advertising to protect the user experience and keep people on the platform. If Pandora ran several minutes of audio ads per hour (the way terrestrial radio does) vs. just a few 15 sec. spots, the %

Third, the Section 801(b)(1)(D) non-disruption standard would fundamentally distort the rate setting process by granting users a *de facto* right to perpetual profitability based on their current business models. Indeed, as I detail in the attachment, experts testifying on behalf of copyright users in the current *SDARS II* proceeding have argued that the non-disruption standard not only requires rates to be set so as to guarantee copyright users profits on their initial investments, apparently in perpetuity, but even to ensure that they can “recover the financial cost of capital for forward-looking investments,” since rates that fail to give users incentives to *continue* investing in their businesses would be “disruptive.”

In the dynamic world of online content delivery – in which new and improved business models are constantly replacing old, obsolete ones – the creation of what licensees argue is a *de facto* right to perpetual profitability is a recipe for technological and marketplace stagnation.⁶

Fourth, and finally, both the act of passing the IRFA and a number of its specific provisions would distort the rate setting process and likely result in the further politicization of rate setting for sound recording performance rights. As I detail in the attachment, a number of the IRFA’s specific provisions, including the changes it would make to the appointment process and qualifications of the copyright royalty judges, would threaten to reduce the objectivity and independence of the CRB.

More broadly, it is a truism that all market participants would prefer to pay lower prices for their inputs – car manufacturers would like to pay less for steel, gas stations less for gas and soft drinks, aluminum plants less for electricity. In the absence of market failures, however, market forces ensure that the prices paid for such inputs are, to paraphrase Goldilocks, neither too high nor too low, but “just right.” The politicization of pricing decisions, on the other hand, results in prices which favor the actors with the greatest capacities for political influence. In this case, Congress should not allow the fact that webcasters have the demonstrated capacity to generate a large volume of emails from their listeners to lead to a result that would, in the end, harm those very same consumers by retarding innovation and destroying incentives for content creation.

* * *

Mr. Chairman and Members of the Subcommittee, that completes my testimony. I look forward to any questions you may have.

of revenues paid out as royalties would be dramatically lower and would be more in line with satellite radio or cable TV. Interestingly, Spotify’s radio product runs substantially more advertising per hour than Pandora.”)

⁶ By contrast, as the D.C. Circuit explained in reviewing the *Webcaster II* decision, the willing buyer/willing seller standard does not require rates to be set so as to preserve inefficient business models. See *Intercollegiate Broadcast System v. Copyright Royalty Board* 574 F. 3d 748, 761 (D.C. Cir. 2009) (“[I]t was not error for the Judges to reject the small commercial webcasters’ pleas that paying per performance would wreck their inefficient business models. The Judges made clear they could not ‘guarantee a profitable business to every market entrant.’ *The Judges are not required to preserve the business of every participant in a market.*”) (emphasis added).

The Sound Recording Performance Right at a Crossroads: Will Market Rates Prevail?

JEFFREY A. EISENACH†

Starting in the 1990s, Federal policy has moved in the direction of a market-oriented approach towards sound recording rights, beginning with Congress' decision to create a sound recording performance copyright in 1995. In 1998, Congress provided that most statutory royalty rates, including the rates paid by webcasters like Pandora Radio, would be set using a market-based "willing buyer, willing seller" (WBWS) standard. Since then, the WBWS standard has been applied in several rate setting proceedings, but complaints from webcasters that the rates were "too high" have led to Congressional intervention and, ultimately, to adoption of rates below market levels. Now, as a new rate setting cycle is about to get underway, webcasters have begun lobbying Congress to replace the WBWS standard with a new version of the so-called 801(b) standard, which promises copyright users a right of "non-disruption." Adoption of the 801(b) standard – and the other changes favored by the webcasters – would result in rates below economically efficient levels, thereby distorting markets, slowing innovation and harming consumers. This paper examines the market for sound recording performance rights, concluding that Congress should resist webcasters' pleas for regulatory favoritism and instead continue moving towards a market-oriented approach, starting with extending the sound performance right to terrestrial radio.

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I. INTRODUCTION

Until 1995, the principal protection afforded to holders of sound recording copyrights were rights of reproduction and distribution. Thus, copyright holders of sound recordings could monetize the copying and distribution of their recordings, but could not charge for “performances,” such as when radio stations played copyrighted music. In the absence of such a property right, naturally, there was no market for sound recording performances.¹

Beginning with passage of the Digital Performance Right in Sound Recordings Act (“DPRA”) in 1995, Congress has moved gradually in the direction of both creating performance rights and putting in place the conditions to allow such rights to be traded at market (that is, economically efficient) rates. The first sound recording performance right, for certain digital performances, was created by DPRA, which also created a compulsory license for nonexempt, non-interactive, digital subscription transmissions. In 1998, Congress expanded the compulsory license to additional digital performances in the Digital Millennium Copyright Act (“DMCA”). As a result, for some rights, particularly “interactive” services, buyers and sellers bargain freely over rates and conditions. However, “non-interactive” services (i.e., radio-like “streaming” services), may take advantage of a compulsory license: Buyers and sellers have the option of negotiating voluntary agreements (which is generally done on an industry-wide basis), but if they fail to do so, sellers are required to license rights at government-determined “statutory” rates.

In this context, the criteria for setting statutory rates are obviously important. For most non-interactive services, the DMCA established a “willing buyer/willing seller” (“WBWS”) standard, which is intended to set rates at the level that would have been reached in a voluntary, marketplace negotiation. In practice, as implemented by Copyright Arbitration Royalty Panels (“CARP”) and later by the Copyright Royalty Board (“CRB”), the WBWS standard has resulted in a market-oriented approach to setting rates.

In adopting the WBWS standard, Congress chose to reject the previous, less market-oriented standard used in the DPRA, namely a four-part test under Section 801(b) of the 1976 Copyright Act. Unlike the WBWS standard, the 801(b) approach requires regulators to take into account non-market based criteria in setting royalties for statutory licenses, including specifically to set rates so as to protect licensees against any “disruptive” effects that might be caused by paying royalties – no matter how market-oriented they may be. Thus, the 801(b) standard arguably grants licensees a *de facto* right to perpetual profitability, allowing licensees to argue that they and their business models have a right to be protected from “disruption.” In the dynamic world of online content delivery – in which new and improved business models are constantly replacing old, obsolete ones – the creation of such a right has obvious negative consequences for innovation.

Fortunately, the 801(b) standard currently applies to only a handful of companies, which were “grandfathered” when the DMCA was adopted. Thus, royalties for all other sound recording performance rights are established either through direct market negotiations among the parties or, for compulsory licenses,

¹ Here and elsewhere in this paper, I use the term “property right” in the colloquial sense, that is, as the right to right to exclude others from using a good.

under the market-oriented WBWS standard. Moreover, in recent years, Congress has shown substantial interest in bringing the one significant remaining area in which property rights are lacking – over-the-air performances by terrestrial broadcasters – under a market-oriented framework, by extending the sound recording performance right to such performances. In short, the recent history of the sound recording performance right has been clearly in the direction of a more market-oriented approach.

In mid-2012, however, legislation was introduced in both the House and Senate that would reverse the pro-market trend by replacing the WBWS standard with the less-market-oriented 801(b) standard for the compulsory licenses for sound recording performances. The Internet Radio Fairness Act (“IRFA”) (H.R. 6480 in the House, S. 3609 in the Senate) – which is supported by some webcasters (e.g., Pandora) – would require copyright judges to take into account whether market-based royalty rates might “disrupt” the business models of licensees. It goes without saying that the webcasters that support the bill expect the 801(b) approach would result in lower royalties than under the current market-based standard.

The IRFA does not stop, however, at imposing the anti-disruption standard on future royalty proceedings. It contains a series of additional measures, all designed to tilt the institutional playing field to the advantage of webcasters, including prohibiting the CRB from considering certain types of evidence and forcing it to ignore relevant precedents. As if to ensure that economics will play as small a role as possible in future CRB deliberations, the Act even removes the requirement that at least one of the three CRB judges have expertise in economics.

As I explain below, the arguments offered in support of the IRFA – that it is necessary to ensure a vibrant market for digital music, or that it will “level the playing field” by subjecting all digital music distributors to the same copyright regime – are unfounded. The market for digital music is growing by leaps and bounds, and the rapid growth of online advertising and wireless broadband, ensure that it will continue to do so. Webcasters are not paying “unreasonable” rates, and they are fully capable of paying market rates in the future. Moreover, imposing the 801(b) standard on webcaster royalty proceedings would not address the most serious imbalances in the current royalty regime, including the fact that over-the-air broadcasts by terrestrial broadcasters continue to be exempt altogether from the sound recording performance right.

The remainder of this paper is organized as follows. Section II presents a brief history of the sound recording performance right. Section III reviews the implementation of the WBWS and 801(b) standards by the CARP and the CRB, and explains why, in practice, the 801(b) standard is likely to result in below-market rates. Section IV explains why the rates established for non-interactive online music services under the WBWS standard are both efficient and “reasonable,” and details the harm to innovation, competition and consumers that would result from adoption of the 801(b) standard for all statutory royalty proceedings. Section V presents a brief summary and offers a few concluding thoughts. Specifically, it recommends that Congress return to the market-oriented path it started down in the 1990s, beginning with extending the sound performance right to terrestrial radio.

II. THE SOUND RECORDING PERFORMANCE RIGHT: A BRIEF HISTORY

Under Section 102 of the Copyright Act of 1976, there are two types of copyrights associated with recorded music.² The first copyright protects the musical composition (consisting of the notes and lyrics) written by the composer.³ This “musical work” copyright is typically held by a music publisher.⁴ The second type of copyright protects subsequent recordings of a given song by a particular artist.⁵ This “sound recording” copyright is typically held by the producer of the sound recording, most often a record label.⁶

Prior to 1995, there was an important distinction between the rights enjoyed by the owners of a musical work copyright and a sound recording copyright. The owner of a musical work copyright was also granted a “performance right,” which entitled her to compensation whenever her copyrighted work was performed or broadcast publicly.⁷ The owners of sound recording copyrights, however, were not granted a performance right.⁸ For example, when a radio station publicly broadcasts a song over the air, it pays a royalty to the holder of the musical work copyright, but not to the holder of the sound recording copyright.⁹ The principal protection afforded to owners of sound recording copyrights was a reproduction and distribution right, which granted

² See e.g., Library of Congress, Copyright Royalty Judges, *Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Rule and Order*, 72 FR 24084 (May 1, 2007) (hereafter *Webcaster II*).

³ *Id.*

⁴ See Kimberly L. Craft, “The Webcasting Music Revolution Is Ready to Begin, as Soon as We Figure out the Copyright Law: The Story of the Music Industry at War with Itself,” *Hastings Communications & Entertainment Law Journal* 24:1 (2001) 1-42 at 4 (hereafter *Craft 2001*).

⁵ See *Webcaster II* at 24086. (“The term ‘musical work’ refers to the notes and lyrics of a song, while a ‘sound recording’ results from ‘the fixation of a series of musical, spoken or other sounds. A song that is sung and recorded will constitute a sound recording by the entity that records the performance, and a musical work by the songwriter.’”) See also Brian Day, “The Super Brawl: The History and Future of the Sound Recording Performance Right,” *Michigan Telecommunications and Technology Law Review*, 16 (2009) 179-212 at 183 (“Sound recording copyrights, on the other hand, are normally owned by the artist or record label and protect the originality of the recording itself as distinct from the underlying written lyrics or melody.”)

⁶ See *Webcaster II* at 24086 (“Typically, a record label owns the copyright in a sound recording and a music publisher owns the copyright in a musical work.”) (citations omitted).

⁷ See *Craft 2001* at 4 (“If a performance of the musical work happens to be broadcast over the airwaves such as by a radio station, each play is also worth money, in the form of royalties, to the songwriter and publisher.”) See also Jeremy Delibero, “Copyright Arbitration Royalty Panels and the Webcasting Controversy: The Antithesis of Good Alternative Dispute Resolution,” *Pepperdine Dispute Resolution Law Journal* 5:1 (2005) 83-114 at 85 (hereafter *Delibero 2005*) (“Within the Copyright Act, [musical] copyright owners enjoy an exclusive right of public performance. The copyright owner may recover royalties anytime a third party publicly performs the work. A public performance includes both the musical work and the sound recording.... Unlike musical works, the owner of a sound recording (usually a record label) is not automatically entitled to performance royalties under the Copyright Act.”)

⁸ See *Webcaster II* at 24086 (“The performance right is granted to all categories of copyrighted works with one exception: Sound recordings. Thus, while the owner of a musical work enjoys the performance right, the owner of a sound recording does not.”)

⁹ See *Craft 2001* at 6 (“While radio broadcasters pay royalties to publishers and writers for use of the musical work, they have, however, never had to pay any sort of royalty or licensing fee to the actual record companies for use of the sound recording.”) See also *Intercollegiate Broadcast System, Inc., et al. v. Copyright Royalty Board*, 574 F.3d 748, 753 (D.C. Cir. 2009) (“The copyright owners of musical works, but not those of sound recordings, have long enjoyed exclusive rights to public performances of their works.”) (hereafter *Webcaster II Circuit Opinion*).

compensation for the physical reproduction and sale of sound recordings (and prevented the unauthorized reproduction and distribution of recordings).¹⁰ This reproduction right was beneficial to sound recording copyright owners prior to the 1990s, when recorded songs were primarily disseminated to consumers via the sale of physical records or CDs.¹¹ Broadcasters also argued that no performance right was necessary because radio airplay helped to promote the sales of sound recordings.¹²

A. *The Digital Performance Rights Act*

In the 1990s, the emergence of digital communications technologies and the growth of the Internet dramatically altered the music landscape.¹³ In addition to purchasing cassettes or CDs, or tuning into AM/FM radio, listeners could access music via digital satellite transmissions, Internet radio (“webcasters”), or cable music services.¹⁴ As digitally broadcast music began to take root, record labels, backed by both the Copyright Office and the Patent and Trademark Office, argued that the prevailing copyright structure would not adequately compensate owners of sound recording copyrights.¹⁵ Congress was concerned that “certain types of subscription and interactive audio services might adversely affect sales of sound recordings and erode copyright owners’ ability to control and be paid for use of their work,” as well as about the potential for further erosion in the future from “pay-per-listen, audio-on-demand, or ‘dial-up’ services for a particular recording or artist” (the so-called “celestial jukebox”).¹⁶ In response to these concerns, Congress enacted the Digital Performance Right in Sound Recordings Act in 1995.¹⁷

The DPRA granted the owners of sound recordings a right to compensation for performances of copyrighted works broadcast “by means of a digital audio transmission,” often referred to as the “digital performance right.”¹⁸ “Terrestrial” broadcasters (like AM and FM radio stations) that simulcast transmissions over the Internet were exempt. Non-subscription (ad-supported) services did not exist at the time.

While DPRA required digital music services to compensate copyright holders, it treated interactive services and non-interactive services very

¹⁰ See Sound Recording Act of 1971, Pub. L. 92-140, 85 Stat. 391 (1971).

¹¹ See *Craft 2001* at 5-6 (“Traditionally, the record companies have made money by selling copies of the sound recording, in form of vinyl albums, and later cassette tapes and CDs. The record companies then pay the musical artist a percentage of these sales (i.e., the artist’s royalties.”).

¹² See e.g., *Day 2009* at 184.

¹³ See *Delibero 2005* at 86-87.

¹⁴ *Id.* See also Eldar Haber, “Copyrights in the Stream: The Battle on Webcasting,” *Santa Clara Computer & High Technology Law Journal* 28:4 (2012) 769-813 at 773 (“Webcasting is a digital transmission of creative work over a network that results in the playing of the work, without storing a permanent copy at the recipient’s end.... Put simply, webcasting is listening to music or watching a video in ‘real time,’ instead of downloading a file and viewing or listening to it after the downloading is complete or at any other time.”).

¹⁵ See U.S. Senate, Committee on the Judiciary, *Digital Performance Right in Sound Records Act of 1995* (Report 104-128, August 4, 1995) at 11-15 (hereafter *DPRA Senate Report*).

¹⁶ *Id.*, at 15.

¹⁷ Public Law 104-39, 109 Stat. 336 (1995).

¹⁸ See *Beethoven.com LLC v. Librarian of Cong.*, 394 F.3d 939, 942 (D.C. Cir. 2005); see also *Webeaster II Circuit Opinion* at 753 and *Webeaster II* at 24086.

differently.¹⁹ Because interactive services provide the ability to listen to a given song “on demand,” thus obviating the need to purchase a physical copy of a sound recording, they arguably pose a more potent threat to music sales than non-interactive services (which are more akin to radio).²⁰ Thus, Congress established an exclusive copyright for interactive services, allowing rights holders to negotiate freely in the market for such rights.²¹

For non-interactive services (i.e., radio services or “webcasters”), on the other hand, DPRA created a compulsory license granting users full access to record companies’ libraries of sound recordings.²² Royalty rates could still be voluntarily negotiated by the parties, but if they failed to agree, rates were set through binding arbitration by a Copyright Arbitration Royalty Panel convened by the Librarian of Congress, subject to his review and a right to appeal to the D.C. Circuit Court of Appeals.²³

Notably for our purposes, DPRA borrowed the substantive criteria for arbitrated royalty rates from a pre-existing four-part standard found in section 801(b)(1) of the Copyright Act of 1976. Specifically, 801(b)(1) requires that royalty rates achieve four objectives:

- (A) Maximizing the availability of creative works to the public;
- (B) Affording copyright owners a fair return for their creative work and a fair income under existing economic conditions;
- (C) Reflecting the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media;
- (D) Minimizing any disruptive impact on the structure of the industries involved.²⁴

As discussed below, the first three criteria, standing alone, imply a standard that is similar to the market-based WBWS standard. However, the fourth criterion, requiring “non-disruption,” reflects a departure from the principle of

¹⁹ See Matt Jackson, “From Broadcast to Webcast: Copyright Law and Streaming Media,” *Texas Intellectual Property Law Journal* 11 (2003) 447-498 at 456 (hereafter *Jackson 2003*).

²⁰ *Id.*

²¹ *Id.* See also Day 2009 at 185.

²² See Amy Duvall, “Royalty Rate-Setting for Webcasters: A Royal(ly) Mess,” *Michigan Telecommunications Technology Law Review* 15 (2008) 267-295 at 270, n. 20 (“The statutory license is compulsory because the user of the copyrighted work need not get individual permission from the copyright holder; their permission is automatically given if the user complies with the requirements of the statute.”) (hereafter *Duvall 2008*). The requirements of the statutory licenses included limitations on the number of songs by a single artist or from a single album that could be played per hour, as well as a prohibition on releasing an advance playlist of upcoming songs. *Id.* at 271.

²³ *Id.*, at 271.

²⁴ 17 U.S.C. 801(b)(1). See also Copyright Royalty Board, Library of Congress, *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services: Final Rule and Order*, 73 FR 4080 (January 24, 2008) at 4082 (hereafter *SDARS D*).

market-based rates in favor of protecting licensees from potentially “disruptive” changes in royalties. Today, only a handful of services remain subject to this anachronistic standard.

B. *The Digital Millennium Copyright Act*

The years immediately following passage of the DPRA saw the emergence of the Internet and the rapid growth of “streaming radio.” These new services were generally non-interactive and non-subscription, relying on advertising for revenue. Because advertising-supported services were not in existence at the time DPRA was passed, they were not covered by its compulsory license.²⁵ In 1998, Congress addressed this oversight by expanding the scope of the compulsory license as part of the Digital Millennium Copyright Act (“DMCA”).²⁶ The DMCA offered these new non-interactive services the benefit of a statutory license (rather than requiring these services to negotiate licenses with individual sound recording copyright owners).²⁷

The DMCA divided non-interactive digital audio services into two groups. The first group consisted of FCC-licensed satellite digital audio services (SDARS) that existed prior to July 31, 1998 (i.e., satellite radio companies Sirius and XM) and three subscription services: DMX, Music Choice and Muzak (called Pre-Existing Subscription Services, or PSS).²⁸ Under the DMCA, PSS and SDARS were “grandfathered” under the 801(b)(1) standard, under the theory that they had relied on the standard at the time.

The second group consisted of “new” digital subscription services and services making “eligible non-subscription transmissions,” which included Internet-only radio webcasters like Pandora and simulcasts of over-the-air broadcasts.²⁹ For these services, in the absence of a voluntary agreement between copyright holders and the webcasters, the DMCA directed that the rates for

²⁵ See *Day 2009* at 187. See also *Jackson 2003* at 457 (“At the time the [DPRA] was written, webcasting was a nascent technology. By 1998, webcasting had proliferated with hundreds of radio stations and webcasters streaming music on the Internet. As Congress prepared to pass the Digital Millennium Copyright Act, the RIAA successfully lobbied to insert language to the provisions of the DPRA to close the ‘loophole’ that prevented them from licensing non-subscription webcast performances.”). See further *Craft 2001* at 12 (“The new technology, along with its various Internet applications, spread quickly. Suddenly, online-only webcasters were streaming digital music over the Internet – not merely on the envisioned subscription basis like satellite and cable companies, but also on a non-subscription basis by means of paid advertisements, like ordinary radio programming.”).

²⁶ See *Webcaster II* at 24086.

²⁷ See *Craft 2001* at 15 (“This license would ease the burden of having to locate and pay all of the individual record companies that held the sound recording copyrights to the various musical selections transmitted...”).

²⁸ See *SDARS I* at 4080, n. 3 (“Section 114(j)(11) of the Copyright Act defines the term ‘preexisting subscription service’ to mean ‘a service that performs sound recordings by means of noninteractive audio-only subscription digital audio transmissions, which was in existence and was making such transmissions to the public for a fee on or before July 31, 1998...’”). DMX was subsequently liquidated and its assets purchased by another company, and therefore lost its “grandfathered” status.

²⁹ See *Duvall 2008* at 272 (“The Digital Millennium Copyright Act (DMCA) addressed royalty payments for webcasters under Section 114. The DMCA adopted the statutory license for two types of webcasting: ‘preexisting subscription services’ and ‘eligible non-subscription services.’ These two categories included terrestrial radio stations’ online rebroadcasts as well as pure webcasters, but excluded providers who allowed users to download or select music of their choice.”).

statutory licenses and royalties should be set by the CARP to “represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller” (the “willing buyer/willing seller” standard, or “WBWS”).³⁰

As discussed further below, Congress has intervened directly in the setting of webcaster royalties twice since passage of the DMCA, both times by passing legislation favorable to webcasters. In 2002, it passed the Small Webcasters Settlement Act of 2002, which “encouraged” record labels to negotiate lower rates with small webcasters than had been set by the CARP in the *Webcaster I* proceeding. Then, in 2008 and 2009, it passed (and then extended) the Webcaster Settlement Act, which again “encouraged” rights holders to negotiate lower royalty rates, this time offering all webcasters a discount from the rates set by the CRB in its 2007 *Webcaster II* decision.³¹

Notably, neither the DPRA nor the DMCA extended the sound performance rights to the most prolific users of sound recordings, terrestrial radio stations. However, in the late 2000’s, Congress considered adopting legislation, the Performance Rights Act of 2007 (H.R. 4789/S. 2500) and its successor, the Performance Rights Act of 2009 (H.R. 848/S. 379), which would have extended the sound recording right to terrestrial radio, established a compulsory license for terrestrial radio stations, and adopted a single “fair market value” standard for all terrestrial broadcasters, cable, satellite and Internet services. Specifically, as passed by both the House and Senate Judiciary Committees, Section 2 of the Performance Rights Act instructed the CRB to establish statutory rates under the first three prongs of Section 801(b)(1), but rejected Section 801(b)(1)(D), the non-disruption standard.³² Based on CRB precedent, the first three prongs of the 801(b)(1) establish a market-based standard which is similar, if not identical, to the WBWS standard. Thus, the Performance Rights Act would thus have created

³⁰ See 17 U.S.C. § 114(f)(1) (pre-existing services) and 17 U.S.C. § 114(f)(2) (eligible non-subscription services and new subscription services). With respect to the WBWS standard, Congress directed that several considerations be taken into account. See 17 U.S.C. § 114(f)(2)(B) (“In determining such rates and terms, the copyright arbitration royalty panel shall base its decision on economic, competitive, and programming information presented by the parties—including (i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound record copyright owner’s other streams of revenue from its sound recordings; and (ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.”); and Committee on the Judiciary, U.S. House of Representatives, *Section-by-Section Analysis of H.R. 2281* (105th Congress, 2d Session, September 1998) at 57-59.

³¹ In addition, in 2004, Congress passed the Copyright Royalty and Distribution Reform Act, (CRDRA) (Public Law 108-419), which implemented procedural changes favored by webcasters. Among other changes, the law replaced the *ad hoc* CARP panels with a three-judge Copyright Royalty Board. See e.g., *Congressional Record* 150:26 (March 3, 2004 at h762-h772 (available at http://capitolwords.org/date/2004/03/03/H762_copyright-royalty-and-distribution-reform-act-of-2/)). See also Robin Jewcler, *The Copyright Royalty and Distribution Reform Act of 2005*, Congressional Research Service (2004) (available at http://www.ipmall.info/hosted_resources/crs/RS21512_041216.pdf).

³² See e.g., Committee on the Judiciary, *Performance Rights Act (H.R. 848)* Report 111-680 (December 14, 2010) at 14 (“The section further establishes rate standard parity among terrestrial broadcasters, cable, satellite, and Internet services, by creating one rate standard for Copyright Royalty Judges (CRJs) to consider, regardless of the platform involved. The new standard will be the old 801(b) standard minus subpart (D)...”) (available at <http://www.gpo.gov/fdsys/pkg/CRPT-111hrpt680/pdf/CRPT-111hrpt680.pdf>).

a level playing field for all users of sound performance rights with rates set either through voluntary negotiations or, where necessary, through a statutory license based on a market-based standard.

III. THE SOUND RECORDING PERFORMANCE RIGHT IN PRACTICE

Since passage of the DPRA and DMCA, sound recording performance copyright holders and licensees have engaged in multiple rounds of negotiations over digital performance royalties, sometimes arriving at voluntary agreements, but more commonly settling rates through litigated proceedings before the CARP and its successor, the CRB.³³

Since 1998, there have been three full-blown copyright royalty proceedings for non-pre-existing digital music services under the WBWS standard (known as *Webcaster I*, *Webcaster II*, and *Webcaster III*); in addition, as noted above, there have been two direct statutory interventions, the Small Webcaster Settlement Act of 2002 and the Webcaster Settlement Acts of 2008 and 2009. As detailed in the first subsection below, the formal proceedings have involved extensive economic analysis, supported by literally dozens of industry and economic experts, with multiple layers of administrative and judicial review. While the results of these proceedings have in many regards favored webcasters, webcasters have nevertheless succeeded on more than one occasion in lobbying Congress to intervene in the process in favor of still lower rates. Thus the IRFA is merely the latest in a string of efforts by webcasters to have royalties set at below-market rates.

In addition to the three *Webcaster* proceedings, there have been two formal proceedings (*PSS I* and *SDARS I*) to set rates for PSS and SDARS, and a second (*SDARS II*) is underway. Rates in these proceedings have been set under the 801(b) standard and, as discussed in the second subsection below, demonstrate that the 801(b) standard has resulted in rates below market-based levels.

Table 1 presents a brief summary of the primary *Webcaster* and *SDARS* proceedings.³⁴

³³ In the meantime, of course, rights holders have also negotiated voluntary agreements with online interactive services, such as Spotify. As discussed below, these voluntarily negotiated rates have been used by the Copyright Royalty Board as the basis for setting compulsory license rates.

³⁴ The following review addresses the central issues in these proceedings and for copyright policy going forward, namely the terms and level of royalty rates for the primary sound performance right at issue. Each proceeding has also addressed a variety of ancillary issues, such as the rates for “ephemeral” recordings (which are digital copies made for the purpose of facilitating online music distribution), minimum fees applicable to smaller webcasters, the division of certain proceeds between studios and artists, and so forth. No effort is made here to present a complete or comprehensive treatment of these ancillary issues.

TABLE I:
SELECTED RATE PROCEEDINGS, 1998-2012

Term	Governing Standard	Proceeding	Decision Date	Appeal Complete	Final Statutory Rate	Royalty Metric
<i>Non-Interactive Services</i>						
1998-2005 ³⁵	WBWS	Webcaster I	Feb. 2002	Jan. 2005	0.07¢ (1998-2002)	Per-performance
2006-2010	WBWS	Webcaster II	May 2007	Jul. 2009	0.08¢ (2006) – 0.19¢ (2010)	Per-performance
2006-2015	WBWS	Webcaster Settlement Act Pureplay Rates	Jul. 2009	n/a	Greater of 25% of revenues or 0.08¢ (2006) – 0.14¢ (2015)	Per-performance
2011-2015	WBWS	Webcaster III	Mar. 2011	n/a	0.19¢ (2011) – 0.23¢ (2015)	Per-performance
<i>Pre-existing Services (PSS and SDARS)</i>						
1996-2000	801(b)	PSS I	May 1998	May 1999	6.5%	Percentage of gross revenue
2007-2012	801(b)	SDARS I	Jan. 2008	Jul. 2009	6% (2007) – 8% (2012)	Percentage of gross revenue
2013-2017	801(b)	SDARS II	Ongoing	n/a	n/a	n/a

A. Webcaster Rates and the Willing Buyer/Willing Seller Standard

As noted above, there have been three full-blown rate proceedings to establish rates for Internet-only webcasters and simulcasters since 1998. Each time, the adjudicating body (first a CARP, then the CRB) held extensive hearings, took testimony from numerous expert economic and industry witnesses, engaged in full briefing schedules, and issued a written decision explaining the basis for the resulting rates; and, each decision has been subject to appeal before the D.C. Circuit. Nevertheless, each decision has led to complaints by webcasters, who have lobbied Congress to intervene and set lower rates. Indeed, most webcasters today are paying royalty rates negotiated pursuant to the Webcaster Settlement Act of 2009, which are below the market-based rates

³⁵ Non-subscription webcasting rates for 1998-2002 were the result of the *Webcaster I* proceeding. See 67 FR 45240 (July 8, 2002) (affirmed in *Beethoven.com v. Librarian of Congress*, 394 F.3d 939 (D.C. Cir. 2005)). Rates for non-subscription webcasting for 2003-2004, and rates for subscription webcasting for 1998-2004, were settled. See 68 FR 23241 (May 1, 2003); see also 68 FR 27506 (May 20, 2003); 68 FR 50,493 (Aug. 21, 2003); 69 FR 5693 (Feb. 6, 2004); at 69 FR 8822 (Feb. 26, 2004). Rates for 2005 were the result of an extension of the 2004 rates in the Copyright Royalty and Distribution Reform Act. See Pub. L. No. 108-419 § 6(b)(3); 70 FR 6736 (Feb. 8, 2005) (terminating pending proceedings).

established by the CRB in the *Webcaster II* proceeding. This subsection describes the process by which webcaster rates have been established since 1998.

1. *Webcaster I*

The *Webcaster I* proceeding began on November 27, 1998, after a six-month voluntary negotiation period between webcasters and the RIAA resulted in a number of agreements between individual webcasters and the record companies, but failed to produce an industry-wide agreement.³⁶ In accordance with the DMCA, a CARP was convened to establish the rates and terms for a statutory license. Its report, recommending royalty rates for the period from October 28, 1998 through December 31, 2002, was released more than three years later, on February 20, 2002.³⁷

The CARP proceeding was extensive by any standard. It included a full cycle of direct and rebuttal testimony, with 49 economic and industry expert witnesses presenting direct testimony and 26 on rebuttal, as well as oral arguments and multiple rounds of briefs.³⁸ The resulting record was “one of the most voluminous records in CARP history,” including a written transcript of over 15,000 pages, many thousands of pages of exhibits, and over 1,000 pages of post-hearing submissions” by counsel.³⁹

In reaching its decision, the CARP grappled with and resolved a number of highly technical legal and economic questions, many of which were resolved in favor of webcasters. For example, under the statute, the CARP concluded that the WBWS standard was created to set rates and terms “that would have been negotiated” been a willing buyer and a willing seller in a “hypothetical marketplace” in which no compulsory licenses existed and rates were determined by negotiations between music services and copyright holders.⁴⁰ While the parties agreed that the willing “buyers” in this context were non-interactive digital music services, they disagreed as to the identities of the hypothetical “sellers.”⁴¹

The RIAA, representing the interests of the copyright holders (i.e., record companies), asserted that the seller in the hypothetical marketplace should consist of “a single collective of sound recording copyright owners (such as RIAA), offering a blanket license” for access to the sound record libraries of its

³⁶ See United States Copyright Office, Library of Congress, *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*; Final Rule, 67 FR 45240 (July 8, 2002) at 45241 (hereafter *Webcaster I*) (“These proceedings began on November 27, 1998, when the Copyright Office announced a six-month voluntary negotiation period to set rates and terms for the webcasting license and the ephemeral recording license for the first license period covering October 28, 1998–December 31, 2000. 63 FR 6555 (November 27, 1998). During this period, the parties negotiated a number of private agreements in the marketplace, but no industry-wide agreement was reached. Consequently, in accordance with the procedural requirements, the Recording Industry Association of America, Inc. (“RIAA”) petitioned the Copyright Office on July 23, 1999, to commence a CARP proceeding to set the rates and terms for these licenses.”).

³⁷ See United States Copyright Office, Library of Congress, *In the Matter of Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings, Report of the Copyright Arbitration Royalty Panel*, (February 20, 2002) (hereafter *2002 CARP Report*).

³⁸ *Id.*, at 11-15.

³⁹ *Id.*, at 18.

⁴⁰ *Id.*, at 21.

⁴¹ *Id.*

members.⁴² The music services, in contrast, argued that in a hypothetical marketplace where compulsory licenses did not exist, a single RIAA-like entity could not negotiate on record companies' behalf, because the antitrust exemption granted to RIAA that allowed it to bargain on behalf of the collective was conditional on the compulsory nature of the licenses at issue.⁴³ The services contended that a single RIAA-like entity in the hypothetical marketplace would wield market power sufficient to distort negotiations.⁴⁴ Instead, the services proposed that the "sellers" in the WBWS market be comprised of a "non-trivial number" of smaller collectives, offering blanket licenses in competition with one another.⁴⁵ Ultimately, the CARP rejected both proposals, concluding instead that the appropriate "sellers" in the hypothetical marketplace were neither a single collective nor a number of smaller collectives, but rather individual record companies, offering blanket licenses for each company's particular repertory of sound recordings.⁴⁶ From the perspective of the webcasters, this was a highly favorable result, as it meant that rates were based on the assumption that all copyright owners were competing against one another in the marketplace rather than being represented jointly by bargaining agents.

In addition, the CARP concluded that the WBWS standard did not necessitate any *ex post* adjustments of the royalty rates it determined based on the "additional factors" enumerated in Section 114(f)(2)(B), finding that these factors would already be "fully reflected in any agreements *actually negotiated* between webcasters and copyright owners in the relevant marketplace."⁴⁷

In the course of this extensive proceeding, RIAA and the music services presented competing proposals for determining royalty rates, each backed by expert testimony. RIAA proposed basing rates on the agreements negotiated between the RIAA and 26 separate webcasters during the voluntary bargaining period,⁴⁸ noting that those agreements involved "the same buyer, the same seller, the same right, the same copyrighted works, the same time period, and the same

⁴² *Id.* at 21-22.

⁴³ *Id.* at 23 ("We recognize that the hypothetical marketplace we seek to replicate would operate more efficiently, with lower transactional costs, if a single collective designated by the services could negotiate with a single collective designated by the record companies. Even if such negotiations were non-exclusive, Congress clearly perceived antitrust concerns with such an arrangement. Congress authorized antitrust exemptions respecting such negotiations *only* within the context of compulsory licenses.") (emphasis in original).

⁴⁴ *Id.* at 22 ("The Services' perception of the sellers, in the hypothetical marketplace envisaged by Congress, is starkly different. They assert that RIAA's vision 'would eviscerate the protections sought by the Justice Department and implemented by Congress to prevent the exercise of market power [by the RIAA or the record companies].'")

⁴⁵ *Id.*

⁴⁶ *Id.* at 44 ("We concluded above that the... hypothetical marketplace is one where the buyers are DMCA-compliant services, the sellers are record companies, and the product being sold consists of blanket licenses for each record company's repertory of sound recordings.")

⁴⁷ *Id.* at 35 (emphasis in original).

⁴⁸ *Id.* at 26, 38 ("The second foundational issue relates to the type of evidence that can most reliably be used for deriving the royalty rates we must determine in this proceeding. On this issue, the two sides present starkly different viewpoints. RIAA argues that the best available evidence of the rate which willing buyers and willing sellers would agree to can be found in the 26 agreements it actually negotiated with the licensees for the rights in question. The Services, on the other hand, contend that these agreements are fatally tainted in numerous respects and that willing buyer/willing seller rates are best derived from the thoughtful, theoretical model developed and explicated by Dr. Adam Jaffe, a distinguished economist.")

medium as those in the marketplace that the CARP must replicate.⁴⁹ Webcasters, on the other hand, proposed rates derived from a theoretical model which attempted to estimate appropriate royalty rates for the *sound recording right* based on rates for *musical work performance rights* established between music publishers and over-the-air-radio broadcasters.⁵⁰

The CARP ultimately decided that the webcasters' theoretical model was unreliable, in part because of intrinsic differences between the musical work performance right and the sound recording performance right.⁵¹ Moreover, it concluded, "the quest to derive rates which would have been negotiated in the hypothetical willing buyer/willing seller marketplace is best based on a review of actual marketplace agreements, if they involve comparable rights and comparable circumstances."⁵² Taking multiple factors into account, the CARP concluded that while 25 of the 26 agreements that had been negotiated by RIAA were "unreliable benchmarks,"⁵³ the freely negotiated agreement with Yahoo! was "evidence of an entirely different character,"⁵⁴ reflecting "a truly arms-length bargaining process on a level playing field between two major players of comparable skill, size, and economic power."⁵⁵ Thus, based largely on the Yahoo! agreement, the CARP set a statutory performance royalty rate of 0.14¢ per performance for Internet-only ("IO") webcasters.

In adopting the per performance rate structure, the CARP rejected arguments that it should set rates as a percentage of licensees' revenues. It found that the per-performance structure was superior because (1) a per-performance metric is directly reflective of the right being licensed; (2) percentage-of-revenue models are difficult to implement because relevant webcaster revenues are complex; and, (3) many webcasters are small and do not generate much revenue, so that the adoption of a percent-of-revenue model could result in copyright owners receiving little or no compensation for the use of their material.⁵⁶

The CARP also grappled with the issue of whether webcasters promoted music sales, especially in the context of radio retransmissions (i.e., copyrighted material contained in Internet retransmissions of broadcast radio signals). Based on "undisputed testimony that traditional over-the-air radio play has a

⁴⁹ *Id.*

⁵⁰ *Id.* at 28 ("Accordingly, Webcasters calculated their proposed per-performance and per-hour sound recording performance fee by extrapolation from the aggregate fees paid to ASCAP, BMI, and SESAC by over-the-air radio stations holding blanket performance licenses.").

⁵¹ *Id.* at 40 ("The Panel is uncomfortable with many of these assumptions and the cumulative effect casts significant doubt on the reliability of the ultimate conclusions. The Panel finds that this theoretical construct suffers serious deficiencies.").

⁵² *Id.* at 43.

⁵³ *Id.* at 60.

⁵⁴ *Id.* at 60.

⁵⁵ *Id.* at 61. See also *Duvall 2008* at 273-274 ("To determine the rates that would have been negotiated in the marketplace under the per performance model, CARP reviewed actual royalty agreements to comply with its statutory obligations under the DMCA. It found that the RIAA/Yahoo! agreement provided an appropriate benchmark for the rate-setting because it was the only RIAA-negotiated agreement 'to reflect a truly arms-length bargaining process on a level playing field between two major players of comparable skill, size, and economic power.'").

⁵⁶ See *2002 CARP Report* at 36-37. The CARP also recommended a minimum royalty fee of \$500 per annum. *Id.*, at 95 ("The Panel concurs with the Services that one purpose of the minimum fee is to protect against a situation in which the licensee's performances are such that it costs the license administrator more to administer the license than it would receive in royalties. Another arguable purpose is to capture the intrinsic value of a service's access to the full blanket license, irrespective of whether the service actually transmits any performances.") (emphasis in original)

tremendous promotional impact on phonorecord sales,” and the lack of any basis in the record for concluding that the impact of Internet simulcasts was any less significant,⁵⁷ the CARP set a (lower) Radio Retransmission (or “RR”) rate of 0.07¢.⁵⁸

As provided for under the DPRA, the CARP’s findings were reviewed by the Register of Copyrights and the Librarian of Congress (“LOC”). In its Final Rule and Order, released on July 8, 2002,⁵⁹ the LOC – after reviewing briefs filed by both sides – upheld the CARP’s determination regarding the definition of the participants in the relevant hypothetical marketplace,⁶⁰ but ruled that the CARP erred in setting a higher royalty rates for Internet-only webcasters than for radio retransmissions.⁶¹ While the LOC accepted that the RIAA’s agreements with webcasters served as a more reasonable benchmark than the webcasters’ proposed “theoretical model,” it lowered the IO webcasting rate from 0.14¢ per-performance to 0.07¢ per-performance⁶² (to match the royalty rate for RR entities).⁶³ Thus, the LOC cut the per-performance rate set by the CARP for pureplay webcasters, which was based on the actual rate agreed to by RIAA and Yahoo!, by 50 percent.

The LOC’s decision also contained important language concerning the distinction between the 801(b) and WBWS standards. The two standards, it concluded, “are not the same.” Rather, the 801(b) standard is “policy-driven, whereas the standard for setting rates for nonsubscription services set forth in section 114(f)(2)(B) is *strictly fair market value* – willing buyer/willing seller. Thus, any argument that the two rates should be equal as a matter of law is without merit.”⁶⁴

The LOC’s ruling was upheld on appeal by the D.C. Circuit Court of Appeals.⁶⁵ However, even before the appeal was decided, Congress – heeding complaints from small webcasters that the rates (even after being cut in half by the LOC) were too high, stepped in by passing the Small Webcasters Settlement Act of 2002 (SWSA),⁶⁶ which “gave noncommercial and small commercial

⁵⁷ *Id.*, at 74-75.

⁵⁸ *Id.*, at 77.

⁵⁹ *See Webcaster I*.

⁶⁰ *Id.*, at 45244-45.

⁶¹ *Id.*, at 45243 (“After carefully considering the Panel’s report and the record in this proceeding, the Register has concluded that the rates proposed by the Panel for use of the webcasting license do not reflect the rates that a willing buyer and willing seller would agree upon in the marketplace. Therefore, the Register has made a recommendation that the Librarian reject the proposed rates (\$0.14 per performance for Internet-only transmissions and \$0.07 per performance for radio retransmissions) for the section 114 license and substitute his own determination (0.07¢ per performance for both types of transmissions), based upon the Panel’s analysis of the hypothetical marketplace, and its reliance upon contractual agreements negotiated in the marketplace.”).

⁶² *Id.*

⁶³ *See Duvall 2008* at 275-276 (“However, the Librarian disagreed with CARP and found that there was no basis for differentiating between royalty rates for Internet-only webcasters and webcasters who retransmitted radio broadcasts and that CARP’s decision to distinguish between them was arbitrary.”).

⁶⁴ *See Webcaster I* at 45244 (emphasis added).

⁶⁵ *See Beethoven.com LLC v. Librarian of Cong.*, 394 F.3d 939 (D.C. Cir. 2005).

⁶⁶ Public Law No. 107-321. *See also* Committee on the Judiciary, *The Webcaster Settlement Act of 2009* (Report 111-139, June 8, 2009) at 2.

webcasters additional time to negotiate,⁶⁷ and expressed to copyright owners “the strong encouragement of Congress to reach an accommodation with the small webcasters on an expedited basis.”⁶⁸ Shortly thereafter, the small webcasters reached a compromise agreement with RIAA setting royalty rates that were capped as a percentage of small webcasters’ revenues or expenses rather than calculated on a per-performance basis.⁶⁹

2. *Webcaster II*

The next statutory license proceeding for webcaster royalty rates, covering the period 2006-2010, established rates through another formal rate proceeding, this one lasting more than two years, from February 2005 until May 2007,⁷⁰ this time under the purview of the Copyright Royalty Board (CRB), the successors to the CARP panel.⁷¹ The *Webcaster II*, proceeding again involved direct and rebuttal testimony from dozens of expert witnesses, including formal hearings, hundreds of motions and pleadings, and over 13,000 pages of transcripts.⁷²

As in *Webcaster I*, the CRB evaluated several proposed benchmarks for royalty rates proposed by copyright owners and webcasters, again embracing an approach based on rates for comparable rights which had been negotiated freely in the marketplace. Specifically, the CRB embraced a model proposed by SoundExchange’s economic expert, Dr. Michael Pelcovits. Termed the “Interactive Webcasting Market Benchmark,”⁷³ the model utilized the royalty rates negotiated individually between copyright owners and interactive music services (adjusted for differences in interactivity) as a basis for royalties for non-interactive services under compulsory licenses.⁷⁴ Based largely on the interactive services benchmark, the CRB set per-performance rates at 0.08¢ for 2006, rising gradually to 0.19¢ in 2010, as shown in Table 2.⁷⁵ Thus, under *Webcaster II*, the statutory rate was scheduled to reach the 0.14¢ per performance rate initially

⁶⁷ See *Day 2009* at 188-189.

⁶⁸ Public Law No. 107-321, Section 2(3) (“The representatives have arrived at an agreement that they can accept in the extraordinary and unique circumstances here presented, specifically as to the small webcasters, their belief in their inability to pay the fees due pursuant to the July 8 order, and as to the copyright owners of sound recordings and performers, the strong encouragement of Congress to reach an accommodation with the small webcasters on an expedited basis.”).

⁶⁹ See Librarian of Congress, *Notification of Agreement Under the Small Webcaster Settlement Act of 2002*, 67 FR 78510 (Dec. 24, 2002). Rates were set at 10 percent of revenues up to \$250,000, 12 percent of revenues above \$250,000, or seven percent of expenses, whichever was greater.

⁷⁰ See, generally, *Webcaster II*. See also Library of Congress, Copyright Royalty Judges, *Digital Performance Right in Sound Recordings and Ephemeral Recordings, Notice Announcing Commencement of Proceeding*, 70 FR 7970 (February 16, 2005).

⁷¹ In the interim, Congress had passed the Copyright Royalty and Distribution Reform Act in 2004 which replaced the *ad hoc* CARP panels with a permanent Copyright Royalty Board. See Public Law 108-419.

⁷² See *Webcaster II* at 24085 (“In addition to the written direct statements and written rebuttal statements, the Copyright Royalty Judges heard 48 days of testimony, which filled 13,288 pages of transcript, and 192 exhibits were admitted. The docket contains 475 entries of pleadings, motions and orders.”).

⁷³ *Id.* at 24092.

⁷⁴ See *Duwall 2008* at 279. The CRB also concurred in the *Webcaster I* determination that the preferred metric for calculating statutory royalties is a per-performance model, as opposed to royalties based on a percentage-of-revenue. See *Webcaster II* at 24089-90.

⁷⁵ See *Webcaster II* at 24096.

recommended by the CARP (in *Webcaster D*) for 1998 in 2008 – i.e., a decade later than under the original CARP report.

TABLE 2:
STATUTORY ROYALTY RATES FOR COMMERCIAL
WEBCASTERS UNDER WEBCASTER II

Year	Per-Performance Royalty
2006	\$0.0008
2007	\$0.0011
2008	\$0.0014
2009	\$0.0018
2010	\$0.0019

Source: 72 FR at 24096.

The CRB's decision was appealed to the D.C. Circuit Court of Appeals, in *Intercollegiate Broadcast System v. Copyright Royalty Board*.⁷⁶ The Court upheld the CRB's determination of royalty rates for commercial webcasters, including specifically its decision to base royalties on the market-based interactive services benchmark.⁷⁷ The Court also rejected webcasters' assertions that the rates set by the CRB were "crushing and disproportionate,"⁷⁸ and found in any case that the WBWS standard does not require to the CRB to set rates that allow all firms in the market to earn a profit:

Finally, it was not error for the Judges to reject the small commercial webcasters' pleas that paying per performance would wreck their inefficient business models. The Judges made clear they could not "guarantee a profitable business to every market entrant." The Judges are not required to preserve the business of every participant in a market. They are required to set rates and terms that "most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B). If small commercial webcasters cannot pay the same rate as other willing buyers and still earn a profit, then the Judges are not required to accommodate them.⁷⁹

Thus, the court ruled, while webcasters are guaranteed access to sound recording performance rights under a compulsory license, Congress did not extend to them a right to perpetual profitability.

⁷⁶ See 574 F. 3d 748 (D.C. Cir. 2009).

⁷⁷ *Id.*, at 758.

⁷⁸ *Id.*, at 760. The Court did, however, vacate the \$500 minimum fee for both commercial and non-commercial webcasters, remanding those portions of the CRB's ruling for reconsideration. *Id.*, at 762.

⁷⁹ *Id.*, at 761.

3. *The Webcaster Settlement Act and the 2009 Compromise*

As with *Webcaster I*, many webcasters reacted negatively to the *Webcaster II* decision.⁸⁰ Pandora and others claimed that the CRB's royalty rates would push webcasters to the verge of collapse,⁸¹ with Pandora asserting that the CRB rates would force it to pay almost 70 percent of its revenues in performance royalties.⁸²

As in 2002, Congress reacted sympathetically to webcasters' complaints,⁸³ this time by passing the Webcaster Settlement Act of 2008 and later the Webcaster Settlement Act of 2009 (together, the "WSAs"). Modeled on the Small Webcaster Settlement Act of 2002, the WSAs expressed to copyright owners "the strong encouragement of Congress to reach an accommodation with the webcasters on an expedited basis,"⁸⁴ and provided a window of time in which to do so.⁸⁵ Not surprisingly, rights holders entered into negotiations with webcasters over lower rates, reaching eight separate agreements (containing a total of 12 royalty schedules) with different segments of the webcasting market (e.g., non-commercial webcasters, non-commercial educational webcasters, pureplay webcasters, etc.) in late 2008 and early 2009. The new rates, which were available to qualified webcasters on an opt-in basis, overrode the market-based *Webcaster II* rates established by the CRB for webcasters that elected the alternate rates, and generally covered the 10-year period from 2006-2015.⁸⁶ Table 3 shows the alternate schedule of rates for Pureplay webcasters, which are substantially lower than the rates determined by the CRB in *Webcaster II*. For example, the royalty rate per-performance under *Webcaster II* in 2010 would have been 0.19¢, while the WSA Pureplay rate is only 0.097¢. And, the 0.014¢ originally scheduled under *Webcaster I* to take effect in 1998, and delayed under *Webcaster II* until 2008, was pushed back another seven years, until 2015.

⁸⁰ See e.g., *Duvall 2008* at 283.

⁸¹ See *Day 2009* at 190-191 ("The reaction to the CRB rates was immediate and dramatic. Small and large webcasters alike predicted the CRB rates would result in the 'end of Internet Radio.' For instance, Pandora Internet Radio ("Pandora"), the largest and most successful online music webcaster, maintained that it was 'on the verge of collapse' as a result of the new rates.").

⁸² *Id.*

⁸³ See Elabe Izadi, "Pandora Growing Up Washington Style," *National Journal* (July 9, 2012) (available at <http://influencealley.nationaljournal.com/2012/07/pandora-all-grown-up.php>).

⁸⁴ See Small Webcasters Act of 2002 as modified by Webcaster Settlement Act of 2008 (available at <http://www.copyright.gov/legislation/pl107-321.pdf>).

⁸⁵ See The Webcaster Settlement Act of 2008, Pub. L. No. 110-435, 122 Stat. 4974. The original deadline for negotiations, February 15, 2009, was extended through July 2009 by the Webcaster Settlement Act of 2009. See also statement of Senator Patrick Leahy, *Congressional Record* (June 17, 2009) at S6740 (available at <http://www.gpo.gov/fdsys/pkg/CREC-2009-06-17/pdf/CREC-2009-06-17-pt1-PgS6740-3.pdf#page=1>).

⁸⁶ See Library of Congress, *Notification of Agreements Under the Webcaster Settlement Act of 2009*, 74 FR 34796 (July 17, 2009) (hereafter *2009 Webcaster Settlement*).

TABLE 3:
ROYALTY RATES FOR PUREPLAY WEBCASTERS
UNDER THE 2009 WEBCASTER SETTLEMENT ACT COMPROMISE

Year	Per-Performance Royalty
2006	\$0.00080
2007	\$0.00084
2008	\$0.00088
2009	\$0.00093
2010	\$0.00097
2011	\$0.00102
2012	\$0.00110
2013	\$0.00120
2014	\$0.00130
2015	\$0.00140

Source: 74 FR at 34799.

Importantly, Congress directed the LOC to make it clear that the Webcaster Settlement Act rates were not to be interpreted as “market based.” To highlight that fact, Congress made clear in section 114(f)(5)(C) that the new rates were to be considered the result of “unique” circumstances and, specifically, were not precedential with respect to the WBWS standard:

It is the intent of Congress that any royalty rates, rate structure, definitions, terms, conditions, or notice and recordkeeping requirements, included in such agreements shall be considered as a compromise motivated by the *unique business, economic and political circumstances* of webcasters, copyright owners, and performers rather than as matters that would have been negotiated in the marketplace between a willing buyer and a willing seller....⁸⁷

Thus, the rates currently being paid by webcasters like Pandora are not “market based,” but rather the result of a compromise which set rates below those established by the CRB under the WBWS standard, and extended the term of the agreement through 2015, and required large pureplay webcasters to pay the greater of 25 percent of revenues or the agreed upon per play rates.⁸⁸

4. Webcaster III

While rates for 2011-2015 were established for most webcasters by the various Webcaster Settlement Act compromises, the CRB was still obliged to undertake a new royalty rate proceeding to establish statutory rates and terms for the 2011-2015 term for webcasters that were not in existence at the time of the

⁸⁷ See *2009 Webcaster Settlement* at 34796 (emphasis added).

⁸⁸ *Id.* at 34799.

Webcaster Settlement Act or chose not to opt-in to one of the WSA rate schedules.⁸⁹ Despite the fact that most webcasters did not participate in the proceeding, the *Webcaster III* proceeding involved extensive direct and reply testimony by numerous experts from all sides, full briefing schedules, and so forth.

Applying the WBWS standard, the CRB once again (as in *Webcaster II*) set rates by reference to a benchmark based on the rates negotiated between rights holders and interactive digital services, which are not subject to the compulsory copyright and thus are *prima facie* market-based.⁹⁰ The CRB released its rate determinations on March 9, 2011, with rates again established on a per-performance basis, as shown in Table 4.

TABLE 4:
STATUTORY ROYALTY RATES FOR
COMMERCIAL WEBCASTERS UNDER *WEBCASTER III*

Year	Per-Performance Royalty
2011	\$0.0019
2012	\$0.0021
2013	\$0.0021
2014	\$0.0023
2015	\$0.0023

Source: 76 FR at 13048.

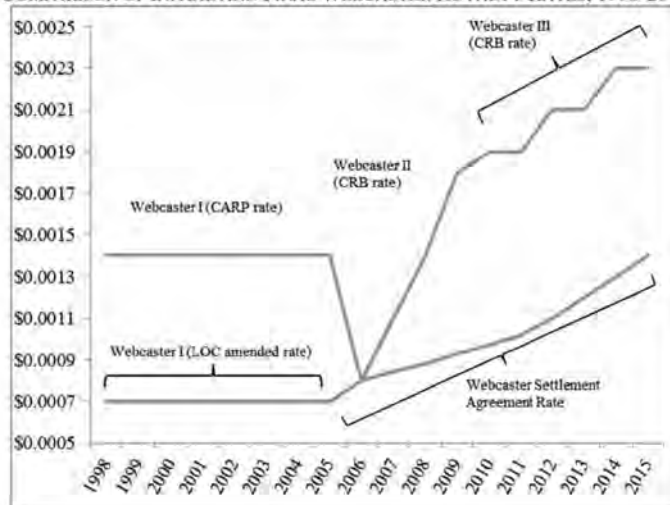
Figure 1 below illustrates the disparity between the royalty rates determined by the CARP and CRB under the WBWS standard in the *Webcaster I*, *Webcaster II* and *Webcaster III* proceedings and the royalty rates actually paid by pureplay webcasters. The blue line in Figure 1 represents the original royalty rates set by the CARP and the CRB, which applied the WBWS standard after extensive proceedings in which economic evidence was used to estimate a market-based rate. The red line represents the final royalty rates actually charged to webcasters after their appeals to the Librarian of Congress (for *Webcaster I*) and to Congress (after *Webcaster II*).⁹¹

⁸⁹ See, generally, Library of Congress, Copyright Royalty Board, *Digital Performance Right in Sound Recordings and Ephemeral Recordings. Final Rule and Order*, 76 FR 13026 (March 9, 2011) (hereafter *Webcaster III*). The *Webcaster III* proceeding began on January 9, 2009, and thus overlapped with the negotiations then under way under the Webcaster Settlement Act. Those negotiations resulted in voluntary agreements among many of the parties for which rates would otherwise have been determined under *Webcaster III*.

⁹⁰ *Id.* at 13031.

⁹¹ Note that rates negotiated by small webcasters under the Small Webcaster Settlement Act, which were expressed as a share of revenues rather than on a per-performance basis, are not shown.

FIGURE 1:
COMPARISON OF INITIAL AND FINAL WEBCASTER ROYALTY RATES, 1998-2015



As Figure 1 shows, some pureplay webcasters (including Pandora) have secured per-performance royalty rates well below the market-based rates mandated by Congress under the DMCA.

B. Section 801(b) and the "Non-Disruption" Standard

Unlike the WBWS standard, the 801(b) standard now being advocated by webcasters is explicitly not market-based – that it, it is not designed to replicate the rates that would be achieved in a competitive market. Rather, the fourth pillar of the 801(b) standard (Section 801(b)(1)(D)) reflects Congress' desire that rates be set so as to "minimize" any "disruptive" impact on the parties; that is, if market-based rates are determined to be disruptive for licensees, they must be lowered. From a policy perspective, the "non-disruption" standard may result in locking in place inefficient or obsolete business models, or even encouraging inefficient investments by firms which know that, under the 801(b) standard, rates will be set so as to prevent "disruption" to their business models. For licensees and their investors, such a guarantee is obviously quite valuable.

This subsection briefly reviews the application of the 801(b) standard since its adoption in the 1976 Copyright Act, focusing on proceedings involving royalty rates for SDARS services, *SDARS I* (completed in 2008) and *SDARS II*. In *SDARS I*, the non-disruption criterion played an important role, leading directly to rates lower than would have been reached under the WBWS standard. And, while the *SDARS II* proceeding is not yet complete, the expert economic testimony presented there demonstrates that, at least in the eyes of copyright

users, the non-disruption criterion amounts to a guaranteed return on investment for licensees, now and into the future.

Before addressing the two SDARS proceedings, it is useful to briefly review three prior proceedings in which the 801(b) standard was applied.

1. Early Interpretations of the 801(b) Standard

Prior to the creation of the Copyright Royalty Board, the 801(b) standard was applied twice by the Copyright Royalty Tribunal (CRT) in 1981, and once by Copyright Arbitration Royalty Panel (CARP) in 1997.⁹² The two CRT proceedings involved the statutory licenses for jukeboxes and for the mechanical license, i.e., the right to use a musical composition when making a copy of a sound recording. As the CRB later noted, in the 1980 Jukebox License Proceeding,⁹³ neither the CRT nor the D.C. Circuit (which reviewed the decision on appeal) dealt substantively with the 801(b) standard as such.⁹⁴ The CRT's decision in the 1981 Mechanical License Proceeding, however, did address the standard, focusing on the statutory requirement that rates be "reasonable," and suggesting that the individual 801(b) standards could be satisfied by rates lying within a "zone of reasonableness."⁹⁵ In its subsequent review, the D.C. Circuit agreed.⁹⁶

In 1997, a CARP took up the issue of royalties for PSS under the recently passed Digital Performance Right in Sounds Recordings Act.⁹⁷ When the CARP's decision came down heavily on the side of the PSS, it was reviewed and revised by the Librarian of Congress, and rates ultimately were set at 6.5 percent of revenues. However, neither the Librarian's decision nor the subsequent D.C. Court of Appeals decision (rejecting an appeal by the Recording Industry Association of America) dwelt on the proper interpretation of section 801(b).⁹⁸

⁹² See, generally, General Accounting Office, Letter from Mark Goldstein to Senator Arlen Specter, GAO-10-828R (August 4, 2010) (hereafter *GAO 801(b) Letter*).

⁹³ 46 FR 884 (January 5, 1981).

⁹⁴ See *SDARS I* at 4082 ("While the Tribunal's decision was somewhat lengthy, its consideration and application of the standard and the Section 801(b)(1) factors was not.... In reviewing the Tribunal's decision, the U.S. Court of Appeals for the Seventh Circuit gave no attention to the Section 801(b)(1) factors or the Tribunal's application of them, focusing instead on the appropriateness of the Tribunal's choice of 'marketplace analogies.'")

⁹⁵ 46 FR 10466 (February 3, 1981).

⁹⁶ See *SDARS I* at 4083, quoting *Recording Industry Ass'n. of America v. Copyright Royalty Tribunal*, 662 F.2d 1 (D.C. Cir. 1981) ("To the extent that the statutory objectives determine a range of reasonable royalty rates that would serve all these objectives adequately but to differing degrees, the Tribunal is free to choose among those rates, and courts are without authority to set aside the particular rate chosen by the Tribunal if it lies within a 'zone of reasonableness.'")

⁹⁷ See *SDARS I* at 4083 ("Unlike prior statutory licenses where the Congress fixed the initial rates within the statute, the rates for the new digital performance right license were left to resolution by a CARP. The Librarian convened a CARP in 1997 for PSS and SDARS. The SDARS settled with copyright owners and withdrew from the proceeding, and the CARP rendered a determination only with respect to the PSS. The Librarian reviewed the CARP's determination and rejected it with respect to the rate as well as to certain terms, and the U.S. Court of Appeals for the District of Columbia Circuit reviewed the Librarian's decision.")

⁹⁸ See *Recording Industry Ass'n of America, Inc. v. Librarian of Congress*, 176 F.3d 528.

2. *SDARS I*

In January 2006, the CRB initiated a rate proceeding to establish statutory royalties for PSS and SDARS for 2007/2008 through 2012.⁹⁹ The PSS services negotiated voluntary agreements, which were ratified by the CRB in late 2007,¹⁰⁰ but the SDARS services (at that time, Sirius and XM) did not, and the CRB issued statutory rates for SDARS services in January 2008. The decision, known as *SDARS I*, left no doubt that the 801(b) standard, as interpreted by the CRB and reviewed by the DC Circuit, is likely to result in rates lower than the market-based rates set under the WBWS standard.

Like the *Webcaster* proceedings, *SDARS I* was a full-blown rate proceeding, featuring dozens of economic and industry experts, direct and rebuttal testimony and so on.¹⁰¹ The CRB began its analysis by seeking to establish a benchmark based on voluntarily negotiated rates for comparable services, and ultimately chose again – as in the *Webcaster II* and *Webcaster III* proceedings – to rely on a model based on the market rates negotiated for interactive subscription services.¹⁰² Based largely on an analysis by Dr. Janusz Ordoover, the CRB determined that a royalty rate equal to 13 percent of subscriber revenue constituted a “reasonable estimate of a marketplace derived benchmark.”¹⁰³

The next step in the CRB’s analysis was to establish a “zone of reasonableness” within which the final rates – based on the 801(b) criteria – would have to lie. The Board determined that the 13 percent benchmark “marks the upper boundary of a zone of reasonableness for potential marketplace benchmarks,” that a lower boundary was established by the 2.35 percent of revenues paid by SDARS for musical works licenses, but that “based strictly on marketplace evidence, a rate close to the upper boundary is more strongly supported than one close to the lower boundary.”¹⁰⁴ Hence, prior to explicit consideration of the four 801(b) criteria, the judges had in mind a rate closer to 13 percent than to 2.35 percent.

The next step in the Board’s analysis was to determine “whether these policy objectives weigh in favor of divergence from the results indicated by the marketplace benchmark evidence.”¹⁰⁵ Looking at the first two criteria, which require, respectively, “maximizing the availability of creative works to the public” and providing a “fair return” to both copyright holders and users, the Board determined that no adjustments from market rates were necessary and,

⁹⁹ See Library of Congress, *Adjustment of Rates and Terms for Preexisting Subscription and Satellite Digital Audio Radio Services*, 71 FR 1455 (January 9, 2006); see also *GAO 801(b) letter* at 3-4. The PSS term started in 2008, while the SDARS term started in 2007.

¹⁰⁰ See Library of Congress, *Copyright Royalty Board, Adjustment of Rates and Terms for Preexisting Subscription and Satellite Digital Audio Radio Services, Final Rule*, 72 FR 71795 (December 19, 2007).

¹⁰¹ See *SDARS I* at 4081 (“In addition to the written direct statements and written rebuttal statements, the Judges heard 26 days of testimony, which filled over 7,700 pages of transcript, and over 230 exhibits were admitted. The docket contains over 400 pleadings, motions, and orders.”).

¹⁰² *Id.*, at 4093.

¹⁰³ *Id.*, at 4085-88. The CRB explained that, while it continues to prefer a per-performance metric to one based on a percentage of revenues, several factors made it impractical to utilize a per-performance metric in this case.

¹⁰⁴ *Id.*, at 4094.

¹⁰⁵ *Id.*

indeed, that the criteria do not as a general matter imply rates different from those set in the market.¹⁰⁶

The Board reached a different conclusion, however, with respect to the latter two criteria, section 801(b)(1)(C) (which requires an assessment of the “relative roles” of the copyright owner and user with respect to creative contribution, technological contribution, capital investment, cost, risk and contribution to the opening of new markets) and section 801(b)(1)(D), the non-disruption standard.

With respect to the “relative roles” criteria, the CRB found that the need for SDARS to make “new expenditures related to their satellite technology...might weigh in favor of a discount from the market rate.”¹⁰⁷ However, it determined that this issue was “intimately intertwined” with the non-disruption standard, and decided to “treat the potential disruptive effect of postponing investment in new satellite technology” as part of its consideration of the non-disruption standard.¹⁰⁸

In applying the non-disruption standard, the Board concluded that a deviation from market rates was justified on two grounds – profitability and investment. First, it concluded, raising rates to the market-based level would “increase costs and raise the necessary critical mass of subscribers sufficient to generate revenues that yield EBITDA profitability.”¹⁰⁹ Thus:

In order not to significantly delay the attainment and amounts of EBITDA profitability and positive free cash flow, some rate within the zone of reasonableness that is less than 13% is warranted.¹¹⁰

Second, with respect to investment, it decided that royalty rates should be set so as not to place “any undue constraint on the SDARS’ ability to successfully undertake satellite investments planned for the license period.”¹¹¹ Based on these factors, the Board found it “appropriate to adopt a rate from the zone of reasonableness for potential marketplace benchmarks that is lower than the upper boundary most strongly indicated by marketplace data.” Accordingly, it set an initial rate of six percent of revenues, rising to eight percent over the six-year (2007-2012) term of the license – roughly 50 percent below the 13 percent benchmark it had initially concluded reflected a “reasonable estimate of a marketplace derived benchmark.”¹¹²

3. *SDARS II*

Perhaps the best way to understand the impact of the 801(b) non-disruption standard is to examine how it is invoked in an actual proceeding, such as the one the CRB is presently engaged in to determine rates for PSS and SDARS for the

¹⁰⁶ *Id.*, at 4094-4096.

¹⁰⁷ *Id.*, at 4097.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ SoundExchange appealed the CRB’s ruling to the D.C. Circuit Court of Appeals, arguing that the royalty rates set by the CRB were too low. The Court upheld the CRB’s ruling, stating that the CRB did not act unreasonably in setting rates. The Court did not, however, make a determination on whether the rates themselves were too high or too low. See *SoundExchange v. Librarian of Congress*, 571 F.3d. 1220 (D.C. Cir. 2009).

¹¹² *Id.*

five-year term beginning in January 2013.¹¹³ In that proceeding, experts for copyright users repeatedly invoke the 801(b) standard as the basis for claiming that rates should be set below marketplace levels in order to guarantee their clients a rate of return on both past and future investments, arguing that the standard not only permits but could require the CRB to deviate from market-based rates in order to advance “social values”¹¹⁴ such as “distributive justice.”¹¹⁵

For example, one expert arguing on behalf of XM-Sirius asserts that the CRB is required to “ensure that all participants would still have voluntarily engaged in the market transactions needed to make satellite services available had they been aware of the rates when they made the decisions to enter into those transactions,”¹¹⁶ which is equivalent to requiring that rates be set so as to guarantee investors profits on their initial investments, apparently in perpetuity. Another expert testified that section 801(b) requires rates low enough that copyright users are able not only to “recover the start-up costs of entering the industry,”¹¹⁷ but also to ensure that they can “recover the financial cost of capital for forward-looking investments,” since rates that failed to give users incentives to *continue* investing in their businesses would be “disruptive.”¹¹⁸

To summarize, while it is theoretically possible for the 801(b) standard to result in the same rates as under the WBWS standard,¹¹⁹ there is no question that the two standards are – as one supporter of the IRFA recently agreed – “starkly different.”¹²⁰ Nor is it surprising that, as one knowledgeable observer recently noted, “the change from the willing buyer/willing seller standard to the 801(b) standard is widely anticipated to significantly lower the royalty rates that online radio services pay.”¹²¹ As discussed further below, other elements of IRFA are also designed to ensure copyright users continue to pay below market rates in the future.

¹¹³ See United States Copyright Royalty Board, *Determination of Rates and Terms for Preexisting Subscription and Satellite Digital Audio Radio Services*, (Docket No. 2011-1 CRB PSS/Satellite II).

¹¹⁴ Written Rebuttal Testimony of Roger Noll on Behalf of Sirius-XM Radio Inc. (http://www.loc.gov/erf/proceedings/2011-1/rps/sxm_vol_3.pdf) at 6, 50.

¹¹⁵ *Id.*

¹¹⁶ Written Rebuttal Testimony of Dr. Michael A. Salinger on Behalf of Sirius-XM Radio Inc. (Docket No. 2011-1) at 16 (available at http://www.loc.gov/erf/proceedings/2011-1/rps/sxm_vol_3.pdf at 81).

¹¹⁷ Written Direct Testimony of Roger Noll on Behalf of XM-Sirius (http://www.loc.gov/erf/proceedings/2011-1/pss/sxm_wds.pdf) at 951.

¹¹⁸ *Id.*, at 1005.

¹¹⁹ See e.g., *GAO 801(b) Letter* at 5.

¹²⁰ Indeed, the desire to lower the “high royalty burdens” paid by webcasters is the primary rationale offered by IRFA’s proponents for its enactment. See John Villasenor, “Digital Broadcast Music Royalties: The Case for a Level Playing Field,” Center for Technology Innovation at Brookings, *19 Issues in Technology Innovation* (August 2012) 1-28 at 9 (hereafter *Villasenor*).

¹²¹ See Jodie Griffin, “The Internet Radio Fairness Act: Revamping the Online Radio Marketplace,” Public Knowledge Policy Blog (Nov. 2, 2012) (available at: <http://www.publicknowledge.org/blog/overview-internet-radio-fairness-act>).

IV. BEYOND THE NON-DISRUPTION STANDARD: THE PROPOSED INTERNET RADIO FAIRNESS ACT AND THE MARKET FOR ONLINE MUSIC

The Internet Radio Fairness Act (H.R. 6480/S. 3609)¹²² would fundamentally alter both the standards and the process by which statutory royalties are established for non-interactive webcasters like Pandora. As described in the first subsection below, the clear purpose, and the virtually certain effect, would be to tip the playing field against copyright owners in favor of the webcasters, resulting in lower royalty rates for covered webcasters – which of course is why the webcasters support it.¹²³ As explained below, there is no evidence that high royalty rates are stifling the growth of online music in general, or for that matter of Pandora in particular, or that such services would be unable to pay market based rates in the future.

Beyond simply lower rates, another argument made for IRFA is that it is necessary to create a level playing field – that is, to make webcasters like Pandora subject to the same standard that now applies to the three remaining PSS and SDARS services. The biggest problem with this argument is that non-interactive webcasters' biggest competitors arguably are not PSS or SDARS, but rather interactive services (like Spotify), which obtain sound recording performance rights *without the benefit of a compulsory license* of any sort. Thus, what Pandora is seeking through IRFA is to *increase* the competitive advantage it already holds over interactive services by obtaining an even more attractive compulsory license. Meanwhile, IRFA would do nothing to address the other obvious imbalance in the sound recording performance right, which is the continuing exemption enjoyed by the over-the-air transmissions of terrestrial broadcasters.

The first subsection below reviews IRFA's main provisions and explains their likely effects on the rate setting process and its results. The second subsection shows why the rates currently being paid by webcasters are not unreasonable, and why IRFA is not necessary to preserve a vibrant and growing market for online music. The third subsection explains why the uneconomic rates IRFA would produce, along with the perverse incentives inherent in the non-disruption standard, would reduce incentives for content creation, slow innovation, and harm consumers.

A. The IRFA Would Dramatically Tilt the Rate Setting Process in Favor of Webcasters

If one set out to write statutory language designed to favor webcasters over copyright owners in rate setting proceedings, the result would look a lot like the IRFA. While a complete exegesis is beyond the scope of this study, a partial listing of its more significant provisions provides a sense of the proposal's scope and ambition. Among other things, the IRFA would: (a) impose a heavily-modified version of the section 801(b) criteria for royalty rates, with the modifications further favoring webcasters;¹²⁴ (b) directly intervene in the rate setting process, by extending the webcaster-friendly Webcaster Settlement Act

¹²² See H.R. 6480: Internet Radio Fairness Act of 2012.

¹²³ See e.g., *Villasenor* at 11.

¹²⁴ See H.R. 6480: Internet Radio Fairness Act of 2012, Section 3(a)(2)(bb)(II) and Section 3(a)(2)(C)(i)(I) and (II) ("In establishing rates and terms under this paragraph, the Copyright Royalty Judges shall apply the objectives set forth in section 801(b)(1).").

rates (for small pureplay webcasters) for an extra year;¹²⁵ (c) shift the burden of proof to copyright holders to show that proposed rates do not exceed an amorphous new standard;¹²⁶ (d) prohibit copyright royalty judges from considering certain types of evidence likely to favor copyright holders;¹²⁷ (e) reverse the CRB's (economically-grounded) decision to favor "per performance" royalties over "percentage of revenue" royalties;¹²⁸ (f) prohibit the CRB from relying on some (but not other) prior decisions as precedents;¹²⁹ (g) reverse the Webcaster Settlement Act's guarantee that rates negotiated under the Act would not have precedential value for rate setting purposes;¹³⁰ (h) create a special class of antitrust liability for joint activities by copyright owners, but not copyright users;¹³¹ (i) inject politics into the process by requiring copyright judges to be confirmed by the Senate rather than appointed by the Librarian of Congress;¹³² (j) eliminate the requirement that at least one of the copyright judges be an expert in copyright, and one an expert in economics;¹³³ and, (k) subject CRB rate decisions to *de novo* review, requiring the D.C. Circuit to essentially re-hear every rate case.¹³⁴

Among the many changes proposed by IRFA, the most profound include the provisions altering the substantive standards for rate setting, specifying what evidence the CRB can consider, and changing the makeup of the CRB itself.

First, in addition to replacing the WBWS standard with 801(b), IRFA adds four additional criteria which must be considered in setting rates: (1) the public's interest in both the creation of new sound recordings of musical works and in fostering online and other digital performances of sound recordings;¹³⁵ (2) the income necessary to provide a reasonable return on all relevant investments, including investments in prior periods for which returns have not been earned;¹³⁶ (3) the value of any promotional benefit or other non-monetary benefit conferred on the copyright owner by the performance;¹³⁷ and (4) the contributions made by

¹²⁵ *Id.*, Section 3(a)(3)(E) ("The rates and terms of any settlements made pursuant to the amendments made by the Webcaster Settlement Act of 2009 (Public Law 111-36; 123 Stat. 1926) that were to expire before December 31, 2015, shall be extended through December 31, 2015, according to the rates and terms applicable to 2014.").

¹²⁶ *Id.*, Section 3(a)(2)(bb)(II) ("In any proceeding under this subsection, the burden of proof shall be on the copyright owners of sound recordings to establish that the fees and terms that they seek satisfy the requirements of this subsection, and do not exceed the fees to which most copyright owners and users would agree under competitive market circumstances.").

¹²⁷ *Id.*, Section 3(a)(2)(C)(ii) ("To the extent the Copyright Royalty Judges consider marketplace benchmarks to be relevant, the Copyright Royalty Judges shall limit those benchmarks to benchmarks reflecting the rates and terms that have been agreed under competitive market circumstances by most copyright users.").

¹²⁸ *Id.*, Section 3(a)(2)(D)(i) (the CRJs "shall not disfavor percentage of revenue-based fees.").

¹²⁹ *Id.*, Section 3(a)(2)(D)(v) (The CRJs "shall not take into account either the rates and terms provided in licenses for interactive services or the determinations rendered by the Copyright Royalty Judges prior to the enactment of the Internet Radio Fairness Act of 2012.").

¹³⁰ *Id.*, Section 3(a)(3)(b).

¹³¹ *Id.*, Section 5.

¹³² *Id.*, Section 2(1)(A).

¹³³ *Id.*, Section 2(2)(A).

¹³⁴ *Id.*, Section 6(d).

¹³⁵ *Id.*, Section 3(a)(2)(C)(i)(D).

¹³⁶ *Id.*, Section 3(a)(2)(C)(i)(II).

¹³⁷ *Id.*, Section 3(a)(2)(D)(iii).

the digital audio transmission service to the content and value of its programming.¹³⁸ Each of these criteria is favorable to webcasters, none more so than the requirement that the rates be set so as to ensure copyright users earn profits on past investments.

Further, IRFA shifts the burden of proof in rate setting proceedings to copyright owners, who would be required to establish that the fees in any statutory license do not exceed those to which “most copyright owners and users would agree to under competitive market conditions,” defined as conditions in which none of the participants have market power.¹³⁹ As a practical matter, it is likely that the only agreements that would meet this standard would be ones negotiated by the smallest independent record labels – i.e., the ones willing to accept the lowest royalty rates.

Second, in applying the new criteria, IRFA directs the CRB to ignore some evidence, but demands that other evidence be considered. Judges are prohibited from taking into account the rates and terms in licenses for interactive services (which have provided the benchmark for the market-based rates in *Webcaster II* and *Webcaster III*) or in the CRB’s previous determinations, but permitted to consider the rates set by the Copyright Royalty Tribunal in the early 1980s and the CARP/LOC 1998 *Webcaster I* decision.¹⁴⁰ In the meantime, rates negotiated under the Webcaster Settlement Act are, contrary to the Webcaster Settlement Act itself, now accorded precedential value.¹⁴¹ In short, evidence favorable to webcasters is required to be admitted, while evidence favorable to copyright owners is *a priori* inadmissible.

Third, IRFA would change the makeup of the CRB itself. Judges would no longer be appointed by the Librarian of Congress, but instead by the President with the advice and consent of the Senate – thus ensuring that the filling of every vacancy becomes a vehicle for a political contest between the interested parties. Of equal concern is that the qualifications of the judges themselves would be changed, removing the current requirement that one of the three judges have a significant knowledge of economics and another have significant knowledge of copyright law. In the future, judges would be required simply to have ten years of experience in arbitration or litigation – that is, to be process experts rather than substantive ones.¹⁴²

At the end of the day, there is no question that, as Villasenor puts it, the “obvious consequence” of imposing the 801(b) standard “would be lower rates for webcasters.”¹⁴³ As discussed below, however, forcing copyright owners to effectively subsidize webcasters through artificially low royalties is neither necessary to promote the growth of online music nor desirable from the perspective of innovation or consumer welfare.

B. The IRFA is Not Necessary to Ensure a Vibrant Market for Online Music

The market for online music is intensely vibrant and growing rapidly. Tens of thousands of new listeners are signing up to services like Pandora and Spotify

¹³⁸ *Id.*, Section 3(a)(2)(D)(iv).

¹³⁹ *Id.*, Section 3(a)(1)(B).

¹⁴⁰ *Id.*, Section 6(a)(2), Section 3(a)(2)(D)(v).

¹⁴¹ *Id.*, Section 3(a)(3)(b).

¹⁴² *Id.*, Section 2.

¹⁴³ See *Villasenor* at 13.

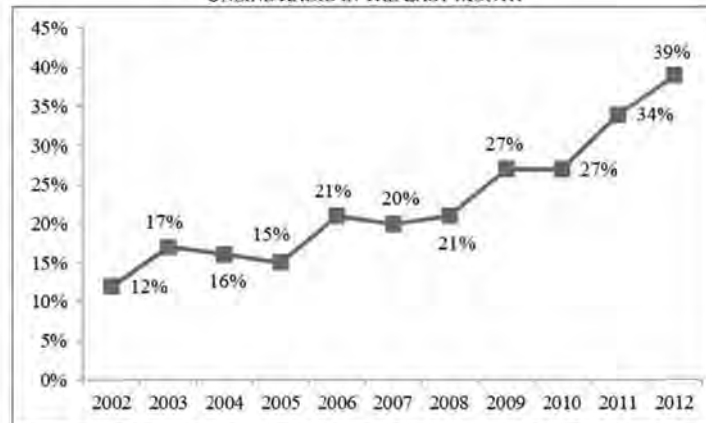
every week, and existing listeners are using the services more and more intensely every year. Online advertising revenues are growing 30 percent per year¹⁴⁴, new firms are entering the market at a rapid pace, and existing firms are garnering billion dollar market valuations. As Villasenor puts it, “The future of music distribution is clearly digital.”¹⁴⁵

Against this reality, IRFA proponents argue that webcasters need the below-market rates and guaranteed profits the legislation would provide in order to “grow and evolve.”¹⁴⁶ Moreover, they argue, the current system, is broken because the “onerous” WBWS standard can result in webcasters paying a higher percentage of their revenues in royalties than other firms, including in particular Sirius-XM.¹⁴⁷ Neither argument withstands even cursory scrutiny.

First, the current copyright regime is manifestly not preventing the online music industry from “growing and evolving” at a rapid pace. Online radio is a two-sided market, involving both listeners (who, depending on the business model, may also be subscribers) and advertisers. Both sides of the market are growing explosively.

For example, Figure 2 below shows the proportion of Americans who have listened to online radio in the past 30 days from 2002 through 2012. Growth throughout the period has been rapid but has accelerated in recent years, with listenership rising by nearly 50 percent in just the last two years.

FIGURE 2:
PERCENT OF AMERICANS WHO HAVE LISTENED TO
ONLINE RADIO IN THE LAST MONTH



Source: Edison Research, “The Infinite Dial 2012: Navigating Digital Platforms 2012,” Presentation Companion, at 8.

¹⁴⁴ See Figure 4 below.

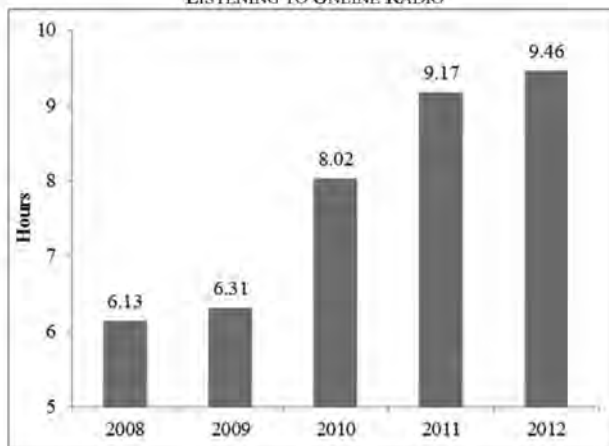
¹⁴⁵ See Villasenor at 17.

¹⁴⁶ See Edward Black, “Congress Should Pass the Internet Radio Fairness Act,” *The Hill’s Congress Blog* (October 25, 2012) (available at <http://thehill.com/blogs/congress-blog/technology/263915-congress-should-pass-internet-radio-fairness-act>).

¹⁴⁷ See Villasenor at 17.

As the figure shows, Edison Research/Arbitron reports that an estimated 103 million Americans, or 39 percent of the entire U.S. population aged 12 and older, now tune in to some form of online radio each month.¹⁴⁸ Similarly, the amount of time that listeners spend engaged with online radio has also increased dramatically. As shown in Figure 3, in 2012, listeners reported spending an average of 9 hours and 46 minutes per week listening to online radio, up from 6 hours and 13 minutes in 2008 (an increase of over 57 percent).¹⁴⁹

FIGURE 3:
AVERAGE WEEKLY HOURS SPENT
LISTENING TO ONLINE RADIO



Source: Edison Research, "The Infinite Dial 2012: Navigating Digital Platforms 2012," Presentation Companion, at 8.

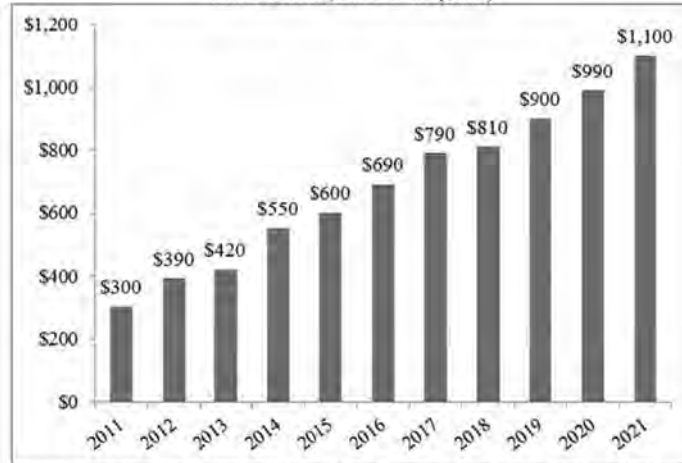
Not surprisingly, the rapid growth in listenership is leading to equally rapid growth in advertising revenues. Overall, online advertising is the fastest growing category of advertising worldwide, growing at 7.2 percent over the past year.¹⁵⁰ As shown in Figure 4 below, online radio advertising is growing even faster: According to SNL Kagan, online radio advertising revenues will approach \$400 million in 2012, and are projected to grow at a compound annual rate between 12 and 14 percent over the next decade.

¹⁴⁸ See Edison Research, "The Infinite Dial 2012: Navigating Digital Platforms 2012," Presentation Companion, at 8.

¹⁴⁹ *Id.*

¹⁵⁰ See Nielsen, *World Trends* (2012) (reporting that online advertising was the fastest growing category of advertising in the first half of 2012, up 7.2 percent compared to the same period in 2011).

FIGURE 4:
PUREPLAY INTERNET MUSIC AND RADIO AD REVENUE
PROJECTIONS, 2011-2021 (\$MIL)



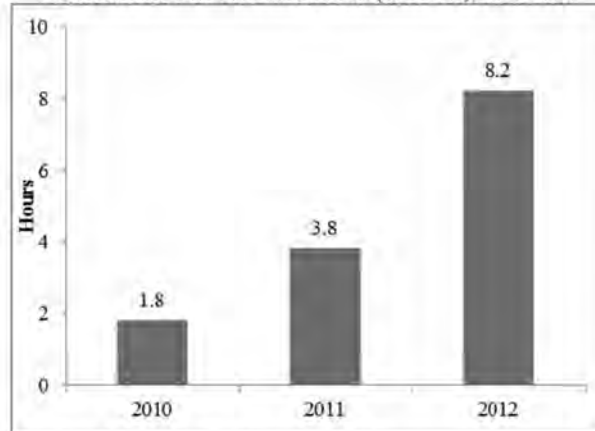
Source: SNL Kagan 2011. Includes online/mobile ad revenues from Internet Music and Radio Pureplays (i.e., AccuRadio, AOL Radio, GooM Radio, Last.fm, Live 365, MOG, Pandora, Slacker, Stitcher, Turntable.fm, Yahoo!Music, etc.).

The rapid growth of the industry has translated into financial success for existing firms and the entry of new ones. Pandora, which is by its own account the “leader in internet radio in the United States,” with a dominant market share of 69 percent, has been the biggest beneficiary.¹⁵¹ As shown in Figure 5 below, Pandora’s annual listener hours have more than quadrupled in the last two years, from 1.8 billion to 8.2 billion. Revenues over the same period have grown even faster, from \$55.2 million in 2010 to \$240.0 million in 2012.¹⁵²

¹⁵¹ See Pandora Media, Inc., 2012 Form 10K at 42 (“Pandora is the leader in internet radio in the United States, offering a personalized experience for each of our listeners. We have pioneered a new form of radio – one that uses intrinsic qualities of music to initially create stations and then adapts playlists in real-time based on the individual feedback of each listener. In January 2012, we had over 125 million registered users, which we define as the total number of accounts that have been created for our service at period end, and we added two new registered users every second on average. For the fiscal year ended January 31, 2012, we streamed 8.2 billion hours of radio and as of January 31, 2012, we had 47 million active users. According to a January 2012 report by Triton, we are one of the top 20 internet radio stations and networks in the United States and we have more than a 69% share of internet radio. Since we launched the Pandora service in 2005, our listeners have created over 2.4 billion stations.”)

¹⁵² *Id.* at 40.

FIGURE 5:
PANDORA ANNUAL LISTENER HOURS (BILLIONS), 2010-2012

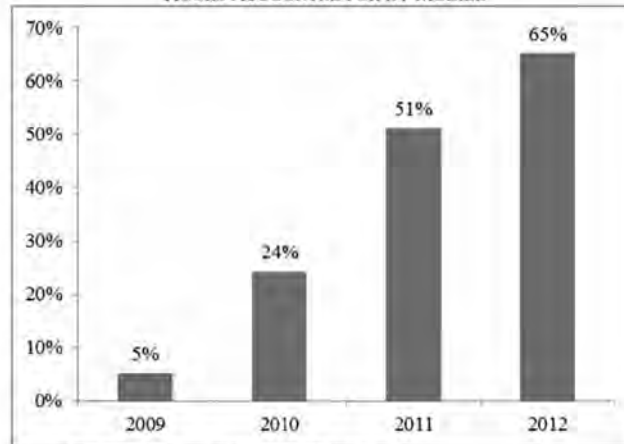


Source: Pandora Media, Inc., 2012 Form 10K, at 14.

Much of the rapid growth that has occurred in the past few years is associated with the rapid adoption of smart phones and the accompanying increase in mobile consumption of digital media. For example, as shown in Figure 6 below, Pandora reports that as of 2012, nearly two thirds of all listening hours are accounted for by mobile devices. Notably, SNL Kagan reports that in 2011, Pandora was the fifth largest U.S. mobile ad network by revenue, ranking behind only Google, Apple, Facebook and Twitter, and was growing at 476 percent annually, far faster than any of the other top 25 firms.¹⁵³

¹⁵³ See SNL Kagan, *Mobile Ad Networks by Revenue, United States (2011)* (subscription required).

FIGURE 6:
PERCENTAGE OF TOTAL PANDORA LISTENING
HOURS ACCOUNTED FOR BY MOBILE



Source: Pandora Media, Inc., 2012 Form 10K, at 14.

As a result of its rapid growth, and of market expectations that it would continue to prosper in the future, Pandora successfully “went public” in 2011, garnering large payoffs for its early investors.¹⁵⁴ The firm now trades on the New York Stock Exchange under the symbol “P.” As of mid-November 2012, Pandora was valued at \$1.3 billion.¹⁵⁵

Pandora’s defenders argue, however, that the company has not yet achieved profitability, and that “extremely high royalty burdens” are to blame, with content costs accounting for 60 percent or more of revenues.¹⁵⁶ The situation would be even worse, they warn, if Pandora and the other webcasters currently covered by the Webcaster Settlement Act agreement were forced to pay the (higher) rates determined by the CRB in *Webcaster III*.¹⁵⁷

There are several problems with these arguments. First, the fact that Pandora has not yet achieved profitability is hardly a surprise. Other successful online firms, including Facebook, Google, Vonage and many others, have taken years to achieve profitability; some have yet to do so. There is a good reason for this: Internet markets are characterized by network effects, meaning that firms compete (in what is sometimes referred to as a “land grab strategy”) to achieve critical scale. While it is thus typical for firms like Pandora to invest in customer acquisition for an initial period before becoming profitable,¹⁵⁸ there is no

¹⁵⁴ For example, in the first 11 months of 2012, Pandora cofounder Tim Westergren sold 937,000 shares of Pandora stock valued at over \$9.9 million. See <http://www.marketwatch.com/investing/stock/p/insiders?pid=78349198>.

¹⁵⁵ See Yahoo! Finance.

¹⁵⁶ See *Villasenor* at 11.

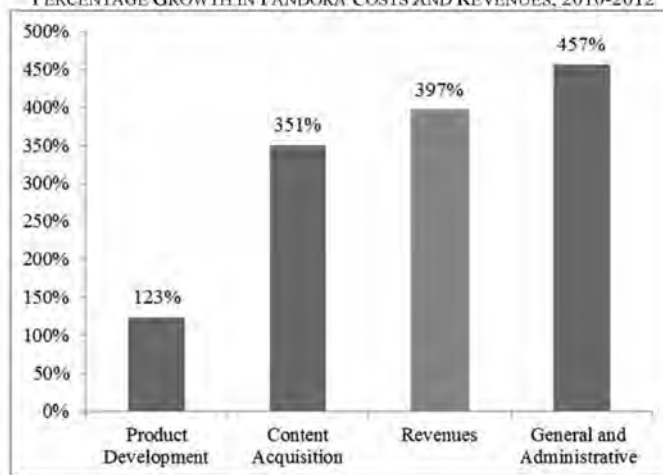
¹⁵⁷ *Id.*

¹⁵⁸ See, generally, Jeffrey H. Rohlfs, *Bandwagon Effects in High-Technology Industries* (MIT Press, 2003). See also Pandora Media, Inc., Form S-1 (February 11, 2011) at 11 (“Since our

economic or public policy rationale for forcing their suppliers to subsidize such strategies.

Second, while Pandora's content acquisition costs have indeed grown rapidly, they have not grown as rapidly its revenues or, for that matter, as its overhead. As shown in Figure 7 below, Pandora's content acquisition costs have grown by 351 percent over the past two years. However, its revenues have increased even faster, by nearly 400 percent, while its administrative and overhead expenses have grown even faster, by 457 percent over the past two years.

FIGURE 7:
PERCENTAGE GROWTH IN PANDORA COSTS AND REVENUES, 2010-2012



Source: Pandora Media Inc., 2012 Form 10-K.

Third, while Pandora makes much of the fact that content acquisition accounts for a large proportion of its revenues,¹⁵⁹ in fact its content costs as a proportion of revenues are comparable to other, similar firms. For example, while Netflix offers video rather than audio, and its revenues come more from subscriptions than from advertising, its basic business model – offering on-demand audio-video content over the Internet while minimizing its own infrastructure costs – is very similar to Pandora's.

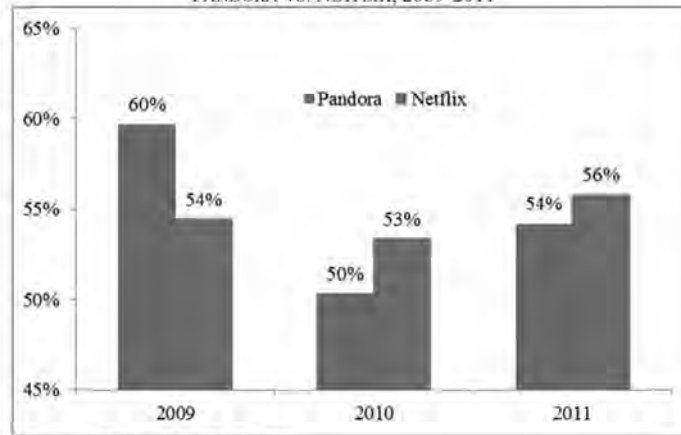
As shown in Figure 8 below, the proportion of revenues accounted for by content costs for Netflix and Pandora have been nearly identical over the last three years (2009-2011) for which data is available from both firms; indeed, for

inception in 2000, we have incurred significant net operating losses and as of October 31, 2010, we had an accumulated deficit of \$83.9 million. A key element of our strategy is to aggressively increase the number of listeners and listener hours to increase our market penetration.”)

¹⁵⁹ See e.g., Pandora Media Inc., 2012 Form 10K at 7.

each of the last two years, Netflix has paid a higher proportion of its revenues for content acquisition than has Pandora.¹⁶⁰

FIGURE 8:
CONTENT COSTS AS A PERCENTAGE OF REVENUES
PANDORA VS. NETFLIX, 2009-2011¹⁶¹



Sources: Pandora 10-K; Netflix 10-K.

It is noteworthy that, like some of Pandora's competitors in the audio market, Netflix does not benefit from a compulsory license, but instead relies on negotiating contracts with content owners on a voluntary basis. And while the firm has had some stumbles over the past year, its market capitalization in late 2012 stood at over \$4.4 billion. As of November 2012, the firm was fighting off a takeover bid by investor Carl Icahn, who believes it is undervalued, notwithstanding the fact that it pays over 50 percent of its revenues for content.¹⁶²

Fourth, and finally, Pandora's claims of impending doom with respect to content costs are belied by the fact that other firms are rapidly entering the market to compete with it. As it reports in its most recent 10-K, "the audio entertainment marketplace continues to rapidly evolve, providing our listeners

¹⁶⁰ More broadly, it is commonplace for digital music distributors of all stripes to pay 60 percent or more of their revenues for content. See e.g., Steve Knopper, "The New Economics of the Music Industry," *Rolling Stone* (October 25, 2011) (available at <http://www.rollingstone.com/music/news/the-new-economics-of-the-music-industry-20111025>).

¹⁶¹ Notes: Pandora reports "content acquisition costs" in its annual 10-K filings. According to Pandora's 2012 10-K, "Content acquisition expenses principally consist of royalties paid for streaming music or other content to our listeners. Royalties are calculated using negotiated rates documented in master royalty agreements and are based on both percentage of revenue and listener metrics." See Pandora Media, Inc., Form 10-K (Jan. 31, 2012) at 46. Netflix reports "cost of subscription" data in its annual 10-K filings. According to the company's 2012 10-K, "Cost of subscription revenues consists of expenses related to the acquisition and licensing of content, as well as content delivery costs." See Netflix Inc., Form 10-K (Feb. 10, 2012) at 28.

¹⁶² See Greg Bensinger, "Icahn Slams Netflix 'Poison Pill,'" *The Wall Street Journal* (November 5, 2012) (available at <http://online.wsj.com/article/SB10001424052970203846804578100662260454122.html>).

with a growing number of alternatives and new media platforms.¹⁶³ Among its competitors: Last.fm, iHeartRadio, Slacker Personal Radio, Rhapsody and Amazon. Recent entrants including Rdio, “a rival streaming service created by the founders of Skype,”¹⁶⁴ and Spotify, which has four million subscribers worldwide paying \$10 per month for the right to access music online¹⁶⁵ and was recently valued at \$3 billion.¹⁶⁶ As of late 2012, reports indicated that Apple was also preparing to enter the market for online radio.¹⁶⁷

The flood of new participants in the online music business is important for two reasons. First, these firms (and their investors) obviously do not share Pandora’s gloomy forecasts regarding their ability to earn a fair return on investment. Second, and at least equally important, many of these firms – including, for example, Spotify – are not eligible for the compulsory license at all, and thus have no choice but to negotiate copyright agreements in the marketplace. According to reports, Apple may choose to enter the online radio market through negotiated contracts, eschewing the compulsory license altogether.¹⁶⁸

The fact that other firms see opportunities to profit in the online music marketplace suggests to some that Pandora needs to take a closer look at its business model. As noted above, online music is a two-sided market, with some (and sometimes more or even all) of the revenues coming from advertisers. Yet, if a firm (like Pandora) is engaged in a land grab strategy designed to maximize its market share in the short run in order to capture economies of scale, too much advertising risks driving consumers to competitors. A number of analysts have noted that Pandora has failed to fully monetize its large and growing audience. As one well-respected journalist put it:

Throughout the music industry there is a wide belief that Pandora could solve its financial problems – the company, which went public a year ago, has never turned an annual profit – by simply selling more ads.¹⁶⁹

¹⁶³ See Pandora Media Inc., 2012 Form 10-K at 7.

¹⁶⁴ See Andy Fixner and Adam Satariano, “Apple’s Online Radio Service to Challenge Pandora in 2013,” *Bloomberg* (Oct. 26, 2012) (available at: <http://www.bloomberg.com/news/2012-10-25/apple-s-online-radio-service-to-challenge-pandora-in-2013.html>) (hereafter *Fixner and Satariano 2012*).

¹⁶⁵ See Peter Kafka, “Where Did Spotify’s Billion Dollars Go? Ask Netflix,” *All Things* (Nov. 11, 2012) (available at: <http://allthingsd.com/20121111/where-did-spotifys-billion-dollars-go-ask-netflix/>).

¹⁶⁶ See Evelyn M. Rusli and Jessica E. Lessin, “Spotify Seeks \$3 Billion Valuation,” *The Wall Street Journal* (November 9, 2012) (available at <http://professional.wsj.com/article/SB10001424127887324894104578109482459713880.html>).

¹⁶⁷ See *Fixner and Satariano 2012*.

¹⁶⁸ See *Fixner and Satariano 2012*.

¹⁶⁹ See Ben Sisario, “Proposed Bill Could Change Royalty Rates for Internet Radio,” *The New York Times* (September 23, 2012) (available at <http://www.nytimes.com/2012/09/24/business/media/proposed-bill-could-change-royalty-rates-for-internet-radio.html>). See also Richard Greenfield, “Congress Should be Working to Raise Royalty Rates on Pandora, Not Lower Them,” *BTIG Research* (September 24, 2012) (available at <http://www.btigresearch.com/2012/09/24/congress-should-be-working-to-raise-royalty-rates-on-pandora-not-lower-them/>) (“[T]he reason why companies such as Pandora pay such high royalty rates as a percentage of revenues is because they severely limit audio advertising to protect the user experience and keep people on the platform. If Pandora ran several minutes of audio ads per hour (the way terrestrial radio does) vs. just a few 15 sec. spots, the % of revenues paid out as royalties

To summarize, Pandora's argument that royalties need to be reduced in order to preserve a healthy market for online music is simply not consistent with the facts. The market is vibrant and growing, and expected to continue to grow and evolve in the future. Pandora has been a major beneficiary of that growth, and while – like any firm – it would prefer to pay less for inputs into its production process, there is no public policy basis for forcing content creators to subsidize it or other webcasters by setting royalties at below-market rates.

C. The IRFA Would Exacerbate Market Distortions, Reduce Incentives to Create Content, Slow Innovation, and Harm Consumers

The IRFA is advanced by its proponents on grounds that it would create a level playing field for users of sound recording rights, increase revenues to artists and record labels, and even promote innovation. Each of these claims is incorrect. In fact, on each count, the opposite is true.

First, while it is accurate that the sound recording performance right currently does not use the same rate standard for all users and in all markets, it is entirely inaccurate to argue that IRFA would improve the situation. Currently, interactive services are subject to the sound recording performance right, but have no compulsory license. PSS and SDARS are subject to the 801(b) standard, webcasters, simulcasters and new subscription services are subject to WBWS, and terrestrial broadcasters are exempt altogether. AM/FM radio stations pay royalties when they “simulcast” sound recording performances over the Internet, but pay nothing to “broadcast” them over the airwaves.

The goal of creating a more level playing field is a desirable one, but the IRFA would hardly achieve that purpose. By lowering rates to non-market levels for non-interactive users like Pandora, it would widen the gap between firms like Pandora and interactive webcasters, like Spotify, who arguably are their closest competitors. At the same time, it would do nothing to rectify the imbalance between terrestrial broadcasters and all other users, as the former would continue to be exempt. From an economic perspective, IRFA would not ameliorate, and might well exacerbate, the economic distortions associated with the current system.

It is informative, in this regard, that IRFA's proponents are unable to proffer a policy-based, let alone an economically plausible, rationale for leaving the terrestrial exemption in place. For example, the only rationale Villasenor offers for not extending the sound recording performance right to over-the-air terrestrial broadcasters is a political one: “legislation including a provision ending the terrestrial broadcasters exemption would be likely to fail.”¹⁷⁰

Second, the argument that artists and record labels would be better off under artificially low rates fundamentally ignores the economics of two-sided markets, in which firms like Pandora act as intermediaries between consumers, advertisers and content providers. In such markets, market rates strike the correct balance between the quantities provided on each side of the market. The efficient outcome, in other words, is the one that occurs when all market participants face

would be dramatically lower and would be more in line with satellite radio or cable TV. Interestingly, Spotify's radio product runs substantially more advertising per hour than Pandora.”)

¹⁷⁰ See Villasenor at 13.

market prices. As the CRB has said, “We agree with Dr. Ordover that ‘voluntary transactions between buyers and sellers as mediated by the market are the most effective way to implement efficient allocations of societal resources.’”¹⁷¹ Indeed, even some of the IRFA’s proponents appear to recognize the flaw in this argument, acknowledging that “while rates that are too high can be punitive, so can rates that are too low, as they shortchange the content creators on which the entire music broadcasting industry depends.”¹⁷² It is crucial to remember, in this regard, that a significant proportion of performance rights royalties flow through to the performers. Thus, the cross-subsidies granted to webcasters under the IRFA would come not just from the record labels, but from the artists themselves.

Finally, the argument that IRFA – by imposing a *non-disruption criterion* on the rate setting process for a vibrant, rapidly changing digital music distribution industry -- would *enhance innovation*¹⁷³ is as misguided upon close examination as it seems upon first blush. While it is true that “[o]ne obvious consequence of broadly applying 801(b) would be lower royalty rates for webcasters,”¹⁷⁴ it does not follow that lower rates would cause webcasters to be more innovative. To the contrary, imposing a non-disruption standard would protect *incumbent* webcasters from competition and innovation by demanding that rates be set so as to provide a guaranteed profit on both previous and new investments.¹⁷⁵ This is the stuff of public utility regulation, not the dynamic Internet, and it would retard innovation, not advance it. As Dr. Janusz Ordover put it in his expert testimony in the ongoing SDARS II proceeding:

[T]he fourth policy factor ... should never be used to shield the service at issue from the full rigors of vigorous marketplace competition. Doing so is likely to harm consumers and also impede (or deter) entry and expansion of rival services.¹⁷⁶

To summarize, the primary purpose of IRFA, and one of its certain effects, would be to produce below-market royalty rates for one class of online music distributors, providing its beneficiaries with a *de facto* cross subsidy. Further, IRFA would effectively lock in the resulting profits by guaranteeing webcasters a return on both existing and future investments. The asserted public policy justifications for these proposed market interventions are without merit; indeed, the impact of IRFA would be to distort markets, retard innovation and ultimately deprive consumers of the benefits associated with competition and free markets.

¹⁷¹ See *SDARS I* at 4094.

¹⁷² See *Villasenor* at 15.

¹⁷³ See *e.g.*, *Villasenor* at 2 (“It also furnishes a strong disincentive to potential new market entrants and to the introduction of innovative new business models for delivering digital music.”)

¹⁷⁴ *Id.*

¹⁷⁵ Again, even the IRFA’s supporters acknowledge this problem. See *e.g.*, *Villasenor* at 15 (“[I]f due to technological obsolescence, poor management, or other factors, a legacy company had poorer EBITDA prospects than a new market entrant, would the fourth 801(b) factor be employed as a protectionist measure to prop up the legacy company...?”).

¹⁷⁶ Testimony of Janusz Ordover in *SDARS II* (available at: http://www.loc.gov/crb/proceedings/2011-1/pss/sx_vol_2.pdf) at 5-6. To the extent lower rates increased potential profits for non-interactive webcasters, they might attract entry. However, such entry would be of the “copycat” variety, spawned by the desire to take advantage of the arbitrage opportunity created by below-market rates.

VI. SUMMARY AND POLICY RECOMMENDATIONS

The current sound recording performance right is imperfect, most notably because of the distortions associated with the fact that it does not apply to terrestrial broadcasters.¹⁷⁷ Over the course of nearly 20 years, however, Congress has moved gradually in the direction of expanding the sound recording right and, in so doing, increasing the role of market forces in allocating the economic resources used to produce, distribute and consume musical entertainment. As long as government remains enmeshed in the process of setting rates, there will be calls from interested parties for Congress to intervene on their behalf. Such calls should be seen, however, for what they are, and resisted. There is no public policy case in favor of the IRFA, only a political one.

¹⁷⁷ For a more comprehensive treatment of the arguments in favor of the sound performance rights for terrestrial broadcasters, see e.g., Sunny Noh, "Better Late than Never: The Legal Theoretical Reasons Supporting the Performance Rights Act of 2009," *Buffalo Intellectual Property Journal* 6 (Spring 2009) 83.

Mr. COBLE. Mr. Huppe.

**TESTIMONY OF MICHAEL HUPPE, PRESIDENT,
SOUNDEXCHANGE, INC.**

Mr. HUPPE. Mr. Chairman, Ranking Member, Members of the Subcommittee. Thank you for giving me the opportunity to set out the reasons why the music community stands united in its opposition to the so-called Internet Radio Fairness Act. The entire music industry, and many groups beyond this industry, all reject this attempt to subsidize companies at the expense of artists. Worse yet, a bill that claims to seek fairness and parity blatantly ignores the fact that traditional over-the-air radio, representing a huge aspect of the radio market, pays nothing to artists when it is their music that makes radio possible.

Contrary to what you may have heard, Mr. Chairman, digital radio is flourishing under the current royalty structure. As this slide demonstrates, the number of such services has grown from 850 in 2007 to more than 2,000 services today.

SoundExchange wants to foster that type of growth; it is, after all, good for everybody. But we must always remember that the statutory license which enables this growth is a tremendous commercial benefit, a gift really, to these online services. It allows them to use every sound recording ever released to build their own business. The very least Congress can do is ensure that artists are paid fairly for this forced transfer of rights.

Now, Mr. Chairman, there has been a lot of talk about what these payments really mean, so let us try to put it in everyday perspective. As you heard Jimmy Jam say, Pandora currently pays about one-tenth of a penny to stream a single song. So when the average Pandora listener listens for 20 hours per month throughout the entire year, Pandora pays to SoundExchange less than \$4, less than \$4, in royalties for 250 hours of music.

Mr. Chairman, that is less than some people in this room spent on their coffee this morning for an entire year's worth of listening. And remember, that \$4 is divided among hundreds of featured artists, background musicians, record labels and others who created the music that drives the industry. And this legislation before you today seeks to lower those payments even further. That is why over 130 artists listed in this ad recently signed a letter in support of fair payment and against this bill.

So how are most artists paid now? Current law sets a fair-market standard for compensating artists. Specifically it considers what a willing buyer would negotiate with a willing seller in the marketplace; in other words, what is the fair market value? That rule applies to more than 2,000 digital services.

As this slide demonstrates, only 3 digital services out of the 2,000 do not operate under this fair-market standard. Why only three, you ask? Because they happened to be in business back when the standard was established in 1998. In other words, Mr. Chairman, they are getting this break merely because they have been around a while. This bill is really about trying to lower those 2,000 modern services down to a subsidized rate, rather than raise the three outliers up to the modern fair-market standard.

As you have heard, terrestrial radio must also pay for the music that drives its success. To paraphrase Mr. Watt, we shouldn't nibble around at the edges and avoid the biggest problem out there. We cannot have a meaningful discussion about fairness if we allow the \$14 billion radio industry to continue to pay nothing to artists. We are thankful that this Committee has recognized that inequity by favorably reporting out the Performance Rights Act of 2009. And we also want to commend Mr. Nadler's draft interim first act, which seeks an interim solution to this decades-long injustice.

Lastly, Mr. Chairman, the bill has a litany of unfair and unwise provisions that are too long to list here, but reveal it for the one-sided, unfettered wish list that it is. So we agree that the current situation is unfair, but it is unfair to artists and labels. It is unfair that traditional radio gets to use sound recordings for free. It is unfair that SiriusXM, a multibillion-dollar company, pays less than the market rate. And it is unfair that thriving Internet radio companies like Pandora want Congress to make artists subsidize their business.

In closing, Mr. Chairman, it is no secret that the music community, like any healthy family, has any complicated relationships over complicated issues. It is not often that you see agreement on a given topic from artists, musicians, managers, producers, songwriters, publishers and labels, so it is noteworthy when we all come together as one voice opposing something like this bill. But it is not just us, Mr. Chairman. We stand shoulder to shoulder with groups as diverse as the AFL-CIO and the Americans for Tax Reform, the NAACP and the American Conservative Union, SAG-AFTRA and AFM, and Citizens Against Government Waste. That type of outcry is a clear indication to Congress that this bill is bad policy and would make bad law. Mr. Chairman, we want Pandora and other digital services to succeed, but the law must ensure that artists are treated fairly in the process.

I appreciate the opportunity to testify today. We look forward to working with Congress to develop a comprehensive approach that treats creators of music fairly and all music platforms equally.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Huppe follows:]

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Statement of

Michael Huppe
President
SoundExchange, Inc.

before the

HOUSE COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON INTELLECTUAL PROPERTY, COMPETITION AND THE
INTERNET

“Music Licensing Part One: Legislation in the 112th Congress”

on

November 28, 2012

Chairman Goodlatte, Ranking Member Watt and Members of the Subcommittee, I appreciate the opportunity to appear before you to discuss the importance of true parity for all radio services and the adoption of rules of the road which ensure musicians are treated fairly. Ultimately, the question before you boils down to this: Should artists be entitled to a fair market price for their works, which form the core input of digital music services, or should they instead be forced to subsidize services that exploit those works for their own commercial gain?

I am Michael Huppe, and I am the President of SoundExchange. SoundExchange represents more than 70,000 artist and 24,000 copyright owner accounts. SoundExchange administers the statutory license for digital radio used by services reaching more than 100 million Internet radio listeners and 23 million satellite radio subscribers.¹ In fact, more than 2,000 digital radio services – like Pandora, iHeartRadio, SiriusXM and Music Choice – rely on the statutory license every month for the rights to the sound recordings that make their businesses possible. Without SoundExchange serving as the “one-stop” administrator for the statutory license, they would all face the difficulty and expense of locating and paying each of the thousands of copyright owners whose sound recordings they want to use.

Our operations are overseen by a board of directors comprised of representatives of those on whose behalf we work – artists and record labels (both major and independent) – meaning that our focus is maximizing the distribution of royalties to those who have earned them. We have built state-of-the-art systems that are always evolving, and we maintain one of the lowest administrative rates in the industry – 5.3 percent in 2011. Our payments to artists and record labels are based on an open and transparent process supervised by our joint board, and we’ve paid out more than \$1 billion in performance royalties to artists and copyright owners since our inception.

In my testimony today, I wish to discuss four topics: First, the statutory license works best when it results in the fair compensation of artists and record labels, which, by definition means that they receive the fair market value of their recordings. Second, there are a number of fundamental problems with the so-called Internet Radio Fairness Act (H.R. 6480) (“IRFA”) – a bill that departs significantly from the principle of fairness which must be the foundation of the statutory license. Third, I want to shed some light on the real economics of Internet radio to show how much of the rhetoric has concealed the reality of the statutory regime, and demonstrate that the system, including the Copyright Royalty Board (“CRB”), has worked well and exactly as Congress intended.

¹ Edison Research and Arbitron, “The Infinite Dial 2012,” available at <http://www.edisonresearch.com/home/archives/2012/04/the-infinite-dial-2012-navigating-digital-platforms.php>. SiriusXM’s 10Q report for the quarter ending September 30, 2012, available at <http://investor.siriusxm.com/sec.cfm>.

Fourth, and finally, I discuss the “elephant in the room” whenever we are talking about performance rights for sound recordings. Namely, the fact that terrestrial (i.e., over-the-air) radio is required to pay nothing for the sound recordings that drive its business. IRFA ignores this glaring injustice. Representative Nadler’s draft bill, by contrast, both seeks to establish true rate parity and takes the first important step toward rectifying this major defect in U.S. law.

I. The “willing buyer/willing seller” standard is the proper standard to determine the royalties to be paid by Internet radio services.

The willing buyer/willing seller standard is proper as a matter of principle, and complaints regarding its application to Pandora and other Internet radio services are both inaccurate and grossly overblown.

a. If the law is going to give services the right to use sound recordings, at a minimum the law should ensure that creators receive market value for the use of those recordings.

At its essence, a statutory license involves the forced surrender of property at the direction of the government so that third parties may use it to build their business. The owner of the property (the music) has no say about which services get to use it. The owner has no say over the conditions of its use or the timing of when it will be used. In essence, the owner does not have the ability to withhold that right from anyone seeking to use it for any purpose, as long as they meet the requirements of the statute. For instance, from the moment Pandora started using the statutory license, it had more rights to the repertoire of artists like Adele, Metallica, AC/DC or the Black Keys than did Spotify, which had to directly license music for its on-demand service.

If we are going to have this mandatory surrender of property, the least we can do is ensure that creators receive fair market value when their work is used.

The willing buyer/willing seller rate standard is the best way to fairly compensate creators because it is a standard that ensures that the CRB will base its decisions on actual market evidence. In practice, of course, there is no actual market for noninteractive digital radio because the “market” is distorted by the existence of the statutory license itself. Instead, the CRB has considered evidence of market value derived from *other* parts of the digital music industry that are not subject to a statutory license. In these referential areas, there are sophisticated and willing buyers engaged in arms-length negotiations with sophisticated and willing sellers. This is exactly the type of marketplace evidence on which the rates for the statutory services should be based. By relying on evidence of freely negotiated agreements in the market outside of the statutory license, the CRB also gets the benefit of the market’s assessment of the wide variety of factors that are taken into account by parties to those negotiations.

To be sure, there is no way to replicate an exact market price through a judicial proceeding, but the current standard at least ensures that the CRB will attempt to set a rate based on what parties in non-statutory markets have done – thus getting as close as possible to ensuring that artists are being paid a market rate for their work. It is, in short, the best way to determine a fair market price within the statutory regime.

b. The claims that the current rates are “too high” are wrong, overblown, and based on an incomplete and premature record.

- i. Pandora’s rate is not statutorily set at 50 percent of revenues: it is a per-performance floor against 25 percent of revenue.

Pandora’s founder, Tim Westergren, has been making the argument that because Pandora’s royalty payments last year amounted to 50 percent of its revenue and SiriusXM’s royalty payments last year amounted to 8 percent of its revenues, Pandora should pay musicians less. While Pandora’s description of its effective royalty rate may be technically accurate, it is misleading in several respects.

First, the current rate for non-subscription streaming under the Pureplay rates used by Pandora is a formula: the greater of 25 percent of total U.S. gross revenues *or* a per-performance rate of \$0.0011, rising to \$0.0014 in 2015. This means that at its current \$0.0011 per-performance rate, Pandora would owe only \$4 *per year* for every user who listened to Pandora for 20 hours *a month*.

Pandora’s statutory royalty rate is thus *not* 50 percent of revenues. The fact that Pandora may currently pay 50 percent of its revenues in performance royalties simply reflects Pandora’s (deliberate) choice to focus on building its audience – and thus its usage – while keeping its advertising load and subscription fees low. This is not an uncommon path for Internet companies to take. Like many Internet companies before it, Pandora has focused first on building an audience, growing its user base, and promoting its brand. It has only relatively recently focused on monetizing its audience.

A perfect example of Pandora focusing on growing its user base instead of revenue is demonstrated in a fee that Pandora used to charge its non-subscription users. In 2009, Pandora began to charge “heavy users” in any given month a supplemental fee. Under this policy, if a non-subscription user chose to stream in excess of 40 hours in any given month, that user would be assessed a surcharge of \$0.99 for that month. Pandora elected to cease the fee in September 2011, presumably because it was a disincentive for users. In other words, Pandora placed a higher priority on gaining and retaining listeners than on earning revenue.

There may be nothing inherently wrong with this approach. Many companies have followed a similar path, and it is, in any event, Pandora's choice to determine what business model it elects to follow. But it is misleading and inappropriate to suggest that because Pandora has chosen a path which prioritizes growing its listener base over growing revenues, then musicians should therefore be forced to subsidize its choice.

ii. Pandora's per stream rate is actually much lower than its competitors.

Pandora pays a much lower per-stream rate versus its commercial competitors, even among those that negotiated rates rather than have them set by the CRB – parties such as SiriusXM and the National Association of Broadcasters (“NAB”). To illustrate, for 2013, the default commercial webcasting rate set by the CRB, \$0.0021 per stream, is the same as the negotiated rate for SiriusXM and lower than the negotiated rate with the NAB (\$0.0022 per stream). Pandora, however, will only pay \$0.0012 per stream – representing a discount of over 40 percent from what these other services pay.



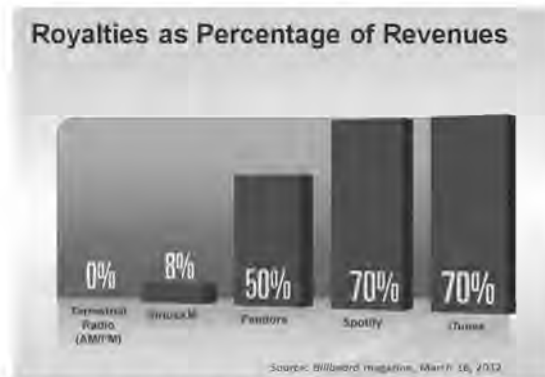
Importantly, Pandora celebrated these rates just three years ago, immediately following the announcement of the Pureplay rates that became available pursuant to the Webcaster Settlement Act of 2009. Specifically, Tim Westergren exclaimed that “the royalty crisis is over” and that “Pandora is finally on safe ground with a long-term agreement for survivable royalty rates.”² A critical component of the Pureplay rates and terms, as well as the settlements negotiated with the NAB, SiriusXM, and the other parties to the Webcaster Settlement Act deals, was that they were not only for the prior period – the Webcasting II proceeding – but they were forward looking as

² <http://blog.pandora.com/pandora/archives/2009/07/important-update-1.html>

well, covering the period that was the subject of the Webcasting III proceeding. In other words, and as a result of voluntary settlements among the parties, SoundExchange settled with more than 90 percent of the webcasting industry *before* the Webcasting III rate case really got underway. In fact, we negotiated rates with the NAB and with SiriusXM (for webcasting) that were in the same range as the market rates that the CRB ultimately adopted. Thus, the argument advanced by some that the statutory system makes it impossible for parties to reach settlements is not only wrong – it is exactly backwards.

- iii. It is appropriate for digital music services to pay a substantial portion of their revenue to the musicians that make the services possible in the first place.

Pandora suggests that its rates are out of step with the norm based on a comparison of its rates to the below-market rates enjoyed by SiriusXM. In fact, however, it is SiriusXM's rates which are out of step with the marketplace, given the fact that other competitors in the digital music marketplace actually pay more in royalties relative to revenues. If one looks at competitors to Pandora like Spotify or iTunes, the ratio of cost to revenues for Pandora is certainly within industry norms. As the chart below demonstrates, Spotify's and iTunes' costs for content (i.e. their main input) are approximately 70 percent of their revenues – demonstrating that the effective percentage of revenue rate about which Pandora complains is in fact perfectly consistent with the outcome in the private market.



Again, I must emphasize, when a service's entire business depends on music (or any single input), one should expect music (or that input) to receive a substantial part of the revenue generated by that business. In fact, this is typically the outcome in the market.

iv. As Pandora and other webcasters monetize more effectively, the effective percentage of revenue will drop.

Whether Pandora's costs relative to its current revenues are higher or lower than its competitors, it is interesting that Pandora has been making this "disparity" argument – not only because it is misleading – but because Pandora made a conscious business decision *not* to maximize revenues in the early stages of its business. Pandora followed a purposeful strategy of prioritizing the number of listeners over maximizing revenues. It initially decided *not* to run many advertisements, and its audio advertising load is still very low. It decided *not* to charge a monthly subscription – not even 99 cents – for its services to most listeners. It decided *not* to charge users a small fee for downloading its mobile device app (as many services do), but instead to give it away for free. Pandora's strategy has so far been successful: it was able to undertake a successful IPO in 2011 and currently sits with a market cap of \$1.3 billion (as of November 21, 2012). And as I mentioned earlier, it is not SoundExchange's position or intention to dictate to Pandora how to run its business.

But for that same company to run to Congress – after having just raised an enormous sum of money in a successful IPO – and ask for a hand-out is an outrage. Even now, when its shareholders are asking the company to shift strategy and focus more on revenues and profitability, Pandora only runs about 2 to 3 audio ads per hour,³ and recently many of those ads appear to be filled with calls to action in connection with IRFA. Similarly, Clear Channel has announced that it isn't going to run any ads at all on iHeartRadio until at least April 2013.⁴ To be clear, we are not suggesting that Internet radio services need to run as many advertisements as traditional terrestrial radio – or even that they have to run advertisements at all. Indeed, the nature of Internet radio is such that there are many new and creative ways to monetize a service beyond advertising. And even for the advertising, the mechanics and functionality of Internet radio services means they have the potential to run better, more effective, and more lucrative advertising once they tap fully into the market. But whether it is an ad supported or some other revenue model, the statutory license must have a fair market philosophy in order to drive services to build a business that fairly compensates artists. If Pandora chooses to focus on an ad supported model, that choice should not mean that artists receive less than they are due.

We believe in the future of advertising supported Internet radio, but if Internet radio companies choose to prioritize number of listeners over revenues at this stage, there's no reason the artists and copyright owners on whose backs the new services are built should be forced to subsidize that strategy.

v. Internet radio is on the verge of a breakthrough – the disruption of traditional radio.

³ <http://www.fi-magazine.com/Article/Story/2012/10/Dealers-Tuning-In-To-Pandora/Page/2.aspx>.

⁴ <http://kurthanson.com/news/iheartradio-custom-stations-remain-commercial-free-%22until-april%22>.

SoundExchange believes that the growth of Internet radio will continue, and that Pandora and other Internet radio companies will in turn increase their revenues and profits. One need look no further than the statements of Pandora's executives themselves:

"We generate considerable revenue from mobile. I believe we're one of the biggest mobile advertising sites in the country. Today, mobile advertising is more nascent than desktop advertising, which took 10 to 15 years to develop, but mobile is growing far faster. Key pieces of the puzzle, like third-party measurement, are just coming in. We'll benefit tremendously from that." Joe Kennedy, Pandora CEO, June 2011.⁵

"With now almost 6 percent share of all radio listening in this country we are effectively larger than the largest AM or FM radio station in many markets in this country and on our way to being larger in most markets. What that means is to the traditional radio advertiser Pandora is a highly relevant compelling choice." Joe Kennedy, Pandora CEO, CNBC, May 2012.

"We've seen tremendous growth in the adoption of mobile by advertisers. In fact, we more than quadrupled our mobile ad revenue last year from about \$25 million to over \$100 million." Joe Kennedy, Pandora CEO, CNBC, May 2012.

So who are we supposed to believe? The Pandora that tells Wall Street its best days are ahead? Or the Pandora that is asking Congress to bail it out?

We think Pandora is fundamentally right about the promise of Internet radio. For example, look at the growth in its revenues. According to a report by BIA/Kelsey, Internet radio revenue in 2010 was \$410 million. In 2011, that grew to \$440 million, and 2012 is projected to reach \$510 million in revenue.⁶ Pandora's revenue has grown from \$55 million in its 2010 fiscal year to \$274 million in 2012.⁷ And more than a year after its successful IPO, the company is valued at \$1.3 billion.

Clearly, Pandora does not need to be subsidized by artists, especially when it is in its infancy and the numbers are so promising. In light of the relative youth of Pandora as a company, and its projected growth pattern (as demonstrated in recent years and lauded for the future years), it would be ill-advised for Congress to step in and manipulate the market to subsidize a thriving and innovative company.

⁵ <http://allthingsd.com/20110617/pandora-had-a-good-wednesday-and-a-terrible-thursday-what-about-the-next-couple-years/>.

⁶ <http://www.biakelsey.com/company/press-releases/120410-Radio-Industry-Revenues-Flat-in-2011-While-Online-Revenues-Jump-15.1-Percent.asp>

⁷ Pandora's 10K report for the fiscal year ending January 31, 2012 available at <http://sec.gov/Archives/edgar/data/1230276/000119312512120024/d280023d10k.htm>.

Internet radio, for all its recent explosive growth, is still in its relative infancy, especially when it comes to the disruption of traditional radio. Discussing Pandora's current revenue model, based on this year's numbers, is like assessing Google in 1999 or Facebook in 2006. It's simply too early to tell where Internet radio is headed, but it is clear that it is poised for continued explosive and transformative growth.

II. Any new legislation should be fair in fact, not just in name, and establish true rate standard parity.

a. IRFA would drag the thousands of services now subject to a market rate standard down to the below market rate standard that only three services now enjoy.

At its core, the driving motive behind IRFA is clear. It is, quite simply, an attempt by webcasters to reduce the royalty fees that they pay to recording artists and copyright owners for the privilege of using their sound recordings on digital radio. This bill would be a huge step backwards – applying an old standard currently used by only three “grandfathered” digital services (SiriusXM for satellite radio, Music Choice, and Muzak) for their performance of sound recordings.

Congress should not be asking whether 2,000 services should enjoy the perks enjoyed by the three grandfathered services. Rather, Congress should be asking why the law forces artists to subsidize successful companies like SiriusXM under the outdated 801(b) standard – a company that is now sitting on hundreds of millions of dollars in cash and continues to outperform expectations in growth and revenues.

It is important to note that the three grandfathered companies operating under the 801(b) standard are granted that below-market subsidy merely because they happened to be in existence in 1998 – in other words, because they are “old.” At the time of passage of the Digital Millennium Copyright Act, these companies were given this exemption based upon a theory of business reliance. While we might dispute whether this theory was justified in 1998, any possible justification for providing a subsidy to these services no longer has merit following the intervening 15 years. It should not be the case that 801(b) is used to subsidize any company – regardless of its size, business model, or degree of success – simply because it had the good fortune of existing in 1998.



Wouldn't true "fairness" dictate that SiriusXM and the other two "grandfathered" services simply pay at the modern fair market value standard? That is the fairest, most economically-sound path to true rate standard parity, a goal which SoundExchange supports.

The main goal of the IRFA, however, is radically different. It is to lower the rate standard for all digital services down to the antiquated below-market rate, rather than requiring that all services pay at the more reasonable fair market rate. This isn't "fair;" it is predatory – particularly when you consider that the law allows digital radio services to build their businesses off any commercially available work without music creators' having the ability to withhold. At the very least, the law should require that those creators be compensated at a fair market rate.

b. IRFA suppresses innovation by subsidizing a specific category of businesses.

Let's talk about why it is not appropriate for Pandora (and other would-be champions of innovation and technological disruption) to be supporting the antiquated 801(b) standard. The 801(b) standard favors old technology over new technology. It also favors status quo over innovation by allowing the CRB to insulate Pandora and other Internet radio services from the so-called "disruptive impact" of market rates.

It is ironic that Pandora and others in the technology world now ask the government to step in to protect them from the consequences of the market. Under the antiquated 801(b) standard, which Pandora seeks, the CRB Judges are directed to set the rates according to the following criteria:

(A) To maximize the availability of creative works to the public.

(B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.

(C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.

(D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices. (Emphasis supplied.)

That last factor bears repeating – “to minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.” The IRFA would extend this protection against “disruptive impact” to every online radio service taking advantage of the statutory license. But don’t this country’s most innovative companies embrace “disruption?”

Look at what this country’s technological leaders have said:

- *“One of the things about technology is that technology is fundamentally disruptive ... and my experience now, and I’ve done this for a long time, is that people are always shocked at how real disruption occurs and how much change can occur through empowerment.”* Eric Schmidt, Google Executive Chairman, October 2010.⁸
- *“As a company, one of our greatest cultural strengths is accepting the fact that if you’re going to invent, you’re going to disrupt.”* Jeff Bezos, Amazon Founder and CEO, November 2011.⁹
- *“Wired was founded on the notion that change is good... Disruption is the ultimate change.”* Chris Anderson, *Wired* Editor-in-Chief, May 2011.¹⁰

And Pandora has followed suit, emphasizing its role in disrupting traditional radio:

- *“We have the audience to massively disrupt this market,”* Joe Kennedy, Pandora CEO, May 2012.¹¹
- *“We now find ourselves at an exciting moment, at the cusp of a... substantial disruption in one of the largest consumer media categories – radio.”* Joe Kennedy, Pandora CEO.¹²
- *“Pandora is transforming the last medium yet to be disrupted by the Internet.”* Tim Westergren, Pandora Founder and Chief Strategy Officer.¹³

⁸ <http://arstechnica.com/tech-policy/2010/10/does-google-still-qualify-for-sainthood/>

⁹ http://www.wired.com/magazine/2011/11/ff_bezos/2/

¹⁰ <http://www.businessnewsdaily.com/929-disruptive-technologies-jumpstart-economy-wired-conference.html>

¹¹ <http://www.radioworld.com/article/pandora-looks-to-disrupt-am-fm-advertising/213619>

¹² <http://soundcloud.com/edwardryan/joekennedy-0>

But while Pandora champions its own disruption of the consumer media industry to Wall Street, it wants Congress to protect it from the ostensibly “disruptive” impact of paying fair market value for the music it plays.

Arguing for business progress while at the same time seeking to minimize “disruption” through artificially low rates for its own use of music is inherently contradictory. After all, innovation is based on disruption. And capitalism rewards disruption. Pandora and those from the technology sector who support it should not be able to glorify disruption when it suits them, and yet bemoan it when they are seeking a subsidy.

c. IRFA contains a litany of other unfair provisions clearly designed to tip the balance decidedly in favor of Internet radio services.

Just as bad, the bill amounts to a wish list for copyright users, with a host of one-sided provisions that would politicize the CRB and impose limits on copyright owners’ and artists’ ability to participate fairly in rate setting proceedings. It would also require the CRB to base its decision on evidence that doesn’t exist and ignore available evidence of how the market and the music industry actually works.

To name just a few of the troubling provisions proposed in this bill:

- The requirement that at least one judge should have expertise in economics would be eliminated, even though the judges are supposed to be setting rates based on market evidence.
- The ability of copyright owners and artists to effectively participate in rate settings, and their ability to speak freely about critical public policy issues regarding the statutory license, would be radically hamstrung.
- The bill would inexplicably place the burden of proof solely on copyright owners and artists.
- Normal and customary market benchmarks, such as rates paid for on-demand services, or any rates agreed to by major record labels, would no longer be usable as evidence, even though that is the best evidence of how the industry actually works.
- Marketplace evidence would be limited to agreements that do not currently exist or shed light on the market.
- The bill would impose new, one-sided burdens on record companies and recording artists in the rate-setting proceedings.
- Copyright judges would need to be confirmed by the Senate rather than appointed by the Librarian of Congress, exposing the rate-setting process directly to electoral politics.

¹³http://www.nysemagazine.com/pandora?utm_medium=etoc&utm_term=jan12&utm_source=pandora&utm_campaign=article

Indeed, it is these provisions (and more) that in many ways reveal IRFA for what it is: a wish list for the digital music services completely unmoored from any principles of fairness.

III. **The reality instead of the rhetoric: the Internet radio industry is thriving under the current statutory regime.**

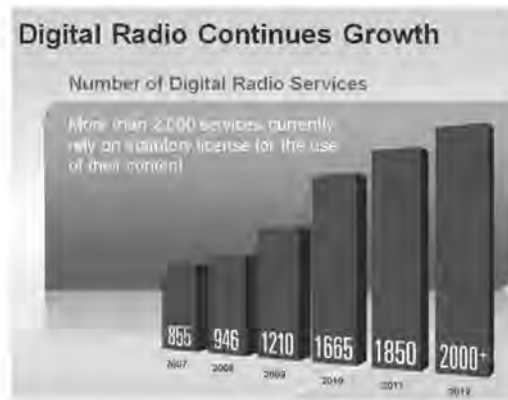
a. The statutory license has enabled tremendous growth, in part, by providing services a “one stop shop” for sound recording rights.

Congress created the statutory license for digital music to make it easy for webcasters or satellite radio to pay for the music they use to operate their businesses. As a result, these digital radio services do not need to negotiate individual deals with thousands of rights holders and recording artists – or ask permission to play every track. This is an incredible gift for online music services, and Pandora itself has confirmed that it depends on the statutory license for the rights to the sound recordings on which its entire business is based. For Pandora and other entrepreneurs seeking to start a digital music service, the statutory license provides an easy and quick method of obtaining a license and paying royalties. The statutory license gives these services the right to stream every sound recording ever commercially released, merely by filing a short document and meeting the terms of the statute.

SoundExchange, as the steward of the statutory license, thus offers a one-stop shop for sound recording rights. Not only does the statutory license eliminate the need to seek thousands of license agreements; the collective management of the license by SoundExchange eliminates the need for services to make thousands of separate payments and deliver thousands of separate reports to copyright owners and artists.

The growth of digital radio services using the statutory license is astounding. Digital radio is an increasingly substantial portion of all radio listening in this country, and, as we have stated above, today more than 2,000 music services use the statutory license, representing tens of thousands of individual channels and stations. These 2,000 services represent a huge increase over the past five years (see chart),¹⁴ and are a testimony to the benefits that the current licensing regime provides.

¹⁴ Based on number of services reporting to SoundExchange, with prior years adjusted to account for broadcast industry consolidation since 2007.



b. Internet radio provides a critical growing revenue stream for the music industry at a time when other sources of revenue are shrinking.

According to the “Music Acquisition Monitor,” a November 2012 report from market research company The NPD Group, in the past year, the Internet radio audience has grown 27 percent, as the on-demand music audience has grown by 18 percent, year-over-year. As Internet radio and on-demand listening has increased, the number of consumers who reported listening to CDs dropped 16 percent, and the number of consumers listening to digital downloads declined by 2 percent.¹⁵ This means that Internet radio provides a critical growing revenue stream for record labels and recording artists at a time when other sources of revenue are shrinking.

c. Artists participate directly and immediately in this new revenue stream.

One critical component of the revenue stream generated by the statutory license is that digital performance royalties are split 50/50 between the sound recording owners on the one hand and the featured artists (who receive 45 percent of the performance royalties), session vocalists and session musicians on the other (who receive 5 percent of the royalties). If the featured artist is also the copyright owner, that artist receives 95 percent of the royalties. This split was built into the law in response to the efforts of the artists’ unions, AFM and AFTRA (now SAG-AFTRA) to ensure that performers would benefit immediately, directly and transparently from the new digital performance right. Importantly, the artist money is paid *directly* to the artists on a nonrecoupment basis.

¹⁵ <https://www.npd.com/wps/portal/npd/us/news/press-releases/the-npd-group-internet-radio-and-on-demand-music-services-rise-putting-pressure-on-traditional-forms-of-music-listening/>.

meaning that the artists keep 100 percent of their digital radio royalty regardless of whether they are recouped under their record deals, current or historical. And the fact that non-featured musicians and performers meaningfully participate in the downstream revenue opportunities from this new and growing revenue source means that not only does the current digital radio model provide new and growing sources of income for artists, but it distributes that income across a larger and larger number of recipients.



IV. **Any Legislation Related to the Performance Right Must Address the Lack of a Terrestrial Performance Right**

a. *IRFA does not address the single biggest injustice – the lack of a terrestrial right.*

The “Internet Radio Fairness Act” is fair in name only. This bill seeking supposed “fairness” and “parity” utterly fails to address the biggest inequity of all when it comes to radio: the fact that terrestrial radio pays absolutely nothing for the sound recordings on which that multi-billion dollar business is based. It is futile to even begin discussing “fairness” or “parity” in radio while ignoring the most egregious inequity of the system.

Of all the ways we listen to music, terrestrial radio is the only one that doesn’t pay anything to the performers that bring the music to life. The U.S. continues to be an outlier in this regard and is the only industrialized country that does *not* recognize a copyright for the performance of sound recordings for terrestrial transmissions. Every music platform, including terrestrial radio, should pay a performance royalty.

A bill aimed at genuine fairness must necessarily address this omission in U.S. law. Legislation that maintains such a glaring inequity on one of the music industry's biggest performance platforms is hardly "fair" at all.

b. Prior bills, and current draft legislation, are a move in the right direction.

In order to create true parity and fairness, Congress must create a legal performance right for sound recordings played on all platforms – and most importantly terrestrial radio.

In that regard, I want to thank this Committee and former Chairman Conyers for favorably reporting on a bipartisan basis the Performance Rights Act in 2009. Many of the stalwart supporters of that bill are here today. I also want to thank Representative Nadler for working on an interim solution to this decades-long injustice. Representative Nadler's draft legislation recognizes the injustice of denying "fair pay for airplay." His discussion draft proposes a 21st century marketplace standard that treats artists and music services fairly and equally and takes a step toward remedying the lack of a performance right for terrestrial radio. Specifically, his draft bill would not only adopt true rate-standard parity – establishing the "willing buyer/willing seller" standard for all digital music services – it would also take a first, important step forward toward correcting the decades long injustice of the absence of a performance right. While Representative Nadler's draft would not actually create a terrestrial performance right, it would require broadcasters who also simulcast their terrestrial streams to pay a surcharge that reflects what the market value of their over-the-air broadcast would be if a terrestrial performance right properly existed.

SoundExchange agrees with Representative Nadler that the current lack of a performance royalty for terrestrial radio airplay is a significant inequality and grossly unfair. Indeed, it is arguably the single greatest injustice in the music licensing landscape today. We cannot condone a race to the bottom when it comes to rate standards and compensation for artists, and we applaud Representative Nadler for providing a discussion draft that would provide artists with fair compensation for the valuable creations they share with the world.

* * *

This is an exciting time for music fans. Radio is being transformed as we speak. But the law should not lose sight of the fact that these services are nothing without music, and that it is the musicians who give life to Pandora and its peers. If you are going to force creators of music to relinquish their property, they at least deserve a market rate for their work. As musical artists like Rihanna, Billy Joel, Maroon 5 and Sheryl Crow stated in their message in *Billboard* magazine earlier this month, let's not gut the royalties that thousands of musicians rely

upon. Instead, let's work this out as partners and continue to bring fans the great musical experience they rightly expect.

Mr. Chairman and Ranking Member Watt, I appreciate the opportunity to testify today. Moreover, SoundExchange looks forward to working with Congress to develop a comprehensive approach that treats creators of music fairly and ensures that all music platforms properly compensate the musicians upon whose backs their very businesses are built.

I look forward to your questions.

Mr. COBLE. The gentleman's time has expired.
 I want to thank all of the panelists for your time and your presence here today.
 In 1998, there was some question as to how the DMCA was going to affect Internet radio. A series of stakeholders meetings were convened, and the net result of those meetings, you will recall, was willing seller/willing buyer.
 Now, Internet radio has enormous potential for music lovers, the music industry and high-tech industry, but in my opinion it does

not replace the rights of creators and performers. All three, it seems to me, should flourish.

Mr. Kennedy, let me put a two-part question to you. Is Pandora profitable and successful without changes in the law, A; and B, how does Pandora generate revenue, and does that include capital generated from the stock market?

Mr. KENNEDY. Forgive me. I hesitate to frame this as a Pandora-specific issue. As you heard from Mr. Hubbard, the rates that exist today in Internet radio prevent every broadcaster from entering the market or, for those that are there, from making any profit in the market. So we don't really view this as a Pandora issue.

The amount of money we pay, almost a quarter billion dollars a year, is more than the performance rights paid by the entire radio industries of the U.K.—which includes AM/FM payments—France, Germany, every country on the planet.

So I don't think this issue is really about the profitability of Pandora. And to the extent the profitability of Pandora is relevant, then 801(b) is really the appropriate standard, because it is the standard that directs the judges to take into consideration the financial conditions of the companies involved. Willing buyer/willing seller makes no reference to that. And so if you believe that it is a relevant consideration in rate setting, then we certainly would say 801(b) is appropriate, and let the judges completely examine the financial performance of Pandora and every other licensee under section 114 in making their determination of appropriate rates.

We generate revenue by a mix of advertising and subscription, really the way radio has generated revenue for many years. As Mr. Reese talked about, ad-supported radio is the foundation of the radio experience in America, has been that way for roughly 100 years. SiriusXM is a subscription model. We offer both of those business models to consumers. Part of the benefit of the Internet is the ability to give consumers that choice.

Mr. COBLE. I thank you, sir.

Mr. Jimmy Jam or Dr. Eisenach, many established artists, I am told, have signed a letter to Congress opposing this legislation. How about up-and-coming artists; does it affect them as well?

Mr. JAM. Sir, I would say that it probably affects them even more so.

Mr. COBLE. Mr. Jam.

Mr. JAM. The green light is on. Maybe come a little closer? How is that?

Mr. COBLE. That is better.

Mr. JAM. That is why I am a producer and not a singer. I know how to set it up, but—

Mr. COBLE. I bet you do both pretty well, Mr. Jam.

Mr. JAM [continuing]. I leave it to the talented people to do it.

The ad actually includes a lot of people who I think would be thought of as up-and-coming artists certainly, but, yeah, it affects everybody across the board. And I think that, you know, part of the reason that I am passionate about it, and I have been fortunate to have a lot of success in the industry, but to me it is important that it continues on.

And it is really simple to me. When we talk about the music business, the word “music” comes first. There has to be music. We have to support the music before anything else, before the business gets done. And I just feel that the idea of lowering rates that are already in place and were already acknowledged by Pandora as they could function under those rates, it seems a little bit interesting to me that 3 years later we are here in front of you arguing that for some reason they can’t make the business model work.

Mr. COBLE. I want to try to beat the illumination of that red light. Thank you, Mr. Jam.

Mr. Reese, if you would distinguish—strike that.

Regarding terrestrial radio, how would you distinguish terrestrial from satellite, cable radio and Internet radio?

Mr. REESE. I think two principle distinctions, Mr. Chairman. First is that AM/FM radio is local and free, and that is a distinguishing characteristic from the others, which are at least subscription driven and in many cases subscription and advertiser supported. And we have been there for 90 years. We have been providing relationships with communities. We played with an important promotional role, a multibillion-dollar promotional role, in promoting the music industry.

It was said by one of the witnesses that music makes radio possible. Radio makes music possible. There has been a terrific relationship there for nearly 100 years now, and we believe the free local nature of our business is very important in continuing to make music possible.

Mr. COBLE. I thank you, sir.

I see my red light has appeared, so I will yield back the time I don’t have.

Mr. WATT. Mr. Chairman, I am going to defer to the other Members and go last in case we run out of time, so I will go to Mr. Conyers.

Mr. COBLE. The distinguished gentleman from Michigan is recognized.

Mr. CONYERS. Thank you, Mr. Chairman, and I thank all the witnesses.

I am still trying to determine why artists and performers, whose music is played 24 hours a day on terrestrial radio, don’t get a dime. And I notice that, with all due respect, the first three witnesses said little or nothing about it, and, to me, this is the—I mean, we are not only leaving things at a situation that is unacceptable, but we are making it worse; don’t you think, Mr. Huppe?

Mr. HUPPE. Thank you, Congressman. I absolutely believe we are making it worse. As I mentioned earlier, to attempt to solve the problem piecemeal and avoid the biggest elephant in the room, which is the \$14 billion over-the-air industry, is really a huge mistake.

You know, it was stated just a minute ago that without radio there would be no music, and I believe it was asserted that without—without music there would be no radio. Mr. Reese asserted without radio there would be no music. I respectfully beg to differ. Music is what drives radio. Music is one of our greatest cultural assets. The American music industry, American artists, American unions, American record companies are the most popular musical

asset around the world. It is American music that is played overseas. It is American music that is played in Europe. And the fact that we stand alone in not rewarding the artists who feed that music to the radio station so they can make their profit from advertising is unacceptable. And I would note—

Mr. CONYERS. So our country is the only country that doesn't compensate.

Mr. HUPPE. It is the only industrialized country that does not do it.

Mr. CONYERS. And pay royalties to those who are performing.

Mr. HUPPE. It harms performers twice, because not only do they not share in any of that \$14 billion profit made every year by the radio industry off their hard work, but because we do not have that right in this country, there are hundreds of millions of dollars overseas collected on behalf of American artists that don't ever work their way to American artists because we lack the reciprocity. So they are harmed not once, Mr. Conyers, but twice.

Mr. CONYERS. Dr. Eisenach, could you put in some order the importance of the four principles that you articulated in connection with this subject matter? What is at the bottom of all of this, if we were putting it simply?

Mr. EISENACH. Two concepts. First, the notion of applying a non-disruption standard to the Internet, I hope everyone would recognize how nonsensical and perverse that is. The Internet is the world's greatest example of the process of creative destruction. The Internet works because people come to the table with new ideas; they invest their sweat and their energy and their money. Sometimes they succeed; sometimes they fail. They don't have a right to succeed. And section 801(b)(4)—(b)(1)(D) would, in effect, seek to give them that right. So it is a recipe for technological and marketplace stagnation.

Secondly, and this responds to something Mr. Kennedy said, the advantage of the willing buyer/willing seller standard is precisely that it does not guarantee the profitability of individual companies, precisely that, right? This is the stuff of public utility regulations. We have rate commissions which are designed to preserve the profitability of our electricity companies. But that is not the kind of innovative marketplace that we are dealing with here. We don't want to guarantee these companies the right to eternal life.

Mr. CONYERS. Thank you very much.

I wasn't going to ask the former head of The Recording Academy any questions, but, you know, Jimmy Jam, you come off as a very able witness. You are in the industry. Don't you think that just a sense of fairness would require that somewhere along the line—we tried it once; I think we passed the bill of mine at least once here already—in terms of giving performers some share of all of the enjoyment they are giving to hundreds of millions of people, and everybody is doing it in almost every country on the planet but us.

Mr. JAM. Right. Yeah. This is an area where it doesn't really make a whole lot of sense that artists do not get paid royalties on AM/FM radio. I am sorry, I don't remember which gentleman it was of the experts on this side that basically alluded to the fact that there were some private deals that had taken place. We like the idea that that has happened because basically it is an acknowl-

edgment that it is the fair thing to do. And those companies that have chosen to go into a private agreement, that is wonderful.

The thing that I would say, though, is that we need an industry-wide solution to that problem. And really only Congress can make that happen and make it so that—this is actually a letter that was written by Scott Borchetta, who is the CEO and President of Big Machine Records. So this is one the private deals that was done. But in his letter, even though that they have struck the private deal, which we think is a good thing moving forward, he does call that the idea that the government needs to get involved at this point to make it an industrywide solution, even he, as part of this private deal, feels that that needs to happen.

So we would obviously like to see that happen on that side, and we want to just create the right that the rest of the developed world has. We are the only Nation that doesn't have that for the artists.

Mr. CONYERS. I am so glad that all of you are here, and I thank the Chairman and return any unused time.

Mr. SENSENBRENNER. [Presiding.] The time of the gentleman has expired. The new Acting Chair will recognize himself for 5 minutes.

Mr. Kennedy, as you know, I have been pretty sympathetic to the concerns that webcasters have brought up. And during the 6 years when I was the Chairman of the full Committee, the Committee reported out and was enacted into law two changes in royalties. And after my retirement as Chairman of the full Committee, the Webcaster Settlement Act was passed.

Digital Millennium Copyright Act established a compulsory license, which I think was necessary to allow this industry to get off the ground, but it also said that the license fee should be based on a willing buyer/willing seller principle, which I basically interpret as saying that it should be based on market principles. That was in 1998.

In 2002, there was political pressure to reduce the royalty payment, and Congress, during my chairmanship, passed the Small Webcaster Settlement Act. Then 2 years later we passed the Copyright Royalty and Distribution Reform Act, and the trade association that led the lobbying campaign for the webcasters issued a press release boasting that they were thrilled that Congress had passed the legislation, and that the redesigned royalty arbitration process will be more efficient and the rates would be more fair to participants as a result of the revision in the law.

Then during Mr. Conyers' chairmanship, there was another bill passed, which was called the Webcaster Settlement Act of 2008, and Pandora praised the deal as, quote, "the agreement we have been waiting for," unquote, and, "Pandora is finally on safe grounds with a long-term agreement for survivable royalty rates."

Now here we are back again, and this is the 1, 2, 3, 4, fifth attempt of the Congress and specifically this Committee to deal with this issue. Mr. Kennedy, when is a deal a deal, and you have to accept a bad deal as well as cash in from a good one?

Mr. KENNEDY. Mr. Sensenbrenner, several comments in that regard. The webcasters who were there in 1998 when this law was first passed were two fledgling webcasters who are now no longer in business. The webcasters who are present in the 2002 and 2004

time frames that you reference are no longer in business. We have not been part of any of those legislative changes. The webcaster settlement agreement that we reached with SoundExchange extends through 2015, and we fully sign up to live within the provisions of that webcaster settlement agreement.

The issue before us is that that settlement agreement expires in 2015, and we enter a new rate setting for the period 2016 through 2020 with the system in place that, as you allude to, has failed to develop outcomes that are considered by all parties—fair by all parties in any of its applications. We seek now to address that fundamental flaw in the legislation precisely to get Congress out of the business of having to intervene into these proceedings.

Mr. Huppe would have the exact numbers, but the overwhelming majority of the payments to SoundExchange today from Internet radio do not come by rates that were set by the CRB. They come as a consequence of settlement agreements entered into only after congressional intervention.

That is not the way the system should work. The system should be able to generate rates that all of the parties consider fair, and we seek to achieve what Mr. Berman alluded to in the context of a symbiotic system, an approach that can truly generate outcomes that are considered fair by all parties.

Mr. SENSENBRENNER. Well, Mr. Kennedy, my time is about ready to expire, but let me say that the Members of this Committee have, you know, spent probably more time dealing with this issue than with any other single issue in the last decade or decade and a half, and we have got lots of other stuff on our plate that we have got to deal with, as everybody in the room knows. So what would happen if we just said, well, your time is up, we can't spend any more time on this, let 2015 come, and let the current agreement expire?

Mr. KENNEDY. I think the issue for you to consider is that under the rates that are established by the CRB, again rates under which very few, if any, services operate, to give you a perspective, if those rates were applied to all of radio in this country, based on a study by a very well-respected music business professor at Washington and Lee University, this study, unfunded by any participant, completely independent, estimated that the total payments due from the radio industry under the current rate structure set by the CRB would be \$4 billion a year. That is illustrative of what the willing buyer/willing seller and current CRB process establishes as the appropriate rate.

I am not aware of anyone who studied this issue who believes that the appropriate answer is to charge AM/FM radio \$4 billion a year, that that would truly represent a fair market rate that broadcast radio would be a willing buyer at those rates. Yet those are the rates last set by the Copyright Royalty Board. They are completely out of line by any standard in the U.S., in the world, and in order to establish a system that generates fair outcomes to all parties, this system fundamentally needs change.

The attempts to develop new and different rate standards, new and different processes, while undoubtedly well meaning over the last 15 years, have generated a rate standard and a rate system that, as you allude to, simply have not delivered results that have been considered fair by all parties and, as you say, have taken far

too much time of Congress. It is time to fix that fundamental system.

Mr. SENSENBRENNER. Well, my time has long since expired.

The gentleman from California Mr. Berman.

Mr. BERMAN. Well, thank you, Mr. Chairman.

It is quite clear that a rate that all parties agree on is easier said than done. There are obviously a few people at that table who think willing buyer/willing seller is not a fair market rate. My guess is there are a few people at that table who think the 801(b) standard is not a rate that reflects a fair market value. And part of the problem here, as Mr. Sensenbrenner has said, there is great value in the compulsory license in terms of getting music out there, but it is sort of hard to figure out what a fair market rate is in a compulsory license. No one wants to appeal that.

What is the glaring incongruity in this legislation is to call it the Internet Fairness Act when the issue should be sort of the Music Fairness Act for the people who create the music and the people who deliver the music.

And it is disingenuous, I have to say, Mr. Reese, for you to talk about finding the rate that will incentivize more webcasting by radio stations without acknowledging any obligation to be subject to a performance right for over-the-air broadcasting. You want to talk about parity without discussing the ultimate inequity, the fact that over-the-air broadcasters do not pay for the music they play.

If radio stations want to be all talk radio, they shouldn't have to pay a penny of music performance rights, but when they live and thrive and sell lots of advertising—Mr. Kennedy talked about \$4 billion, why that would be unfair to charge to webcasting. Is zero fair to charge to broadcasters?

There is a potential bargain here, even though it is a fair market rate bargain, but it is in the context of dealing with all the inequities in the platforms, and without that you are not going to find this fair rate for all parties. So I think the broadcasters have to come to terms with maybe some of your guys don't want to go into webcasting, and they like it free, but at the end of the day, if webcasting is a major part of the future, I think we are at a point in time where you are going to have to come to terms with free doesn't work anymore in terms of incentivizing creators and fairness. And so in a Music Fairness Act, it is a huge albatross around this legislation's neck to ignore that issue.

I understand the Pandora problem. They are not an over-the-air terrestrial broadcaster, and they are part of a coalition to try and change a standard. But I am predicting that, and I won't be here to determine it, but I am predicting that standard will not change in the desire to find that fair market rate.

By the way, as Mr. Kennedy acknowledged, no one is paying the willing buyer, or hardly anyone is paying the willing buyer/willing seller rate, it has only been discounted by agreements. I was very involved in the most recent agreement back in 2008 and early 2009.

But the absence of a performance right for terrestrial broadcasting is what is going to make this a very interesting academic exercise that isn't going to produce a piece of legislation, and we have to come to terms with that on all sides, and including most

specifically the broadcasters. You may be able to stop that from happening, but you are not going to be able to get what you think is the rectification of an injustice on the digital side without coming to terms with that.

And with that I yield back.

Mr. CHAFFETZ. [presiding.] I thank the gentleman.

I now recognize the gentleman from California Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman.

I am going to follow up on my distinguished colleague and friend. And when I say that, Howard, you got kind of a standing ovation before you came out because of your good work on this Committee, and you are going to be missed until you pop up somewhere else, and then we are going to be glad to have you back in whatever roll you choose to have. So I want to personally take a few moments to thank you for the work you have done with me on both this Committee and others.

Mr. BERMAN. If the gentleman would yield, I do not want to be on the copyright royalty tribunal.

Mr. ISSA. You know, Howard, one of the beauties of not being in elected office is that your obligation is only what you want in the future.

Mr. REESE, I am going to follow up on what Mr. Berman started on. Do you think that if you webcast from a terrestrial-based location, you promoted the artist the way you do on a regular terrestrial radio station, your price should be the same as it is on terrestrial radio station? It is not a trick question; we all know the price is free.

Mr. REESE. Well, the price over there in terms of a cash price has been free. In terms of the promotional value that has been provided—

Mr. ISSA. Well, then the question is if Pandora, sitting next to you, or yourself in a Web broadcast, if do the same promotion, should the price be the same? Because I tell you, Mr. Kennedy is perfectly happy, I suspect, to add an equal amount of promotion to Pandora on behalf of the artist if it gets him a price of free.

Mr. REESE. Well, Mr. Kennedy recently, or just moments ago, volunteered for our industry to pay \$4 billion in as well. So I agree with you, he would be happy for us—

Mr. ISSA. No, actually he wants your price. I have no doubt, and I am not going to ask him to state it, because it is just too obvious—

Mr. REESE. No. I—

Mr. ISSA. Just hear me out for a second. I have been working with Mr. Conyers and Mr. Berman and others for years on this trying to figure out how do we get to something that Mr. Jam and others can have their business model work, and, of course, all those people who want to create, and yet be fair to the competition between the two of you. And I think it is wonderful that you are seated next to each other, because one of you has not made a profit because, in fact, you are paying a tremendous amount of royalties on the music and trying to have a business model—as good a model as it is in gross revenues—have a business model that has some net revenues.

But they are paying the equivalent of your \$4 billion, if you will. You are paying zero. And every time we talk about paying anything, you know, National Association of Broadcasters push back and say, we are all going out of business, we can't afford it.

So am I to presume that I have to discount Mr. Kennedy to some new numbers so he can break even, but even at free you are going to go out of business. So my question to you is isn't harmonization, an amount greater than free, that allows specifically Congress to unwind its past participation that created multiple standards where like competitors pay vastly different amounts of royalties—and I say so because I am a cosponsor of the bill not because I think it is the final bill, but because there had to be a discussion and starting point, and it was a new approach to it. So I would love to hear your answer, sir.

Mr. REESE. We are here because we think it is important that we discuss these issues. Several of the Members have alluded to the desirability of a free market business. Mr. Sensenbrenner suggested this Committee is sick and tired of dealing with this issue, and that we ought to address this.

We have seen free market solutions begin to happen here, and we believe that is the right way to approach this, rather than having a mandate of some variety come in here. We will, for economic reasons, continue to do our best as an industry to maintain our viability as a business to be able to continue to serve our communities, to be there in times of emergency, but we don't believe that a mandate is the way to address that. We believe that a free market approach is the way to work, and it is beginning to work. We would encourage this Committee to allow that process to continue to thrive.

Mr. ISSA. Mr. Jam, you obviously are in a different position. You receive nothing in some cases, some money in others, and no particular difference in what you are delivering to those industries; isn't that true?

Mr. JAM. No, I mean, the music is the music. I get paid as an artist on one side, and on the terrestrial radio side I don't.

But Mr. Reese brought something up that is kind of interesting. If you allow me just 20 seconds here, I can read, because he is talking about let the private industries come to an agreement.

This is just a piece of a letter that I alluded to earlier from Scott Borchetta, who is the president and CEO of Big Machine Records, who had come to a private deal with Clear Channel and, I believe, a couple of other of the terrestrial broadcasters. He states, while the debates on this subject are many, the absolute need for legislation cannot be emphasized enough. Only then will American artists properly participate in performance monies earned around the world. The United States of America stands inauspiciously in line with North Korea, Iran, Afghanistan and China—

Mr. ISSA. I thought Cuba was in there.

Mr. JAM. They might be. He doesn't mention them there, but they could be—in not paying artists for terrestrial sound recording performances. And he goes on to say, respectfully, this is despicable and unacceptable.

Mr. ISSA. Mr. Chairman, I want to thank you for your participation in creating this hearing and your willingness to continue with this issue.

Mr. NADLER. Can't hear you.

Mr. ISSA. Maybe somebody finally decided I should cut my mic. But thank you again, Mr. Chairman. I yield back.

Mr. GOODLATTE. [presiding.] I thank the gentleman for his comments and his questions.

And the Chair recognizes the gentlewoman from California, Ms. Chu, for 5 minutes.

Ms. CHU. Thank you, Mr. Chair.

I would like to address questions to Mr. Eisenach on the composition of the Copyright Royalty Board. There is a change that is proposed by this bill, and, in fact, this bill would eliminate the requirement that one of the copyright royalty judges have significant knowledge of economics, and that one of the other judges be an expert in copyright law. Given that economics and copyright are certainly central to deliberations of this Board, what are your thoughts on this change?

Mr. EISENACH. Well, first of all, I find the provision eliminating the requirement for someone with economic knowledge to be especially personally offensive and hope the Committee would take that under consideration.

But, you know, the rate-setting process, the notion of establishing independent commissions to set prices in circumstances where either as a matter of first instance in the case of public utilities or as a matter of a backstop in the instance of the compulsory licenses here, the independence of those bodies and the ability of those bodies to operate as expert bodies and apolitical bodies is at the core of the whole notion of how we approach these issues. We seek to set politics aside and to have an expert group dispassionately look at the evidence and arrive at the best possible conclusion.

Now, I have reviewed the major proceedings that have taken place under the Digital Millennium Copyright Act, and I believe that is what has taken place. And that is different from saying that they have hit the right price on the mark to the penny each time. That is not going to happen in this kind of rate-setting proceeding. But have they established a rate which reasonably approximates the market-based rate? I believe they have.

And the changes that are proposed, the ones that you mention and others, in IRFA are changes—for example, I think requiring that the Copyright Royalty Board judges be confirmed, but also that the Board not be able to function without a full capacity really guarantees that each time there is a vacancy on the Board, all of these issues, which are contentious economic issues properly decided outside the realm of politics, but properly decided in an expert realm, all of these issues will be forced to be represented in a political framework.

So that is what I think we are trying to get away from when we establish an entity like the Copyright Royalty Board, and the changes that IRFA would make, you know, would throw us back into the fire that we were trying to escape from in the first place.

Ms. CHU. In fact, I would like to follow up on that issue, the political appointments of the Copyright Royalty Judges. Mr. Huppe, I could direct this toward you, which is this curious change that the Senate confirm the Copyright Royalty Judges, and given the politics and stagnation that is mired around any nomination appointment to the Senate, is this advisable? There are many political appointees that have yet to be confirmed right now, and wouldn't adding the CRB judges to this list of positions requiring confirmation lead to a lot of inefficiencies in the system? Both of you.

Mr. EISENACH. Well—

Mr. HUPPE. Congresswoman, absolutely that is true. The Copyright Royalty Judges perform a very important function, and it has been set up in a certain way by Congress, and the system is working. To echo the words of Mr. Eisenach, the judges have developed a very particular expertise, and there are very complicated cases that they review.

There has been the impression left, I think, by some of our witnesses that these are willy-nilly rates that are set by these judges. Nothing could be further from the truth. These are very complex hearings with many witnesses, many days of trial testimony, unbelievable amounts of discovery, complex economic theory, looking at markets, looking at actual deals that have happened in the marketplace. These decisions are based on real deals out in the real marketplace involving free sellers and free buyers. They are the absolute thing that the judges should look to.

So they have developed this expertise, and politicizing the process by making them subject to Presidential appointment would be a problem firstly because it politicizes the process, and it is exactly this type of process that we do not want to politicize. And it would also lead the system to encounter serious problems. There is almost always something going on before the judges. With all the different classes of service both in 114 and other sections of the Copyright Act, there is an ongoing and very high-volume business that judges have to deal with. To have that interrupted with gaps and political disagreements over who should sit and who should not would work great harm to the system.

Ms. CHU. And, Dr. Eisenach, I don't know if he wanted to continue his thought.

Mr. EISENACH. I just repeat what Mr. Huppe said and say that if you go back over the course of about 100-plus years of, both through State Public Utility Commissions and through independent regulatory commissions at the Federal level, this notion of taking, what are essentially direct economic fights, what is before you today is two constituencies, each of which wants to get paid more, or multiple constituencies all of whom want to get paid more. Now, the question is are we going to do that on the basis of who can get the most postcards mailed to their Members of Congress, or are we going to do it on the basis of some kind of objective standard, and what is that standard going to be?

And I think you want an objective process to decide those things, first of all. And second of all, I think what you want is an objective standard that aims to hit at something approximating the market-based rate, which is willing buyer/willing seller.

Ms. CHU. Thank you. I yield back.

Mr. GOODLATTE. The gentleman from Utah Mr. Chaffetz is recognized for 5 minutes.

Mr. CHAFFETZ. Thank you.

Mr. HUPPE, at the very beginning of your presentation, you put up a chart that showed the royalties paid. What percentage is Pandora paying of those dollars going in?

Mr. HUPPE. I am not actually permitted to disclose those numbers. I will tell you this—

Mr. CHAFFETZ. No. I want to know what percentage.

Mr. HUPPE. What percentage of the overall revenues?

Mr. CHAFFETZ. Yes. Yeah.

Mr. HUPPE. Pandora, they pay a substantial portion of our revenues.

Mr. CHAFFETZ. I want to know a percentage. You are here testifying before Congress. Don't tell me you don't have permission from your mom. Tell me what the number is.

Mr. HUPPE. Well, with all due respect, Mr. Chaffetz, my mom is not here today.

Mr. CHAFFETZ. And I am, and I want to know what percentage—

Mr. HUPPE. Of the current, based on numbers that I have most recently seen, Pandora, of Internet revenues or overall revenues to SoundExchange?

Mr. CHAFFETZ. What?

Mr. HUPPE. Are you asking overall revenues or Internet revenues, Mr. Chaffetz?

Mr. CHAFFETZ. Based on that chart that you put up there. You used a chart earlier.

Mr. HUPPE. I used a chart that showed the growth of services.

Mr. CHAFFETZ. Let us get both numbers.

Mr. HUPPE. Roughly a third. Somewhere between a third and a half of our revenue is from Pandora.

Mr. CHAFFETZ. Overall. What about from just the Internet portion?

Mr. HUPPE. Just the Internet? They are in the neighborhood of 60 to 70 percent.

Mr. CHAFFETZ. Thank you.

Do you feel the 801(b) standard is working when you determine what record labels base songwriters; is that the right standard, is that working?

Mr. HUPPE. You are referring to the 115 standard, Congressman?

Mr. CHAFFETZ. Yes. On how record labels pay songwriters, does the 801(b) standard work?

Mr. HUPPE. I think the best standard that everyone should follow—and it is my understanding that the record labels, if it is part of a broader solution involving comprehensive reform like has been discussed here multiple times today, I believe the record labels are willing to play by the same rules as everybody else.

Mr. CHAFFETZ. Well, we will have to further explore that.

Mr. Jam, as you know, currently the amount SoundExchange receives for any given recording played by an Internet radio station, generally 50 percent goes to the copyright holder, which is usually the record label; 45 percent goes to the artist; and 5 percent is set

aside for background and session musicians. Do you think that the majority of that should go to the copyright holder, essentially the record label, or should the artist get more?

Mr. JAM. Well, let me hit my button here. Sorry about that. I guess I feel that, first of all, 50 percent for the compulsory rate is fair because it—

Mr. CHAFFETZ. So you are not suggesting that artists should get the majority of the revenue.

Mr. JAM. I don't think I am suggesting anything yet because I had only started talking. I believe that the 50 percent is the correct—as the rate the court has set, that is the correct way to go.

Mr. CHAFFETZ. I am sorry, I only have got 5 minutes. I have to keep going. If you like the way the rates are set, I accept that, and let me move on.

Mr. Kennedy, it is obvious from the part of the argument you just need to pay more. You are not paying enough. I would like to you address that.

Maybe I should actually start with Mr. Pakman here. Why aren't more companies going into this? One of the things that is disturbing is MTV, Rolling Stone, Microsoft, Yahoo, AOL, they all tried to get into this business and couldn't make it work. And the argument is, well, these guys need to pay more; they just need to pay more. Why don't they just go out and charge? I mean, obviously there is a marketplace, according to the argument on this side of table. The argument is that they are just not charging enough. Their ad sales team isn't good enough. How do you view that?

Mr. PAKMAN. Congressman, we don't have a market here. We have very few willing sellers, huge amount of concentrated power, and we have almost no buyers. We have only one large stand-alone company in Internet radio, and we have plenty of other players who are in digital music, but they subsidize digital music with profits from elsewhere in their business. In a sense they use music as loss leaders.

We want an ecosystem where we have hundreds or thousands of participants, licensees offering music services, Internet radio and others.

Mr. CHAFFETZ. I'm sorry, my yellow light is already on. I got to keep going. Mr. Kennedy, can you address that please.

Mr. KENNEDY. I think the evidence is that Pandora monetizes Internet radio better than any other entity based on all of the public information that I've seen. This is not a Pandora-specific issue. The issue is that at 7 percent of all radio listening in the U.S., we're paying a quarter of a billion dollars. That if the CRB rates were applied to all music radio listening in this country, the rates due would be over \$4 billion.

Mr. CHAFFETZ. Sorry to interrupt you right there, but based on what happened in your last experience, what percentage of your revenue would have had to be paid out in royalties?

Mr. KENNEDY. If the CRB ruling in 2007 were let to stand, we would have to pay more than 100 percent of our revenue in royalties and would have run out of business.

Mr. CHAFFETZ. Mr. Chairman, as I yield back, I believe that the 801(b) standard, what this bill is suggesting that we would move

toward, would be the more fair opportunity for those to have this discussion and take into account all of the factors that are out there, not just cherry-picking, some selected deals in order to convince some judges out there, I really do believe it can actually get to that standard.

So this is the beginning of this, Mr. Chairman. I appreciate the discussion here, but I hope that this will continue to bear fruit because Internet radio should be thriving far and above and beyond just Pandora.

Mr. HUPPE. Mr. Chairman, may I respond to that?

Mr. GOODLATTE. Yes. The gentleman's time is expired but we'll allow you to respond.

Mr. HUPPE. Thank you, Mr. Chairman. There's been much said about Pandora and the percentage of revenue that they pay. And what I think it's important for everyone to understand is that percentage of revenue can be a very misleading quote. The only person that has control over Mr. Kennedy's revenue in this room is Mr. Kennedy. Pandora has focused over the past several years and they've made a conscious business decision, and we don't fault them for it, but it's a business decision that was made to focus on growing their user base, growing their audience, growing their brand, growing the hype. They've done a very good job of it and we congratulate them.

They had an IPO last year. But the fact that they have done things other than focus on revenue is a very important part of this discussion. A few years ago, they would charge heavy users who went—

Mr. CHAFFETZ. Can you point to anybody else that is successful? Point to one. Just name one.

Mr. HUPPE. It depends what you mean by success, Mr. Chaffetz.

Mr. CHAFFETZ. Revenue, money, dollars, stock.

Mr. HUPPE. There are many companies who do not—

Mr. CHAFFETZ. Name one.

Mr. HUPPE. There are many companies who do not start off in a revenue positive situation.

Mr. CHAFFETZ. I know, because there's none. Name one.

Mr. HUPPE. We are—

Mr. CHAFFETZ. It's been out there for awhile. The Internet is thriving. I think it's going to be around for awhile. Name one that is successful under this model.

Mr. HUPPE. If you look to success as a measure of investment, \$1.5 billion market cap of Pandora, commercial—

Mr. CHAFFETZ. Outside of Pandora, name one other company that's successful.

Mr. NADLER. Mr. Chairman.

Mr. GOODLATTE. The time of the gentleman has expired. For what purpose does the gentleman from New York take recognition?

Mr. NADLER. I just ask that Mr. Huppe was answering a question and then Mr. Chaffetz came in with some other question. I would like to hear the end of the answer he was giving. It was very fascinating as far as he got.

Mr. GOODLATTE. We're going to let him very briefly answer that, and then we are going to move on to the gentleman from Florida who has been waiting patiently to ask his questions.

Mr. HUPPE. Thank you, Mr. Chairman. As an example of Pandora's focus on users over revenue, a few years ago for heavy users who went over 40 hours a month they would charge \$0.99 if a heavy user went over 40 hours a month. There came a point where they stopped doing that.

Mr. CHAFFETZ. Mr. Chairman, he's not answering the question.

Mr. GOODLATTE. I know, but we all exceeded the amount of time, so we're going to discontinue and we'll allow the gentleman from Florida to follow up on that if he wishes to. But the Chair recognizes Mr. Deutch for 5 minutes.

Mr. DEUTCH. Thank you, Mr. Chairman. I choose not to follow up on that. Here's what I would like to do. Mr. Kennedy, you and I have spoken before about your service. I've suggested to you that there may be no one in Congress who spends as much time enjoying your service as I do. I'm a huge fan. What I've learned in preparation of this hearing that was the most troubling to me though, quite frankly, is that for all of the discussion about percentage of revenue, the number, and I would like to give you the chance to talk about this, but the number that there seems to be general agreement on, that listeners like me wind up contributing to the artists is \$4 per listener, \$4 per listener goes to the artist. And that according to some of the estimates that we've seen, the recording industry has some and there are some others out there, that number under this legislation would be reduced to less than \$0.70.

So I guess I'm troubled by that. And I would actually get back to Mr. Chaffetz's line of questions here, and the exchange that was taking place. I understand that there's this discussion about revenue, but the fact is that there is some control that you have over revenue. And why is it that instead of—why is it that this entire discussion is about a percentage of your current revenue compared to others' percentage of current revenue instead of a discussion of how you monetize, and the fact that the results of the way you monetize while successful generate \$4 per listener for all the time I listen to be reduced under this bill to less than \$0.70.

Mr. KENNEDY. Mr. Deutch, part of what has, I think, complicated this debate is to talk about the royalties paid by fractional pieces; how much per song, how much per user. The fact of the matter is that we'll pay SoundExchange this year almost a quarter of a billion dollars.

Mr. DEUTCH. We don't dispute that you're paying a lot of money. I'm just looking at how that actually translates to what artists are paid. And as a per listener, on a per listener basis.

Mr. KENNEDY. And I think for perspective we pay that quarter billion dollars for approximately 7 percent of radio usage in this country. A study by a well-respected music business professor at Washington Lee University said what if we took the CRB rates and applied them to every song played on the radio across the U.S. The results in payments due under the CRB willing buyer/willing seller are estimated by this professor to be over \$4 billion. And for perspective it's important to know the entire revenue of the recording industry in this country is that same zone.

Mr. DEUTCH. I understand that. I'm just asking whether there are other ways to monetize what you do. Well, let me just turn to Mr. Reese who has figured this out with the benefit of not having

to pay the performers at all. But Mr. Reese, you said that—you spoke earlier in your testimony about the fact that there would be a—I want to make sure that I get this right. I mean, you talked about broadcast radio being always free and available all the time, and you worried about—you warned against this performance tax that may be coming. And I just wanted to clear one thing up there. On your stations that are talk radio stations, you pay the hosts, right? And on the stations that are talk radio stations that don't have local hosts but have syndicated hosts who aren't in the studio but your producers there are producing the show, they still, those hosts still get paid as well.

So I guess what I'm trying to figure out is, as Mr. Kennedy and Pandora grapples with how to make it work on that side, here—why is it that you would characterize as a performance tax a payment that you make regularly in very large amounts of money to talk show hosts all throughout the country?

Mr. REESE. We are more than a music service. We are not Pandora, we are not any other webcaster with AM/FM radio. We are local, we are produced. We're more than just someone who pushes a button randomly and music comes out. Music comes out, with all due respect to the brilliant algorithms that Mr. Kennedy's people have developed. There's a lot more involved in this. There has been a lot of support here for a negotiated resolution of this problem. We need a solution where everybody thrives. On the webcast side only, which is what this legislation addresses, there's a system in which one side doesn't have a way to make a profit. We haven't demonstrated it yet, and a number of people have tried. We haven't been able to sustain a profitable business on the webcasting piece. And this piece of it needs a different solution. Ideally, a negotiated solution.

Mr. DEUTCH. I understand. I hope this is the start, as Mr. Conyers said, I hope this is the start of our discussion. But the one question I'm just trying to figure out is, and Mr. Chairman, this will be my last question, if you could just explain to me, and I'm not trying to be flip, I want to understand, the difference between your station that pays an awful lot of money for Rush Limbaugh's broadcast to Rush Limbaugh, and the station that plays Rihanna many, many times an hour, but doesn't pay her anything, can you just explain that to me?

Mr. REESE. We are paying the disk jockey who is introducing Rihanna and is helping her label sell lots and lots of music over the year. So again, it's not just the musician who's involved here. I understand your question. It is an issue that has been addressed and continues to be addressed. It's a very complicated issue. It lends itself best to private negotiation. And we're beginning to see that. We believe that's a better solution than a mandated solution on a one-size-fits-all basis.

Mr. GOODLATTE. Thank you, Mr. Reese. The time of the gentleman has expired. And the Chair recognizes the gentleman from New York for 5 minutes, Mr. Nadler.

Mr. NADLER. Thank you, Mr. Chairman. Let me say first of all, just following up on the gentleman from Florida, I don't think it's a complicated question, I think it's a very simple question. People ought to be paid for their service. As far as I can tell performing

artists and over-the-air-radio are the only people in the United States or the world for that—well, slave labor in some other parts of the world, but only people in the United States who are not paid for their labor, period. And to me, that's very simple. I believe basically in the free market, though some people may not think I do, but I do. I also believe in government intervention when strictly necessary, but when strictly necessary. And that brings the question of when it's strictly necessary. I don't understand why—I do think that the bill we're talking about here should not be enacted except perhaps as part of a larger global solution to the problems we're talking about because any of the specifics just increase the distortion of something that we keep distorting all the time.

With that in the background, let me ask a couple of specific questions. Mr. Kennedy, two questions. First of all, you've referenced several times a well-respected professor. Can you tell us who that is?

Mr. KENNEDY. Forgive me for not pronouncing his last prior. His name is David Touves, T-O-U-V-E-S.

Mr. NADLER. And where is he?

Mr. KENNEDY. A longstanding business professor at Washington and Lee University.

Mr. NADLER. Washington and Lee. Thank you. Secondly, as Mr. Huppe points out in his testimony, the founder of Pandora, who I think is your predecessor, said only 3 years ago in July of 2009 after the private negotiations on rates concluded that "Pandora is finally on safe ground with a long-term agreement for survivability royalty rate—for survivable royalty rates. This ensures that Pandora will continue streaming music for many years to come." Now you're saying the rates are too high. Are we going to have to change the law every time the CRB decides a rate under the law that is not to your liking or to the Internet community radio's liking? Three years ago you said this would be fine for a long time, and now you're back and saying we got to change the law.

Mr. KENNEDY. Yes. And I would encourage you to read that entire—

Mr. NADLER. Yes what? Yes, we have to change the law every time you don't like the ruling from the CRB?

Mr. KENNEDY. We truly want to get Congress out of this business. And I think all of us who run businesses would like to spend our time running businesses. But there's unfinished business here. And I would encourage you to read that full blog post by Tim Westergren following the settlement in 2009.

Mr. NADLER. But my real question is, without going into another long discussion here, 3 years ago, the head of Pandora said after the rate setting, we're finally on clear ground, it's going to take us for a long time, this ensures Pandora will continue streaming music for many years to come. The implication was Congress can relax, forget about it, it solved the problem for a long time. Now it's 3 years.

Mr. KENNEDY. In the very same posting, first of all, that agreement expires in 2015. We are fully prepared and are living with that—

Mr. NADLER. So in other words when you—excuse me. So when your predecessor 3 years ago said Pandora continues streaming music for many years to come, he was talking about for 6 years?

Mr. KENNEDY. Yes.

Mr. NADLER. Okay.

Mr. KENNEDY. In one sense he was talking about the prospect of going out of business. It's also very important, in a subsequent paragraph, Tim said, the system remains fundamentally unfair.

Mr. NADLER. Okay. Fair enough. Secondly, let me ask Mr. Huppe. At \$4 a year to a recording artist, which seems a ridiculous figure, but if it's only \$4 a year why are royalty payments 50 percent of their revenues?

Mr. HUPPE. And yes, actually, Congressman, it's \$4 to everybody. Only half of that goes to the artist side. The other half goes to copyright owners. Two dollars goes to the artist side.

Mr. NADLER. So even more so, why is it—

Mr. HUPPE. And the reason that it is such a big percentage of the revenue is, as I mentioned, Pandora has made a very conscious business decision. They could do lots of things to monetize more than they do.

Mr. NADLER. Okay. So the answer is they should be looking more at the revenue side?

Mr. HUPPE. The revenue side would definitely change that ratio, yes.

Mr. NADLER. Thank you. I don't want to rush, but I have more questions. Finally to Mr. Eisenach.

Professor Eisenach, the Internet community says it would like Congress to change the rate standard it faces from willing buyer/willing seller to the factors found in section 801(b). In fact, the Chaffetz bill would use the factors in 801(b) but then they add additional factors to the current 801(b) law. First of all, what is our evidence of the kind of rate the CRB has set in the past using the 801(b) standard?

Mr. EISENACH. Well, in SDARS I proceeding, for example, the Copyright Royalty Board established that its best estimates of the appropriate rate, and they were setting it on the basis of percentage of revenues, was 13 percent. And then they came back, they considered the 801(b), the fourth standard in particular, the disruption standard, and decided that, in fact, the correct standard was 7 percent, so they cut it about in half.

Mr. NADLER. I have two quick questions. Well, I'll make it one last one. If the CRB interprets 801(b) as compelling a below market rate, what will likely happen to the royalties received by artists under H.R. 6480 which uses a version of this standard?

Mr. EISENACH. As referred today, half of the royalties paid under the compulsory license go to the artist, so I think that's a good estimate. They would lose half of what their—half of whatever the impact was.

Now, on the question of what would that be, if you just—a lot of things happen when you change prices. Let me just say it's very important, you're hearing two numbers here. You're hearing cost as a percentage of revenues. That's not a number that economists look at when they think about how competitive is a market or what are people paying, right? The only thing you've heard today that ap-

proximates a price is \$4 per year. That's a price. The price per play which that is based on, that's a price. Now, when you start changing prices, which is what would happen, you would end up with a lower price, a lot of things can move around. But if you simply take the status quo, other things equal, and do the math, rates would go down by—revenues would go down by 85 percent.

Mr. KENNEDY. Can I answer just briefly?

Mr. GOODLATTE. Actually, we are running very low on time and neither the Ranking Member or the Chairman have asked any questions yet, so the gentleman's time has expired.

Mr. NADLER. Thank you. I yield back.

Mr. GOODLATTE. And the Chair recognizes the gentleman from North Carolina, Mr. Watt, for his questions.

Mr. WATT. Thank you, Mr. Chairman. And it's been an interesting hearing, a lot of different concepts discussed. The one I'm kind of fascinated with is the one that Mr. Reese seems to support, which is this free market solution. And I want to kind of go at that, what that really means. Under free market solution, I take it we would do away with a compulsory license, and you would have to go and negotiate with every artist for the playing of their music. And if you played their music, you would be subjected to litigation for playing it.

And so I'm trying to figure out what this free market system is that you are talking about. If you wanted to play Mr. Jam's music, you had no compulsory license, you got to go find Mr. Jam because you'd like his music to play on your station like you go and find your talk artist. Maybe you like Beyoncé for awhile so you will contract with her for a whole year. You got to pay her. If you like her and you don't go and track her down and negotiate with her whatever the rates are, she sues you when you play her music and you're in litigation forever.

That's the free market we're talking about? Or that is assuming we just passed a law that recognizes a performance right. We don't do anything else. We don't do anything other than say performers have a right to be paid for their music just like everybody else has the right to be paid for whatever they produce. Is that the free market that you're talking about, Mr. Reese?

Mr. REESE. Well, there are a lot of nuances to your question.

Mr. WATT. A lot of nuances to my question, but that's the free market, I take it. Let me just ask the bottom line question. Would you accept that free market concept in that way? Would that be a successful deal for all of the stations?

Mr. REESE. What seems to be beginning to work, Mr. Watt, is in the current context of a compulsory license record labels and—

Mr. WATT. So you've done away with the free market because you've created a compulsory license?

Mr. REESE. You've also created a right that doesn't exist as well.

Mr. WATT. Okay. We don't do anything. We don't even recognize a performer's right. So when you use somebody's music, you get sued. Is that a world that you think would be successful for the broadcast industry?

Mr. REESE. What seems to be working, beginning to work here is in the context, in the current world in which we exist, record la-

bels and broadcasters seem to be beginning to find a solution here that works for both sides.

Mr. WATT. I understand that, I do recognize that.

Mr. REESE. We are not supportive of a creation of a new right, we're also not supportive of undoing much of what we've got so far.

Mr. WATT. That was really the question I was asking. Mr. Pakman, you've been, since you've testified, left out of most of the questions and answers. How would you go about monetizing the rights that Mr. Kennedy has, other than paying for them through the musicians taking a hit?

Mr. PAKMAN. I think Pandora is doing a fine job of exploiting the two business models available to it.

Mr. WATT. My question is are there some revenue sources that Pandora could access to monetize their business to make it more viable? That's the question I'm asking. If everything else was great are there some other revenue sources they could access?

Mr. PAKMAN. I believe the only two available to it are to ask its users to pay and to ask brands to pay, and that they ask both of them to pay. So I believe they're pursuing the two business models available to them.

Mr. WATT. Mr. Eisenach, you seem to disagree with that.

Mr. EISENACH. And very briefly, two points. First of all, there's a lot of entry going on in this marketplace. Pandora just raised 50—excuse me, Spotify just raised \$50 million for Goldman Sachs who are no dummies and would not be doing that if they didn't think there were profits to be made. And veterans of Skype have just entered this market. Apple is considering entering this market. They all think they're going to make money.

Mr. WATT. I understand that. I'm trying to find out how you monetize this other than on the backs of musicians.

Mr. EISENACH. Pandora is the fifth largest wireless on-line ad network in the world behind companies like Google and Facebook, just behind them, and fast and growing, faster than any of them. That's another source of revenue, which is all of the information that they are accumulating about their listeners and the ability to sell advertising not only—to sell that information to other users.

Mr. WATT. Okay. All right. Well, I'm out of time. I'm just theorizing here. I mean, this is something I proposed the last time we had this discussion about performance rights. Let's just do a performance right. If you don't like the rate, let the market take care of it. I believe in the free market. Lawyers believe in litigation. I mean, you know. There's some benefits that we're providing here to all parties, and it just seems to me that everybody needs to get a grip here and sit down and try to work this out rather than trying to nibble around the edges of it. I don't think we can solve this problem by dealing with 7 to 10 percent of the industry. We got to be dealing with the entire package here, otherwise I personally don't have much interest in it.

Mr. KENNEDY. Mr. Chairman, may I have a minute to respond?

Mr. GOODLATTE. Actually, we are very low on time, so I'm going to recognize the gentleman from Georgia, Mr. Johnson, for 5 minutes.

Mr. JOHNSON. Thank you. Mr. Eisenach, in your written testimony, you argue that market-based rates result in an efficient sys-

tem that maximizes consumer welfare, and yet there is testimony that the market is anticompetitive due to a small number of competitors that have disproportionate influence over music licensing. If you would give us a short explanation of that and also, or an example of that, and also tell us whether or not the marketplace is freely functioning or is it too complex, calculated or closely controlled?

Mr. EISENACH. Well, first of all, I would note that the Federal Trade Commission just as recently as September approved a major merger between two of the largest, two of the four largest record labels, and did so saying that there was no market power issues to be concerned about in approving that merger. So the current Federal Trade Commission, I think, if they thought there were market power issues on that side they would have said so. On the other side of the market, Pandora brags, or states, "brags" isn't fair, we should be proud of the fact that it has 69 percent of the market for online radio. So who is the dominant firm if we're going to simply look at market shares? It is not obvious which is which. Now in all markets like this, you have firms with large market shares. That's how they work, and the way they're likely to work in the future. The battles between these firms over sharing the value that's created among them are always heated battles, and that's what you're seeing here. The question is should that battle take place in a hearing room or should they take place in a negotiation room someplace probably in Silicon Valley.

Mr. JOHNSON. Let me ask this question of you, sir, since we are on the subject of competitiveness. The bill contains certain activities by copyright owners. It targets those activities as per se violations, but would permit webcasters to engage in the same types of communications. Can you elaborate on that for us?

Mr. EISENACH. Just very briefly. When you establish a system like the one we have of compulsory licenses, you have bargaining agents by the nature of the institutional arrangements involved. And so the paper that I submitted I go through a long list of things that are in IRFA, the proposed legislation, which attempt to tilt the playing field. And it's, I think, a very kind of bold face attempt to simply gain the upper hand.

Mr. JOHNSON. Let me ask Mr. Huppe also on that issue.

Mr. HUPPE. Thank you, Congressman. It's important to be able—what SoundExchange does, for instance. When we administer this license, this is the job we've been selected to do. And part of what we have to do when we administer that license is educate our side of the table and let people know what's going on with the statute. It's very important to remember that when the CRB sets a rate it is binding on all record companies. It forces them to surrender their property at the rate the CRB sets. And I would note there's no such similar obligation on the other side. It doesn't bind the webcasters to do anything. It binds the record companies.

So it's not only the right thing to do. We believe it's our duty to work with them, talk to them, educate them about what's going on and when we go to the CRB, represent them on their behalf. And some of the language in the bill, which is one-sided directed our way, is troubling in its restrictions.

Mr. JOHNSON. Thank you. Let me ask Mr. Reese. Mr. Reese, in 1998, we responded to the rise of satellite and digital technologies by amending the Copyright Act to create a performance right, but exempted terrestrial broadcasters from paying royalties for this right. The rationale for this exemption was that broadcasters and sound recording owners enjoy a mutually beneficial relationship where broadcasters promotion and increased exposure of music benefit sound recording owners through increased sales, tours and other sources of income. Has that relationship between the broadcasters and the sound recording owners changed?

Mr. REESE. I don't believe that mutually beneficial relationship that was talked about in 1998 has changed. And that is indicated by the efforts the recording industry goes to with the radio industry to continue to encourage us to play their music, even though they're not getting paid for that performance directly.

Mr. JOHNSON. Do you believe that it's fair to both artists and owners of sound recordings, and it's fair to all providers of music or publishers of those sound recordings, do you think it's fair for there to be some discrimination between any of those platforms or artists?

So in other words, what I'm saying is I believe that we should treat artists fairly across the spectrum regardless of what medium or what platform we're on, and we should also treat all particular phases of a platform equally as well. Do you believe that that is true?

Mr. GOODLATTE. I hate to interrupt the gentleman from Georgia to say that's a great question. The answer is going to have to be in writing. And because the time has expired all of my questions will be submitted to the members of the panel in writing as well. Both the Republican Conference and Democratic Conference have business that started at 2 p.m. And I regret that we have to cut the hearing short, but I thank you all for your contribution. This has been a very good start to discussing a very important issue.

Without objection, all Members will have 5 legislative days to submit to the Chair additional written questions for the witnesses which we will forward and ask the witnesses to respond as promptly as they can, so their answers may be made a part of the record. Without objection, all Members will have 5 legislative days to submit any additional materials for inclusion in the record. And with that I want to again thank our witnesses for their contribution today, and the hearing is adjourned.

[Whereupon, at 2:09 p.m., the Subcommittee was adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE HEARING RECORD

Prepared Statement of the Honorable John Conyers, Jr., a Representative in Congress from the State of Michigan, Ranking Member, Committee on the Judiciary, and Member, Subcommittee on Intellectual Property, Competition, and the Internet

Today we examine various music licensing issues and will explore ways to improve the current music licensing system.

It is my understanding that this process will continue into the next Congress, which I strongly support.

The Internet has dramatically changed the way music is produced, marketed, and distributed. In particular, Internet radio has become a major source of music for many listeners.

In addition, technological developments have changed the ways by which artists are discovered. In past years, new artists and their songs were typically introduced via the radio.

Today, artists are discovered through a vast array of platforms, including blogs, YouTube videos, webcasts, satellite radio broadcasts, and even the artists' own websites.

In today's world, music is accessible to the public in whatever format is desired, at any time, and on demand.

As we discuss the various issues presented by these technological developments, it is essential that we also consider the potential impact that our decisions will have on songwriters and whether their entitlement to proper compensation is adversely affected by these decisions.

Among the issues we should address during today's hearing and the hearings we anticipate holding in the next Congress are the following.

To begin with, I am concerned that H.R. 6480, the "Internet Radio Fairness Act," may not actually improve the current system and that it could result in artists receiving less compensation.

The bill seeks to facilitate a process by which all digital music services would be judged by the same rate-setting standard.

The bill does this by changing the existing "willing buyer, willing seller" standard that Internet webcasters currently use to the 801(b) standard used for determining rates for satellite and cable television music channels.

As a result, H.R. 6480 would lower the royalty rate for Internet webcasters as well as lower the royalties that Internet webcasters would pay to artists by *more than 85 percent*.

Let me point out one obvious fact: musicians and singers across all musical genres depend on these royalties, which are often their only compensation for their work.

Not surprisingly, this explains why more than 125 artists have signed on to a letter expressing strong opposition to H.R. 6480.

It also explains why the bill is opposed by the AFL-CIO, NAACP, musicFirst Coalition, SAG-AFTRA and the American Association of Independent Music.

It is clear that we cannot ignore these serious concerns.

Another issue that must be examined is whether our efforts to improve the music licensing scheme will be, in fact, truly fair if it does not include performance rights for sound recordings.

As everyone here knows I am a strong supporter of artists and believe that the current compensation system on terrestrial radio—by which I mean AM and FM radio—is not fair to artists, musicians or the recording labels.

When we hear a song on the radio, the individual singing the lyrics receives *absolutely no compensation*.

To address this inequity, I introduced the “Performance Rights Act of 2009,” that would have created both an AM/FM performance right and set a new standard for digital services.

Every other platform for broadcast music—including satellite radio, cable radio, and Internet webcasters—pay a performance royalty. *Terrestrial radio is the only platform that does not pay this royalty.*

This exemption from paying a performance royalty to artists no longer makes any sense and unfairly deprives artists of the compensation they deserve for their work.

And, finally, the process for setting rates for music royalties should be inherently fair.

Some, however, claim that the current rates are too high.

The compulsory license for digital music radio services dates back to 1995 with the passage of the Digital Performance Right in Sound Recordings Act.

This Act allowed digital musical broadcasters—like cable and satellite services—to transmit sound recordings without asking permission or negotiating rates with rights holders. Instead, the rates would be set by statute.

In 1998, Congress granted Internet radio services permission to take advantage of this compulsory license, but established that a market-oriented “willing buyer, willing seller” would be put in place moving forward.

Some, however, allege that this standard is not fair.

Thus, our goal should be to examine the *bona fides* of these claims to ensure that our royalty system is, in fact, fair and competitive.

I look forward to working together with my colleagues to ensure that the music licensing process is fair and does not have unintended consequences that will harm artists.

ATTACHMENT

November 27, 2012

The Honorable Bob Goodlatte
Chairman
House Committee on the Judiciary
Subcommittee on Intellectual Property,
Competition, and the Internet
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Ben Quayle
Vice Chairman
House Committee on the Judiciary
Subcommittee on Intellectual Property,
Competition, and the Internet
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative,

The best economic outcomes result from private negotiations in the marketplace, free from government distortions and certainly free from government price controls. This is among the most fundamental principles of free markets. That's why believers in free markets seek to reduce, rather than increase, the government's role in markets and price-setting whenever possible.

Accordingly, on behalf of the undersigned organizations, we respectfully write to express our grave concerns about H.R. 6480, the misnamed "Internet Radio Fairness Act of 2012." This potentially disastrous bill would overturn existing voluntary "willing buyer/willing seller" agreements between webcasters such as Pandora and the music industry to establish royalty rates through 2015. Those agreements have provided the foundation for the successful Internet radio marketplace, which has witnessed exponential growth in services and audiences. In the past five years alone, the number of Internet radio services has blossomed from 855 to nearly 2,000, and their annual revenues have exploded as well.

In economic terms, H.R. 6480 would provide a government subsidy to a private interest in the form of a below-market royalty price distortion created by government. And it would be doing so largely for the benefit of Pandora, a company that raised \$235 million in an IPO and is currently valued around \$1.72 billion.

We congratulate Pandora and their competitors for their market success. This is not, however, by any means an industry in need of a "bailout."

Today, we are witnessing a proliferation of new business models for the distribution of digital content. Various players are attempting many varieties of business models in order to determine what works for consumers. This is an exciting demonstration of the vitality of free-markets at work, and it's too soon to even guess what the outcomes will be.

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Some business models incorporate greater degrees of reliance upon advertising, while others rely more heavily upon subscription fees and other sources of revenue. No two business models are alike, and we don't want them to be—we want wide experimentation with differing business models, so consumers and the marketplace will be the beneficiaries.

Because these differing business models vary to such a wide degree, it is inappropriate to compare royalty rates freely negotiated by differing business models to argue for inequity. Indeed, the differing details of the various business models is a strong argument for private negotiation and against government price and rate setting.

Yet Pandora is doing exactly that—using an over simplistic comparison between widely divergent business models to argue that they are paying too much, and they are demanding legislative relief in the form of H.R. 6480 from their freely negotiated royalty arrangements.

Pandora is free to choose which business model it pursues, and to adapt and modify its business model as the market dictates. But it should not be able to turn to Congress to intervene and reduce its cost structure in order to enhance or salvage a struggling business model.

Further, a bill designed to benefit a single company would seem to be not only an example of corporate welfare, but also a form of crony capitalism.

Proponents of H.R. 6480 claim that three cable and satellite radio companies that existed in 1995 were unfairly granted a “grandfather clause” below-market rate by Congressional legislation. While we do not necessarily agree with that assertion, a fair resolution would be to address the mandatory below-market rate granted to those entities in 1995, rather than create new price controls for the thousands of companies created in an open market since that date.

H.R. 6480 would represent an unwarranted governmental intrusion into a fledgling and thriving digital radio market, weakening of property rights, imposition of price controls, abrogation of existing and freely-negotiated contracts between independent parties, and rent-seeking by companies that are growing and thriving without the help of government distortion.

There are, of course, other offenses caused by H.R. 6480, not the least of which is fewer royalties being paid to the original musicians and creators of the raw material upon which Pandora is building its business.

And a comprehensive solution to this problem would have to address the most glaring inequity

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in the copyright royalty universe, the fact that terrestrial radio pays zero royalties to the artists whose music it plays.

Thank you very much for your attention to this important issue.

Sincerely,

Timothy Lee
Center for Individual Freedom

Eli Gold
The Harbour League

Mario Lopez
Hispanic Leadership Fund

Andrew Langer
Institute for Liberty

Tim Giovanetti
Institute for Policy Innovation

Judson Phillips
Tea Party Nation

cc: House Judiciary Committee Subcommittee on Intellectual Property, Competition, and
the Internet



**Prepared Statement of the Honorable Jared Polis, a Representative in
Congress from the State of Colorado**

I am pleased that the House Judiciary Subcommittee on Intellectual Property, Competition and the Internet is holding a hearing today on music licensing, and specifically discussing the Internet Radio Fairness Act, a bill sponsored by Representative Chaffetz and myself. I am thankful to Subcommittee Chairman Goodlatte and Ranking Member Watt for holding this hearing on this very important and timely issue.

The Internet Radio Fairness Act (IRFA) is a common-sense proposal to address the discriminatory and unfair royalty rates currently imposed on Internet radio. The premise of the bill is simple: put Internet radio under the same standard which is used to establish rates for their competitors in the satellite and cable radio industries.

In 1998, the Digital Millennium Copyright Act established the “willing buyer-willing seller standard now used by the Copyright Royalty Board (CRB) to set performance royalties for Internet radio. As time has shown, the “willing buyer-willing seller” approach is unworkable and has required Congressional intervention every time it has been applied. It assumes there is a competitive market for sound recording performance royalties when a true market has never existed. Under this broken royalty system, Internet radio providers pay exorbitant royalty rates: approximately half of their total revenues go to royalties. Without Congressional intervention, internet radio companies would be paying more than 100% of revenue and most would have shuttered their doors. In comparison, satellite radio will pay 7.5%, and cable radio will pay 15% in revenues in 2012.

Before coming to Congress, I launched several online companies, so I know the Internet’s power to launch new businesses and to create jobs. The existing standard has not only harmed the ability of Internet radio providers’ ability to grow and compete, it has prevented new entrants from entering the marketplace. Several large companies have attempted to enter the marketplace, but have failed because they can’t make a profit under the current royalty system.

Under this legislation, Internet radio would be judged under the more equitable 801(b) rate-setting standard, which sets forth four balanced objectives to maximize the availability of creative works to the public, provide copyright owners a fair return, and support the development of innovative technologies that offer copyrighted works to the public. This standard has been used for 30 years to determine copyright license fees, and is the same standard that satellite and cable radio currently enjoy. Applying this same standard would promote innovation, increase consumer choice, and generate economic growth.

The rate structure problems Internet radio faces are compounded by the fact that the laws governing the CRB provide few procedural protections for the parties. Current CRB proceeding rules do not allow copyright users to present all relevant evidence, such as marketplace agreements, which harms the judges’ ability to accurately determine the royalty rates. Moreover, the existing process to select CRB judges prevents adequate Congressional oversight, and has resulted in discriminatory rate decisions.

This bill attempts to address these problems by interjecting due process and fairness into the royalty rate structure. It adds procedural protections consistent with the Federal Rules of Civil Procedure and Federal Rules of Evidence, as appropriate, to further information-sharing between the parties, promote voluntary settlements, reduce discovery and litigation costs, and subject the CRB decisions to judicial review. It also calls for the appointment of judges by the president, with the advice and consent of the Senate, instead of by the Library of Congress.

Unfortunately, we have seen a pattern of misinformation from the other side about the underlying bill. For example, claims that the bill will cut rates by 85% are misleading. The bill does not set an actual rate, it sets a standard. The rate set by CRB if this bill passes is unknown, but the intent is to allow the CRB to set a sustainable rate to allow Internet radio to grow and flourish. Simply put, claims about an actual number at this point are purely hyperbole.

Also contrary to opponents’ claims, the premise of the IRFA is not about paying artists less, it’s about allowing Internet radio providers to thrive—resulting in more

exposure and more revenue for singers, songwriters, and record labels of all kinds. Further, allowing the industry to expand will spur further innovation and improve artists' ability to build a base of support and find new audiences.

As a co-sponsor of the Performance Rights Act, I share the concerns raised by many witnesses at this hearing that we need to address the broadcast radio problem. However, it is my belief that the Internet radio royalty structure is an entirely separate and distinct issue and the time for consideration of Internet radio rates is **now**. The CRB is set to begin the next rate-setting proceeding in 2015. Internet radio's potential must be unleashed now—not sometime in the future.

It is time for America's outdated laws to catch up with today's technology so we can foster even greater innovation and job creation—generating more opportunities for artists and radio competition—for the benefit of us all.



**Response to Questions for the Record from Joseph J. Kennedy,
Chairman and Chief Executive Officer, Pandora Media, Inc.**

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Questions Offered by Chairman Bob Goodlatte

1. *Over the long term, do you believe this legislation would result in higher or lower net royalty payments to performers and why?*

Response: Over the long term, we believe that this legislation will result in higher net royalty payments to performers. It will enable new webcasting services to enter the market and allow current services to invest and expand by adding more predictability and transparency into the rate-setting process. It will place webcasters under the same rate-setting standard, 801(b), enjoyed by satellite and cable radio providers, thereby eliminating the arbitrary distinction that currently exists between Internet-delivered transmissions and those delivered through means other than the Internet. It will also import standard Federal Rules of Civil Procedure and Federal Rules of Evidence into rate-setting proceedings to ensure that relevant evidence can be presented in an orderly and fair fashion.

2. *Is the failure of many Internet radio companies to turn a profit a result of a failure of those companies to adopt the right business models, a result of the rate setting standard, a combination of both, or due to other factors?*

Response: We concur with the statement of David Pakman: "The problem is simply that the rates available to internet radio companies under this compulsory license are too high. They frighten off investment capital, prevent great entrepreneurs from innovating, and kill off exciting attempts to bring great new music services to consumers. American entrepreneurship and innovation require vibrant markets unburdened by artificially high rate structures."

Questions Offered by Ranking Member Mel Watt

1. *At the hearing, you testified that the current system for licensing music was unsustainable. But in 2009, the founder of Pandora, Tim Westergren publically indicated that the company was "on safe ground" with "survivable royalty rates"?*
- When did you conclude that the current royalty rates are unsustainable?*
 - Were you aware of the purported problems with these royalty rates before your IPO in summer 2011? If not, what has changed?*

Response: The reference in this question is a partial and highly misleading use of quotations from a post on the Pandora Blog that Tim Westergren published in July 2009 after a two-year negotiation that followed the Copyright Royalty Board's 2007 decision which set rates that would have shuttered Pandora. An accurate representation of what was actually expressed in that blog post would have necessarily included the following line that comes later in the piece:

"The system as it stands today remains fundamentally unfair...to internet radio services like Pandora, which pay higher royalties than other forms of radio..."

Never has Pandora stated in any way that the terms of the Webcaster Settlement Act represented a fair solution. Establishing "survivable" royalties is not the goal of rate setting. It should

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be noted that the three largest webcasters at that time, AOL Radio, Yahoo! Launchcast and MSN, all abandoned their internet radio businesses as part of the aftermath of the 2007 CRB webcasting decision. Furthermore, it is important to note that Mr. Westergren's comment about a "long-term agreement for survivable royalty rates" specifically referred to the Webcaster Settlement Act that is due to expire at the end of 2015. Absent any legislative action, internet radio companies will once again enter a rate setting process under the demonstrably flawed willing buyer-willing seller standard.

Pandora disclosed the unfavorable nature of the current rates set by the Copyright Royalty Board, and the uncertainty inherent in the current rate-setting system to investors as part of its initial public offering.

2. *You stated in your written testimony that Pandora pays out 50% of its revenue in royalties. If you were able to sell more advertising, which is apparently very low compared to other free to the consumer music services, wouldn't the percentage of revenue paid out in royalties decline?*
- a. *What percentage of a music service's revenue should be devoted to music content? Is there a magic number?*

Response: The problems with the rate standard and process for setting internet radio royalty rates in the U.S. are fundamental and are not specific to any one internet radio service. The magnitude of the payments currently paid by Pandora, which represents just 7% of all radio listening in the U.S., are just one manifestation of these fundamental problems. In the year just now finishing, Pandora will have paid almost a quarter of a billion dollars in sound recording performance royalties. Pandora pays more in absolute dollars than any other radio company—AM/FM, satellite, cable or internet—in the world. In fact, Pandora pays more sound recording performance royalties than are paid by the entire radio industry (AM/FM, satellite, cable and Internet combined) in every other individual country in the world—so much more that Pandora's royalty payments actually exceed the amounts paid by all of the radio industries in the UK, France, Canada, and Australia combined. The purpose of the proposed legislation is not to set specific rates but rather to establish a rate standard and process that can consistently generate rates considered fair and reasonable to all parties. Doing so will ultimately benefit artists, innovators, and the tens of millions of Americans who cherish internet radio. The absence of significant investment in internet radio, particularly from the radio broadcasters for whom this represents an otherwise logical strategic priority, is unequivocal proof that the problem is not lack of sales execution. These broadcasters are mature advertising based businesses with massive national and local sales teams and sophisticated systems for optimizing revenue. They simply don't see an economic opportunity.

3. *Should a rate standard seek to minimize disruptive impact on industries? If so, why? Do you believe that market disruption facilitates growth and innovation? Please explain.*

Response: The rate standard set forth in the Copyright Act at 17 U.S.C. §801(b)(1) provides that judges shall set "reasonable terms and rates of royalty payments" to achieve four objectives:

(A) To maximize the availability of creative works to the public.

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(B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.

(C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.

(D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

This rate standard was first introduced in the Copyright Act of 1976 with the involvement and support of record labels, artists, music publishers and songwriters. It has been used since that time to guide the setting of rates that music labels and performing artists must pay to songwriters and publishers for the use of their musical works.

While the "willing buyer-willing seller" rate standard has consistently failed (virtually none of the Internet radio royalties paid to SoundExchange since its establishment have been paid pursuant to rates set by judges trying to use this standard), the 801(b) standard has consistently yielded results considered fair and reasonable by all parties involved. Copyright judges have clearly found the balance of considerations that this combination of four factors provide to be helpful. The 801(b) standard should become the standard for internet radio royalty determination.

4. *What is Pandora's current market cap?*

- a. *Is it true that top executives have cashed out \$35 million in company stock since your IPO?*
- b. *Will Pandora be a profitable and successful company without the changes in the law you are requesting?*

Response: The most up to date financial information about Pandora, including the compensation of its executives, is publicly available on the web, including at the SEC's website.

There are fundamental problems with the process and standards under which internet radio royalties are determined, as demonstrated by the need for Congressional intervention after each of Webcaster I and Webcaster II, which are not specific to any one internet radio service. The purpose of the proposed legislation is to establish a rate standard and process that can consistently generate rates considered fair and reasonable to all parties. Doing so will ultimately benefit artists, innovators, and the tens of millions of Americans who cherish internet radio. The severity of the rate imbalance is starkly illustrated by the lack of new investment in the category, most notably from the broadcasters for whom this would otherwise represent a natural strategic priority

5. *The Internet Radio Freedom Act (IRFA) eliminates the requirement that at least one copyright royalty judge has knowledge of economics and one has knowledge of copyright law. DiMA, your trade association, pressed for these requirements in 2004 as part of the overhaul of the process for setting*

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rates. An understanding of copyright and economics is central to rate proceedings before the Copyright Royalty Board (CRB). What has changed since 2004? How would a selection process that sanctions less knowledge of copyright and economics of the CRB judges improve the rate-setting process?

Response: The procedural proposals in IRFA reflect two major changes from 2004 to the present affecting the CRB and the webcasting industry. First, webcasting was still in its infancy in 2004. Significant legal issues remained undecided relating to the scope of the statutory license. Those questions now have been resolved by the Copyright Office in the course of past CRB proceedings and in cases before the federal courts. To the extent that any additional questions remain, the Copyright Office remains available to answer these questions for the CRB under IRFA. Second, the amount of royalty payments at stake was substantially lower than today, nearly a decade later. Where *sui generis* procedures sufficed for the relatively smaller royalty levels of a decade ago, today's royalty payments eclipse the amounts at stake in the vast majority of civil cases, including cases involving copyright. Fairness today therefore requires the more comprehensive procedural protections afforded under the Federal Rules of Civil Procedure and through experienced judges such as those sitting in federal district courts. Federal district court judges who do not have a professional history with economics or copyright law but who meet the criteria described in the Internet Radio Fairness Act often are called upon to consider economic principles and copyright theories in the cases that come before them. We believe that individuals who satisfy the criteria for Article III judges are fully capable of managing and adjudicating the rate-setting proceedings, as judges in the District Court for the Southern District of New York have done for several decades with respect to public performance royalties for musical works pursuant to the consent decrees under which ASCAP and BMI operate.

6. *Under the antitrust provisions of IRFA, certain activities by copyright owners are deemed as per se antitrust violations. However, potential collusive activities by webcasters are not proscribed. Thus, Pandora and other webcasters could presumably arrange boycott of any rates, but artists and labels would be prohibited from discussing appropriate rates.*
- What is the basis for this imbalance?*
 - The law currently allows agents to negotiate to make the process of reaching agreements easier and more efficient. Would the agreements under the Webcaster Settlement Acts that you have applauded been possible if IRFA were the law?*

Response: The sponsors of the legislation have indicated that they are looking at this language carefully as they redraft the legislation for introduction in the 113th Congress.

7. *In 2009, Mr. Westergren said the following: "The system as it stands today remains fundamentally unfair both to Internet radio services like Pandora, which pay higher royalties than other forms of radio, and to musical artists, who receive no compensation at all when their music is played on AM/FM radio. We, along with the artists whose music we play, strongly support the establishment of a level playing field, a truly fair system, as articulated in a new bill called the Performance Rights act (h>R. 848)." In July 2012, Professor John Villesnor, who supports lowering rates for Internet radio, addressed the disparities in music licensing in Forbes, and said the following:*

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So what should be done? To start, Congress should end the terrestrial performance royalty exemption. This would rectify a glaring inconsistency in American copyright law and would also bring American artists one important step closer to receiving overseas terrestrial broadcast royalties.

Do you agree with Professor Villesenor that Congress must first enact legislation mandating that terrestrial radio pay a performance royalty before addressing any perceived inequity among rates for digital transmissions?

Response: Pandora did support the Performance Rights Act of 2009 and we were deeply disappointed that, having done so, the RIAA and NAB failed to heed the request of Congressional leaders to work out a compromise that would resolve the decades old dispute over terrestrial radio royalties. The stark reality is that the process for setting Internet radio royalty rates for the 2016-2020 time period will begin in less than one year. The current rate standard and process for doing so have consistently failed. Since the enactment of the willing buyer-willing seller standard in 1998, every major rate determination adjudicated using this standard has required congressional intervention. Virtually none of the Internet radio royalties paid to SoundExchange have been paid pursuant to rates set by judges trying to use this standard. The issues that the Internet Radio Fairness Act addresses require urgent action – they cannot be held hostage to lack of progress on a royalty issue over which we have no control and on which the impacted parties have been unable to agree for decades.

8. *On September 21, 2012, Mr. Westergren wrote to subscribers that “The Internet Radio Fairness act will address this discrimination by extending to internet radio the same standard used to determine virtually all copyright rate-setting processes, including satellite and cable radio, allowing us to compete on a level playing field.” However, the IFRA does not adopt a standard for Internet radio that is identical to that governing cable and satellite radio. What is the purpose of justification for the changes to the 801(b) standard in IFRA?*

Response: The rate setting standard in the Internet Radio Fairness Act is the 801(b) standard. Any additional language is intended primarily to assure that various interpretations and conclusions that the Copyright Royalty Judges have made while operating under the willing buyer-willing seller standard are not applied while operating under the 801(b) standard.

Question Offered by Representative Howard Coble

1. *Did you engage in any formal dialogue with the membership organizations that represent artists (such as The Recording Academy, the American Federation of Musicians, or SAG-AFTRA) before seeking congressional intervention via the Internet Radio fairness Act? If so, please identify the individuals/organizations and discussions that you felt supported consensus and broadened support for the Internet Radio Fairness Act.*

Response: Throughout the development of the Performance Rights Act of 2009 and Congressional consideration of that bill we worked extensively with the members of the MusicFirst coalition. As part of that bill, this coalition of label and artist organizations supported changing the rate standard to a modified version of 801(b) for Internet radio. We did not engage in new formal discussions with the

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groups you mentioned prior to stating our support of the Internet Radio Fairness Act. Members of the broad based Coalition who support the Internet Radio Fairness Act include:

Abacast Inc.
 AccuRadio
 CCIA
 Clear Channel
 Consumer Electronics Association
 Digitally Imported
 Digital Media Association
 Digital Sound and Video
 Engine Advocacy
 HD103.com
 HD Radio Network
 Musera Radio
 National Religious Broadcasters Music License Committee
 Pandora
 PEARadio
 Radio Paradise
 Salem Communications
 Senzari
 Small Webcaster Alliance
 Triton Digital
 TruLocal Media
 WSUI online
 977 Music

Questions Offered by Representative Jason Chaffetz

1. *SoundExchange and Professor Eisenach both argue that the problem of you paying out over 50% of your revenues in royalty payments can be rectified by you modifying your business model and increasing your revenues, presumably by selling and running more ads, charging more for ads, or a combination of both. Can you discuss this?*

Response: There are fundamental problems with process and standards under which internet radio royalties are determined and are not specific to any one internet radio service. The magnitude of the payments currently paid by Pandora, which represents just 7% of all radio listening in the U.S., are just one manifestation of these fundamental problems. In the year just now finishing, Pandora will have paid almost a quarter of a billion dollars in sound recording performance royalties. Pandora pays more in absolute dollars than any other radio company—AM/FM, satellite, cable or internet—in the world. In fact, Pandora pays more sound recording performance royalties than are paid by the entire radio industry (AM/FM, satellite, cable and Internet combined) in every other individual country in the world—so much more that Pandora’s royalty payments actually exceed the amounts paid by all of the radio industries in the UK, France, Canada, and Australia combined. The purpose of the proposed legislation is not to set specific rates but rather to establish a rate standard and process that can

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consistently generate rates considered fair and reasonable to all parties. Doing so will ultimately benefit artists, innovators, and the tens of millions of Americans who cherish internet radio. The absence of significant investment in Internet radio, particularly from the broadcasters for whom this represents an otherwise logical strategic priority, is unequivocal proof that the problem is not lack of sales execution. These broadcasters are mature advertising based businesses with massive national and local sales teams and sophisticated systems for optimizing revenue. They simply don't see an economic opportunity.

2. *Several of the witnesses have compared the costs that Pandora pays for content to those paid by Netflix, iTunes and Spotify. However, these services are quite different than non-interactive radio like Pandora. Can you please talk about the differences in the business models and why comparing them isn't valid?*

Response: Pandora is fundamentally different from on-demand services such as Netflix, iTunes and Spotify in that Pandora does not provide specific content, either streams or downloads, in direct response to a consumer request for that specific content. Pandora is radio, where users can indicate a general preference for the kind of music they like, but cannot control what songs are played, or in what order. By contrast, on a service like Spotify, a user can hear any song they want, as many times as they want, on demand. It is effectively a "celestial jukebox." On-demand services are thus fundamentally substitutional as they function as an alternative to purchasing, while radio services are fundamentally promotional as they drive discovery and incremental commerce. This difference yields completely different royalty rates, and in turn completely different business models. On-demand services are generally subscription-based as consumers have greater willingness to pay for the value of on-demand listening, while radio is predominantly advertising-based, reflecting the lack of consumer willingness to pay for a radio service that does not offer on-demand capability. Pandora does offer an advertising-free subscription version, but the conversion rate is low, even at the very low price point of \$3/month.

Finally, the licensing structures are quite different. Pandora is eligible for the statutory license under Sections 112 and 114 of the Copyright Act. On-demand services are not eligible for this license and as a consequence must enter into direct deals with copyright owners. The statutory license provides that artists receive 50% of proceeds that SoundExchange collects for the performance of sound recordings. By contrast, 100% of the proceeds that on-demand services pay goes to record labels.

3. *Where would Pandora be right now if Congress had not stepped in and the original rates imposed by the CRB under the so called willing buyer, willing seller standard had been imposed? Response:* If forced to pay the rates determined by the CRB in 2007 Pandora would have had royalty costs greater than all of its revenue and would not have been able to continue operations.

Questions Offered by Ranking Member Mel Watt on behalf of Representative Jared Polis

1. *You mention in your testimony evidence that the record industry has actively worked to squash the development of the internet radio industry. Can you support that statement?*

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There are numerous examples. It is illustrative to quote the final report *written by the judges themselves* in the very first webcasting hearing: "Before negotiating its first agreement, RIAA developed a strategy to negotiate deals for the purpose of establishing a high benchmark for later use as precedent, in the event a CARP proceeding were necessary. The RIAA Negotiating Committee reached a determination as to what it viewed as the 'sweet spot' for the Section 114(f)(2) royalty, both on a percent-of-revenue basis and per-performance basis. It then proceeded to close only those deals (with the exception of Yahoo!) that would be in substantial conformity with that 'sweet spot.'

"Numerous internal documents from months of negotiations with many licensees confirm this consistent RIAA strategy." (From Webcasting I, CARP Report, February 20, 2002)

In addition, the RIAA successfully lobbied to change the 801(b) standard under the DPRA to the "willing buyer / willing seller" standard in the DMCA, even as it enjoyed the benefits of the 801(b) standard for making reproductions of musical works under the Section 115 compulsory license. In other words, the recording industry utilizes the traditional four-factor § 801(b) rate-setting standard when it is a licensee in proceedings to set songwriters' royalties, but successfully advocated for a different standard it felt would be more favorable to it when it is licensor in the Internet radio context.

2. *We have heard you say that play on Pandora translates to sales through purchases of downloads, increased concert attendance, etc. But can you quantify that spins on Pandora translate to sales? If so, how?*

Response: In September 2012, NPD Group, one of the largest and most respected research companies in the U.S., published results from its Q2 2012 survey of American consumers that addressed Pandora's impact on music purchases. This study was not commissioned by Pandora; rather, it is a syndicated study that NPD has run for many years and is subscribed to by many different companies in the music and entertainment industry. The sample size of the survey is over 4,000 and is structured to be representative of the entire U.S. Internet connected population age 13 or older. NPD's summary of its analysis highlights two major themes: first, that listening to Internet radio, including Pandora, is coming primarily at the expense of time spent listening to AM/FM; and, second, that the discovery that Pandora enables is leading to increased music purchasing. NPD's analysis specifically shows that people who listen to Pandora are more likely to purchase CDs and digital downloads than the rest of the U.S. population. The percentage of Pandora listeners who purchased a digital download in Q2 of this year was 32.8%, compared with the percentage of the rest of the U.S. population who purchased a digital download in Q2 of this year which was 12.9%. Similarly, the percentage of Pandora listeners who purchased a CD in Q2 of this year was 18.2%, compared with the percentage of the rest of the U.S. population who purchased a CD in Q2 of this year which was 10.1%. To summarize, Russ Crupnick, SVP NPD, citing NPD's Music Acquisition Monitor study said: "Overall music purchasing was down in the last year, while the average Pandora listener purchased 29% more music during the second quarter of 2012 compared with last year. Additionally, Pandora listeners' music acquisition came increasingly from legal purchases, while non-listeners showed a decline."

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3. *What kinds of improvements to Pandora could come about if your rates were lower? Are there innovative services that you would/could develop that would help artists build a base of support/fill concert halls that you can't because of the rates?*

Response: The percentage of Pandora's revenue that is spent on product development is lower than that of every other significant Internet company. If Pandora's royalty rates were lower, Pandora would certainly have greater financial flexibility to explore new product offerings that would further advance the company's long-standing objective to support artists and enable them to connect with audiences that might not otherwise discover their music through traditional radio services.

4. *Why shouldn't all forms of digital radio be put under the willing buyer standard?*

Response: The "willing buyer-willing seller" rate standard has consistently failed: virtually none of the Internet radio royalties paid to SoundExchange since its establishment in 1998 have been paid pursuant to rates set by judges trying to use this standard. By contrast, the 801(b) standard has consistently yielded results considered fair and reasonable by all parties involved. Copyright judges have clearly found the balance of considerations that its combination of four reasonability factors provide to be helpful. The 801(b) standard should become the standard for Internet radio royalty determination.

The 801(b) rate standard was first introduced in the Copyright Act of 1976 with the involvement and support of record labels, artists, music publishers and songwriters. It has been used since that time to guide the setting of rates that music labels and performing artists must pay to songwriters and publishers for the use of their musical works. Its use was expanded in 1995 to set rates that satellite and cable radio pay for the performance of sound recordings. It has never required Congressional intervention.

5. *You have a long history in the music business. Do you think if the standard were changed and rates lowered investment and innovation would flourish? Would that result in more services like Pandora, or better than Pandora? Would the pie ultimately grow?*

Response:

- We concur with the statement of David Pakman, venture capitalist at the large and well established firm, Venrock. "The problem is simply that the rates available to internet radio companies under this compulsory license are too high. They frighten off investment capital, prevent great entrepreneurs from innovating, and kill off exciting attempts to bring great new music services to consumers. American entrepreneurship and innovation require vibrant markets unburdened by artificially high rate structures. I am hopeful you will see through the rhetoric often employed in this debate and make sensible policy based on sound economics. I would like nothing more than to invest in the many entrepreneurs we have met who have great ideas about the future of music. With a sensible rate structure in place, our focus on this market could return."

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**Response to Questions for the Record from Bruce Reese,
President and Chief Executive Officer, Hubbard Radio, LLC**



**Hearing on
“Music Licensing Part One: Legislation in the
112th Congress”**

**United States House of Representatives
Committee on the Judiciary**

***Subcommittee on Intellectual
Property, Competition, and the Internet***

November 28, 2012

**Responses to Questions For the Record
of Bruce Reese
Hubbard Radio, LLC**

**On behalf of the National Association of
Broadcasters**

Questions Offered by Chairman Bob Goodlatte

1. *Over the long term, do you believe this legislation would result in higher or lower net royalty payments to performers and why?*

Answer: NAB continues to review the specific provisions contained in the Internet Radio Fairness Act, and to study the potential impact of the legislation on both webcasting rates themselves and royalty payments. Preliminarily though, I believe this legislation could certainly result in higher royalty payments to performers.

Performers are paid when their music is streamed over the web. All things being equal, the higher the number of entities that stream, the more performers' music will be played and the more those performers will collect in royalties. Unfortunately, today, the number of entities providing music streaming on the Internet remains relatively low, and the principal reason is the barrier imposed by high royalty rates. There is only one major pureplay webcaster in the United States – Pandora; and there remains a lack of interest on the part of many broadcasters in streaming their stations over the Internet.

Any reduction in royalty rates would, I believe, very likely lead to an increase in both pureplay and broadcast entrants into the streaming business. On the pureplay side in particular, even modest entry would result in a significant boost to competition. This increase in the number of streaming services would lead to increased song play over the Internet and, in turn, increased royalties, even if the per performance rate received by the artist is marginally lower.

2. *Is the failure of many Internet radio companies to turn a profit a result of a failure of those companies to adopt the right business models, a result of the rate setting standard, a combination of both, or due to other factors?*

Answer: As a representative of the broadcast industry, I can only speak to the experience of radio broadcasters that either stream their music over the Internet, or have attempted to stream their music over the Internet. The principal impediment to broadcasters' expansion into Internet radio is the unreasonably high cost of webcasting royalties. As I mentioned in my testimony before the Committee, regardless of the size of the broadcaster or its audience, the revenue that can be generated from streaming simply does not offset the costs. This imbalance is impeding the adoption and growth of Internet radio among many broadcasters. Such broadcasters consider streaming as not worth the investment, since it is nearly impossible for broadcasters' streaming revenue to exceed the associated costs and royalty payments. Because these rates change unpredictably with each rate-setting proceeding, radio broadcasters cannot make reliable projections regarding their future content acquisition costs.

3. *The new 801(b) standard proposed in the current bill requires that licensees receive a reasonable return on investment. Are you aware of any other federal law that requires a private sector company or industry to be guaranteed a reasonable return on investment? What, in your estimation, is a reasonable return for providing an online simulcast of a terrestrial broadcast? Why doesn't fairness require that federal law similarly guarantee sound recording copyright owners and the owners of musical compositions a reasonable return on investment?*

Answer: The Internet Radio Fairness Act, as introduced last Congress, instructs the Copyright Royalty Board to set rates that provide a reasonable return on investment for both parties in setting royalty rates, not just the licensee. The 801(b) standard explicitly instructs that royalties should be calculated to both afford the copyright owner a "fair return for his or her work," as well as providing the copyright user a "fair income under existing economic conditions." It is my understanding that this language in H.R. 6480 was intended to clarify and amplify how the original four factors of the 801(b) standard should be applied by the Copyright Royalty Judges, not to provide a new standard.

As applied to broadcasters that stream their stations over the Internet, such a return on investment varies significantly depending on geographic location, market characteristics such as population density and competition, and the nature of the technology used by the particular station.

In the terrestrial marketplace, broadcasters do provide musicians and record labels with a significant return on their investments in the form of free airtime and promotional value. These benefits result in increased record sales, concert ticket revenues and name recognition.

Questions Offered by Ranking Member Mel Watt

1. *With approximately 13 major radio conglomerates in the United States, thousands of labels, and millions of artists, is it realistic to argue that private deals are a workable alternative to a legally recognized terrestrial performance right?*
 - a. *How many private deals between artists and broadcasters have taken place so far this year?*
 - b. *Approximately how much time and legal expense is involved in negotiating and documenting private deals?*
 - c. *What leverage do artists have in negotiating private deals? Because there is no terrestrial performance right, are artists forced into a bargaining posture where they are compelled to relinquish their digital revenues in order to ink a deal?*

Answer: Yes, I believe it is realistic to believe that private, marketplace-based deals can work in the current marketplace. As with any new development in the market, we need to watch and evaluate how it impacts broadcasters, artists, and consumers; but I believe that private deals tailored to the needs of specific broadcast groups and specific groups of artists are proving to be mutually beneficial. The greater harm would be to create a one-size-fits-all terrestrial performance right that is modeled on the current disastrous digital framework; that is, inviting a government entity to set so-called "market-based" fees before a marketplace actually exists on which to base those fees.

I am aware of the private deals between record labels and broadcasters that have been reported in the press. As a trade association, NAB is not privy to private deals between its members that are not announced publicly, so I cannot speak to the number or nature of these deals. I also do not personally have any familiarity with the amount of time and legal expense involved in negotiating and documenting private deals.

It is my understanding that artists are not involved in negotiating private deals, unless they own the rights to their music. In most cases, artists transfer any ownership rights that they may have to their employers, the record labels. Only three record labels represent an overwhelming proportion of music artists in the United States. As a result, those labels possess tremendous bargaining power. Since I am not familiar with the terms of any private agreements between radio and record companies, I cannot speculate about the relative bargaining power between the specific labels and broadcast groups that have executed private deals. However, I can attest that the lack of a terrestrial performance right has not prevented record labels, artists, and the independent promoters that they hire from consistently and persistently urging radio stations to play their music - presumably because they perceive a benefit in the free exposure and promotion it provides.

2. *Are there other rationales beyond "promotional value" that broadcasters maintain provide legitimate basis for denying musicians and artists any compensation when their work is performed over terrestrial radio? Are the rationales that were articulated to justify the exemption still relevant today?*

Answer: For over 80 years, there has been a productive, interdependent relationship among American radio broadcasters and the music and recording industries. Record labels and performing artists profit from the free exposure provided by radio airplay, while local radio stations receive revenues from advertisers that purchase airtime to sell their products and services. By all indications, radio play is an important ingredient to the success of new albums and artistic performances. For example, according to research by Dr. James N. Dertouzos, music played on the radio affects music sales more than other factors, including local demographics such as age, race, geographical location and

income.¹ Dertouzos further found the impact estimated from exposure to music on the radio to be positive and significant across all music genres and radio formats. For example, a survey of rock music buyers found that half of those surveyed claim to be influenced by radio in making their music purchase choices.

Despite the many dramatic changes that have occurred in the digital music industry over the past decade, this interdependent relationship between radio and the music and recording industries remains fundamentally the same. In the ecosystem created by both the government and the free enterprise system to reward a mix of creative endeavor, ownership, distribution and promotion, radio has retained its essential character: it is local; it is free to listeners; and it is supported by commercial advertising. Local stations use on-air personalities and DJs to differentiate their programming, including by commenting on the music they play.

3. *In 2009, when the National Association of Broadcasters (NAB) appeared before this Committee, it asked that the Government Accountability Office (GAO) study the issue before the Performance Rights Act moved forward. Chairman Conyers requested that study and it has been completed. The GAO found that stations that play music make on average \$225,000 more than stations that do not, and that the promotional value of radio was “not clear” anymore. It also found that stations making over \$1.25 million would pay 90% of performance royalties, with or without the sliding scale, as former Chairman Conyers’ legislation proposed.*
 - a. *Does NAB dispute the finding of the GAO?*
 - b. *If promotional value is unclear or limited, what other basis is there for denying royalties to performers?*

Answer: To my knowledge, the GAO report did not actually find that the promotional value of radio was “not clear” anymore. To the contrary, although it reported several self-serving record industry statements regarding promotional value and found that there is “little empirical research” examining the impact of radio airplay on record and concert ticket sales, it also stated that “[s]takeholders from both the recording and broadcast radio industries told us that broadcast radio is the leading means by which listeners discover new music,” and recognized that the fact that record companies employ staff dedicated to the promotion of music to radio exemplifies “the importance of radio airplay to a sound recording.”

Indeed, in the new, fragmented world of the digital environment, in which millions of bands are vying for the attention of hundreds of millions of fans, on millions of websites, one of radio’s greatest strengths is that it cuts through the clutter. Local radio stations continue to provide new and emerging artists with needed exposure and access to a listening audience, not just with radio airplay, but also from on-air interviews and promotions of local concerts and new albums.

¹ Radio Airplay and the Recording Industry: An Economic Analysis by James N. Dertouzos, Ph.D., pp. 31, 32, rel. June 2008.

If that were not so, record labels, artists, and the independent promoters they hire would not continue to incessantly petition radio stations to play their music.

4. *Does Bonneville or the NAB support or oppose the IRFA in its current form? If not, please identify the changes you believe are necessary to secure your support?*²

Answer: NAB supports legislative efforts to establish fair webcast streaming rates and will work with the bill's sponsors and all interested parties to create broadcast radio streaming rates that promote new distribution platforms and new revenue streams that foster the future growth of music. However, NAB did not endorse any specific webcasting proposal introduced in the 112th Congress, including the Internet Radio Fairness Act. With over 8,500 members, NAB continues to internally discuss proposals for reducing the egregiously high webcasting rates, and looks forward to being part of a continued dialogue on the issue with this Congress.

Aside from high royalty rates, there are additional impediments to broadcasters' adoption of streaming that could be removed through additional reforms to the copyright law. These include the burdensome sound recording performance complement (*i.e.*, limitations in song play over certain time periods) and unrealistic reporting requirements that make compliance nearly impossible.

Additionally, section 114 requires other burdensome administrative requirements such as a prohibition on the publishing of an advanced program schedule, prohibitions on prior announcements, and the requirement that the station stream text of the title and artists contemporaneously with the public performance. The ephemeral license requirements are an additional concern, some of which is addressed in H.R. 6480.

Questions Offered by Representative Jason Chaffetz

1. *What is the number one reason more broadcasters don't have an Internet radio platform?*

Answer: The principal impediment to broadcast entry into Internet radio is high streaming rates. The rates today make it extremely difficult for most radio stations to make any profit. It really comes down to a basic cost/benefit analysis. It is virtually impossible for broadcasters' streaming revenue to exceed the associated costs and royalty payments. Those broadcasters who choose to webcast must subsidize their operations with other revenue streams. A change in the current rate

² I am currently President and CEO of Hubbard Radio, so I cannot answer on behalf of Bonneville. I previously worked for Bonneville from 1984-2011. In 2011, I joined Hubbard Radio following its acquisition of 13 radio stations from Bonneville.

structure would allow for greater innovation in the industry and wider use of webcasting among broadcasters, which would create a more vibrant competitive marketplace for radio streaming services. These developments, in turn, would benefit consumers.

2. *Would passage of this bill result in more broadcasters moving into Internet radio?*

Answer: NAB continues to review the specific proposals contained in the Internet Radio Fairness Act, and is still studying the potential market impact. Preliminarily, NAB believes that a reduction in webcasting royalty rates would likely increase the number of broadcasters that stream their stations on the Internet.

3. *I'm curious, what do you think of SoundExchange's argument that all Pandora needs to do to solve this problem is increase their revenues, presumably by selling and running more ads, charging more for ads, or a combination of both? It seems to me if Pandora's business model was so seriously flawed and it really was that simple to make money in this space someone would step in and do it – perhaps even a broadcaster. Please discuss.*

Answer: I cannot speculate on Pandora's decisions on whether and how to monetize certain aspects of its website. I can say that broadcasters have a long history of monetizing our stations, but have yet have to find a viable way to make our webcasting businesses profitable ones.

Questions Offered by Ranking Member Mel Watt on behalf of Representative Jared Polis

1. *Why shouldn't all forms of digital radio be put under the willing buyer standard?*

Answer: The streaming rates that have resulted from proceedings by the Copyright Royalty Board (CRB) under the so-called "willing buyer/willing seller" standard have been shown to be artificially inflated, to the detriment of both services that wish to stream and ultimately, the songwriters and performers who would benefit, in the form of increased exposure and royalties, from increased streaming. Over the years, the "willing buyer/willing seller" standard has increased royalty rates to levels that are suffocating radio streaming services, thereby dampening the growth of new competitive markets. For too long, the marketplace has been ordered to function based on a legal fiction – that of a functional "free market" – that has none of the rival market restraints and initiatives that drive products and services to set value. Instead, the formalistic rate-setting mechanism set up by the CRB in applying the "willing buyer/willing seller" construct ends up simply picking "winners" and "losers."

Broadcasters prefer abandoning the “willing buyer/willing seller” standard and transitioning to a standard closer in substance to the “801(b)” standard that is currently used to set sound recording performance royalty rates for other digital services. The 801(b) standard has effectively and efficiently balanced the interests of copyright owners, copyright users, and the public for decades, in various contexts and proceedings. In the ever-changing communications marketplace, balance is a key to achieving fair and equitable results for all parties in interest.

2. *You have a long history in the music business. Do you think if the standard were changed and rates were lowered investment and innovation would flourish? Would that result in more services like Pandora, or better than Pandora? Would the pie ultimately grow?*

Answer: The principal impediment to broadcast entry into the webcasting business is high streaming rates. A rate standard that would result in lower webcasting rates would likely lead additional radio broadcasters to begin streaming their terrestrial stations. That could mean higher revenues for artists whose songs would enjoy more radio airplay over the Internet and increased exposure to more listeners.



**Response to Questions for the Record from David B. Pakman,
Partner, Venrock**

United States House of Representatives
Committee on the Judiciary
Subcommittee on Intellectual Property, Competition and the Internet

Responses to Questions for the Record for Mr. David Pakman

Hearing on:

“Music Licensing Part One: Legislation in the 112th Congress”

Wednesday, November 28, 2012
11:30 am
2141 Rayburn House Office Building

RESPONSES

Responses to Questions Offered by Chairman Bob Goodlatte

1. Over the long term, do you believe this legislation would result in higher or lower net royalty payments to performers and why?

Because I believe the amount of entrepreneurial activity in digital music today is suppressed by the unattractive economics afforded music licensees, I believe this legislation would make the economics of Internet radio more conducive to building successful, stand-alone Internet music companies. That, in turn, would attract more companies to offer Internet radio services to consumers. More companies competing with Pandora and the handful of other companies left in the space would result in more royalties to performers. For these reasons, I believe this legislation would result in higher total net royalties to performers.

2. Is the failure of many Internet radio companies to turn a profit a result of a failure of those companies to adopt the right business models, a result of the rate setting standard, a combination of both, or do to other factors?

Internet radio companies fail to turn a profit because their cost of content is too high. Quite simply, the gross margin of Internet radio companies is unattractive and all but relegates these companies to be break-even businesses, at best.

3. You stated in your written testimony that the digital music business is one of the most perilous of all Internet businesses and that you're skeptical that profitable standalone businesses can be built. Can you describe the level and state of current investment in the digital music business? Has there been any growth over the past 10 years? If yes, does this suggest the current statutory licensing scheme has stimulated growth and investment?

Regretfully, I do not have data detailing the level and state of current investment in digital music. Anecdotally, I believe, compared to other tech markets such as social media, advertising technology, ecommerce and enterprise software, Internet music has been one of the most challenging market segments in which to raise venture capital. I do not have data indicating whether there has been growth over the past 10 years.

Responses to Questions Offered by Representative Jason Chaffetz

1. If this bill passed and was signed into law, what will the likely result be for the Internet radio ecosystem?

The economics of operating Internet radio companies would become more attractive and would afford entrepreneurs the chance to build profitable, standalone businesses. This would attract more entrepreneurs to Internet music and would allow Internet radio operators to have a viable business model. The result of more entrepreneurial activity would create more competition for Pandora and the hand full of others in the space and would result in more music being played and more royalties being generated.

2. In contrast, if the current procedures and standard remain in place, what will the likely result be for the Internet radio ecosystem?

Without changes, fewer and fewer standalone companies will remain in Internet radio and only companies prepared to have their online radio offerings produce little or no profit will be able to sustain Internet radio offerings.

3. What do you think of SoundExchange and Professor Eisenach's argument that all Pandora (and presumably other competitor companies that you might consider investing in) need to do to become profitable is increase their revenues, presumably by selling and running more ads, charging more for ads, or a combination of both? Can it really be that simple?

I do not believe that point of view has merit. Under the current licensing regime, the costs of music content are too high to allow standalone companies to operate with reasonable and sustainable profit margins. Pandora already employs both advertiser-supported and user-supported business models. Pandora (and others like them) already has plenty of incentive to maximize revenue and I believe does a fine job of selling ads to brands and selling the service to consumers.

**Responses to Questions Offered by Ranking Member Mel Watt on behalf of
Representative Jared Polis**

1. Why shouldn't all forms of digital radio be put under the willing buyer standard?

There are not enough buyers and sellers in the marketplace to establish appropriate market rates. I do believe all forms of digital radio should effectively have the same rates and no form of delivery should be advantaged over others.

2. You have a long history in the music business. Do you think if the standard were changed and rates were lowered investment and innovation would flourish? Would that result in more services like Pandora, or better than Pandora? Would the pie ultimately grow?

Yes, I believe that if the standard were changed and if rates were effectively lowered, it would be possible to build standalone, sustainable Internet radio companies. This would encourage more entrepreneurs and investors to innovate and invest in this space, creating more competition for Pandora. More companies operating successfully will increase total royalty payments to rights holders and the pie would ultimately grow.



**Response to Questions for the Record from Jimmy Jam, Chair Emeritus,
The Recording Academy, Record Producer, Songwriter, Recording Artist**

United States House of Representatives
Committee on the Judiciary
Subcommittee on Intellectual Property, Competition and the Internet

Hearing on:
“Music Licensing Part One: Legislation in the 112th Congress”
Response to Questions for the Record for Mr. Jimmy Jam

Questions Offered by Chairman Bob Goodlatte

1. *Over the long term, do you believe this legislation would result in higher or lower net royalty payments to performers and why?*

Response:

In the long term, the “Internet Radio Fairness Act” will lower the value of recorded music and cripple the ability of artists and musicians to make a living in their chosen profession. Proponents of the bill insist that it will expand the market for digital music, but they offer no evidence to support this vague and lofty promise. All we know for sure is that the legislation will force musicians to accept below-market compensation for their work, both now and in the future. If the bill were to accomplish the stated goal of its supporters, royalty payments by Internet radio could drop by as much as 85 percent.

2. *Is the failure of many Internet radio companies to turn a profit a result of a failure of those companies to adopt the right business models, a result of the rate setting standard, a combination of both, or due to other factors?*

Response:

I’m not a business analyst, but I strongly believe that any business model that depends on below market price-fixing by the government to be profitable is not a very good business model. As an entrepreneur and small business owner myself, I know that I will succeed or fail based on my own skill, creativity and hard work, and I can’t go ask Congress to rig the playing field in my favor. Recording artists should not be required to carry the burden of ensuring the profitability of Pandora or any other Internet radio company. Regardless of what business model an Internet radio company chooses to employ, the artists and professionals who create the music that Internet radio relies on should be compensated fairly.

Questions Offered by Ranking Member Mel Watt

1. *As a producer, recording artist and songwriter, what are your views on whether imposing a rate setting standard that mandates below market rates for webcasting services is in the long-term best interest of recording artists. Do you believe that below market rates would support the growth of internet radio and provide better opportunities for artists in the long run?*

Response:

I have seen no credible evidence that supports the view that lowering the royalty standard to create below-market rates will foster the growth of Internet radio. The only thing it will do with certainty is lower the royalty payments made to artists. Even worse, it will further lower the value of music, making it even harder for artists and musicians to make a living.

2. *During the hearing, there was testimony that there are up to 1800 radio services that take advantage of the compulsory license. To what do you attribute the fact that Pandora accounts for up to 60 to 70% of SoundExchange revenues? Is its presence as a monopoly in the internet radio space a significant factor? To the extent that the internet radio market has not grown at a faster pace, can that be attributed to the devaluation of music by Pandora's free to consumer business model with which new entrants into the market can't compete?*

Response:

To clarify, I believe that SoundExchange President Michael Huppe testified that Pandora's payments represented 60-70% of *Internet* radio royalties and between a third and a half of *all* royalties (SoundExchange collects royalties for other forms of digital radio as well as Internet radio.). That said, Pandora clearly has a large share of the Internet radio market, and while I am not an expert on the radio industry, I would like to see other services able to compete and see the type of success that Pandora has seen. While I do agree that free services like Pandora make it harder for premium services to succeed, I don't want to tell Pandora or anyone else how to run their business or how they should make money (through advertising, subscriptions, or otherwise). However, we cannot have a system in which Pandora is allowed to pay a below-market rate for music simply because it has chosen to offer a free, ad-supported service without first having a plan for how to pay a fair market rate for all of the music that it is delivering. It is up to Pandora to decide how to make money and pay fair market value for music; it is not up to the musicians to subsidize Pandora while it continues to grow.



**Response to Questions for the Record from Jeffrey A. Eisenach,
Managing Director and Principal, Navigant Economics**

United States House of Representatives
Committee on the Judiciary
Subcommittee on Intellectual Property, Competition and the Internet
Hearing on “Music Licensing Part One: Legislation in the 112th Congress”
November 28, 2012

Jeffrey A. Eisenach
Responses to Questions for the Record

- 1. Over the long term, do you believe this legislation would result in higher or lower net royalty payments to performers, and why?**

Answer: The Internet Radio Fairness Act (IRFA) is intended to, and would have the effect of significantly reducing royalty payments by webcasters for the digital sound performance right. Since performers receive a portion of these royalties, passage of IRFA would lower the payments received by performers.

- 2. Is the failure of many Internet radio companies to turn a profit a result of a failure of those companies to adopt the right business models, a result of the rate setting standard, a combination of both, or due to other factors?**

Answer: It is commonplace for start-up firms, especially Internet firms that experience both supply-side and demand-side economies of scale, to earn negative profits for extended periods of time, as they invest in customer acquisition and brand recognition. For such firms, the absence of short-run profits is not a sign of failure, but rather a conscious strategy of investing in growth in order to increase market penetration and achieve economies of scale ahead of their competitors, ultimately earning large profits. This phenomenon – not excessive royalties or failed business models – is the primary reason why many Internet radio companies are not currently reporting profits. Further, as I noted in my testimony, the fact that investors continue to fund new entrants in the Internet radio business provides definitive economic evidence that *expected* profits are positive.

- 3. How do you believe the proposed changes to the 801(b) factors will affect rates? Do you believe the factors listed under the proposed bill will provide better basis to arrive at a fair rate than current law? Why or why not?**

Answer: For the reasons stated in my written testimony and attachment, the substantive and procedural changes that would result from passage of IRFA would dramatically skew the rate setting process in favor of webcasters and against copyright holders, resulting in rates below the economically efficient level. By contrast, as implemented by the Copyright Royalty Board (CRB), the willing buyer/willing seller standard has resulted in rates that reasonably approximate economically efficient levels.

- 4. Is there any economic rationale for limiting the amount of market-based evidence that can be used to determine reasonable rates and terms? What is the best evidence of market rates? Direct licensing between the same parties? Or licenses of different parties under a different statutory license?**

Answer: The best evidence of market rates may vary depending on the licenses at issue, as well as over time. This is precisely why it is important not to limit the amount or types of market-based evidence that can be considered by the CRB in setting reasonable rates and terms, as IRFA would do. In assessing what types of evidence provide the most relevant benchmarks, the CRB should consider the totality of the evidence. However, limiting the evidence to markets subject to statutory licenses, as IRFA would do, would distort the process, since the outcomes in such markets are affected by the statutory “backstop” and thus are not indicative of what rates would be in a truly voluntary negotiation.



**Response to Questions for the Record from Michael Huppe, President,
SoundExchange, Inc.**



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HOUSE COMMITTEE ON THE JUDICIARY SUBCOMMITTEE ON INTELLECTUAL
PROPERTY, COMPETITION AND THE INTERNET

“Music Licensing Part One: Legislation in the 112th Congress”

Questions for the Record: Michael Huppe, President of SoundExchange

Questions Offered by Chairman Bob Goodlatte

1) Over the long term, do you believe this legislation would result in higher or lower net royalty payments to performers and why?

The legislation is clearly designed to lower net royalty payments. The explicit intent of those who support the Internet Radio Fairness Act is to adopt a below market rate standard in order to lower net royalty payments to artists and copyright owners. Some have estimated that the net reduction in royalty payments could be as high as 85 percent.

My view is not unique. It is consistent with the economic analysis provided by Dr. Jeffrey Eisenach as part of his testimony at the hearing as well as news coverage about the legislation that clearly states the goal of the bill: “Pandora and its supporters believe that standard would yield lower rates.”¹

2) Is the failure of many Internet radio companies to turn a profit a result of a failure of those companies to adopt the right business models, a result of the rate setting standard, a combination of both, or due to other factors?

Given that SoundExchange administers the statutory license for digital radio used by services and does not run the services themselves, I do not believe I am in a position to comment on what is a “right” business model for an Internet radio service. Nor am I sure there is one “right” business model. I do think it is clear, however, that Pandora and other free, advertising-supported Internet radio services have focused more on building audience than on revenue. Even now, when its shareholders are asking the company to shift strategy and focus more on revenues and profitability, Pandora only runs about 2 to 3 audio ads per hour.² Similarly, Clear Channel has announced that it isn’t going to run any ads at all on iHeartRadio until at least April 2013.³

¹ <http://www.nytimes.com/2012/09/24/business/media/proposed-bill-could-change-royalty-rates-for-internet-radio.html>

² <http://www.fi-magazine.com/Article/Story/2012/10/Dealers-Tuning-In-To-Pandora/Page/2.aspx>

³ <http://kurtihanson.com/news/iheartradio-custom-stations-remain-commercial-free-%22until-april%22>

To be clear, we are not suggesting that Internet radio services need to run as many advertisements as traditional terrestrial radio – or even that they have to run advertisements at all. Indeed, the nature of Internet radio is such that there are many new and creative ways to monetize a service beyond advertising. And even for the advertising, the mechanics and functionality of Internet radio services means they have the potential to run better, more effective, and more lucrative advertising once they tap fully into the market. But whether it is an ad supported or some other revenue model, the statutory license must have a fair market philosophy in order to drive services to build a business that fairly compensates artists. As it stands, the willing buyer/willing seller standard does just that – it ensures that artists are fairly compensated. If Pandora chooses to focus on building its audience first, that choice should not mean that artists receive less than they are due.

Questions Offered by Ranking Member Mel Watt

1) Do you believe that rates set under the 801(b) standard are necessarily lower than if they would have been set under the willing buyer/willing seller standard? What evidence do you have that the 801(b) standard cannot result in a fair market rate?

The best evidence that the 801(b) standard results in below market rates is the rate that has been set for satellite radio. In 2008, the Copyright Royalty Board (“CRB”) concluded that a rate at or near 13 percent of gross revenues was the rate best indicated by marketplace data. Based on the 801(b) standard, however, the judges ultimately chose a below-market rate of 8 percent of gross revenues (which was phased in gradually from 6 percent in 2007). Then, in December 2012, the CRB once again adopted a below market rate based on the 801(b) standard for the next satellite radio term. These downward adjustments, based on non-market considerations, would simply not occur under a willing buyer/willing seller standard. The judges have similarly adopted below market rates for the two “grandfathered” cable radio services – Music Choice and Muzak – based on application of the 801(b) standard. In fact, in the history of the application of the 801(b) standard for digital radio, the CRB has never adopted a market rate.

To be clear, it is theoretically possible for the CRB to adopt a market rate under 801(b). But it has historically not done so, and there is no good reason to allow the CRB to deviate from a market standard for the benefit of a certain class of businesses. Why should any statutory services get a below market rate, and why should artists be required to subsidize companies such as Pandora, Sirius XM, and Music Choice? The law should have a single market-based standard for the setting of statutory rates for all digital radio platforms.

2) Would you support the application of an 801(b) standard to webcasting if the non-disruption factor were removed (similar to the standard agreed to in the 2009 Performance Rights Act)?

I believe that all services should be subject to a simple, “willing buyer/willing seller” standard. The 801(b) factors are each open to interpretation; while in one case, the CRB may read them to point to a market-based rate, in another case, the CRB may decide to deviate from the market evidence on the basis of one of them. It would be simpler, and clearer, to have a single, market based standard and a clear instruction to look to market evidence to set the rates.

3) Has Sound Exchange actively encouraged or supported direct licensing deals?

SoundExchange is not in a position to either support or oppose any licensing decisions made in the marketplace. We play no role in the negotiation of direct licensing deals, nor do we take part in any decisions made by the parties to those deals. Our job is to administer the statutory license for digital radio used by services reaching more than 100 million Internet radio listeners and 23 million satellite radio subscribers. We provide information regarding the statutory license to the more than 70,000 artist and copyright owners who we represent (as well as to services who use the statutory license), and they are free to make any decisions which they feel are in their best interests.

4) Can you explain why there has been so much congressional intervention into rates set under the willing buyer/willing seller standard and little to no congressional intervention in rates set under the 801(b) standard? Does this suggest that the 801(b) standard has more validity?

We have played by the rules that Congress has set, even when the rules are stacked against us. For example, we were unhappy with the rates set for satellite radio in the first satellite radio proceeding. Rather than run to Congress, however, we appealed the decision to the D.C. Circuit, and when that appeal was not successful, we lived with the results. Unfortunately, the same has not been true for the webcasters. They have a pattern of repeatedly asking Congress to change the rules and the outcome after the fact, and there is no reason to think they wouldn't consider doing the same if they were unhappy with the results following a proceeding under a different rate standard.

5) If you agree that the willing buyer/willing seller standard provides the best way to achieve a fair market rate, would you be willing to support the application of that standard to all statutory license determinations, including the mechanical license under section 115?

We would be open to discussions regarding this matter as part of a broader effort to ensure true rate standard parity across all platforms, including terrestrial broadcasters.

Questions Offered by Representative Jason Chaffetz

1) Do you feel the 801(b) standard results in a "below market, government subsidized rate" when it is used to determine how much the record labels pay songwriters?

We would be open to discussions regarding this matter as part of a broader effort to ensure true rate standard parity across all platforms, including terrestrial broadcasters.

2) Why do you feel so few direct deals get done between the rights holders and the Internet radio platforms?

Because of the statutory license, Internet radio platforms don't need to do direct deals with rights holders; they get all of the sound recording rights they need from Congress. For instance, from the moment Pandora started using the statutory license, it had more rights to the repertoire of artists like Adele, Metallica, AC/DC or the Black Keys than did Spotify, which had to directly

license music for its on-demand service. In addition, the statutory license in effect sets a ceiling on what rights holders can charge for their music, because a service can always use the statutory rate for Internet radio. If the statutory rate was above market, you'd expect to see many more direct licenses because Internet radio platforms would simply choose not to launch unless rights holders offered rates below the statutory rate. Instead, we see the opposite – hundreds of webcasters representing tens of thousands of stations and custom radio services, all using the statutory regime.

3) The last time the so-called willing buyer, willing seller standard was employed it resulted in rates so high that the largest webcaster, Pandora, would have paid over 100% of its revenues out in royalty rates.

a. Does that really sound like a deal that a true willing buyer, willing seller negotiation would have arrived at?

This question needs to be put in perspective; first, with the simple fact that many successful online businesses operate at a loss in their early years; and second, with what Pandora's revenue is and how Pandora raises its revenue. Notable online businesses, like Amazon, Facebook and YouTube took and – in YouTube's case – are taking, several years to gain profitability but are still considered runaway successes.⁴ In addition to that, Pandora can control its revenue through the use of various monetizing structures – the one it has chosen to primarily pursue is advertisements. It is completely up to Pandora to decide how it wants to maintain a positive cash flow, but advertisements are not its only option. Importantly, Pandora *chose* to massively build its audience – now claiming more than 7 percent of all radio listening – before it knew how to monetize that audience. If it chose another path, it could likely monetize each listener better. Put another way: if Pandora's offer was to make music available to listeners for free, without specific plans for monetizing that listening, a seller of music would still presumably insist on being paid a market rate for its product.

b. In fact, the rates were so high that Congress was forced to step in and intervene. Do you feel the Webcaster Settlement Acts of 2008 and 2009, which both passed the House by voice, were a mistake?

No. We joined Pandora in supporting the Webcaster Settlement Acts of 2008 and 2009 (“WSA”). In fact, under the WSA, we were able to negotiate rates for the subsequent webcasting rate-setting proceeding with over 90 percent of the webcasting industry. In other words, the WSA not only addressed the rates for the Webcasting II proceeding (for 2006-2010), it was the vehicle for settling most of the Webcasting III proceeding (for 2011-2015).

⁴ http://www.nytimes.com/2005/07/10/business/yourmoney/10amazon.html?pagewanted=all&_r=0;
<http://articles.latimes.com/2011/mar/16/business/a-fi-youtube-20110316>;
<http://www.theatlantic.com/business/archive/2009/09/facebook-turns-a-profit-users-hit-300-million/26721/>.

Questions Offered by Representative Ted Deutch

1) Mr. Huppe, during the hearing my colleague, Mr. Chaffetz, observed that MTV, Rolling Stone, Microsoft, Yahoo, AOL and other established businesses tried to get into the online music business, but each could not find a sustainable business model to make online radio work. He posited that the high royalty rates are a reason for their failure. Similarly, Public Knowledge's testimony submitted for the record noted that "what should be an innovative, competitive market is instead a market dominated by one company in which not one significant company have made a profit." Why do you think that there would be so few Internet radio companies generally and that so many of those would have left the business or had difficulty making online radio services profitable? Are excessive royalties a component of this problem? Do you agree that the costs to the nascent music services are causing their businesses to fail, or exacting too high a price on their business model?

I do not agree with the idea that there are "so few Internet radio companies generally." To the contrary, there are over 2,000 and counting representing an increasingly large proportion of radio listening generally. As for royalties, I do not believe they are too high or that they are limiting the profitability of Internet radio. Contrary to the suggestions of some, Internet radio is thriving and will continue to thrive. Success is defined in many ways, not just profits. If we want to look at profit as a measure of success, then Pandora recently had a successful quarter. Other music and media services with cost structures similar to Pandora's and Internet radio are profitable as well. The iTunes' music service, which adds tremendous value in drawing people to the multi-billion dollar iTunes Store, is profitable. Netflix, as a streaming video distributor, is solidly profitable as a standalone media company.

But profit is not the only measure of success, especially in the world of Internet media or music.

There are other important yardsticks as well, such as the growth and size of the audience and revenue. As I've mentioned before, the number of Internet radio services using the statutory license has grown from 850 in 2007 to more than 2,000 today. The audience has dramatically increased as well, as has revenue. For example, SNL Kagan has projected that online digital radio revenue will reach \$1.55 billion in 2021 – from \$713 million in 2011.⁵ From 2011 to 2012, the Internet radio audience has increased 30 percent.⁶

We believe widespread profit will eventually come, particularly as the mobile advertising market matures. As Pandora's Chief Revenue Officer, John Trimble, recently stated, after building radio listening share, "there is a latency of catching up in the ad sales efforts," and that "at points in time, [Pandora's] hit that inflection point of being profitable.... [A]s we catch up on the revenue side, we'll hit that inflection point again."⁷ Right now, mobile advertising is much less lucrative than desktop advertising, and represents only an 8 percent share of the total online

⁵ <http://www.kurthanson.com/category/issue-title/rain-1027-snl-kagan-forecasts-net-only-radio-be-1-billion-business-10-years>.

⁶ Edison Research and Arbitron, "The Infinite Dial 2012," available at <http://www.edisonresearch.com/home/archives/2012/04/the-infinite-dial-2012-navigating-digital-platforms.php>.

⁷ <http://www.radioink.com/Article.asp?id=2603124&spid=24698>; <http://adage.com/article/special-reports/pandora-monetize-mobile/239096/>.

advertising market.⁸ Pandora has focused its growth on the mobile market, however – 77 percent of its listening hours are mobile, even though mobile online advertising is currently a challenge for all Internet companies.⁹ But the potential for mobile advertising is huge; by some estimates, it is projected to grow more than 400 percent from 2012 to 2016,¹⁰ and Pandora’s most recent quarterly report shows a 111 percent increase in mobile revenue for the past year alone.¹¹ Pandora clearly sees the potential in mobile ad sales – with John Trimble calling the audio ad, which dominates mobile advertising, “the killer ad.”¹²

Lastly, I must point out that MTV, Rolling Stone, Microsoft, Yahoo, and AOL did not feel compelled to get out of the business of streaming. In fact, MTV still operates a music streaming service under the statutory license. Yahoo never left the business of Internet radio and has recently formed an alliance with iHeartRadio. Slacker Radio currently delivers Internet radio to AOL. And with a great deal of fanfare, Microsoft recently launched its XBOX Music service, which combines interactive streaming of songs and music videos, a Pandora-like radio service, and music downloads, all through direct licensing with content providers. (We are not aware of a radio service offered by Rolling Stone.) Whether through partnerships with other companies, direct licensing, or utilization of the compulsory license, these companies, and many others, find it worthwhile to be in the business of Internet radio and music streaming. I do not think they, or any other company, need a subsidy from anyone, much less from the artists on whose backs their businesses are built.

⁸ IAB internet advertising revenue report 2012 first six months’ results, October 2012, available at http://www.iab.net/media/file/IAB_Internet_Advertising_Revenue_Report_HY_2012.pdf.

⁹ <http://seekingalpha.com/article/1045431-pandora-media-s-ceo-discusses-q3-q4-results-earnings-call-transcript>; Pandora’s 10Q report for the quarter ending October 31, 2012, available at <http://investor.pandora.com/phoenix.zhtml?c=227956&p=irol-sec>.

¹⁰ <http://www.emarketer.com/newsroom/index.php/unexpected-growth-facebook-google-lead-significant-uptick-mobile-advertising-us-market-share/>.

¹¹ Pandora’s 10Q report for the quarter ending October 31, 2012, available at <http://investor.pandora.com/phoenix.zhtml?c=227956&p=irol-sec>.

¹² <http://www.radioink.com/Article.asp?id=2603124&spid=24698>.



A Fair and Competitive Royalty System for Music Services

BY DANIEL CASTRO, NOVEMBER 2012

Congress has an opportunity to reform the broken music-royalty system and foster a new era of innovation in the music and broadcasting industries.

Many different platforms provide consumers access to music services, such as terrestrial radio (i.e., traditional AM/FM over-the-air radio), satellite radio, Internet radio, and subscription music services on cable TV.

However, the rules used to determine which types of royalties each platform must pay and how much each has to pay vary from service to service. While the existing royalty system was created to foster innovation and facilitate fair compensation, today it achieves neither goal. The system used to determine the royalty rates for music services is antiquated and broken. It is long overdue for Congress to consider legislation to remedy this situation and create a balanced system that provides fair compensation and encourages innovation.

The purpose of this report is threefold: first, to propose a set of criteria to evaluate music royalties; second, to evaluate how the current rules and the proposed Internet Radio Fairness Act measure up to these criteria; and third, to offer an alternative solution that better meets these criteria.

CRITERIA FOR MUSIC ROYALTIES

To foster innovation in the music industry and among music services, the process used to set the rates for music royalties should be fair and the resulting markets should be competitive. Use of these criteria should not be a matter of much controversy. Unfair rate-setting processes disadvantage particular businesses or business models, and businesses may use unfair rules to protect their interests from competitors. Moreover, systematic unfairness

may depress the potential for innovation in a particular industry. Similarly, uncompetitive markets do not reward innovation or encourage new entrants. Conversely, fair processes and competitive environments give equal opportunities to both incumbents and new entrants in a particular industry and allow different technologies to compete on their merits.

Both music services and copyright owners have criticized the current music royalty rates as unfair because of how much (or how little) is paid in royalties.¹ For example, the CEO of the Computer and Communications Industry Association (CCIA) Edward Black (a supporter of legislation to reform the existing copyright royalty system) argues that the rates paid by webcasters “now can exceed 50 percent of a company’s revenues, unlike other digital broadcasting platforms.”² First, it should not be surprising that a significant portion of the revenue generated by music services goes to royalties since licensed music is their primary input. Second, comparisons with other music services, such as satellite radio, may be inappropriate since much of the programming is talk radio rather than music. Third, this criticism ignores the fact that webcasters like Pandora do not pay royalties as a percent of revenue (like, for example, SiriusXM Radio), but rather pay a rate based on the number of users they have and the amount of music they broadcast.³ This means that the percent of revenue they are paying decreases as the amount of revenue they generate per subscriber increases. If a webcaster believes it is paying too high a percentage of its revenue in royalties, it could try to remedy this by generating more revenue, through higher subscription fees or more advertising (or both).

While some of the claims about rates are likely inaccurate, it is difficult, if not impossible, to describe what a fair outcome would be for music royalties, since fairness is mostly a matter of distributive justice. Equality cannot be used as a standard of fairness because of differences in business models. A better approach would be to define fairness in terms of an equitable process for setting royalty rates (i.e., procedural fairness). First, a fair process should be transparent. This means that the decision process for setting royalty rates, including who makes the decision, the rationale for a decision, and the information used to make the decision, should be clear to all. Second, a fair process should apply uniformly to all participants. This means that the same rate-setting process should apply to all platforms, and that all platforms must pay the same type of royalties (i.e., platform parity). This does not mean that all music services would necessarily pay the same amount—there might be legitimate reasons why one platform or one company pays more or less than another. But all platforms should be subject to the same types of royalties (e.g., royalties for both sound recordings and musical compositions) and to the same rules and processes for determining royalty rates (e.g., the same rate-setting process for statutory licenses, the same evidence standard, etc.).

The process for setting rates for music royalties should also be evaluated based on whether it fosters a competitive market. Competition can be evaluated at three levels: inter-platform competition, intra-platform competition, and inter-music competition.

- Inter-platform competition is competition between different platforms, such as terrestrial radio, satellite radio, Internet radio, and cable TV music channels. Inter-platform competition would allow the best platforms to succeed based on

consumer demand and technical merits, rather than on unfair differences in royalty rates and rate-setting standards.

- Intra-platform competition is competition between companies using the same platforms, such as two local terrestrial radio broadcasters or different Internet radio webcasters. Intra-platform competition would allow the best companies to prosper based on how well they innovate or how efficiently they operate, rather than on whether certain companies were grandfathered in to lower rates.
- Inter-music competition is competition between different copyright holders, such as between competing musicians or competing song writers. In a competitive music market, musicians would be able to compete with one another when licensing to music services based not only on artistic quality but also on price.

HOW THE INTERNET RADIO FAIRNESS ACT COMPARES TO THE CURRENT MUSIC ROYALTY SYSTEM

Music royalties should be set through a fair process that results in a competitive market, and policymakers should evaluate both the existing royalty system and alternative proposals against these criteria. This section first describes the current royalty system and a legislative proposal to alter the current royalty system, the Internet Radio Fairness Act. Then, it evaluates how these two systems stack up to the criteria of fairness and competitiveness.

The Copyright Royalty System Today

Imagine a driver listening to music in his car. If he is listening to FM radio, then the artists and record labels will not receive royalties for the broadcast. If he is listening to a simulcast (i.e., a terrestrial radio broadcast that is re-transmitted online) of the exact same song over the Internet via a mobile Internet connection, then the artists and record labels will receive compensation. The reason for this discrepancy is that U.S. copyright law exempts terrestrial radio from compensating musical artists and record labels.

Music recordings have two copyrights: one for the musical composition and one for the sound recording. The musical composition copyright encompasses the notes and lyrics to a song, and the songwriter or music publisher typically owns this copyright. The sound recording consists of the actual sounds and the interpretation of the musical composition by the performing artist, and the record label usually holds this copyright. U.S. law exempts terrestrial radio from paying a performance royalty for sound recordings to the copyright owner. However, all other music services, including Internet radio, satellite radio and other digital music services must pay for this performance right.

Before 1998, both terrestrial radio and Internet radio paid royalties only to the copyright owner of the musical composition; they paid no royalties to the copyright owner of the sound recording. ASCAP, BMI and SESAC, the three performance rights organizations in the United States, collect these royalties for musical compositions. The Digital Performance Right in Sound Recordings Act of 1995 (DPRA) created for copyright owners a new performance right for the digital transmissions of sound recordings. The Act defined three categories of digital transmissions: AM/FM broadcast transmissions, subscription transmissions (e.g., cable and satellite), and on-demand transmissions (e.g., Rhapsody).

The Act exempted broadcast transmissions from the performance right, thus broadcasters did not have to pay royalties to owners of sound-recording copyrights. The Act also created a statutory (or compulsory) license for subscription music services. And, it gave copyright owners full rights to negotiate licenses for the on-demand transmission of their work.

Initially the DPRA did not address how the sound recording performance copyright would apply to non-subscription, non-interactive services such as Internet radio. However, in 1998 a provision of the Digital Millennium Copyright Act (DMCA) amended the copyright law to include these services, including webcasting, as a separate category subject to the statutory license. The law continued to exempt terrestrial radio, including digital terrestrial radio (HD radio), from this statutory license even though both Internet radio and HD radio involve the digital transmission of music.³ The DMCA did not include simulcasts in this exemption.

The statutory license provides all entities that meet certain conditions the right to use a copyrighted work without obtaining consent from the copyright owner. For example, in the case of sound recordings, any webcaster may broadcast music if it pays the statutory royalty fee and meets the terms of the statutory license. These terms may include restrictions such as how many songs may be broadcast from a particular album or artists in a given time period. With a statutory license the webcaster does not need to negotiate a license with the copyright holder, and the copyright holder cannot deny the webcaster the right to broadcast his or her work. Internet radio companies pay the statutory license fees to SoundExchange, a non-profit industry group, which then redistributes the money to the copyright owners, featured artists and non-featured artists (such as non-featured musicians and vocalists). The Copyright Arbitration Royalty Panel (CARP) originally set rates and terms for the statutory license; however, the Copyright Royalty and Distribution Reform Act of 2004 replaced CARP with a system of three judges on the Copyright Royalty Board (CRB). Copyright owners and webcasters can set the rate for the license through voluntary negotiations; if they fail to reach an agreement, they present their case to the CRB judges, who then determine the rates and terms for the statutory license.⁴

The Internet Radio Fairness Act

Earlier this year, Reps. Jason Chaffetz (R-UT), Jared Polis (D-CO), Darrell Issa (R-CA), and Zoe Lofgren (D-CA) in the House and Sen. Ron Wyden (D-OR) in the Senate introduced H.R. 6480 and S. 3609, respectively, the Internet Radio Fairness Act of 2012 (IRFA). This legislation would amend the rate-setting process for music royalties in federal copyright law and change the standard used to set royalty rates for the compulsory license for Internet radio. The IRFA has received extensive support from the Internet Radio Fairness Coalition, a group of webcasters who are pushing for legislation to change the royalty-setting standard for Internet radio.⁵ The most vocal supporter of this legislation is Pandora, an Internet radio company that believes that the legislation, if enacted, would allow it to pay significantly less in music royalties.

The IRFA contains a number of changes to the current music royalty system. Rather than use the existing "willing buyer, willing seller" standard for setting royalty rates, the IRFA would use the standard currently used to determine rates for some satellite and cable TV

music channels. This standard, found in section 801(b) of the Copyright Act, would have the CRB judges set rates based on the following four goals:⁸

- To maximize the availability of creative works to the public.
- To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
- To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.
- To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

The IRFA would also add two additional factors to be considered when setting rates:⁹

- The public's interest in both the creation of new sound recordings of musical works and in fostering online and other digital performances of sound recordings.
- The income necessary to provide a reasonable return on all relevant investments, including investments in prior periods for which returns have not been earned.

Finally, the IRFA directs the CRB judges to abide by the following conditions when establishing rates:¹⁰

- Shall not disfavor percentage of revenue-based fees.
- Shall establish license fee structures that foster competition among the licensors of sound recording performances and between sound recording performances and other programming, including per-use or per-program fees, or percentage of revenue or other fees that include carve-outs on a pro-rata basis for sound recordings the performance of which have been licensed either directly with the copyright owner or at the source, or for which a license is not necessary.
- Shall give full consideration for the value of any promotional benefit or other non-monetary benefit conferred on the copyright owner by the performance.
- Shall give full consideration to the contributions made by the digital audio transmission service to the content and value of its programming.
- Shall not take into account either the rates and terms provided in licenses for interactive services or the determinations rendered by the Copyright Royalty Judges prior to the enactment of the Internet Radio Fairness Act of 2012.

The IRFA would also change other aspects of the rate-setting process, such as the

qualifications for the judges for the CRB (the IRFA would increase the years of legal experience for the judges and drop the requirement that at least one judge have significant knowledge of economics and one judge have significant knowledge of copyright law) and how the judges are selected (currently these judges are selected by the Librarian of Congress; the IRFA changes this to the President of the United States with the advice and consent of the Senate).

Finally, the IRFA would make a number of other technical changes to the Copyright Act and the rate-setting process for compulsory licenses. These include requirements about rights to make ephemeral (i.e. temporary) copies of a recording as part of operations, requirements on using Federal Rules of Civil Procedure and Federal Rules of Evidence in proceedings, and requirements for a *de novo* judicial review of the CRB's legal rulings (i.e., the court does not defer to the CRB's rulings).

Comparing the Current Royalty System to the IRFA

Clearly neither the current system nor the IRFA satisfy the fairness and competitiveness criteria outlined in the previous section. The obvious failing is that the IRFA does not address the fact that terrestrial radio pays royalties for musical composition but not for sound recordings, while other music services must pay both types of royalties. If Congress wanted to create a performance right for sound recordings, it should have done so for all technologies and not single out AM/FM transmissions for special exemption. The method of transmission should be irrelevant to decisions on whether or not to grant a performance copyright. Until all platforms are required to pay both sound recording and musical composition royalties, no amount of wrangling about the rate-setting process will address this inherent inequality. Thus, both the existing royalty system and the IRFA fail to create a fair system.

However, it may appear that the IRFA would create at least a marginally fairer system than the one in place today since it would move Internet radio services to the same 801(b) standard that is used by satellite radio and cable TV music channels (a similar argument could be applied to moving satellite and cable TV to the willing buyer-willing seller standard). In fact, this is the heart of arguments by supporters of the legislation, including Gregory Barnes at the Digital Media Association (DiMA), who complains that the willing buyer-willing seller standard is unfair because "no other form of digital radio—and in fact no other music use at all—comes under this rate-setting standard."¹¹ However, this claim is not entirely accurate. While most of today's satellite and cable TV music channels operate under the section 801(b) standard, it is because they were grandfathered in to this other system. The Copyright Act includes a number of provisions that limit this standard to a few specific companies. For example, with regards to satellite radio, the standard does not apply to "a satellite digital audio service that is in operation, or that is licensed by the Federal Communications Commission, on or before July 31, 1998."¹² A competitor to SiriusXM Radio would not fall under this standard. A similar clause applies to music services on cable television and grandfathers in certain services provided by companies such as Muzak and Music Choice; however, new entrants are not subject to this same standard (indeed, there are not more competitors to some of these cable TV music subscription services at least in part because new entrants would be subject to higher royalty rates).¹³

Furthermore, in regards to competition, the IRFA does not address inter-platform competition, intra-platform competition, or inter-music competition, all of which suffer in the current royalty system. As noted above, inter-platform competition is hindered by special exemptions for different platforms and different rate-setting standards. Also as noted above, intra-platform competition is hindered by clauses that grandfathered in certain companies thus creating an uneven playing field for new entrants. Finally, inter-music competition is stymied by the statutory licensing, which values all music equally, whereas every song is *not* the same. By creating a statutory license with a single rate for all music, Congress has essentially eliminated competitive pricing for sound recordings.

Finally, some of the other proposed changes in the IRFA are cause for at least some concern. For example, the IRFA proposes that royalty rates be chosen, in part, based on the ability of music services to earn “reasonable returns” on past investments. Why should a company pay lower royalty rates because it made bad investments in the past? It is also unclear why the IRFA drops the requirements that the CRB judges should have expertise in economics and copyright law, two issues which have been most debated in past proceedings. Nor is it clear why the IRFA proposes making the CRB judges presidential appointees since this would further politicize the process.

There is also something inherently troubling about a rate-setting process that has a goal of minimizing the “disruptive impact” on industry since innovation is typically disruptive. Historically, many technological innovations have resulted in substantial disruptions in the economy and society, from the cotton gin to the automobile. Even recent examples, such as the impact of Netflix and Redbox on traditional video rental stores like Blockbuster, show the disruptive effect that innovations can have on an industry. Indeed it would seem that if Congress were to pass the IRFA, it would be favoring the status quo over innovation in the music and broadcasting industries.

If Congress were to pass the Internet Radio Fairness Act, it would be favoring the status quo over innovation in the music and broadcasting industries.

Criteria	Current System	Internal Radio Fairness Act	ITF Proposal
Do all platforms pay the same type of royalties?	No	No	Yes
Do all platforms have the same rate-setting standard?	No	No	Yes
Is there inter-platform competition?	Limited	Limited	Yes
Is there intra-platform competition?	Some platforms	Some platforms	Yes
Is there inter-music competition?	No	No	Yes

Table 1: A comparison of the current music royalty system with different alternatives

AN ALTERNATIVE PROPOSAL FOR MUSIC ROYALTIES

If Congress pursues legislation to reform copyright royalties for sound recordings, it should implement a comprehensive fix, rather than apply half measures that further reduce fairness

and competition. As noted earlier, it is nearly impossible for Congress to specify fair music royalty rates. Congress cannot set a "fair" rate for music royalties any more than it can set a "fair" rate for gasoline, movie tickets or hamburgers. What Congress can do is ensure that the rate-setting process, whether it is the free market or another process, is fair. To that end, ITIF recommends two changes.

First, Congress should uniformly apply the performance copyright for sound recordings to all broadcasts. The current system discriminates against non-terrestrial music services by imposing a performance copyright on sound recordings for all non-terrestrial radio broadcasts. Congress should promote technology-neutral policies to ensure a fair and competitive market for all forms of radio. Not only does this exemption for terrestrial radio disadvantage competing technologies, it also results in unfair compensation to the copyright holders. Congress should take an all-or-nothing approach so that terrestrial radio, Internet radio, satellite radio and other digital music services can compete fairly. In other words, everybody should pay (ideally), or nobody should pay, but the discrepancy should be eliminated. Terrestrial radio should not be the only technology platform exempt from paying royalties for performances of sound recordings.

Second, Congress should replace the broken CRB system for setting royalty rates for the statutory license with a dynamic, market-driven rate-setting system. Just as a popular band can charge more for tickets to its concert than an unpopular band, so too should musicians be able to license their music at different rates. To that end, Congress should mandate that the Library of Congress, in partnership with SoundExchange, create an electronic database of all sound recordings and allow copyright owners to determine the statutory license rate for each of their works. The database would allow copyright owners to specify separate royalty rates for different types of music services, both by type of technology (e.g., terrestrial, satellite, cable, Internet) and by status (e.g., commercial and non-commercial). In addition, Congress should rule that royalties not apply if copyright owners choose not to specify a rate. This policy would allow only those copyright owners who want to charge royalties to specify a royalty rate. These rates would be published online in an electronically accessible format for music services to access. To limit a music service's potential liability for broadcasting a song, a maximum royalty rate or other type of safeguard should be set.

These changes would address both the fairness and competitiveness criteria while preserving the benefits of a statutory license (i.e., reduced transaction costs). With regards to fairness, this proposal would make all platforms subject to the same types of royalties and process for setting their rates. This proposal also addresses the competitiveness issue. The creation of a national database of sound recordings with corresponding performance royalty fees would allow copyright holders to set music royalty fees at competitive market rates while still allowing music services to benefit from a statutory license. Music services could make decisions about what music to play based, in part, on the published rate of particular songs, and they would no longer be subject to an artificial royalty fee that values all music equally. Copyright owners would be able to adjust fees to meet their promotional needs and, if they desire, provide reduced pricing for noncommercial music services such as non-profit college radio stations. A separate fee schedule for non-commercial music services

would allow consumers to continue to benefit from non-commercial broadcasts, while allowing copyright owners to obtain fair-market value from commercial music services.

Currently, SoundExchange must maintain a database of all sound recordings and of their corresponding copyright holders. They could extend this database to include separate statutory rates. Copyright owners must already identify their sound recordings to SoundExchange, so they could also notify SoundExchange of their preferred royalty rate. The Library of Congress should maintain an open version of this database as a valuable public resource. Just as the Library of Congress maintains useful data on published works such as title, author and subject, it could expand its services to offer similar information on sound recordings. Indeed, an authoritative database of sound recordings could be an enormous information resource for consumers. One could easily imagine how developers might use an open database such as this to create value-added services for consumers, copyright owners, and music services. For instance, a service could expand the database to allow users to tag music with keywords representative of that song and help others then find music relating to a certain genre, year, band or subject.

To keep U.S.-based Internet radio services competitive worldwide, the U.S. government should promote this system internationally. Congress should direct the Library of Congress, the Office of the United States Trade Representative (USTR), and the Intellectual Property Enforcement Coordinator to establish an international framework for sound recording copyrights based on the aforementioned model. An international agreement would help ensure that copyright holders receive fair compensation internationally and allow webcasters to broadcast globally without fear of copyright infringement. In fact, elements of this idea are already contained in the IRFA. Section seven of the legislation calls for the creation of a "global music rights database" that would "include all known or copyrighted musical works, the writers of the work, the owners of the rights, the entity on behalf of those owners who can license such rights on a territory-by-territory basis, and all known sound recording data."¹⁴

CONCLUSION

Congress should work to modernize the music royalty system to achieve a fair royalty system that fosters competition and innovation. Unfortunately the IRFA does not achieve this goal. Instead it merely substitutes one broken system for another and repeats the history of using copyright law to give an unfair advantage to one group at the expense of another. However, interest in the IRFA gives Congress the opportunity to reform the broken music-royalty system and foster a new era of innovation in the music and broadcasting industries.

ENDNOTES

1. See for example, Ben Sisario, "Fight Builds Over Online Royalties," *The New York Times*, November 4, 2012, <http://www.nytimes.com/2012/11/05/business/media/fight-growing-over-online-royalties.html>, Jennifer Martinez, "Songwriters oppose Pandora-backed Internet royalty bill," *The Hill*, November 16, 2012, <http://thehill.com/blogs/hillicon-valley/technology/268467-songwriters-oppose-pandora-backed-internet-royalty-bill> and Austin Carr, "Pandora and SoundExchange Spar Over Royalty Fees," *Fast Company*, January 10, 2012, <http://www.fastcompany.com/1806776/pandora-and-soundexchange-spar-over-royalty-fees>.
2. Edward Black, "Congress should pass Internet Radio Fairness Act," *The Hill*, October, 25, 2012, <http://thehill.com/blogs/congress-blog/technology/263915-congress-should-pass-internet-radio-fairness-act>.
3. To be more precise, "pureplay" services like Pandora have the option of paying either the rates established by the CRB or the rates established in the webcaster settlement in 2009. Since 2009, Pandora has elected to pay the rates negotiated under the settlement. Under the settlement, Pandora pays the greater of the per performance rates or 25 percent of U.S. gross revenue. See U.S. SEC Form 10-K, Pandora Media, Inc. for fiscal year ending January 31, 2012, available at <http://sec.gov/Archives/edgar/data/1230276/000119312512120024/d280023d10k.htm>.
4. "The Digital Millennium Copyright Act of 1998: U.S. Copyright Office Summary," U.S. Copyright Office, (December 1998), 15-16, <http://www.copyright.gov/legislation/dmca.pdf>.
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6. Internet Radio Fairness Coalition, "About the Internet Radio Fairness Coalition," n.d., <http://internetradiofairness.com/about-us/>.
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8. See Section 801(b) of 17 U.S.C. 801 available at U.S. Copyright Office, <http://www.copyright.gov/title17/92chap8.html>.
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10. *Ibid.*
11. Gregory Alan Barnes, "A Common Sense Approach to Internet Radio Royalties," *The Huffington Post*, November 11, 2012, http://www.huffingtonpost.com/greg-barnes/a-common-sense-approach_b_2087909.html.
12. 17 U.S.C. 114 available at U.S. Copyright Office, <http://www.copyright.gov/title17/92chap1.html#114>
13. 37 Code of Federal Regulation 383.3 available at <http://www.law.cornell.edu/cfr/text/37/383.3>.
14. U.S. House, 2012. Internet Radio Fairness Act of 2012, 112th Cong., 2nd sess. H.R. 6480, <http://beta.congress.gov/112/bills/hr6480/112hr6480h.pdf>.

ACKNOWLEDGEMENTS

The author wishes to thank the following individuals for providing input to this report: Rob Atkinson. Any errors or omissions are the author's alone.

ABOUT THE AUTHOR

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ABOUT ITIF

The Information Technology and Innovation Foundation (ITIF) is a Washington, D.C.-based think tank at the cutting edge of designing innovation strategies and technology policies to create economic opportunities and improve quality of life in the United States and around the world. Founded in 2006, ITIF is a 501(c)3 nonprofit, non-partisan organization that documents the beneficial role technology plays in our lives and provides pragmatic ideas for improving technology-driven productivity, boosting competitiveness, and meeting today's global challenges through innovation.

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**Music Creators North America
European Composer and Songwriter Alliance**

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November 19, 2012

Honorable Bob Goodlatte
Chairman of the Subcommittee on
Intellectual Property, Competition, and the Internet
House Committee on the Judiciary
2240 Rayburn House Office Building
Washington, DC 20515

Honorable Mel Watt
Ranking Member of the Subcommittee on
Intellectual Property, Competition, and the Internet
House Committee on the Judiciary
2304 Rayburn House Office Building
Washington, DC 20515

Re: November 2012 Music Licensing Reform Hearing

Dear Chairman Goodlatte and Ranking Member Watt:

We are writing on behalf the Songwriters Guild of America, Inc. (SGA), the Music Creators North America alliance (MCNA), and the European Composer and Songwriter Alliance (ECSA), whom together represent tens of thousands of American songwriters, lyricists and composers and their international colleagues, collectively referred to in this letter as "music creators." While we write in part to express our opposition to the introduction of H.R. 6480 (the "Internet Radio Fairness Act of 2012"), we also respectfully take this opportunity to comment upon several other issues of importance to the music creator community as Congress begins to explore the issues surrounding music licensing, particularly in the wake of the introduction of this legislation.

As you are aware, issues involving the music industry are complicated, in part because there are two separate and distinct copyrights involved in music. The first copyright is for the underlying musical composition authored by one or more music creators. The second copyright is for any recording of that musical work by a recording artist and his or her record label, commonly known as the "sound recording" copyright. Sometimes, there is a tendency to think that authors of these separate and distinct copyrights have identical interests. But often, the interests of these two groups do not coincide, and the rights of music creators such as songwriters, composers and lyricists must be considered quite apart from those of recording artists.

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The introduction of H.R. 6480 has sparked a vigorous debate over the fairness of various rate standards used to set royalties for sound recordings under Section 114 of the Copyright Act. Internet radio broadcasters and numerous other new services pay under a "willing buyer/willing seller" standard, which generally (barring various anomalies such as corporate vertical integration) provides market-based compensation to recording artists and labels for their sound recording copyright. Satellite radio, on the other hand, pays under the so-called 801(b) standard, the result of which is a far lower level of compensation to artists and labels due to the factors that must be considered under this rate standard. Various other portions of the U.S. Copyright Act are also unfortunately subject to the 801(b) standard, including mechanical royalties for music creators under 17 U.S.C. § 115 ("Section 115").

As Congress examines potential changes to these royalty rate standards applicable to sound recordings, it is our firm conviction that songwriters and other music creators should no longer be subjected to the more onerous 801(b) standard for purposes of mechanical licensing under Section 115. This rate formula grossly underpays music creators for their creations, and it should be changed to the willing buyer/willing seller standard.

In making their case that labels and recording artists should be compensated under the willing buyer/willing seller standard for their sound recording copyright, the interested parties have noted that the 801(b) standard is a "below market, government mandated subsidy." As we make the argument that recording artists and labels should enjoy the more generous willing buyer/willing seller standard, the same should be applied for music creators under Section 115.

Quite significantly, what has also been lost in the discussion about H.R. 6480 is the astonishingly low level of royalties currently being paid to songwriters, composers and lyricists by internet radio providers like Pandora. In fact, Pandora pays only 4% of its revenue to music creators (who often must split such royalties with music publishers), while it pays nearly 50% of its revenue to labels and recording artists. Put another way, for every dollar paid in music royalties by internet radio, only 8¢ of it is going to music creators and publishers, while 92¢ is paid to record labels and recording artists. That is a ratio of more than twelve to one against music creators, representing an outrageous and indefensible disparity. To make matters worse, Pandora has just recently sued ASCAP to further reduce the already nominal amount that Pandora pays to music creators and publishers, threatening to make an already untenable situation worse. Thus, we are endeavoring with our colleagues to develop proposals that we respectfully suggest can be considered, at the appropriate time, as separate legislative initiatives to address these grossly unfair situations.

Before closing, we would also like to join with our PRO colleagues in pointing out that while the lion's share of H.R. 6480 is focused on altering the standard for rate-setting for the digital transmission

of sound recordings -- so as to achieve a lower rate-- the bill contains a number of additional provisions that are so broad that they might have unforeseen, negative consequences on the business practices of PROs and the musical works the PROs license. Our concerns with each of these provisions, similarly expressed in a separate communication to you by the PROs, are as follows:

- H.R. 6480 would prohibit the use of collective licenses as benchmarks in Copyright Royalty Board rate proceedings, by only permitting the introduction of agreements with a licensor that does not possess market power resulting from the aggregation of copyrights, either by a licensing collective or individual owner. See H.R. 6480, Sec. 3(a)(3)(B) (definition of “Competitive market circumstances,” and Sec. 3(a)(1)(B) and Sec. 3(a)(2)(A)(ii)(placing burden of proof of competitive market circumstances on the copyright owners). While this provision would not directly impact PRO rate court proceedings, the language could be perceived to treat as inherently suspect the model of collective licensing, a licensing method that the United States Supreme Court, in the CBS case, recognized as an efficient means of providing blanket access to a wide-ranging musical repertoire. The suggestion, implicit in this bill, is that collective licenses (which often represent the product of negotiations between rights organizations and sophisticated and well-funded business conglomerates) are inherently untrustworthy instruments of market power. Such a suggestion is unfounded and would preclude the Copyright Royalty Board from even considering (and, in its discretion, giving the weight it chooses) to any industry-wide collective voluntarily negotiated license.
- H.R. 6480 prohibits owners of sound recordings, or their agents, from taking any action that would “prohibit, interfere with, or impede direct licensing by copyright owners of sound recordings.” This language, particularly with its prohibition against “impeding” direct licensing, is both unduly broad and vague.
- H.R. 6480 calls for the establishment of a federal government-facilitated or established global music registry. This is wholly unnecessary, particularly in light of the ongoing initiative led and funded by the world’s PROs, with the participation of music publishers and music users, to establish just such a registry. The contribution of the federal government’s energies and resources are not needed, and Congress should allow the ongoing privately-driven initiative to proceed without government interference.

In conclusion, we welcome the Committee’s review of music licensing reform, beginning with H.R. 6480. We fear, however, that the Committee’s focus is too narrow, and should take into account a more balanced view that includes the impact on those with interests in musical works, namely the music creators who form the bedrock of musical culture in the United States and throughout the world.

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The past, piecemeal Congressional approach to music licensing has led to the serious under-valuation of music works in the U.S., to the great detriment of American and international music creators. This economic and cultural trend is counter to global practices and anathema to US interests, and must be corrected. As such, we look forward to working with your Committee in fashioning comprehensive solutions to the serious problems and issues outlined above, and thank you as always for your expertise and consideration.

Sincerely,



Rick Carnes, President
SGA, Co-Chair, MCNA



Eddie Schwartz, President
Songwriters Association of
Canada, Co-Chair, MCNA



Alfons Karabuda, Chair
ECSA

ECSA Members

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Music Creators North America members

Songwriters Guild of America

Songwriters Guild of America Foundation

Songwriters Association of Canada

La Société professionnelle des auteurs et des compositeurs du Québec

Screen Composers Guild of Canada



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 2304 Rayburn House Office Building
 Washington, DC 20515

Re: November 2012 Music Licensing Reform Hearing

Dear Chairman Goodlatte and Ranking Member Watt:

We are writing on behalf of the American Society of Composers, Authors and Publishers (“ASCAP”), Broadcast Music, Inc. (“BMI”) and SESAC, the three American performing rights organizations (collectively, the “PROs”) and the Nashville Songwriters Association International (NSAI), representing the public performing right in musical works of America’s songwriters, composers and music publishers. We understand that your Committee intends to hold a hearing focused on the “Internet Radio Fairness Act of 2012,” H.R. 6480 (“IRFA”), and in that regard we must voice our concerns regarding both the purported rationale behind IRFA and several of its key provisions. On a more global basis, the narrow focus of IRFA completely ignores a much greater problem in the online music licensing world: the undervaluation of the public performing right in musical works. This undervaluation of the public performing right runs contrary to global practices which often yield two times the fees generated by US license rates or more, when compared to equivalent economies, and represents a trend that is harmful to both America’s music creators and the larger economy. Any Congressional examination of online music licensing issues needs to address this serious issue to ensure that the interests of writers and publishers – the very foundation fueling the music industry – are not further deteriorated.

Background

Before we address the substance of our thoughts and concerns, it would be useful to distinguish the separate and distinct copyrights that benefit different music rights owners, and which, as a group, are differentially impacted by H.R. 6480. To illustrate this distinction, consider the classic song, “Baby I Need Your Loving.” Most people know the song through the Four Tops’ recording of the work. However, the song itself – the words and music – were written by the songwriting team of Eddie Holland, Lamont Dozier and Brian Holland (known professionally as “Holland-Dozier-Holland”). Indeed, many hit songwriters focus on the craft of songwriting, never stepping on a stage.

As PROs, we represent songwriters, composers and music publishers who create and own the underlying musical works. In the case of “Baby I Need Your Loving,” the performing right organization representing the writer and publisher of the song (in the case of this song, BMI) licenses the public performance of the work – the performance of the Holland-Dozier-Holland-composed song

(no matter who performs it) on radio, on television, on cable, on the internet, and in bars, restaurants and clubs, among many other places.¹

By contrast, Motown Records, the owner of the specific Four Tops sound recording of “Baby I Need Your Loving,” licenses the public performance of the sound recording by digital transmission on a variety of online digital platforms through SoundExchange (or directly, if they choose to do so). For such performances of the sound recording, the owners of the sound recording and the performing artists-- but not the separate musical work’s writers (here, Holland-Dozier-Holland) or publishers-- are compensated through this type of license.

Or consider the eponymous theme to the new James Bond movie, “Skyfall.” The composition was written and performed by the well known British pop star, “Adele” (formally, Adele Laurie Blue Adkins) and co-written by Paul Richard Epworth, in this case an ASCAP writer. Mr. Epworth is not a performer, but he is a well-known music writer and producer, and a top Grammy winner. No matter whether Adele performs “Skyfall,” or some other performer goes on to perform it, as writers, Adele and Paul Richard Epworth, and their associated publishers, have the right to be compensated for the public performance of their musical work through licenses issued by their affiliated PROs (or directly if they choose to do so). Again, by contrast, the owners of the sound recording of “Skyfall” would in the U.S. license the public performance of the sound recording by digital transmission through SoundExchange (or directly, if they choose to do so), and compensation would flow as mentioned in the paragraph above.

It is important to keep these different rights in mind; while there may be a tendency to conclude that the interests of these separate rights holders would be identical, that is not the case.

The current bill under consideration, H.R. 6480, demonstrates the potential divergent interests as well as any example. Pandora, the online music service provider and one of the chief proponents of this bill, seeks to substantially lower the fees paid to SoundExchange for the digital transmission of sound recordings. However, any discussion of rate standards needs to address as well the remarkable disparity in license fees paid by webcasters to songwriters and publishers for the use of the underlying musical works (e.g., the compositions of Holland-Dozier-Holland, and Adele and Paul Richard Epworth, respectively) that are incorporated into the sound recordings performed (e.g., the Four Tops and Adele, respectively).

To further illustrate this point: Pandora’s 2012 annual report stated that it paid 49.7% of its revenue in royalties to SoundExchange, and 4.1% of its revenue in royalties to the US PROs, namely, ASCAP, SESAC, and BMI. In other words, from the total pool of monies paid for the performance of music and sound recordings, almost 92% of the money paid by internet radio flows to record labels and performing artists through SoundExchange, and only 8% of it is paid to songwriters and publishers. Another way to view this example is that the owners of the sound recording and the recording artists (e.g., the Four Tops and Adele, as performers, and their record labels) receive \$92 out of every \$100 in total music royalties paid by internet radio providers, with 50% of this \$92 in sound recording fees going to the labels and 50% to the performers.² The individual songwriters and publishers (e.g. Holland-Dozier-Holland, and Adele and Paul Richard Epworth as writers and their publishers), through the PROs, receive only a small fraction -- \$8 -- of the total \$100 paid by Pandora for its performance of music, with 50% of that \$8 going to the writers and 50% to the publishers under normal US PRO distribution rules. This almost 12-to-1 disparity in SoundExchange and PRO

¹ The separate consent decrees with the United States that govern the business practices of BMI and ASCAP each provide for a rate court through which the separate PROs and their music-using licensees can seek the determination of a reasonable license fee.

² To be precise, of the 50% to performers, 5% is split between non-featured performers (such as background singers and musicians), and the remaining 45% is paid to the featured recording artist(s) on the sound recording. 17 U.S.C. (g)

payments is unprecedented in the global music marketplace. Around the world, the opposite occurs; the public performing right in the underlying music composition is paid at far higher rates than the public performance right in the sound recording. In fact, the latter right is sometimes referred to as a “neighboring right,” in recognition that rewarding the creators of the musical work -- when it is publicly performed -- is a central tenet; without the creation of the underlying musical work, there would be nothing to record.

There are many reasons for this disparity, including (a) the mandatory nature of performing rights licenses as required by the BMI and ASCAP consent decrees; and, most critically, (b) the refusal of our rate courts to even consider SoundExchange royalties (pursuant to Section 114(i) of the copyright law). These constraints impact even voluntarily-negotiated licenses between PROs and music users. We welcome the opportunity, at a future point in time, to explore these factors in greater detail.

We believe as a general matter that copyright owners are entitled to fair market value rates. Accordingly, we support the willing buyer/willing seller standard in Section 114. However, this rate disparity illustrates our point that different rights holders are subject to disparate treatment, and identifies an inequity that should be remedied by Congress after reviewing how this gross and anomalous disparity in remuneration received by these distinct sets of rights holders has evolved in the U.S.

As a result, there is in the PROs’ view a gross disparity between the fair market royalties paid to SoundExchange and the nominal license fees paid to songwriters, and the trend, as a consequence, has significantly diminished the value of the musical work copyright below what ought to be its true, fair market value.

Concerns regarding H.R. 6480

While the lion’s share of H.R. 6480 is focused on altering the standard for rate-setting for the digital transmission of sound recordings -- so as to achieve a lower rate -- the bill contains a number of additional provisions that are so broad that they might have unforeseen consequences on the business practices of PROs or to the musical works the PROs license. Our concerns with each of these provisions are as follows:

- H.R. 6480 would prohibit the use of collective licenses as benchmarks in Copyright Royalty Board rate proceedings, by only permitting the introduction of agreements with a licensor that does not possess “market power” resulting from the aggregation of copyrights, either by a licensing collective or individual owner.³ While this provision would not impact PRO rate court proceedings directly, the language could be perceived as treating as inherently suspect the model of collective licensing, a licensing method that the United States Supreme Court, in the *CBS* case, recognized as an efficient means of providing blanket access to a wide-ranging musical repertoire.⁴ The suggestion, implicit in this bill, is that collective licenses (which often represent the product of negotiations between rights organizations and sophisticated and well-funded business conglomerates)

³ See H.R. 6480, Sec. 3(a)(3)(B) (definition of “Competitive market circumstances,” and Sec. 3(a)(1)(B) and Sec. 3(a)(2)(A)(II)(placing burden of proof of competitive market circumstances on the copyright owners).

⁴ The Supreme Court, in the same case, rejected the notion that blanket licenses were a per se violation of the antitrust laws. *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979) (“*CBS*”).

Letter to Hon. Goodlatte and Hon. Watt, November 19, 2012, page 4

are inherently untrustworthy instruments of market power. Such a suggestion is unfounded and would preclude the Copyright Royalty Board from even considering (and, in its discretion, giving the weight it chooses) to any industry-wide collective voluntarily negotiated license.

- H.R. 6480 prohibits owners of sound recordings, or their agents, from taking any action that would “prohibit, interfere with, or impede direct licensing by copyright owners of sound recordings.” This language, particularly with its prohibition against “impeding” direct licensing, is both unduly broad and vague.
- H.R. 6480 calls for the establishment of a federal government-facilitated or established global music registry. This is wholly unnecessary, particularly in light of ongoing international database initiatives led and funded by the world’s PROs, with the participation of music publishers and music users, to establish just such a registry. The contribution of the federal government’s energies and resources are not needed, and Congress should allow the ongoing privately-driven initiative to proceed without government interference.

Conclusion

In sum, the U.S. PROs welcome the Committee’s review of music licensing reform, beginning with H.R. 6480, and in that regard, we have some specific concerns, identified above. However, we fear that the Committee’s focus is too narrow, examining only one group with interests in the sound recordings of musical works, and not taking into account a more balanced view and the impact on other groups with interests in the musical works underlying these recordings -- those of America’s music creators and publishers and our members.

As demonstrated above, there are significant disparities in remuneration for different rights, and an undervaluation of the public performing right in music works in the U.S. This result, counter to global practices, is harmful to America’s music creators and impedes their ability to continue to enrich America’s musical heritage and contribute to America’s economy. PROs represent the creators of this most valuable cultural export, and any discussion of the music licensing landscape needs to include our perspective.

We look forward to working with your Committee in this Congress and next.

John LoFrumento
Chief Executive Officer
American Society of Composers,
Authors and Publishers (ASCAP)
One Lincoln Plaza
New York, NY 10023

Del Bryant
President & Chief Executive Officer
Broadcast Music, Inc. (BMI)
7 World Trade Center
250 Greenwich Street
New York, NY 10007-0030

Pat Collins
President & Chief Operating Officer
SESAC, Inc.
55 Music Square East
Nashville, TN 37203

Barton Herbison
Executive Director
Nashville Songwriters Association
International (NSAI)
1710 Roy Acuff Place
Nashville, TN 37203

cc: Members of the Subcommittee on Intellectual Property, Competition, and the Internet,
Congressional House Committee on the Judiciary

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THE RECORDING ACADEMY®
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 ADVOCACY & INDUSTRY RELATIONS

The Honorable Jason Chaffetz
 U.S. House of Representatives
 1032 Longworth HOB
 Washington, DC 20515

October 1, 2012

Dear Congressman Chaffetz:

On behalf of The Recording Academy, the trade association representing musicians, singers, songwriters and studio professionals, I am contacting you to express our strong opposition to H.R. 6480, the "Internet Radio Fairness Act," which you introduced on September 21, and the companion bill introduced in the Senate by Senator Ron Wyden (S. 3609).

On September 25, in an interview discussing the bill with *Radio Ink*, you stated that "artists are thrilled about this and it would make a lot of sense for artists on all sides of the equation." I assure you this is not the case. Unfortunately, for artists and the other individuals who create music, H.R. 6480 is more "chilling" than "thrilling." In fact, the bill would only add insult to injury for music creators. The insult is that the bill claims to create fairness but fails to address the real inequity that while Internet radio services properly pay creators, terrestrial radio broadcasters pay nothing. The injury is that the bill would severely cut the royalties that digital music providers pay to creators to a below-market level, undermining their ability to make a living from their hard work.

Achieving royalty rate parity for all radio platforms is an important goal that requires Congress' attention, but real parity must include two critical elements. First, real rate parity must include a royalty rate that reflects the fair market value of the music that radio services use to build their businesses, not pushing all services down to a standard that amounts to a government-mandated, below market subsidy. Second, real rate parity must close the loophole that allows broadcast radio to reap billions of dollars in advertising revenue without compensating the music creators they rely on. Radio broadcasters are the only business in America that can use another's intellectual property without permission or compensation. Internet, satellite and cable radio all compensate performers. Fairness in radio will only be realized when Congress closes the terrestrial radio loophole.

I urge you to withdraw the "Internet Radio Fairness Act" and work with the artist community to craft a legislative solution that will provide genuine parity for everyone. We stand ready to work with you to provide the music creators' viewpoint.

Sincerely,

A handwritten signature in black ink, appearing to read "Daryl P. Friedman". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Daryl P. Friedman

Chief Advocacy & Industry Relations Officer
The Recording Academy

cc:
U.S. House of Representatives
U.S. Senate





WASHINGTON BUREAU : NATIONAL ASSOCIATION FOR THE ADVANCEMENT OF COLORED PEOPLE
 1156 15TH STREET NW SUITE 915 WASHINGTON, DC 20005 P (202) 463-2940 F (202) 463-2953
 E-MAIL WASHINGTONBUREAU@NAACPNET.ORG WEB ADDRESS WWW.NAACP.ORG

November 2, 2012

The Honorable Lamar S. Smith
 Chairman
 Committee on the Judiciary
 U.S. House of Representatives
 Room 2138 Rayburn HOB
 Washington, D.C. 20515

The Honorable John Conyers, Jr.
 Ranking Member
 Committee on the Judiciary
 U.S. House of Representatives
 Room 2142 Rayburn HOB
 Washington, D.C. 20515

The Honorable Bob Goodlatte
 Chairman, Subcommittee on
 Intellectual Property, Competition and
 the Internet
 Committee on the Judiciary
 U.S. House of Representatives
 Room B-352 Rayburn HOB
 Washington, D.C. 20515

The Honorable Melvin Watt
 Ranking Member, Subcommittee on
 Intellectual Property, Competition and
 the Internet
 Committee on the Judiciary
 U.S. House of Representatives
 Room B-351 Rayburn HOB
 Washington, D.C. 20515

RE: NAACP OPPOSITION TO THE INTERNET RADIO FAIRNESS ACT

Dear Chairman Smith, Ranking Member Conyers, Chairman Goodlatte, and Ranking Member Watt,

On behalf of the NAACP, our nation's oldest, largest and most widely-recognized grassroots-based civil rights organization, I write to oppose the "Internet Radio Fairness Act" (IRFA), (H.R. 6480 / S. 3609), a bill that would unfairly deprive artists and performers of fair pay for their hard work. As an organization which has, for more than 103 years, fought for economic justice for all Americans, this legislation is clearly antithetical to the work of the NAACP. Quite frankly, the IRFA bill fails the basic test of economic fairness and discriminates against singers and musicians by slashing the compensation they receive when their work is played over digital online radio.

Fair and adequate compensation for a day's work is a fundamental civil and labor right. It was the foundation of Martin Luther King, Jr.'s Poor Peoples Campaign and it's the reason he was in Memphis supporting the sanitation workers in April 1968 when he was murdered. Economic Justice was always central to Dr. Kings' work, as well as to the mission of the NAACP since our inception.

Under current law, all webcasters pay a rate set by the Copyright Royalty Board (CRB) according to a "willing buyer, willing seller" standard. That is to say, they pay the market value for the use of sound recordings, and singers and musicians are compensated accordingly.

More than eighteen hundred Internet Radio stations currently pay performance royalties according to this standard, which is more than a decade old. Yet now, Internet some radio giants want to change the law so they can pay a lower, below-market rate enjoyed by just three digital services that were exempted from the CRB standard (or "grandfathered") when it was established in the 1990s. Thus, the IRFA bill would mandate that more than eighteen hundred Internet Radio stations pay recording artists and musicians far less than their recordings are worth, just because a very few, older, digital services do. This would start a race to the bottom in performer's compensation, violating the founding principle of America's labor movement: a fair day's work deserves a fair day's pay.

Many of the performers who would be affected by this lower compensation rate are the now elderly singers and musicians from the Motown era who received little pay for their original work and are dependent on this modest performance royalty that would be eviscerated under IFRA. These musical heroes may not have written the songs we love, but they brought them to life with their performances and deserve fair pay when their hard work is utilized.

Accordingly, I urge you again to oppose the Internet Radio Fairness Act and instead to work with all stakeholders on a new bill to protect the labor and economic rights of artists and performers and put all forms of commercial broadcast performance on a sound, fair and long-term healthy financial footing.

Thank you for your attention to the concerns of the NAACP. If I can be of any further assistance to you, or if you would like any further elaboration on the NAACP position, please do not hesitate to contact me at (202) 463-2940. I look forward to working with you on this matter.

Sincerely,



Hilary O. Shelton
Director, NAACP Washington Bureau &
Senior Vice President for Advocacy and Policy



A MUSICIANS' PERSPECTIVE ON PANDORA

We are big fans of Pandora. That's why we helped give the company a discount on rates for the past decade.

Pandora is now enjoying phenomenal success as a Wall Street company. Skyrocketing growth in revenues and users. We celebrate that. At the same time, the music community is just now beginning to gain its footing in this new digital world.

Pandora's principal asset is the music.

Why is the company asking Congress once again to step in and gut the royalties that thousands of musicians rely upon? That's not fair and that's not how partners work together.

Congress has many pressing issues to consider, but this is not one of them. Lets work this out as partners and continue to bring fans the great musical experience they rightly expect.



Bryan Adams	Cee-Lo Green	Rush
Alabama	Cyptian	Bobby Rush
Greg Allman	Warren Haynes	Joe Sample
Steve Angello	Don Henley	David Sanborn
Rodney Atkins	Hootie and The Blowfish	Slid Row
Sara Bareilles	Mallory Hope	Michael W. Smith
Big Bad Voodoo Daddy	Bruce Hornsby	Esperanza Spalding
Big Sean	Mick Hucknall (of Simply Red)	Brimey Spears
Clint Black	The J. Geils Band	Ronnie Spector
Jack Blades	Jaimoe	Dave Stewart
Blondie	The Jazz Crusaders	Jacob Summers (of Laura/Laura)
Jonatha Brooke	Jimmy Jam	Survivor
Jackson Browne	Billy Joel	T.I.
Jimmy Buffett	John Paul Jones	Susan Tedeschi
Oteil Burbridge	Mick Jones (of Foreigner)	Robin Thicke
The Cab	Journey	George Thorogood
Colbie Caillat	Jim Kerr and Charlie Burchill	TOTO
Camper Van Beethoven	(of Simple Minds)	Butch Trucks
CoCo Carmel	KISS	Derek Trucks
George Clinton	Jana Kramer	Josh Turner
Keyshia Cole	Lisa Loeb	Frankie Valli and Bob Gaudio
Natalie Cole	Ludacris	(The 4 Seasons)
Common	Maroon 5	Dionne Warwick
Easton Corbin	Nick Mason	Roger Waters
Cowboy Mouth	Duff McKagan	Bobby Whitlock
Cracker	Megadeth	Whodini
Randy Crawford	Janelle Monáe	Chuck Wicks
Robert Cray	Stanton Moore	Otis Williams (of The Temptations)
David Crosby	Aiissa Moreno	Ann and Nancy Wilson (of Heart)
Joel Crouse	Jason Mraz	Brian Wilson
Sheryl Crow	Nas	BeBe Winans
Drew Davis	Graham Nash	Trisha Yearwood
Taylor Dayne	Ne-Yo	Zac Brown Band
Dead Kennedys	Stevie Nicks	
Raheem DeVaughn	Night Ranger	
The Doors	Ted Nugent	
Down	Owi City	
The-Dream	Christina Perri	
Vikter Duplaix	Katy Perry	
Missy Elliott	Pink Floyd	
Lupe Fiasco	Robert Plant	
The 5th Dimension	John Pointer	
Flyleaf	The Pointer Sisters	
John Fogerty	Primus	
Guy Forsyth	Marc Quinones	
The Game	Joel Rafael	
Vince Gill	Bonnie Raitt	
David Gilmour	Martha Reeves	
Genevieve Goings	Rihanna	
Andy Grammer	Eric Roberson	
Amy Grant	Darius Rucker	



Learn more at: www.fairpayforartists.com



October 1, 2012

The Honorable Bob Goodlatte, Chair
Subcommittee on Intellectual Property, Competition, and the Internet
House Committee on the Judiciary
B-352 Rayburn House Office Building
Washington, DC 20515

The Honorable Mel Watt, Ranking Member
Subcommittee on Intellectual Property, Competition, and the Internet
House Committee on the Judiciary
B-351 Rayburn House Office Building
Washington, DC 20515

The Honorable Patrick Leahy, Chair
224 Dirksen Senate Office Building
Senate Committee on the Judiciary
Washington, DC 20515

The Honorable Chuck Grassley, Ranking Member
152 Dirksen House Office Building
Senate Committee on the Judiciary
Washington, DC 20515

RE: H.R. 6480/S. 3609 ("The Internet Radio Fairness Bill")

I am writing on behalf of the American Association of Independent Music ("A2IM") to express our thoughts regarding H.R. 6480/S. 3609 ("The Internet Radio Fairness Bill") and the potential effects on independent music labels and their artists.

Independent labels and artists care deeply about the growth of Internet radio. Pandora and services like it have enabled many independent labels and artists to obtain radio airplay, build their audience and receive crucial compensation. At broadcast (FM/AM) radio, independent music is approximately 10% to 12% of overall radio spins/ratings versus Internet radio where approximately one-third of music streamed is independent music. As a result, you cannot find stronger supporters of Internet radio broadcasters than they have in the independent community. It is important to independents that Internet radio continues to grow and become a larger and sustainable part of the radio landscape to provide access to all creators.

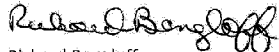
Simultaneously, we are concerned about some of the provisions in H.R. 6480/S. 3609 and we feel strongly that this bill does not represent an appropriate solution. At the outset, the bill purports to create fairness and parity in compensation rate standards among platforms, yet fails to address a glaring inequity in current law: the singular exemption of over-the-air broadcast terrestrial radio from paying a

performance right to performers and music labels for playing their songs, while digital radio does compensate the creators of sound recordings. This disparity not only deprives music creators of fair compensation but also creates an unlevel playing field between music platforms. Any bill that aspires to create fairness and parity must create an FM/AM broadcast radio terrestrial performance right royalty to be paid to artists and labels. The current level of disparity between the royalty rates paid by Internet radio at one end of the spectrum and over-the-air broadcast terrestrial radio—which pays nothing to performing artists and labels—at the other end of the spectrum is an obvious problem and correcting that inequity should be the first legislative step towards creating “radio fairness”.

In addition to this important omission, instead of creating fairness for Internet platforms, the bill starts a race to the bottom by drastically reducing the rate paid for many Internet radio payments to artists and record labels to below the government mandated rate. Under current law, Internet radio broadcasters compensate labels and artists under the “willing buyer, willing seller” rate standard. As the term suggests, it is intended to approximate a fair market rate and is decided via input presented at the Copyright Royalty Board by all sides and then decided upon by this three judge panel insuring that individual negotiated direct licenses need not be negotiated between service and copyright owner (a situation that would enrich attorneys and favor major labels and superstar artists to the detriment of independent creators wishing to be fairly compensated for their contributions). The proposed legislation would change the standard to a far below market rate and would require music labels and artists to take less than their work is worth, in order to subsidize Internet radio companies. We encourage Congress to work with all of the affected parties to develop a solution that enables Internet radio to grow and become a larger and sustainable part of the radio landscape while also assuring that labels and musicians are fairly compensated for their extraordinary creative efforts whenever their music is performed on the radio.

Music labels and artists have taken some hard hits in the last decade as we’ve had to adjust to a business model based largely upon performance royalty revenues as consumer behaviors shift to consuming music via Internet radio and other means in place of music purchasing. It should not be mistaken, however, that these revenue hits and consumer changes indicate a diminished importance in the power of music as a driver for services including radio and Internet radio. Fair compensation should be the common sense rule whereas it applies to any service performing music to attract fans. H.R. 6480/S. 3609 would add further to the financial harm of musical Intellectual Property creators trying to make a living. We urge you to reject misleading titles of “fairness” and claims of “parity” and oppose this bill. Please do not hesitate to contact us with any questions you may have about our position.

Very truly yours,



Richard Bengloff
President
American Association of Independent Music (“A2IM”)

cc: Members, House and Senate Judiciary Committees

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS



815 SIXTEENTH STREET, N.W.
WASHINGTON, D.C. 20006

RICHARD L. TRUMKA
PRESIDENT

ELIZABETH H. SHULER
SECRETARY-TREASURER

ARLENE HOLT BAKER
EXECUTIVE VICE-PRESIDENT

LEGISLATIVE ALERT!

(202) 637 5067

October 19, 2012

Dear Representative:

On behalf of the AFL-CIO, I urge you to oppose H.R. 6480, the "Internet Radio Fairness Act" (IRFA), a bill that unfairly robs recording artists and musicians of their fair pay in order to subsidize the profits of Internet radio companies like Pandora. I urge you not to cosponsor this legislation and instead work with the singers and musicians represented by the AFL-CIO to craft a new bill that would end decades of discrimination in the radio industry.

Under current law, all webcasters pay a rate set by the Copyright Royalty Board (CRB) according to a "willing buyer, willing seller" standard. That is to say, they pay the market value for the use of sound recordings, and singers and musicians are compensated accordingly.

More than eighteen hundred Internet Radio stations pay performance royalties according to this standard, which is more than a decade old. Yet now, Internet radio giants like Pandora want to change the law so they can pay a lower, below-market rate enjoyed by just three digital services that were exempted from the CRB standard when it was established in the 1990s. If Congress were to change anything, it should end this exemption so these three services pay the market rate – not let all webcasters pay unfair, below-market royalties.


Instead, the IRFA would mandate that more than eighteen hundred Internet Radio stations pay recording artists and musicians far less than their recordings are worth, just because three digital services do. This would start a race to the bottom in performers' compensation, violating the founding principle of America's labor movement: a fair day's work deserves a fair day's pay.

Moreover, webcasters do not need a government handout financed on the backs of working musicians. In fact, webcasting is a growing industry that many see as the future of radio. Industry leader Pandora recently celebrated an IPO that raised \$235 million on the first day of trading, and is expected to make more than \$600 million in revenues next year. Major AM/FM radio companies also see opportunities in this space, and are creating their own digital webcasting services. As this industry grows, music creators deserve to benefit, not just corporations.

The deeper flaw in the IRFA is that it fails to close the decades-old special interest loophole that exempts AM/FM radio stations from paying any performance royalty whatsoever. Each year, these radio corporations make billions in advertising dollars by playing hit songs without paying a cent to the singers and musicians that performed those songs. The U.S. is the only developed nation in the world — aside from a few others, like China, North Korea, and Iran — that does not recognize a performance right (and royalty) for over-the-air broadcasts. Any legislation that seeks to “level the playing field” for performance royalties among radio broadcasters must first close this loophole.

For the above reasons, I urge you not to cosponsor the proposed legislation and work with the AFL-CIO to write a new bill that would ensure that all radio platforms fairly compensate recording artists and musicians.

Sincerely,



William Samuel, Director
Government Affairs Department





**AMERICANS
for TAX REFORM**

Grover G. Norquist
President
November 13, 2012

722 15th Street N.W.

Fourth Floor

Washington, DC

20004

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Fax: 202-857-1200

www.atf.org

The Honorable Patrick Leahy,
Chairman
The Honorable Chuck Grassley,
Ranking Member
U.S. Senate Committee on the
Judiciary
224 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Bob Goodlatte,
Chairman
The Honorable Mel Watt
Ranking Member
U.S. House of Representatives
Subcommittee on Intellectual
Property, Competition and Internet
2138 Rayburn House Office Building
Washington, DC 20515

Dear Senators & Congressmen:

On behalf of Americans for Tax Reform, I write to you regarding The Internet Radio Fairness Act. This legislation would replace one compulsory model for government price setting of copyrighted material with another. While the current so-called "willing buyer willing seller" model may attempt to mimic a free market negotiation by looking at free market deals as a benchmark, the standard in IRFA moves in an even worse direction towards forced below-market rates. Both the existing and proposed models pick winners and losers, rather than allowing free market negotiations.

The entire existing price-controlled arrangement is unfortunate and unnecessary. Instead, all parties, e.g. writers, artists, recording companies, broadcasting companies and others, should be allowed to negotiate mutually agreeable terms. There is no way, ultimately, for a legislator to decide what the fair market value of a product or service is. That is what the market is for.

We should move toward a market where setting prices, forbidding actions on one side or the other, preventing the acceptance of payment for one service or another, or prohibiting collection of compensation for the use of property are things of the past.

We believe strongly both in an open and free market, *and* the vigilant protection of property rights. I strongly urge you to move toward a market solution. When the government sets the rate for music, it is enacting price controls, in

AMERICANS
TAX REFORM

Page 2 of 2

opposition to what should be the agenda of a Congress that supports the market economy. Rates should be allowed to emerge according to supply and demand. Government should extract itself from this debate to allow an environment for negotiations to develop among broadcasters, record companies, artists, and other interested parties.

The debate on performance rights is an interesting and important one. Ultimately, it should be made in the marketplace, not in House and Senate office buildings. I urge you to enact reforms that protect intellectual property, nurture the private sector and allow the free market to determine prices and compensation for labor and intellectual property.

Onward,



Grover G. Norquist

CC: U.S. House Committee on the Judiciary, U.S. Senate Committee on the Judiciary



Thomas A. Schatz
President

November 16, 2012

The Honorable Patrick Leahy, Chairman
The Honorable Chuck Grassley, Ranking Member
U.S. Senate Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Bob Goodlatte, Chairman
The Honorable Mel Watt, Ranking Member
U.S. House of Representatives
Subcommittee on Intellectual Property,
Competition and Internet
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Senators and Congressmen,

On behalf of the more than one million members and supporters of the Council for Citizens Against Government Waste (CCAGW), I am writing to you regarding concerns we have with H.R. 6480 and S. 3609, the Internet Radio Fairness Act of 2012.

The growth of Internet radio has added to existing digital satellite and cable services and provided new platforms for listening to music, including mobile access. In this digital radio world, owners and creators of copyrighted material, including artists and recording companies, are subject to compulsory licensing, with rates set by the government. Due to a "grandfather clause," satellite and cable radio rates are still set under a standard developed in the 1970s for television signal retransmission that locks in old business models and technology by preventing "disruption" of established services. This results in below-market rates and a subsidy for these entrenched services. Internet radio rates are set under a newer standard that must consider marketplace benchmarks to determine what a "willing buyer would negotiate with a willing seller in the marketplace" to arrive at a fair market value for the product.

Rather than providing parity by applying the newer free-market based standard to all services, H.R. 6480 and S. 3609 provide the opposite: placing all services under the old standard that forces below-market rates currently paid by the three "grandfathered" services (Music Choice, XMSirius, and Musak.) The result is to move nearly 1,800 entities that currently operate under the market-based standard down to the below-market standard, instead of moving the three grandfathered entities up to the market-based standard. And the bill proposes a new, political, presidentially appointed board that will maximize the lobbying potential of the recipients of the government subsidy.

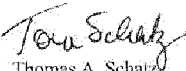
The hearing scheduled by the Subcommittee for November 29 is an encouraging start to a needed debate on reforms that should enable the removal of barriers to market negotiation

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Phone 202-467-5300
Fax 202-467-4253
www.cagw.org

between the owners and creators of copyrighted content and the digital radio services that use their works. While we agree with the basic premise that all services should be treated equally, it should be under market-based standards. It is imperative that Congress protect intellectual property rights, and allow the free-market to work in pricing negotiations.

Thank you for your consideration of CCAGW's comments on this important issue.

Sincerely,


Thomas A. Schatz





November 26, 2012

The Honorable Bob Goodlatte, Chairman
 The Honorable Mel Watt, Ranking Democratic Member
 Subcommittee on Intellectual Property, Competition and the Internet
 Committee on the Judiciary
 U.S. House of Representatives
 Washington, DC 20515

Dear Chairman Goodlatte and Ranking Member Watt:

On behalf of the Recording Industry Association of America (RIAA)¹ and its member companies, I am writing to bring your attention to proposed legislation that would stifle the development of new innovative digital music services, decrease competition in this vibrant marketplace, and completely upend an established rate-setting system in favor of a shockingly one-sided process that rewards entrenched music services at the expense of new business models and music creators.

“The Internet Radio Fairness Act” is anything but fair, discarding a market-based royalty rate-setting standard in favor of one that goes out of its way to disadvantage both new services and the artists who create the music. The standard proposed by IRFA includes a factor that would prevent the “disruption” of old technology and old business models. In other words, it would “lock in” through subsidies the existing services. The standard has also been found by the administrative court to require below-market royalties to those who work to produce the music, and we estimate that artist royalties could be cut by more than 85%. If the government is to insist that recording owners must license their music to these services, shouldn’t the compulsory rate at least be market-based, and promote competition, new business models and new technology?

The legislation claims to create parity in rate standards between music service platforms. We agree that parity is necessary. Market-based rates should apply to all services that use music. A race to the bottom that instead sets rates for music at below-market prices for all services will result in less music, less innovation, and fewer successful business models and services that can compete while serving both consumers and creators. And true platform parity must address the most glaring inequity of all – AM/FM radio. Commercial terrestrial radio can take artists’ music without permission and without paying – the ultimate and complete “special interest” exemption.

Consider Pandora, the company that is leading the charge for this unfair legislation. We have been very supportive of Pandora over the years. The recording industry has helped Pandora grow from a

¹ The RIAA is a trade group representing the U.S. recording industry. Its members create, manufacture and/or distribute approximately 85% of all legitimate sound recordings produced and sold in the United States.

small start-up to a successful and popular online service. But Pandora – the service that claims it needs financial help from Congress – is now a publicly traded company with a valuation of \$1.5 billion. It has enjoyed 99% year-over-year revenue growth and has amassed a listener base of 150 million people. The top five executives were paid \$11.8 million in FY '12, not including founder Tim Westergren's salary or his exercised stock and options worth over \$6 million in the first half of 2012 alone – hardly the poster child of a company in need of a bailout or a government subsidy. Indeed, Pandora itself claims that its future is bright and it doesn't actually need royalty rate relief.

Perhaps this discussion could be taken more seriously if it were the first time Congress was asked to intervene. The fact is that Pandora and other webcasters have repeatedly balked at paying fair rates. When rates were first set in 2002, webcasters engaged their listeners as their grassroots to get a 50% discount. They subsequently demanded a change to the rate-setting system, and supported changes they asked Congress to pass. Yet, when the very Copyright Royalty Board that they fought to establish set new rates in 2007, webcasters – led by Pandora – balked again. Pandora mobilized its vast online user base to mount a massive PR campaign, which led to new legislation for negotiations on lower rates. Content owners granted webcasters a significant discount on market rates, and the settlement, Pandora's Westergren reported, provided the "certainty required for companies to develop more concrete business models." Yet here they are, a mere three years later, back again at your doorstep.

Unfortunately, Pandora has failed to pursue the "more concrete business models" Mr. Westergren promised. The company simply has chosen not to aggressively monetize its service. As one investment analyst noted, "If Pandora ran several minutes of audio ads per hour (the way satellite radio and terrestrial radio do) versus just a few 15-second spots, the percentage of revenues paid out as royalties would be dramatically lower and would be more in line with satellite radio or cable TV." Of course, it's just easier for Pandora to cut costs (*i.e.*, cutting compensation to below-market rates for the creators of the music that drives its business) than it is to work on building revenue.

At some point, Pandora must accept that finding a business model that can compete in the market is essential. The music industry has certainly adapted its business models over the years. Pandora must meet the same market demands. Cutting costs by refusing to properly pay creators of your core product is certainly not fair. Neither is it the right solution. If Pandora has a problem, it's not a cost problem, it's a revenue problem that it alone should solve.

It's time to tell Pandora enough is enough. As the company tells its own investors, there is a lot of upside. But it doesn't need to come at the expense of our country's talented creators. Please oppose "The Internet Radio Fairness Act."

Sincerely,



Cary Sherman
Chairman and CEO



October 22, 2012

Re: H.R. 6480, the "Internet Radio Fairness Act"

Dear Representative:

On behalf of the 160,000 performers who are members of SAG-AFTRA, we urge you **not to cosponsor** H.R. 6480, the "Internet Radio Fairness Act," and **to oppose the bill** should it come to a vote. SAG-AFTRA includes thousands of recording artists and background vocalists who rely on the digital performance royalty streams this legislation would decimate.

Furthermore, of vital importance, H.R. 6480 completely ignores the worst and most longstanding injustice in the radio industry: the special interest loophole that allows terrestrial radio platforms to use sound recordings without paying any performance royalty to performers. This is grossly unfair to our members who earn their livings as recording artists and singers and who deserve to be paid for the use of their creative work.

Over a decade ago, Congress passed federal legislation recognizing a performance right in sound recordings on digital radio services. This legislation established a royalty licensing framework that set performance royalty rates for sound recordings based on a "willing buyer, willing seller" or fair market value standard. This standard has allowed digital radio platforms to innovate and grow and has promoted an artist's right to receive fair pay for the use of their sound recordings. The legislation wasn't an unqualified victory for artists; Congress "grandfathered" an exemption for three entities already in existence, including the now merged XM and Sirius radio. These entities were allowed to pay artists below market rates. But it ensured that the vast majority of digital services – today numbering over 1,800 – would pay a fair, market rate to performers.

Under this framework, the industry has exploded; Pandora completed a profitable IPO last year and expects to bring in more than \$600 million in revenues next year. This framework has also attracted others, like Clear Channel, which recently launched iHeart Radio. Clearly, unlike the lack of a performance right on terrestrial radio, this framework is not broken and it needs no legislative solution.

Instead, H.R. 6480 establishes a new, unfair standard by which digital radio will pay *less than the fair market value* for the use of sound recordings. Proponents argue that all digital radio services should pay below-market rates similar to those enjoyed by just a few companies, including XM/Sirius. But two wrongs don't make a right. If anything, Congress should end below market, grandfathered rates, bringing them up to the fair market value rate and properly compensating artists for the use of their recordings.

We strongly urge you to stand up and **oppose H.R. 6480** on behalf of the hard-working recording artists and singers who deserve to receive fair pay for air play.

Sincerely yours,



Terrie M. Bjorklund
National Director of Government Affairs and Public Policy





733 10th Street, NW | 10th Floor | Washington, DC 20001
 P: 202.640.6858 | F: 202.640.5859 | SoundExchange.com

October 2, 2012

Dear Representative,

On behalf of the tens-of-thousands of recording artists and copyright owners that SoundExchange represents, I am writing to request that you **OPPOSE** the so-called "Internet Radio Fairness Act" (IRFA), (H.R. 6480/S. 3609). Despite its name, the IRFA is simply *not fair* to the creators of music whose work make up the main component of Internet radio. This bill seeks to transfer money from the pockets of musicians into the hands of those who profit from their work.

SoundExchange is the industry-wide organization selected under federal law to administer the statutory license used by more than 1,800 digital radio services - like Pandora, iHeartRadio, and Sirius XM. We collect performance royalties from these digital services for the use of sound recordings, along with immense amounts of usage data, and distribute these royalties quarterly to our over 70,000 performer accounts and 24,000 rights owner accounts. It's our mission to protect the people we represent, and help promote a vibrant future for the digital music industry.

At its core, the IRFA is an attempt by webcasters to reduce the royalty fees that recording artists and record labels are paid for the privilege of using their sound recordings on digital radio. Right now, the law requires the webcasting rates to be set by the Copyright Royalty Board (CRB) under a "willing buyer, willing seller" standard - that is, the fair market value of a recording. This bill, however, seeks a change in the law to revert an older standard that was set more than 15 years ago, and currently used by only three "grandfathered" services. This means that the rate could be set at less than fair market value, potentially much less. In other words, of the more than 1,800 services paying SoundExchange every month for the use of sound recordings, all but three of them are paying at the "willing buyer, willing seller" standard.

The main goal of the IRFA is to lower the rate standard for all services down to the antiquated below-market rate, rather than requiring that all services pay at the more reasonable fair market rate. Nothing could be further from "fair" - particularly when you consider that the law allows digital radio services to build their businesses off any commercially available work without music creators' having the ability to withhold. At the very least, the law should require that those creators are compensated at a fair market rate.

Most surprisingly, this bill seeking supposed "parity" utterly fails to address the biggest inequity of all when it comes to radio: the fact that terrestrial (i.e. over-the-air) radio pays absolutely nothing for the sound recordings on which their multi-billion dollar business is based. It is futile to even begin discussing "parity" in radio while ignoring the most egregious inequity of the system.



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Ultimately, the IRTA would give a subsidy to Internet radio in the form of a below market royalty rates. But Internet radio does not need a government subsidy. Internet radio has seen explosive growth in both usage and revenues in the last few years – a sign of a rapidly growing market. As one very recent and very public example, Pandora had a successful IPO that raised \$235 million, and is currently valued at \$1.72 billion. In addition, many Internet radio services – like many popular online services – are focused on building their audience, and laying the foundation for explosive and disruptive revenue growth in the future. That strategy is a fine one to pursue; however the law should not force artists to subsidize it.

We agree that the current royalty setting situation is not fair. Terrestrial radio does not pay artists one cent for the music it plays. We believe everyone should pay for the use of creators' music, and we believe everyone should pay according to the same rate standard. But that standard should result in a market rate. Only then will true "fairness" be served.

We ask that you join us and fight for true fairness and for the value and future of music.

Sincerely,

A handwritten signature in black ink that reads "Michael Huppe". The signature is written in a cursive, flowing style.

Michael Huppe
President
SoundExchange





May the Market Force Be With You

David Williams

11-26-2012 at 08:09 am



The House Judiciary Committee is holding a hearing this week on proposed legislation that could lock in the way people currently listen to Internet radio, preventing the development of new business models. The hearing will address royalties that are paid by Internet, cable, and satellite radio stations for the music they play. Owners of copyrighted material are subject to compulsory licensing, which means that an individual or company that wants to use valuable commercial copyrighted music can do so without seeking consent from the owner, as long as they are willing to pay a fee fixed by the government. Nothing prevents a digital radio company and a music owner to

negotiate a free market deal outside the compulsory license, but most use it. This is how an artist or record label gets paid and is a critical concept when it comes to listening to digital radio on-line or via cable or satellite.

Currently, Pandora, and all other digital radio services, pay this government-set fee for the music they use to support their businesses. The rate standard used by the government to set this fee was established under a 1998 law, and it requires that an "expert panel" use the free market as a benchmark to determine what should be paid to owners for the use of their music. Three companies (satellite and cable radio companies) were "grandfathered" in under a lower rate standard, because they existed before the new law was passed. This lower standard assures that the fee set by the government for the use of music by these three companies will not "disrupt" their business models or technology. Unhappy with their current financial arrangement, which they actually worked out in the marketplace with music creators, Pandora now wants to lower the market-based rate standard that applies to all companies launched after 1998 to the lower standard that prevents disruption of their current model so they can pay below-market rates.

The problem is that Pandora isn't trying to get this below-market rate on their own, by, for example, offering benefits in the marketplace that will make up the difference or that might otherwise appeal to the owners of the music. Instead, they are using legislative channels to try and lower their costs. Legislation offered by Representative Jason Chaffetz (R-Utah) and Sen. Ron Wyden (D-Ore.) would institute, on top of the compulsory license, a government-forced subsidy creating below-market prices. According to *Roll Call*, "It would require the Copyright Royalty Board to evaluate Internet radio stations using the same standard as applied to satellite and cable radio providers, which, in effect, would lead to lower rates for the Internet stations."

http://www.protectingtaxpayers.org/index.php?blog&action=view&post_id=279

© Copyright Taxpayers Protection Alliance

Let's be honest, the last thing taxpayers need is another bureaucracy choosing winners and losers with no marketplace benchmarks or involvement.

There is no reason that Pandora should get this rate and there is no reason to get the government more involved. Taxpayers and consumers want new services born in the marketplace that offer better technology and better services for lower prices. They don't want the government to lock in or prevent disruption of entrenched services that are political favorites. That's not good for anyone. Over the past five years, there has been an explosion of Internet radio services going from from 855 to nearly 2,000. This is a whopping 134 percent increase. According to *Music Business Journal*, "Pandora is projecting total revenues around \$430 million for this full year and has reported steady growth in active users since 2008 as well as an 80% increase in total listener hours since 2011."

Pandora's expenses are a different story. It has been reported that over 50 percent of their revenue now goes towards licensing fees and Pandora claims that they are at a competitive disadvantage because of the three cable and satellite services that were grandfathered in under the old rate standard. That ignores the reality that there are 1,800 other services that operate under the more appropriate current standard of "what a willing buyer would negotiate with a willing seller" in the marketplace.

It is no wonder that Pandora wants to change their fee structure but it is totally inappropriate for them to get the government involved. They should use some good old fashioned common sense and look for ways to raise revenue and/or cut costs in other areas.

If government is to do something at all, a logical and fair resolution would be to eliminate the grandfathered below-market rate standard granted to the older entities so everyone is treated the same under a market-based rubric, rather than create new price controls for the thousands of companies created in an open market.





Testimony of Jodie Griffin
Staff Attorney
Public Knowledge

Before the
U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Intellectual Property, Competition, and the Internet

Hearing On:
Music Licensing Part One: Legislation in the 112th Congress

Washington, DC
November 29, 2012

Testimony of Jodie Griffin
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U.S. House of Representatives
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Hearing On: Music Licensing Part One: Legislation in the 112th Congress

November 29, 2012

Executive Summary

The Internet Radio Fairness Act (IRFA) sets out to create fairness in the radio marketplace. To actually achieve that goal, IRFA must follow three key principles:

- (1) **Encourage Markets.** IRFA must use a royalty standard that encourages innovation in a robust and sustainable online radio marketplace.
- (2) **Treat Like Services Alike.** IRFA must apply the same royalty standard to *all* types of radio services, including online, cable, satellite, and AM/FM radio.
- (3) **Compensate Artists.** IRFA must ensure that the radio marketplace fairly compensates actual artists.

Without any one of these principles, IRFA would at best be a missed opportunity and at worst could sideline artists and innovators and entrench power structures that discourage new entrants in the market.

In its present form, IRFA succeeds at the first goal and take steps towards achieving the second, but more work must be done to create a comprehensive reform of the online radio marketplace. The § 801(b) factors are a proven standard, taking into account the interests of parties on all sides, including the public. Accordingly, these factors should be applied to all forms of radio services, including traditional AM/FM broadcasting, which currently pays no sound recording royalties at all. IRFA currently does not require AM/FM radio to pay any sound recording royalties: this exemption should be eliminated, and AM/FM radio should pay royalties set under the same rate as that used for cable, satellite, and online radio. Favoring incumbent technologies over innovative new upstarts will only stunt the growth of the music business and discourage entrepreneurs and investors from entering the market.

Finally, the chief stated objection of many opponents to IRFA is that the change in ratemaking standards will decrease overall payouts to artists. Although this concern will not come to fruition if the § 801(b) standard succeeds in stimulating the growth of the online radio business overall and if the bill brings AM/FM radio into the fold, IRFA could add further structural protection for many individual artists by increasing the percentage of royalties that SoundExchange pays directly to the artist.

Introduction

To achieve true fairness in Internet radio, the Internet Radio Fairness Act should have three main goals:

- (1) Establishing a workable royalty standard that encourages innovation in a robust and sustainable online radio marketplace.
- (2) Applying that royalty standard to all types of radio services, including online, cable, satellite, and AM/FM radio.
- (3) Ensuring that royalty splits set by law distribute an adequate portion of the royalties directly to artists.

The online radio marketplace has the promise to be a robust and competitive market that benefits artists and consumers alike. Like many new technologies, online radio may also shake up the incumbent power structure and gatekeepers in the recorded music industry by helping artists reach consumers more meaningfully and get paid more directly. This opportunity should not be squandered, and the law should not waste the potential of the online radio marketplace by subjecting it to different rules and higher royalty rates than its predecessors and current competitors, such as AM/FM, cable, and satellite radio.¹

Online radio services currently pay the highest royalty rate of all radio services because its rates are set by the government under a different standard: the so-called “willing buyer/willing seller” standard. This standard, however, is ill-suited to creating reasonable rates for online radio: it was created before the online radio marketplace began to bloom, so there is no actual marketplace on which to base the rates, and the standard fails to take into account the uniquely monopolistic nature of the marketplace, since only SoundExchange can currently negotiate and administer the relevant rights.

In contrast to the high rates paid by online radio, terrestrial broadcasters pay no sound recording royalties at all.² Thus, services that make essentially the same use incur very different costs, depending only on the type of technology they use to send out programs to listeners. This creates a disincentive for companies to develop and invest in new technologies that provide new avenues for musicians to reach their fans.

The willing buyer/willing seller standard was set in 1998, when broadcasters did not seem to fully appreciate the future of online radio, and pure online radio services had not yet become significant industry players. We have now seen how this standard has proven itself incapable of leading to reasonable royalty rates for the market, and at the same time we have seen how similar services using incumbent technologies thrive under lower royalty rates. The only way to encourage growth in the radio marketplace and ensure reasonable compensation to

¹ These comments will use “radio,” without further qualification, to mean all noninteractive music streaming services, including cable, satellite, AM/FM, and online radio services.

² See *The Performance Rights Act: Hearing on H.R. 4789 Before the H. Comm. on the Judiciary*, 110th Cong. (2008) (statement of Nancy Sinatra) (“The competitive landscape thus is biased in favor of the old establishment players and against new start-up and innovative technologies . . . Now we have a situation where one format—AM/FM radio—has a competitive advantage over another: digital radio. . . This isn’t any more fair to digital radio than it is to artists.”).

artists is to require all radio services—online, satellite, cable, and AM/FM—to pay royalties for their use of sound recordings, and to use the same standard to determine those rates.

IRFA takes several important steps towards creating parity in the radio marketplace while still arranging for reasonable compensation to artists. However, in order to achieve full fairness between platforms, IRFA should also include AM/FM radio broadcasters in its royalty scheme, and include structural protections for artists, like a higher percentage of payments made through the compulsory license and consideration in the § 801(b) factors.

I. IRFA Should Establish a Workable Royalty Standard that Encourages an Innovative and Sustainable Online Radio Marketplace.

The Internet Radio Fairness Act proposes shifting the standard by which online radio royalty rates are set from the willing buyer/willing seller standard to the factors set out in § 801(b) of the Copyright Act.³ The § 801(b) standard is more appropriate and useful for determining reasonable online radio royalties, and indeed should be used for terrestrial radio as well.

The § 801(b) standard is currently used to determine royalty rates for digital cable and satellite broadcasters, namely: Sirius XM, Music Choice, and Muzak.⁴ This same standard is also used to set royalty rates in several other areas of the music industry, like mechanical reproduction royalties paid by record labels to songwriters, and for broadcasters' payments to performing rights organizations ASCAP, BMI, and SESAC.⁵

Section 801(b) directs the CRB to consider a set of factors in setting the relevant royalty rate:

- (A) To maximize the availability of creative works to the public.
- (B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
- (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.
- (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.⁶

³ See 17 U.S.C. § 801(b).

⁴ Glenn Peoples, *Business Matters: Let's Get Ready To Rumble! 2013's Dueling Internet Radio Royalty Bills*, BILLBOARD, (Sept. 27, 2012), <http://www.billboard.biz/bbbiz/industry/digital-and-mobile/business-matters-let-s-get-ready-to-rumble-1007962272.story>.

⁵ See 17 U.S.C. §§ 114(f)(1)(B), 115, 116.

⁶ 17 U.S.C. § 801(b).

These factors balance considerations for the level of compensation that should be distributed to the artists with the public interest in the distribution of works and the impact of the rates on the companies that will have to pay them. The § 801(b) standard is also on its face more in line with the Constitutional purpose of copyright law—creating economic incentives with the ultimate purpose of encouraging artists and platforms to create new works and bring those works to market.⁷

In past ratemakings, the CRB has used evidence from relevant or similar markets to estimate the upper limit of the compulsory rate.⁸ The CRB then applies the four factors of § 801(b) to adjust the rate as necessary.⁹ The first two factors are generally interpreted in the copyright owners' favor, while the third presents an opportunity for all parties to put forth evidence of the economic value of their contribution to the supply chain. In the past, the royalty rates have been lowered under the fourth factor to avoid significant disruption to satellite radio, but would also present an opportunity for copyright owners to present evidence on, for example, any substitution effects the online radio marketplace has on other product markets. Either way, the fourth factor does not in itself protect companies in any part of the process from going out of business.¹⁰

a. The Standard Proposed in IRFA Will Reach the Best Result for the Market

The factors set out in § 801(b) are more likely to consistently reach reasonable royalty rates than the willing buyer/willing seller standard. Practically speaking, the § 801(b) standard is likely to result in lower royalty rates (but not necessarily lower overall royalty payments) for the online radio market than the rate online radio companies currently pay. For example, in 2008, the CRB set a rate of 6-8% for subscription services and 7.25-7.5% for satellite digital audio radio services under the § 801(b) factors¹¹—far lower than the rates paid by online radio, which often equate to more than half of their revenue.¹² Notably, the major record labels have vigorously

⁷ U.S. CONST. art. I, § 8, cl. 8. *See also Mazer v. Stein*, 344 U.S. 201, 219 (1954) (“The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in ‘Science and useful Arts.’”).

⁸ Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 16, 4080, 4093 (Jan. 24, 2008), <http://www.loc.gov/crb/fedreg/2008/73fr4080.pdf>.

⁹ 17 U.S.C. § 801(b)(1)(A)-(D); Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 16, 4080, 4093 (Jan. 24, 2008).

¹⁰ Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 16, 4080 (Jan. 24, 2008) (CRB adjusting rates downward to avoid disruption to satellite companies); 63 Fed. Reg. 89, 25394, 25408 (May 8, 1998) (“The law requires the Panel, and ultimately the Librarian, to set a reasonable rate that minimizes the disruptive impact on the industry. It does not require that the rate insure the survival of every company.”).

¹¹ Royalty Fees for the Digital Performance of Sound Recordings and the Making of Ephemeral Phonorecords by Preexisting Subscription Services, 37 C.F.R. § 382.2 (2008).

¹² Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 Fed. Reg. 16, 4080, 4093 (Jan. 24, 2008). To put this number in a global context,

opposed applying the § 801(b) standard to online radio royalties without mentioning that they themselves use the § 801(b) standard for the royalties they pay to songwriters.¹³

The § 801(b) is no guarantee, however, that rates will always be a simple low percentage; digital cable services, for example, must pay a minimum of \$100,000 per year as part of their royalties.¹⁴ And in certain circumstances the CRB has in the past determined that none of the § 801(b) factors justified lowering the rates from the market evidence presented by the parties.¹⁵

In contrast to the § 801(b) factors, the willing buyer/willing seller standard requires the CRB to envision the rate that would be paid in a hypothetical marketplace.¹⁶ Section 114 also requires the CRB to consider the promotional or substitutional effects of the online radio service for the sound recordings, and the relative contributions of the copyright owner and radio service. These factors are, incidentally, all still included in IRFA: the relative contributions of the parties and the substitutional effects of the service are included in the third and fourth factors of § 801(b), respectively, and the promotional value is listed separately in IRFA, as it does not cleanly fit into any of the existing § 801(b) factors.

Under the willing buyer/willing seller standard, the CRJs look for the perceived economic value of the sound recordings, as demonstrated by the fees that two hypothetical parties in a competitive marketplace would willingly agree to. The difficulty with this standard is that the realities of the marketplace are far removed from a hypothetical negotiation between a willing buyer and a willing seller. For one thing, the online radio market did not begin to grow until after 1998 (Pandora, for example, did not launch until 2000), so the CRJs never had an actual marketplace on which to base their rates. Additionally, the law never granted a digital audio transmission right without either exempting webcasters or establishing a compulsory license. This means that a marketplace with online radio services and rightsholders with the power to withhold permission has never existed. Moreover, the monopolistic nature of the marketplace in these negotiations means that there is no competitive benchmark to compare the rates to, so it is very difficult to determine what an undistorted market would look like.¹⁷

European broadcasters pay 3-8% of revenue to artists, and 3-5% of revenue for all radio broadcasts goes towards music publishers and songwriters.

¹³ See 17 U.S.C. § 115.

¹⁴ 37 C.F.R. § 382.2 (2008).

¹⁵ Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding; Review of Copyright Royalty Judges Determination; Final Rule and Notice, 74 Fed. Reg. 15, 4510, 4523-4525 (Jan. 26, 2009), <http://www.loc.gov/crb/ledreg/2009/74fr4510.pdf>.

¹⁶ 17 U.S.C. § 114(f)(2)(B) ("In establishing rates and terms for transmissions by eligible nonsubscription services and new subscription services, the Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller."). See also 17 U.S.C. §§ 114(j)(6), (8).

¹⁷ See *The Performance Rights Act and Parity among Music Delivery Platforms: Hearing on S. 379 Before the S. Comm. on the Judiciary*, 111th Cong. (2009) (statement of Robert Kimball, Executive Vice President for Corporate Development & General Counsel, RealNetworks, Inc.) at 9, http://judiciary.senate.gov/hearings/testimony.cfm?id=4011&wit_id=8164. SoundExchange is the only entity with authority to license, collect, and distribute digital performance royalties for webcasting. SoundExchange Organization, <http://www.soundexchange.com/about/>.

The rates set under the willing buyer/willing seller standard have repeatedly been so high that that Congress has had to intervene to encourage industry negotiations that would reduce the rate set by the Copyright Royalty Board (CRB), and has led to many webcasters going out of business entirely.¹⁸

IRFA's additional amendments to the ratemaking deliberations will improve the likelihood that the CRB will be able to set reasonable rates that encourage new investment in technology while giving artists a fair return. IRFA instructs the CRB to fairly consider using a rate structured as a percentage of revenue, which is more flexible and better allows online radio companies to budget for their expenses. In fact, the privately negotiated PurePlay Agreement includes a percentage of revenue option, although the radio service is still required to pay the greater of the percentage of revenue or a per-stream fee.

IRFA also rightly instructs the CRB to not consider agreements struck under past law as precedent. In intellectual property, the scope and degree of exclusivity of the right is what sets the market to begin with, so it would be counter-productive to tie the CRB's decisions to a "market" that was negotiated under the auspices of a different royalty standard, or negotiated in a different market, like interactive streaming, that has no compulsory license at all. Such agreements are so far afield from the IRFA standard that they would be more likely to confuse than to be helpful in the CRB's deliberations.

There is, however, one way in which IRFA should be amended to alter the § 801(b) standard. Section 801(b) currently only refers to copyright owners and copyright users, but not to artists directly.¹⁹ Often the copyright owner of a sound recording will be a record label, but the label's interest in these proceedings may not always align with the actual creator. IRFA should remedy this and explicitly include artists in the second and third factors of the § 801(b) standard.

b. The Economics of Online Radio and Sound Recording Royalties

The economics of radio royalties are notoriously complicated. Similar services are currently subject to different standards based on the technology they use, some technologies are exempt altogether, and the rates set by the CRB are often bypassed in favor of negotiated settlements. Research into consumer use of online radio and other streaming platforms is relatively new, and much more data is needed to give a complete picture of the online radio business.

¹⁸ See Webcaster Settlement Act of 2009, S. 1145, 111th Cong., 1st Sess. (2009); Webcaster Settlement Act of 2008, H. R. 7084, 110th Cong., 2d Sess. (2008); Small Webcaster Settlement Act of 2002, Pub. L. No. 107-321, § 3, 116 Stat. 2780, 2781 (suspending payments under CARP rates in favor of subsequently negotiated agreement). For a more detailed history of online radio legislation and ratemakings, see Appendix.

¹⁹ 17 U.S.C. § 801(b).

1. Online Radio: Dominated by One Company and Devoid of Profits

Even a brief overview of the online radio marketplace will reveal that what should be an innovative, competitive market is instead a market dominated by one company in which not one significant company have made a profit.

The online-only webcasters are front and center in the IRFA debate: these are the services that provide noninteractive radio using the Internet. Their service is most analogous to AM/FM radio broadcasters,²⁰ but they must pay a compulsory license set under the willing buyer/willing seller standard, while AM/FM broadcasters need not pay sound recording royalties at all.

The most prominent online-only radio service today is Pandora. Pandora broke new ground in the radio business, creating personalized online radio stations by mapping the “genomes” of songs and using its calculations to make recommendations to users. The company now streams 1.1 billion hours of music per month to 58 million users, and has a \$1.4 billion market capitalization. Pandora currently enjoys 70% of the online radio market, but only 6.4% of radio listening overall.²¹

Pandora is subject to the willing buyer/willing seller standard for compulsory licenses, but currently operates under the privately negotiated 2009 PurePlay Agreement, which gives it around 40% off the rates dictated in the latest CRB ratemaking. This deal expires in 2015. Even so, Pandora paid 64% of its revenues in royalties in the first and second quarters of 2012, and posted a net loss of \$5.4 million in the second quarter alone.²² Pandora incurred this loss despite increasing its advertising and subscription revenues by 51% to \$101.3 million in the second quarter of 2012.²³ Despite its growing revenues, Pandora’s licensing costs are growing more quickly: up 79% to \$60.5 million in the second quarter. As of January 1, 2012, Pandora had an accumulated deficit of \$104 million.

Besides Pandora, the online radio space includes a handful of smaller players experimenting with their own revenue streams and business models for online radio. Rdio, for example, pays artists \$10 for every subscriber they bring to Rdio as a way to build a user base and build relationships with artists directly.²⁴ 7Digital recently announced \$10 million funding for, among other things, a radio service.²⁵ Senzari, a Miami-based competitor to Pandora, has

²⁰ See Bruce Houghton, *If Pandora Can Write Lil Wayne A \$3 Million Check, Why Should They Pay Less?*, HypeBot (Oct. 10, 2012), <http://www.hypebot.com/hypebot/2012/10/pandora-says-top-artists-make-1m-a-year-2000-make-more-than-10000.html>.

²¹ Tim Westergren, *Pandora and Artist Payments*, Pandora (Oct. 9, 2012), <http://blog.pandora.com/pandora/archives/2012/10/pandora-and-art.html>.

²² Pandora Media Inc. Form 10-Q (Sept. 4, 2012).

²³ *Id.*

²⁴ Rdio Artist Program (last visited Nov. 26, 2012), http://www.rdio.com/artistprogram/?utm_source=promoted_US_blog&utm_content=ArtistProgram_2012_10_021.

²⁵ Tim Ingham, *7digital launches streaming service, secures £6m investment*, MUSICWEEK (Oct. 19, 2012), <http://www.musicweek.com/news/read/7digital-launches-streaming-service-secures-6m-investment/052227>.

been acquired by Disco Volante—the same Berlin-based start-up that created wahwah.fm, the now-defunct online radio service that went out of business after trying to negotiate royalty rates directly with the major labels.

Other companies have responded to the pressures of the online radio environment by bundling their radio services with other products. The Samsung Music Hub combines a cloud storage locker, download store, and streaming radio service with unlimited music. Spotify, the interactive streaming company partially owned by the major record labels, has recently introduced a free online radio service for iOS and Android operating systems.

The recently revamped social networking site MySpace has also recently set its focus on the music market. Parent company Interactive Media Holdings is trying to raise \$50 million to re-launch MySpace as a competitor to Spotify and Pandora.²⁶ MySpace's traffic is up 36% since December 2011, but it will still only generate \$15 million in revenue this year. This means that MySpace will lose \$40 million in 2012, and in a pitch to investors, Interactive projected that it will lose another \$25 million in 2013. Notably, MySpace's owners say its biggest advantage over Spotify and Pandora is that it pays a lower per-stream rate for music, in part because MySpace pays no royalties to the 27 million unsigned artists who use MySpace—50% of the music played on the site. This disparity between how MySpace treats record labels and how it treats unsigned musicians would certainly undercut the sustainability of an independent music career if it became standard among digital music services—which is why royalty rates must be set at a level that encourages robust competition among music services, so no single service holds outsized leverage against musicians.

Finally, many online radio companies that have previously used the compulsory licenses have since gone out of business under the weight of high licensing fees.

2. Satellite Radio: Thriving, Growing, and Attracting New Listeners

In contrast to the online-only webcasters, Sirius Satellite Radio—the subscription satellite service owned and operated by Sirius XM Radio²⁷—is thriving while paying approximately 8% of its revenues in sound recording royalties under rates set with the § 801(b) standard, and has developed a healthy business model. In the third quarter of 2012, SiriusXM achieved record revenue of \$867.4 million, \$757.7 million of which was subscriber revenue. Sirius's adjusted earnings before income taxes, depreciation, and amortization was \$245 million, and its year-to-date subscriber acquisitions were up 27% from one year ago, to 1.47 million, resulting in a record of 23.37 million total subscribers. For the entire year of 2012, SiriusXM expects revenue just under \$3.4 billion and adjusted EBITDA of \$900 million.²⁸

²⁶ Nicholas Carlson, *LEAKED: MySpace's Master Plan to Raise \$50 Million and Relaunch as a Spotify Killer*, BUSINESS INSIDER (Nov. 19, 2012), <http://www.businessinsider.com/leaked-myspaces-master-plan-to-raise-50-million-and-re-launch-as-a-spotify-killer-2012-11?op=1>.

²⁷ Liberty Media owns 48% of SiriusXM's common stock, but has a pending request at the Federal Communications Commission to convert its preferred shares into common shares and thus acquire a controlling interest in SiriusXM.

²⁸ Glenn Peoples, *SiriusXM CEO Karmazin Calls Internet Radio 'Race to the Bottom' on Earnings Call*, BILLBOARD (Nov. 1, 2012), <http://www.billboard.biz/bbbiz/industry/digital-and-mobile/siriusxm-ceo-karmazin-calls-Internet-radio-1007995612.story>.

The royalties paid by satellite, cable, and online radio are all administered through SoundExchange, an entity formed by the RIAA in 2000 to administer royalties under the digital transmission compulsory licenses. After the first webcasting ratemaking, SoundExchange was spun off from the RIAA and re-launched as a non-profit organization.²⁹ SoundExchange is currently the only entity authorized by the Library of Congress to negotiate on behalf of sound recording copyright owners and administer, collect, and distribute the compulsory license royalties

3. Online Radio Usage

The relatively recent entry of online music services has benefitted artists and consumers alike, and although online radio has a not insubstantial share of radio listeners, there is still much room for growth. According to one recent NPD study, 50% of 96 million Internet users listened to online streaming services in the past 3 months. 37% of US Internet users listened to online radio, and 36% of US Internet users listened to an on-demand streaming service (although these groups may overlap significantly). In the past year, the Internet radio audience grew 27% and the on-demand music audience grew 18%.³⁰ The extent to which these services supplant older modes of consuming music is still being studied—the NPD study reportedly found that Pandora users were on average less likely to use AM/FM radio, CDs, and portable music players than they were in 2009, but did not examine how much demographic changes in Pandora’s audience or the use of other services like Spotify contribute to the correlation. On the other hand, that study also found that the average Pandora listener purchased 29% more music during the second quarter of 2012 compared with last year, even though music purchases went down overall.³¹

The emergence of online radio has also brought new opportunities for artists. For one thing, 64% of users of online music streaming services reported rediscovering older music, and 51% reported discovering new music on the service.³² And more importantly, as discussed above, online radio services are part of the emerging online music platforms that empower artists to remove unnecessary middlemen.

²⁹ This structural change may have been made in response to allegations of anticompetitive conduct by the RIAA through SoundExchange. See *Webcaster Alliance, Inc. v. RIAA*, No. C-03-3948, 2004 WL 1465722, 2 (N.D. Cal. Apr. 1, 2004).

³⁰ NPD Music Acquisition Monitor, <https://www.npd.com/wps/portal/npd/us/news/press-releases/the-mpd-group-Internet-radio-and-on-demand-music-services-rise-putting-pressure-on-traditional-forms-of-music-listening/>.

³¹ Russ Crupnick, Senior Vice President of Industry Analysis, The NPD Group, citing NPD Music Acquisition Monitor study.

³² NPD Music Acquisition Monitor, <https://www.npd.com/wps/portal/npd/us/news/press-releases/the-mpd-group-Internet-radio-and-on-demand-music-services-rise-putting-pressure-on-traditional-forms-of-music-listening/>.

4. *The Nascent Online Radio Market*

Despite the great promise of online radio, many webcasters have left the business and a surprisingly small number have achieved a critical mass of market share. Notably, the companies that have lost their online radio businesses include large corporations like Yahoo! and Microsoft in addition to many small entrepreneurial webcasters. When companies with deep technological expertise and enormous financial backing cannot create a profitable online radio service, small start-ups and independent companies have little chance of ever reaching a profit.

The financial difficulties of online radio companies in turn discourage investment in the field. As Union Square Ventures partner Fred Wilson noted, music services face extremely high startup costs compared to other industries, like software development.³³ A music startup will need anywhere from \$5 million to \$20 million just to launch its service, much of which goes toward licensing costs. As a result, it is more difficult for would-be music company founders to find funding. Wilson did, however, predict that more advertising dollars would eventually enter the online radio space—but this prediction can only come true if online radio services become sustainable enough to survive the transition.

Online radio stations have reportedly had significant trouble increasing advertising revenue enough to keep up with corresponding increases in listener hours. Some point out that increasing the number of advertisements per hour past a certain point can lead to a service losing its user base: users tend to leave freemium services around the time the service starts interrupting streams with ads.³⁴ As a result, after a certain point in time, the online radio service will be under pressure from its funding to increase advertisement frequency to increase revenues, but if the company does so its users will flock to a newer, ad-free radio service that is not yet under pressure to monetize its business model. Royalty rates exacerbate this problem: rates that are too high cause unsustainability for online radio by forcing start-ups to choose too early between achieving a product that consumers will respond to in the long term, and covering content costs to appeal to investors.

In large part due to the disproportionately high royalty rates that online radio pays compared to its satellite, cable, and terrestrial competitors, the online radio marketplace has the somewhat unique and very concerning characteristic of being devoid of profits. This alone is one of the most persuasive points for why the online radio royalty rates are currently set too high. For-profit companies, like most online radio services, have ample incentive to increase their revenues and earn a profit. The online radio market has yet to produce a single major company that could create a profitable business model. Investors may understand that companies will need to run a deficit in their first few years, but this trajectory is not sustainable in the long term, and

³³ Sarah Mitroff, *So You Want in on the Music Biz? Fred Wilson Has 4 Things to Tell You*, WIREd (Nov. 16, 2012), <http://www.wired.com/business/2012/11/music-startups/>.

³⁴ Joey Flores, *Why Music Startups and Ad Networks Suffer from "Flavor of the Month Syndrome."* SIDEWINDER.FM (Oct. 16, 2012), <http://sidewinder.fm/post/33702805158/why-music-startups-and-ad-networks-suffer-from-flavor>. As Joey Flores put it, "The only thing stopping advertising from being a sustainable model for music startups right now is royalties." *Deep Think: Joey Flores of Earbits on the Challenges of Building a Music Startup*, HYPEBOT (Oct. 30, 2012), <http://www.hypebot.com/hypebot/2012/10/deep-think-joey-flores-of-earbits-on-the-challenges-of-building-a-music-startup.html>.

the overall health of the online radio marketplace will decline if nothing is changed. As more online radio companies go out of business, less music will be heard via online radio, which will ultimately hurt consumers and musicians alike.

It is also important to keep in mind the relative sizes of the business segments at play here. Thus far this year, SoundExchange has distributed a total of \$316.9 million in royalties for all compulsory licenses.³⁵ In contrast, David Touve, Assistant Professor of Business Administration at Washington and Lee University, has estimated that terrestrial radio stations would pay nearly \$2.5 billion per year in royalties if they paid the same royalty rate as online radio does.³⁶ This estimate, however, does not attempt to include any decrease in the size of the AM/FM radio business as a result of the royalties, nor the percentage of terrestrial radio programs that does not include music. Billboard estimated that the rates, adjusted for non-music listening, would be more towards \$2.05 billion instead.³⁷ In a \$15 billion industry, this would mean that AM/FM broadcasters would pay 20% of their revenue in fees.³⁸ While online radio may have a chance at being the future of music access, it is by no means the dominant player in the current marketplace, despite being subject to the highest fees.

c. A Cautionary Tale: Interactive Streaming Services

Rather than go out of business entirely, there is another path that online radio companies could take in pursuit of a profitable business model: giving up their independence and giving equity stakes to companies that are already dominant in the music business, like major record labels or large AM/FM broadcast networks. This would only serve to entrench incumbent power structures and stifle innovation in the online music business, and the compulsory license should certainly not force this result on the industry by making online radio choose between unsustainably high compulsory license rates and private deals with the dominant gatekeepers.

This type of development has already occurred in the interactive streaming market, where digital music services do not have any compulsory license to rely on and so must negotiate directly with the record labels. The major labels have repeatedly abused their leverage in these negotiations: demanding outsized advance fees before the services even launch, requiring royalty rates disproportionately high compared to those given to independent musicians, and even demanding ownership in the streaming companies as a condition to getting a license. Spotify, for

³⁵ Ed Christman, *SoundExchange Pays Out \$122.5 Million In Q3 -- Its Largest Sum Yet*, BILLBOARD (Nov. 14, 2012), <http://www.billboard.biz/bbbiz/industry/digital-and-mobile/soundexchange-pays-out-122-5-million-in-1008015922.story>

³⁶ David Touve, *\$2.5 Billion: The Big Number that "Big Radio" could owe each year if it paid music royalties at Pandora's rates* (Nov. 19, 2012), <http://davidtouve.com/2012/11/19/2-5-billion-the-big-numbers-that-big-radio-could-owe-each-year-if-it-paid-music-royalties-at-pandoras-rates/>. Touve used the "pureplay" webcaster rate of \$0.0011 per performance per listener for these calculations. Touve also calculated rates under the general webcaster rate of \$0.0021 per performance per listener, which were significantly higher.

³⁷ Glenn Peoples, *Business Matters: If Big Radio Had Pandora's Royalty Rate, It Would Owe Billions*, BILLBOARD (Nov. 20, 2012), <http://www.billboard.biz/bbbiz/industry/digital-and-mobile/business-matters-if-big-radio-had-pandora-1008024632.story>.

³⁸ In contrast, Pandora paid out 50.3% of its revenues to SoundExchange in the most recent fiscal quarter.

example, is partially owned by all of the major record labels, and has been dogged with accusations of giving independent and unsigned musicians a lower royalty rate than major label musicians for the same number of streams. The incumbents have thus been able to use their copyrights to create a tax on innovation in the interactive streaming marketplace.³⁹

As Congress deliberates on the right way forward for Internet radio royalties, it should remember how outsized bargaining power can be used to hamper innovation and entrench the dominant players. Setting a compulsory rate too high or otherwise unnecessarily driving companies to direct licensing deals would similarly give major labels and their representatives the opportunity to stymie the progress of the online radio market and disadvantage independent labels and unsigned musicians.

II. IRFA Should Apply the Same Royalty Standard to all Types of Radio Services, Including Online, Cable, Satellite, and AM/FM Radio.

If IRFA is to actually achieve “fairness” in the marketplace, it cannot allow the law to continue to treat the same services differently simply based on the transmission technology used by the broadcaster. Fairness requires treating like service alike. IRFA is right to set online radio royalties by the same standard as that used for cable and satellite radio royalties, and should be amended to also require AM/FM radio to pay royalties under the same standard used by everyone else.

There is no logical reason why the law should impose different royalty standards on companies that all provide essentially the same service to consumers. Whether transmitted by cable, satellite, AM/FM broadcasting, or through an Internet connection, radio companies all offer to consumers a noninteractive stream of music or other audio programming. Their actual royalty payments need not be exactly the same, but the CRB should consider the same factors when setting each of their royalty rates.

This point is much more than legal theories and semantics: experience tells us that the difference in ratemaking standards has led to wildly divergent royalty rates for companies that all provide consumers with substantially similar services. Under the willing buyer/willing seller standard and subsequent settlements, Pandora paid \$60.5 million—64% of its revenue—in the quarter ending July 31, 2012.⁴⁰ Meanwhile, under the § 801(b) standard, satellite radio operator SiriusXM pays only 8% of its revenues of \$867.4 million for the quarter ending September 30, 2012⁴¹—seemingly paying a similar amount in royalties to Pandora despite having more than 8 times the revenue.

Of course, AM/FM radio has the lowest sound recording royalties of any radio services: \$0.00, despite bringing in \$15 billion in revenue. To the extent that the outright exemption for

³⁹ See Mark Cooper & Jodie Griffin, *The Role of Antitrust in Protecting Competition, Innovation, and Consumers as the Digital Revolution Matures: The Case Against the Universal-EMI Merger and E-Book Price Fixing* (June 14, 2012), <http://publicknowledge.org/case-against-umg-emi>.

⁴⁰ Pandora Media Inc. Form 10-Q (Sept. 4, 2012).

⁴¹ Sirius XM Radio Inc. Form 10-Q (Nov. 1, 2012).

AM/FM radio was ever justified, it certainly is not now.⁴² AM/FM radio provides listeners with essentially the same service as other radio services, and the disparity in treatment only serves to entrench industry incumbents and discourage innovation in the market. If IRFA implements the § 801(b) standard for webcasters but lets the AM/FM broadcasters continue to pay no royalties at all, the bill will only entrench the current broadcasters, who will get to enjoy lower rates for their online retransmissions *and* a special exemption for their AM/FM broadcasts. This does not help competition, it does not help artists, and it does not encourage new companies to enter the market. The only solution is to put all radio services under the same ratemaking standard.

III. IRFA Should Ensure that Artists Are Fairly Compensated.

Finally, the reforms in IRFA would be incomplete if they failed to ensure that actual artists are fairly compensated. The distribution system for the online radio compulsory licenses currently offers several important benefits to artists, but IRFA should take this opportunity to improve artist compensation under the compulsory licenses.

The current online radio compulsory license system offers three very important benefits to artists: transparency, equal treatment, and direct payment. The license fees paid by cable, satellite, and online radio are by statute divided between copyright owners and artists.⁴³ Federal law allocates 50% of the royalty to the copyright owner (usually a record label), 45% to the featured artist, 2.5% to side musicians, and 2.5% to back-up vocalists. This law offers a level of transparency that is practically unheard of in the recorded music business. Very often, all revenue related to recorded music distribution is funneled through the artist's record label without transparent reporting to the artist, and the artist's contract makes audits of the record label's accounting expensive and time-consuming. But under the compulsory licenses, the royalty rates and distribution splits are publicized for all to see—an important first step in empowering artists.

The compulsory license also has the benefit of being applicable to all artists, regardless of whether they have signed to a major record label, and independent label, or no label at all. By applying the same rate across the industry, every musician can receive their fair share of the payments made by licensees.

Finally, the current compulsory license system ensures that the actual artists receive fair payment even if they have sold away their copyrights—a practice that is essentially a pre-requisite for signing to a major label. Usually, record labels demand copyright ownership and a sizable share of royalties from artists in return for their financing, production, and distribution services. Moreover, artists usually do not receive any portion of the royalties until she has paid back the entire advance investment the label made in producing and promoting the album. But

⁴² Many broadcasters have justified their exemption in the past by saying that the promotional value of playing the recording on their stations outweighs any value they may owe to the recording artist. If they are correct here, the broadcasters can easily present evidence on the promotional value of their service to artists, which the CRB would duly consider under the factors set out in § 801(b) and IRFA.

⁴³ 17 U.S.C. § 114(g)(2).

under the radio compulsory licenses, artists are directly paid a cut of the royalties, regardless of whether they are still in debt to their record labels.

However, the compulsory license distribution system can and should be amended to direct more compensation directly to artists. Rather than the statutory royalty splits discussed above, the law should distribute 50% of royalties to the featured artist, 5% to side musicians, 5% to back-up vocalists, and 40% to the record label. After all, copyright law's ultimate purpose of incentivizing the creation of works is much better served by directing more payments to actual artists than by giving intermediaries like record labels take an unnecessarily large piece of the pie. This change in royalty splits also offers more structural protection to individual artists, who might be less able to engage in the ratemaking proceedings than record labels and webcasters.

IV. What's At Stake: Online Radio Benefits Artists and Consumers

Emerging online radio services are part of the relatively recent wave of new online music platforms that have been a boon to musicians and their fans alike.

a. Increasing Consumer Access to Legal Music Services

From the consumer's perspective, online radio services allow users to access, discover, and re-discover music more easily than ever before. Particularly as Internet access spreads and music-playing devices become increasingly portable and connected, online radio allows audiences to access radio streams in areas where traditional AM/FM broadcasts did not reach. Online radio technology also allows consumers to access the music that most resonates with them. The global nature of the Internet allows a single niche online radio station to attract a geographically diverse listenership, and sophisticated music analysis technology allows companies to give users more personalized webcasts to fit their specific tastes. This lets musicians with widely spread audiences develop those audiences in a way that geographically-limited AM/FM radio does not.

b. Empowering Artists and Avoiding Gatekeepers

Artists also stand to benefit from the emergence of online radio. When the growth of online radio services reaches new listeners, future fans can discover their next favorite band. Online radio platforms could easily (and often do) incorporate ways for fans to learn more about the musician they are listening to, and even can enable direct merchandising or ticketing opportunities. Online radio also helps to decrease copyright infringement by giving consumers a convenient, affordable way to access music legally.

Perhaps more importantly, online radio has leveled the playing field to help unsigned and independent artists remove unnecessary middlemen and reach fans directly, if they so choose. AM/FM radio has always been limited in the number of stations it can have in any one location, and as a result the most popular music—almost always music owned or distributed by the major

labels—has received a disproportionate amount of airplay. This trend is only exacerbated by increasing consolidation in the ownership of local radio stations.⁴⁴

This scarcity in AM/FM radio outlets created the incentive for money to influence the selection of new music for station playlists. Only companies with the largest budgets could play this game, and independent artists without the money or connections to improperly influence the process were left out.⁴⁵ In contrast, online radio allows any artist to reach consumers, and fans can just as easily reach stations dedicated to niche genres as they can Top 40 music. When the gatekeepers are removed from the equation, the music that gets played is chosen by the artists and their fans, not by the most powerful corporate executives.

As a result, an artist need not sign to a record label or give up her copyright to be played on online radio and, thanks to the compulsory licensing regime, she will be paid using the same rate as a major label act would. In absence of undue influence from incumbent gatekeepers, new technologies can help artists reach consumers more directly, enabling artists to forge their own paths and give them the ability to operate independently of traditional distribution intermediaries. Where they provide substantial value, intermediaries like record labels can still have a place in the business, but building more tools for artists gives them a meaningful choice in how to direct their own careers.

Make no mistake: online radio is an enormous opportunity to create a sustainable platform that is both artist- and consumer-friendly. The fact that no major company has been able to create a profitable online radio service should be of concern to parties on all sides of the recorded music business.

Conclusion

The online radio market is complex and still relatively new, but IRFA takes steps in the right direction to preserve this promising marketplace while still compensating artists for the use of their works.

IRFA takes a well-planned and principled approach to the rate-setting process. IRFA achieves some measure of parity between platforms, which must be extended to include all technologies—including AM/FM broadcasters—under the same rate-setting standard. By being technology-neutral, the law would allow the most efficient and valuable technology reach its appropriate market.

The royalty-setting standard that IRFA sets will also stimulate the growth of online radio, bringing new players to the field. The standard follows the basic purpose of the compulsory license—to guarantee fair compensation but not going so far as to grant an absolute right to refuse a license—is entirely undermined if the rate is set too high. When the sound recording copyright owner has the right to demand a payment higher than any service could pay, there cannot be said to be any true functioning market. By framing the ratemakings through the tried-

⁴⁴ See *False Premises, False Promises*, Future of Music Coalition (Dec. 13, 2006), <http://futureofmusic.org/article/research/false-premises-false-promises>.

⁴⁵ See Jim Ayre, *FMC on Payola and Localism*, FUTURE OF MUSIC COALITION (June 16, 2008), <http://futureofmusic.org/blog/2008/06/16/fmc-payola-and-localism>.

and-true § 801(b) standard, IRFA will encourage the growth of online music, to the benefit of both consumers and artists.

APPENDIX

The History of Online Radio Royalties

The law governing sound recording transmission royalties is currently a patchwork of rules that were written at different times and supported by different influential industry lobbies. It is thus necessary to review the history of the online radio royalties to understand how the Congress arrived at the standard it uses today, and how the Copyright Royalty Board (CRB) interprets that standard.

Until relatively recently, sound recordings did not receive federal copyright protection at all. In 1971, the Sound Recordings Act created copyright protection for sound recordings, but only granted the rights to control reproduction and distribution of sound recordings.⁴⁶

In 1995, the Digital Performance Right on Sound Recordings Act⁴⁷ (“DPR”) granted a public performance right in sound recordings that applied only to digital audio transmissions. The law also gives exemptions from this right for terrestrial broadcasts licensed by the Federal Communications Commission, certain retransmissions of those broadcasts, and certain other transmissions.⁴⁸ Notably, the DPR exempted many webcasters from royalties entirely by exempting noninteractive nonsubscription services.⁴⁹

The DPR also created a new statutory license under which non-exempt, noninteractive online music services could use sound recordings for their online radio services.⁵⁰ The DPR called for this compulsory license to be set according to the standard set in section 801(b) of the Copyright Act.⁵¹

The decision to create a right for digital transmission but exempt AM/FM radio was in part based on the fear that digital music services would supplant sales of recorded music sales, both for singles and for full albums.⁵² Digital music services caused apprehension that the music streaming services would change the entire structure of recorded music consumption, from an ownership model to an access model. The recorded music industry also worried that digital technology would move control over where and how listeners accessed recorded music from the incumbent companies to the users themselves, and would enable listeners to copy and distribute music streams. The exemption of AM/FM radio from this new performance right can also in part be attributed to the influence of groups like the National Association of Broadcasters, which

⁴⁶ Sound Recording Act of 1971, Pub. L. 92-140, 85 Stat. 391 (1971).

⁴⁷ Pub. L. No. 104-39, 109 Stat. 336 (1995).

⁴⁸ 17 U.S.C. §§ 114(d), (j).

⁴⁹ Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (1995).

⁵⁰ 17 U.S.C. § 114(f).

⁵¹ 17 U.S.C. § 801(b)(1). This standard pre-existed the DPR, and was already being used to determine the rates for a compulsory license to reproduce and distribute sound recordings. *See* 17 U.S.C. § 115.

⁵² S. Comm. on the Judiciary, 104th Cong., Digital Performance Right in Sound Recordings Act of 1995, S. Rep. No. 104-128, at 14 (statements by Sen. Hatch) (“[C]urrent copyright law is inadequate to . . . protect the livelihoods of the recording artists . . . who depend upon revenues derived from traditional record sales.”).

argued that terrestrial radio only promoted sales and did not threaten the status quo of the industry.⁵³

Then, in 1998, the Digital Millennium Copyright Act⁵⁴ (“DMCA”) divided online radio services into Internet, satellite, and cable services, and applied a different royalty standard to each.⁵⁵ The DMCA required noninteractive nonsubscription webcasters to pay a license for the first time, creating the category of an “eligible nonsubscription service.”⁵⁶ After the DMCA was passed, webcasters and the major record labels could not agree on the appropriate licensing rates, so a Copyright Arbitration Royalty Panel recommended a rate under the willing buyer/willing seller standard.⁵⁷ The Librarian of Congress then adjusted the recommended rate and issued a final rate.⁵⁸

In 2001 and 2002, the Copyright Arbitration Royalty Board convened the first webcasting ratemaking.⁵⁹ Notably, small webcasters were largely absent from this proceeding, perhaps due to the requirement that participants to the proceeding pay a portion of the arbitrators’ fees. One major issue of contention in this proceeding was the choice between structuring the fee as a percentage of revenue and a flat per-use fee. The RIAA argued for a per-use fee, what small webcasters could participate argued for a percentage of revenue, and the Digital Media Association purposed a combination.⁶⁰ The CARP ultimately relied on a previous agreement between Yahoo! (which at the time was operating an online radio service that has since gone out of business) and the RIAA, and settled on a per-use fee.⁶¹ Many webcasters objected that the Yahoo! and RIAA settlement was an inappropriate model because Yahoo! had accepted a higher fee for online-only transmissions in return for lower radio retransmission rates, which was the bulk of Yahoo! online radio business at the time. Online-only webcasters were therefore stuck with high rates without being able to benefit from the discounted retransmission rates.

⁵³ See *The Performance Rights Act*, Hearing on H.R. 848 Before the H. Comm. on the Judiciary, 111th Cong. (2009) (statement of Steven Newberry, Commonwealth Broadcasting Corporation, On Behalf of the National Association of Broadcasters).

⁵⁴ Pub. L. No. 105-304, 112 Stat. 2860 (1998).

⁵⁵ 17 U.S.C. § 114.

⁵⁶ 17 U.S.C. § 114(j).

⁵⁷ 66 Fed. Reg. 141, 38324-38326 (July 23, 2002).

⁵⁸ Order, Digital Performance Right in Sound Recordings and Ephemeral Recordings (May 21, 2002), <http://www.copyright.gov/carp/webcasting-rates-order.html>; Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings, 67 Fed. Reg. 130, 45239-45276 (July 8, 2002).

⁵⁹ See Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings, 67 Fed. Reg. 45,240 (2002) (codified at 37 C.F.R. pt. 261).

⁶⁰ Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings, 67 Fed. Reg. 45,240 (2002) (codified at 37 C.F.R. pt. 261) at 45,241-42.

⁶¹ *Id.* at 42,250.

The Librarian of Congress ultimately accepted the CARP's structuring of the royalties, but rejected the actual rates as too high, and adjusted the rates downward.⁶² However, this decision was eventually partially superseded by the Small Webcaster Settlement Act of 2002,⁶³ under which the parties re-negotiated a percentage of revenue-based fee for small and noncommercial webcasters.

In 2004, Congress enacted the Copyright Royalty and Distribution Reform Act of 2004, which replaced the CARP system with the Copyright Royalty Board (CRB).⁶⁴ In 2007, the CRB set the online radio compulsory license through 2010.⁶⁵ In this ratemaking, the CRB followed SoundExchange's request to discount rates in the interactive music streaming market to approximate market rates for noninteractive streaming.⁶⁶ After public outcry objecting that the rates were too high for webcasters to operate a sustainable business, Congress enacted two pieces of legislation intended to encourage settlements between the webcasters and copyright owners.⁶⁷

2007 CRB Ratemaking (\$500 minimum)	
Year	Royalty per Digital Transmission
2006	\$0.0008
2007	\$0.0011
2008	\$0.0014
2009	\$0.0018
2010	\$0.0019

By 2009, many webcasters had negotiated settlements with SoundExchange pursuant to the Webcaster Settlement Acts, including the PurePlay Agreement, through which a majority of webcasters pay their royalties through 2015.⁶⁸ The PurePlay Agreement lowered the CRB rates by as much as 40% in return for greater reporting requirements, leading some webcasters to announce that they could now continue to operate for the near future. Meanwhile, terrestrial radio earned \$16.5 billion in profits, but paid \$0 in sound recording royalties.⁶⁹

⁶² *Id.* at 45,255, 45,272.

⁶³ Small Webcaster Settlement Act of 2002, Pub. L. No. 107-321, § 3, 116 Stat. 2780, 2781 (suspending payments under CARP rates in favor of subsequently negotiated agreement).

⁶⁴ Copyright Royalty and Distribution Reform Act of 2004, H. R. 1417, 108th Cong., 1st Sess. (2003).

⁶⁵ Digital Performance Right in Sound Recordings and Ephemeral Records, 72 Fed. Reg. 24,084, 24,088 (May 1, 2007) (codified at 37 C.F.R. pt. 380).

⁶⁶ Digital Performance Right in Sound Recordings and Ephemeral Records, 72 Fed. Reg. 24,084 (May 1, 2007) (codified at 37 C.F.R. pt. 380) at 24,091-94.

⁶⁷ Webcaster Settlement Act of 2008, H. R. 7084, 110th Cong., 2d Sess. (2008); Webcaster Settlement Act of 2009, S. 1145, 111th Cong., 1st Sess. (2009).

⁶⁸ Notification of Agreements Under the Webcaster Settlement Act of 2009, 74 Fed. Reg. 136, 34796 (July 17, 2009).

⁶⁹ *The Performance Rights Act and Parity among Music Delivery Platforms: Hearing on S. 379 Before the S. Comm. on the Judiciary*, 111th Cong. (2009) (statement of Robert Kimball, Executive Vice President for Corporate Development & General Counsel, RealNetworks, Inc.), http://judiciary.senate.gov/hearings/testimony.cfm?id=4011&wit_id=8164.

The PurePlay Agreement created a schedule of rates, terms, and conditions for all commercially available sound recordings through 2015, to which any eligible webcaster can opt-in. If they choose to do so, commercial webcasters must agree to withdraw from any ratemakings before the CRJs and not participate in any ratemakings while the PurePlay agreement is in effect. The PurePlay Agreement contains three rate classes, based on gross revenues and streaming capabilities.⁷⁰

Class	Eligibility Requirements	Rate	Minimum Fee										
Large commercial webcasters	> \$1.25 million annual revenues	The greater of: 25% of U.S. revenues; or per performance rate 40% lower than CRB's set rate (see below).	\$25,000 per year										
Small commercial webcasters	≤ \$1.25 million annual revenues, must place cap on the number of sound recordings they play	The greater of: 12% of their first \$250,000 in revenue and 14% of revenue above \$250,000; or 7% of expenses.											
Webcasters providing bundled, syndicated, or subscription services		Same as those agreed to by the NAB: <table border="1"> <thead> <tr> <th>Year</th> <th>Royalty per Digital Performance</th> </tr> </thead> <tbody> <tr> <td>2012</td> <td>\$0.0020</td> </tr> <tr> <td>2013</td> <td>\$0.0022</td> </tr> <tr> <td>2014</td> <td>\$0.0023</td> </tr> <tr> <td>2015</td> <td>\$0.0025</td> </tr> </tbody> </table>	Year	Royalty per Digital Performance	2012	\$0.0020	2013	\$0.0022	2014	\$0.0023	2015	\$0.0025	
Year	Royalty per Digital Performance												
2012	\$0.0020												
2013	\$0.0022												
2014	\$0.0023												
2015	\$0.0025												

In return for the discounted rates, the PurePlay Agreement requires more stringent reporting requirements for the webcasters to give more detailed census reports to SoundExchange.

The market has most recently begun to see private direct deals that bundle payments for online radio with terrestrial broadcasting. For example, in 2012, Clear Channel and Big Machine Records agree to a deal that encompassed both digital licensing and terrestrial broadcasting, even though the terrestrial sound recording right has never been made law.⁷¹

⁷⁰ Notification of Agreements Under the Webcaster Settlement Act of 2008, 74 Fed. Reg. 40, 9293-99 (Mar. 3, 2009).

⁷¹ Clear Channel, *Big Machine Label Group and Clear Channel Announce Groundbreaking Agreement to Enable Record Company and Its Artists to Participate in All Radio Revenue Streams and Accelerate Growth of Digital Radio*.

CRB Rates	
Year	Royalty per Digital Performance
2012	\$0.0011
2013	\$0.0012
2014	\$0.0013
2015	\$0.0014

Unlike the compulsory license, however, much about the Clear Channel/Big Machine deal remains a mystery. The negotiating process was not public, nor are the exact terms of the deal. Rumors indicate that the deal may split royalties between record labels and artists, but without transparency this is difficult to confirm, and even if true the royalties may be subject to the record label accounting process or even withheld until the record label concludes it has broken even on the album. All of these mechanisms for record labels to decrease the royalties that go directly to the artists are avoided under the compulsory license process, which ensures that a transparent split is distributed directly to sound recording owner and the performing artists.



Future of Music Coalition

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House Subcommittee on Intellectual Property,
Competition Policy and the Internet
2138 Rayburn Office Building
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November 28, 2012

Dear Chairman Goodlatte, Congressman Quayle and members of the committee:

Future of Music Coalition respectfully submits this written testimony for consideration in advance of the committee's November 28, 2012 hearing "Music Licensing, Part 1".

Future of Music Coalition (FMC) is a national non-profit education, research and advocacy organization that identifies, examines and translates the challenging issues at the intersection of music, law, technology and policy. FMC achieves this through continuous interaction with its primary constituency – musicians – and in collaboration with other creator/citizen groups.

For more than a decade, we have observed changes to traditional industry business models, and sought to inform artists about what these changes could mean for artists' ability to reach audiences and grow their careers. Over our twelve year history, we have participated in a number of webcasting-related matters, from the early CARP royalty hearings, to the formation of SoundExchange, to the debates about internet royalty rates and reporting requirements. Our testimony submitted to both chambers of Congress (in 2002 and 2007, respectively) urges stakeholders to work together to strike a balance that recognizes the value of webcasting to creators and listeners, but also properly

compensates performers and labels for uses of their work.¹ Many things have changed since those early days of online broadcasting. Over the past ten years, internet and digital radio has evolved into a robust and viable business. Services like Pandora, Sirius XM, Clear Channel's IHeartRadio and Slacker are leading the way in delivering radio-like services to millions of music fans every day, and paying millions of dollars in digital performance royalties to rightsholders, performers and songwriters.

But as these businesses have grown, the initial licensing procedures – as outlined by the Digital Performance in Sound Recordings Act of 1995 and the Digital Millennium Copyright Act of 1998 – have become a point of contention. Pureplay² webcaster Pandora's royalty bills are based on a per-user, per-stream rate (with a percentage of revenue option that would likely be higher). Meaning, they owe a fraction of a penny for every user, and every stream, the consequence being that as the business grows, so do the costs. Pandora, which states that 50 percent of its gross revenue goes to rightsholders, says that this calculation is unfair – especially when compared with satellite radio's rate of eight percent of gross revenue. Pandora says that the differences in rates are unsustainable going forward.

Currently, there are competing bills that address the issue of radio parity in different ways.

The **Internet Radio Fairness Act**, introduced by Jason Chaffetz (R-UT) on July 20, 2012, seeks to abolish the current rate-setting standard for webcasters like Pandora. The bill proposes, instead, to calculate the royalty based on a percentage of the webcaster's gross revenue. Essentially, Pandora and other pureplay webcasters would simply pay a

¹ Future of Music Coalition testimony before the Senate Judiciary Committee, May 15, 2002
<http://futureofmusic.org/filing/copyright-royalties-where-right-spot-dial-webcasting>

Future of Music Coalition testimony before the House Small Business Committee, June 27, 2007
<http://futureofmusic.org/filing/fmc-testimony-submitted-house-small-business-committee-webcasting-rates>

² A webcaster whose primary business is to transmit sound recordings under the statutory license, and not to sell or promote any other service or product

percentage of gross revenue, similar to how satellite radio's rates are calculated. Critics of the bill say that this will lead to a substantial decline in revenue for artists.

On August 20th, Jerrold Nadler (D-NY) offered a different vision with the **Interim Fairness in Radio Starting Today Act** (Interim FIRST). The bill would put cable and satellite radio services on the same royalty-setting standard as pureplay internet radio. That would make cable and satellite radio stations pay higher royalty fees to musicians. Nadler's bill also calls out the one platform that does not compensate performers and sound recording copyright owners for their music – broadcast radio. Interim FIRST would also compel over-the-air broadcasters to compensate performing artists, albeit through a stopgap measure that involves raising the rates for terrestrial stations' digital simulcasts to make up for what they aren't paying for over-the-air plays. Unfortunately, Interim FIRST would not collect money owed to US performers for international plays. In a tough economic climate for domestic artists, this can only be seen as a partial solution, at best.

Both pieces of legislation are problematic, but in different ways. The IRFA bill, while attempting to create rate parity among large pureplay webcasters and satellite radio, would likely do so by lowering the amount that pureplay webcasters need to pay musicians and copyright owners, by a considerable degree. IRFA also doesn't address the lack of a public performance royalty for sound recordings for terrestrial radio airplay – the most egregious loophole in regards to “parity” out there.

Another point of contention: Section 5 of IRFA contains language that could put limitations on the ability for artists (or their collective representatives) to speak publicly or otherwise advocate for compulsory licenses over direct deals.³ The bill invokes the anti-monopoly provisions in the Sherman Act as justification for these restrictions. This is troubling, as collective management bodies – such as PROs, unions and

³ “Muzzling Free Speech By Artists: IRFA Section 5 Analysis,” The Trichordist, November 8, 2012 <http://thetrichordist.com/tag/sherman-act/>

SoundExchange – offer important leverage to musicians and performers who otherwise lack input into rate-setting and other royalty negotiations.

Interim FIRST attempts to tackle the terrestrial radio exemption, but instead of confronting the problem head on and simply legislating that terrestrial stations must pay public performance royalty for sound recordings, the bill simply raises the rates on the digital part of the business to compensate for this gaping hole in rights. Traditional terrestrial airplay is still hugely important, and consistent airplay generates significant royalties for songwriters and publishers. A real attempt at parity would include the establishment of the public performance royalty for sound recordings for terrestrial airplay.

It is common for stakeholders to suggest legislative fixes that have a favorable outcome for their position. Typically, opponents characterize such proposals as extreme and unworkable, and then offer suggestions that meet their own needs. But this back and forth process gives all stakeholders room to negotiate and compromise on legislation that could achieve more reasonable middle ground.

FMC endorses seven core points that musicians and advocates must defend in the upcoming fights, no matter what the outcome:

- 1. Musicians and songwriters are stakeholders in these debates.** Airplay on terrestrial, satellite and internet radio are an important part of musicians' careers, not only for exposure, but also as a revenue stream via royalties paid by their PRO and/or SoundExchange. Musicians cannot just be the unwitting victims at the tail end of this process. Policymakers MUST include a variety of musicians and songwriters in these ongoing conversations.
- 2. Rate-setting should be reasonably platform neutral.** Although business models and competition should be factored into any rate-setting scheme, we believe that no single technology should be penalized and no platform should be exempted

from compensation obligations. Even if rate-setting standards are harmonized, rates may still differ based on unique market factors.

- 3. Direct payments to performers must be preserved.** Direct payment to musicians for digital performances – as represented by SoundExchange’s direct and simultaneous payments to performers and sound recording copyright owners – is a major advancement in fair and transparent artist compensation. It is important that the direct payment process not be whittled away in the pursuit of bargain-basement licensing deals. Any proposed legislation should include provisions to ensure direct, non-recoupable payment to artists – even under direct licensing agreements.
- 4. Rates should balance the growth of new technologies with fair compensation for creators.** It may be necessary to examine whether emerging radio technologies are able to compete against already established services. However, expansion must not be subsidized on the backs of creators who are the reason this marketplace exists in the first place. We recognize this is a difficult balance to strike, but it is a crucial one for all stakeholders. And the balance is impossible to achieve with the continued exemption for terrestrial broadcasters.
- 5. Musicians’ rights to bargain and advocate collectively must be defended.** Without the leverage offered by collective management bodies, musicians and songwriters lack input in the process of royalty negotiation. Anti-trust law must never be abused to prevent artists from speaking up for their collective best interests.

Beyond the goals of any legislative efforts to address the rate-setting standards, FMC also encourages webcasters and digital music providers to embrace business practices that:

- 6. Make it easy for listeners to discover and take action.** One of digital radio’s greatest assets is its ability to foster music discovery. On many services, webcast tracks are coupled with “buy now” buttons that redirect listeners to iTunes and/or

Amazon for song purchases. But there's more opportunity. Webcasters can help listeners to take action on their discoveries by displaying producer, songwriter and player credits, and connect to artists' websites or social media, or learn about upcoming performances.

7. **Recognize the power of data.** Webcasters like Pandora have something that terrestrial broadcasters can never offer, and that's accurate data about what music is being streamed, how often, and by whom. Not only is this good for the accurate payment of royalties to a huge swath of musicians (many of whom have never seen royalties for traditional airplay), it could also be a new way for artists to leverage other sources of revenue. Giving musicians and their managers access to data about listener engagement could provide musicians with the tools to efficiently route tours, promote new releases, build closer connections with audiences, and offer higher-priced items to dedicated fans. Access to data should not be traded for lowered digital performance royalties, but we encourage musicians to explore the options, and for webcasters to give musicians access to play data to increase the value of their streams and forge mutually beneficial partnerships with the music community.

FMC remains committed to advocating for the fair compensation for musicians and creators. We offer our organization as a resource in any negotiations and encourage policymakers to include musicians in these important conversations.

Casey Rae
Deputy Director
Future of Music Coalition