Statement of
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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"
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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/ppl_uk/docs/ppl_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 fledging 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:

<u>The "Willing Buyer-Willing Seller" Rate Standard Has Failed Repeatedly</u>

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]

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

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 Ordover 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.