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Subcommittee on Intellectual Property, Competition and the Internet
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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.*