Supplemental Statement of the Digital Media Association
Senate Judiciary Committee
Hearing on "Music and Radio in the 21st Century:
Assuring Fair Rates and Rules across Platforms"
July 29, 2008

Chairman Leahy, Ranking Member Specter and Members of the Committee:

On behalf of the Digital Media Association ("DiMA"), thank you again for inviting our Board member, Joe Kennedy of Pandora, to testify at the July 29, 2008 hearing on "Music and Radio in the 21st Century: Assuring Fair Rates and Rules across Platforms". We are pleased that many Committee members voiced support for Internet radio, and for the value that Internet radio delivers to listeners and recording artists. In the coming weeks we hope that support is manifested in legislation that promotes Internet radio's continuing innovation and development.

As the hearing's subject matter was complex, DiMA appreciates the opportunity to supplement Mr. Kennedy's testimony on two issues: (i) what royalty rate standard is appropriate when determining sound recording performance royalties; and (ii) what steps should be taken to address concerns about "streamripping".

I. Royalty Rate Parity Should Fairly Recognize the Contributions of All Parties.

Throughout the hearing there were no defenses offered in support of the current royalty rate-setting standard for Internet radio – the "willing buyer-willing seller" standard found at 17 U.S.C. § 114(f)(2)(B). Instead witnesses and Senator Feinstein discussed what other standard would be appropriate for all digital radio services that might come before the Copyright Royalty Board in the future. DiMA appreciates that forward-looking legislation will appropriately modify the current Internet radio royalty standard, which has failed on two occasions to provide for royalties that are economically reasonable in the context of Internet radio reality.

Toward the end of the July 29 hearing Senator Feinstein noted that her goal is to ensure that royalty rates set by the Copyright Royalty Board reflect the contributions of all parties – performers, recording companies, and programming services. DiMA agrees.

DiMA believes this goal best can be achieved by legislation applying, for all services subject to the Section 114 statutory license, the standards set forth in Section 801(b) of the Copyright Act, 17 U.S.C. § 801(b). These standards were adopted by Congress in the Copyright Act of 1976 to ensure that ratemaking proceedings would result in royalties that were fair both to creative artists and producers, and to copyright users. Since 1976, in each of the four proceedings that have occurred under the Section 801(b) standard, the royalties awarded have been upheld by the courts, and in none of the cases have the parties felt compelled to ask Congress to remedy the determination.

By contrast, the “fair market value” standard has also been tried, and proved a dismal failure the one time it was used in a ratesetting proceeding. The results of that proceeding were so disastrous that the ruling was reversed by act of Congress, with a mandate never to use it again.

“Fair market value” is particularly inappropriate in the case of statutory sound recording licensing, where a true competitive market does not exist for the rate-setting tribunal to approximate or use as a benchmark. The market is highly concentrated among a very few licensors, and represented by a single seller, SoundExchange. As a result, there is no price competition among licensors. For these reasons, a standard seeking solely to value this market or to use voluntary licenses as benchmarks inevitably will set rates at supracompetitive prices that, by definition, are not “fair.”

DiMA therefore urges the Committee to seek parity of ratesetting standards using the only standard that has proven noncontroversial, and that has produced balanced results for all parties: Section 801(b).

Section 801(b) Produces Fair, Reasonable, and Balanced Royalties for All Parties.

Section 801(b) provides that the Copyright Royalty Board shall set “reasonable terms and rates of royalty payments.” … 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 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.

Four proceedings have been conducted under the § 801(b) standards, including two by the Copyright Royalty Tribunal,[1] one by a Copyright Arbitration Royalty Panel[2] and one by the

[1] Adjustment of the Royalty Payable Under Compulsory License for Making and Distributing Phonorecords, 46 FR 10466 (February 3, 1981); Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players, 46 FR 884 (January 5, 1981).

[2] Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings (Final Rule and Order), 63 FR 25394, 25406 (May 8, 1998), *aff’d in part, rev’d in part sub nom Recording Industry Ass’n of America, Inc. v. Librarian of Congress*, 176 F.3d 528, 532 (D.C. Cir. 1999).

Copyright Royalty Board.[3] The latter two proceedings determined rates and terms under the Section 114 statutory sound recording performance license.

In each case, the adjudicatory body began its analysis by reviewing other licenses reached in the marketplace for the same and analogous license rights. The panels then determined whether to accept or adjust these "benchmark" rates according to the degree of similarities and differences between the rights being licensed, the nature of the licenses, and the identities of the parties. Based upon these characteristics, the tribunals established a range constituting a "zone of reasonableness" within which the rates could be set for the licenses that were the focus of the proceeding.

Using the four standard factors of § 801(b), the adjudicators determined a reasonable license rate within that range that reflected the value that the licensors and licensees brought to the license table, and the impact of the rate upon both participating industries. In ratesetting proceedings for the performance right, typically the first factor strongly favors the recording artists and producers. The second factor assures that the royalty payments will equitably compensate artists and producers, while providing a fair return to those services that perform the sound recordings. The third factor assesses the relative strengths of the contributions of each industry. The fourth factor takes into account the economic situation facing each industry and the need for rates or terms to avert potential instability to an industry in flux.[4]

As a result, the rates awarded under Section 801(b) have yielded high royalty payments to artists and the recording industry, without jeopardizing the future economic health of the digital music services.

The Fair Market Value Standard has Never Created Fair Results in Practice.

Congress applied the "fair market value" standard once before in the context of compulsory copyright licenses, with respect to the satellite television industry. As many Committee members may recall, the only rate determination under that statute was so extraordinarily one-sided and unfair that, following a years-long debate, Congress not only reversed the result, it repealed further use of the standard. The lessons learned from that debacle demonstrate why the fair market standard should not be resurrected in the already-contentious debates over webcasting rates.

[3] Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 FR 4080 (January 24, 2008).

[4] At the hearing, Mr. Simson of SoundExchange suggested that the Section 801(b) factors be augmented to consider the potential substitutional effects of performances on sales. While no significant evidence of substitution has yet been proved to arise from listening to noninteractive digital radio services (and, indeed, all evidence tends to show that such listening stimulates rather than depresses sales), the four Section 801(b) factors, and particularly factors (A), (B), and (D), are capacious enough to address his concerns.

Section 119 of the Copyright Act provides satellite video services a compulsory license for retransmitting network stations and superstations for private home viewing. The rates for those retransmissions originally were set by Congress by statute from 1988 through 1997, at rates comparable to rates being paid by the cable industry. The statute prescribed thereafter that the rates would be set by arbitration, according to a "fair market value" standard. The arbitrators had the opportunity to apply that standard exactly once, in 1997, and the result was disastrous.

The rates determined in the arbitration were as much as 11 times the amount that similarly-situated cable television system operators paid for analogous rights under their statutory license, and approximately 3 times the amount that Congress had set by statute. As the House Judiciary Committee noted, “Satellite carriers and distributors are irate over the decision.” H.R. Rep. No. 105-661 Part 2 at 15-16 (1998). The cause of the problem was that the “fair market value” test did not permit the arbitration panel to properly consider the effect of the royalties on the satellite services, or their ability to compete against cable providers not subject to the Section 119 license:

> The CARP decision, however, appears to overlook the impact a royalty rate increase of as much as 350 percent will have on competition in the distribution of cable and satellite programming. The decision adds about $50 million to the annual costs of the satellite broadcast industry. The Committee views the CARP decision with great concern. The decision not only reduces the likelihood that satellite broadcasters will be able to effectively compete against incumbent cable operators, but it also means consumers will inevitably bear the cost of this government-mandated surcharge.

H.R. Rep. No. 105-661 Part 1 at 4-5 (1998). Similarly, the Senate Judiciary Committee believed it necessary that the rate determination should maintain parity among the two competing industries:

> To that end, it is important that the satellite industry be afforded a statutory scheme for licensing television broadcast programming similar to that of the cable industry. At the same time, the practical differences between the two industries must be recognized and accounted for.

S. Rep. No. 106-42 at 10 (1999).

Because of these concerns over the potential impact of these colossal increases on the satellite television industry, competition in the video services market, and on prices to consumers, Congress enacted The Satellite Home Viewer Improvements Act of 1999. SHVIA slashed the so-called “fair market value” rates by 30-45 percent. Moreover, Congress ensured that there would be no future arbitrations under that standard, by setting the reduced rates in the statute, subject to adjustment only by legislative amendment.

This past experience demonstrates that the “fair market value” standard does not produce a “fair royalty.” The only arbitration experience under that standard produced such unfair results that it sparked years of Congressional debate, before being reversed by act of Congress. And Congress assured that such a debacle would never occur again, by precluding use of the "fair market value" standard in any future proceeding.

Thus, the “fair market value” standard is hardly the panacea to solve the current unfairness of the internet webcasting rate determinations. As past history demonstrates, a “fair market value” standard would only invite a repeat performance of the SHVIA controversy.

There is No “Market” to Use As a Benchmark When Determing a “Fair” Value.

The fundamental flaw with the fair market value standard is that the “market” the standard seeks to measure does not exist. First, there is no market for licensing these rights other than under the statutory license itself. The sound recording performance right came into existence at the same time as the statutory license. Today, the statutory license is essentially the sole means for licensing noninteractive services. The only “market” for these rights is the compulsory license market.

Second, there is no history of “fair market” licensing for the rights. To the contrary, all licensing negotiations are conducted under an antitrust exemption, by a single seller (SoundExchange), and are carefully calculated by the seller to set precedent for future arbitration, rather than to reflect a fair market price. On this basis, in the first webcaster rate proceeding in 2001-02, the arbitrators threw out 25 of 26 licenses offered as "benchmarks" by the recording industry. Consequently, in past rate proceedings, the recording industry has instead relied on rates from a fundamentally different market, interactive listening services (*i.e.*, where the listener selects the song and time and place to listen, rather than listening to radio programmed by the service), rather than rates for noninteractive webcast programming.

But these interactive license rates suffer from the same flaws identified above. Because interactive service providers need the repertoires of each major recording company, they cannot substitute a license from one record company for a license from another; the result is a complete lack of price competition and near-monopoly rates. In addition, interactive services provide a product – on-demand listening to any song at any time – that record companies believe substitute substantially for CD sales (and certainly much greater than any substitution that allegedly results from noninteractive webcasting); as a result, the record companies demand rates that account for such substitution and are completely inappropriate as benchmarks for noninteractive radio-like services. Finally, because the recording industry knows these rates will be used as benchmarks for the CRB proceedings, the industry has incentives to maintain these rates at artificially high levels, and to set terms that it hopes will later be adopted in the separate, section 114 noninteractive license CRB proceeding.

Third, because the noninteractive service rates are set by arbitration, the only voluntary licenses for these rights are achieved through settlement agreements. However, settlement agreements can be inherently unreliable indicators of the actual value of a license. In the first webcaster license proceedings the only license (of 26 offered) that the CARP relied upon was a settlement agreement that Yahoo! testified reflected the value not only of the sound recordings, but also of millions of dollars in saved litigation fees, the time its executives otherwise would have devoted to litigation (instead of business), and value of certainty for business planning purposes (rather than the uncertain outcome of an industry-wide arbitration).

Finally, one cannot conceive of valuing a “fair market” in which the largest users – in this case, broadcast radio stations – get the exact same commodity without restrictions and for free. The ability of the largest competitor in the market to use the licensed goods for free ordinarily would lower pricing of these rights in a true free market. And, if broadcast stations were subject to licensing requirements, their negotiations undoubtedly would influence the nature of the market and the shape of the outcome. However, in past proceedings, the panels have been instructed to ignore radio's free use of the exact same rights, and to price the statutory license as if it had been set on a level playing field.

Therefore, the concept of “fair market value” does not, and should not, apply to statutory licenses. The “market” itself is a fiction, and its characteristics display none of the competitive factors that one would expect in a “fair” market.

A "Market" Dominated by Four Major Labels that Can Demand Above-Market Rates Cannot be Deemed to be “Fair.”

Over the last decades, a few major recording labels consistently have exercised market power and an approximately 80-85 percent share over the market for sale of recorded music in the United States. These labels have no incentive to compete for license rights based on price. Each company offers unique content that is not fungible with content from another. The labels understand this need, and leverage it in their negotiations with music services.

To exercise this leverage, the labels rely on “most favored nations” clauses to ensure that the first to deal with any music service gets terms at least as good as those offered every other major label. These clauses have been the rule, rather than the exception, and result in a *de facto* collusion among the labels that distorts the outcomes of licenses, such as the interactive service licenses, that might otherwise be used as a benchmark for “fair market value.”

MFN clauses give undue power to the last label to negotiate. If no one can offer a broad-based compelling music service without a license to all major label content, then the last label can hold out for monopolistic terms; and the first licensor, far from being a forward-thinking trailblazer, will reap the same benefit of supracompetitive pricing. A market that can so readily be manipulated by the seller cannot be deemed a “fair” market, or enable assessment of a “fair market value.”

A "Fair Market Value" Standard will Perpetuate the Current Disputes.

Finally, there is reason to question whether the proposed “fair market value” standard will be any more equitable or, indeed, any different in practice, than the current “willing buyer - willing seller” standard. In his 2002 decision on the arbitrators' decision in the Webcaster arbitration, the Librarian of Congress opined that the two standards are equivalent: “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." Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings; Final Rule, 67 Fed. Reg. 45240, 45244 (July 8, 2002).

After the first CARP webcasting decision under the willing buyer-willing seller standard, Congress stepped in to statutorily reverse the arbitrators' decision as it applied to small webcasters. Under the Small Webcaster Settlement Act of 2002, Congress repealed the rates set by the arbitrators, and allowed the parties to put into place rates set by mutual settlement agreement. The latest determination, the first by the Copyright Royalty Board, has extended that uproar to large and small webcasters alike. While SoundExchange agreed voluntarily to reject one of the most egregious aspects of the CRB decision (that is, the $500 minimum fee per channel), all webcasters are appealing the decision as unfair, arbitrary and capricious, and support a legislative solution to the astronomical and unaffordable rates set by the Judges.

For these reasons, DiMA believes that a "fair market value" standard will merely perpetuate the flaws of past ratesetting determinations for statutory licenses. Hypothesizing "fair market value" in an inherently artificial and monopolistic market structure will guarantee continuing future controversies over the same types of issues that plagued arbitrations for the satellite video industry under that standard, and for webcasters under an equivalent standard. The only standard to date that has not required Congressional intervention, and that has resulted in reasonable rates (and the lion's share of royalty payments) is the Section 801(b) standard. Section 801(b) will provide the most reasonable and equitable results, because it requires balanced consideration of the creative contributions and economic needs of both licensors and licensees. Given the success that Section 801(b) has demonstrated in reaching fair determinations without controversy, it should be adopted as the standard for all ratesetting determinations of sound recording performance rights, for all licensees.

II. The Marketplace is Addressing the Streamripping Concern, and Until Substantial Harm is Documented, Government Action is Premature.

The PERFORM Act requires digital radio services to technologically inhibit consumer recording. The PERFORM Act was introduced when the recording industry and recording artists were engaged in a dispute with satellite radio companies, XM and Sirius (since merged), which were authorizing and promoting consumer recording and disaggregation of individual songs for later enjoyment on-demand and in personal playlists. The bill's sponsors were concerned that consumers' ability to easily disaggregate and library digitally recorded songs would diminish the likelihood they would purchase those songs. PERFORM Act sponsors were equally concerned that XM and Sirius were essentially distributing music but paying royalties only for performing the music. We understand that this dispute has ended, so legislation is no longer needed to address this situation.

Additionally, PERFORM Act sponsors are concerned that software products are marketed for the express purpose of "streamripping", allowing consumers to record Internet or digital radio specifically for the purpose of automatically disaggregating the recorded songs and creating a permanent personal music library – and thereby never having to purchase music again. The PERFORM Act's content protection technology requirement would apply to all digital radio services, even those that are not – like XM and Sirius – promoting and authorizing the recording and disaggregation of songs.

DiMA and webcasters have a business interest in opposing streamripping.

DiMA and our members appreciate the creative genius of America's recording artists and all whose input makes American music great. Moreover, webcasters agree with the recording industry's sharp disapproval of those who market and use "streamripping" software. In contrast to traditional consumer home recording which requires consumers to hear songs and invest personal time to produce a "mix tape" or "party tape" of their favorite recordings, streamripping software often appears to be marketed expressly to help listeners build a personal music library without paying recording artists or record companies.

The Committee should appreciate that streamripping, if it ever became widespread, would not harm only recording artists and companies; it would also harm webcasters. Webcasters succeed by building and maintaining continuing relationships with consumers, who support our businesses by either paying subscription fees or listening to advertisements. If a listener records and libraries all her favorite songs, e.g., from a "Hits of the 1980s" channel, she may never again return to that station and the webcaster will have lost a listener or subscriber. As a result, webcasters' and recording creators' interests are aligned with respect to streamripping.

There is no evidence that streamripping is popular in the marketplace or that it is causing any harm to creators or webcasters.

Over the course of eight years, in two copyright royalty proceedings and several Congressional hearings, recording industry representatives have asserted that streamripping is a source of piracy, is an imminent threat of significant piracy, and that Congress should require digital radio services to technologically inhibit unrelated 3rd party streamripping software products. However, during that time including several instances testifying under oath, the recording industry has not presented any empirical data that supports a conclusion that streamripping programs are being used by listeners, or have been the source of any piracy, and certainly not that they have been the source of substantial piracy.

DiMA members are aware that several dozen streamripping programs exist and are being marketed, but in the 2006 Copyright Royalty Board proceeding the recording industry witness who testified about streamripping admitted under oath that there is no evidence that listeners find the programs interesting or useful or that they actually pay for these programs. Perhaps the programs are downloaded for trial periods that rarely lead to purchases. But if the programs were popular or a significant threat to commerce we would read about them in the popular press such as the New York Times, Washington Post or the Wall Street Journal; investors would take notice (as they did with the original Napster); and there would be interviews of people who use them just as there is ample evidence of people using peer-to-peer software to distribute and acquire music. On August 1, 2008 when DiMA staff checked, there was not one streamripping program listed in the Top 50 most popular software downloads on www.download.com, a leading consumer software website.

Internet radio services already are required by the Copyright Act to take certain steps to defeat streamripping.

Since 1998 Internet radio services have been obligated to utilize content protection technology in situations where it is essentially incorporated into a service's chosen streaming technology. For example, the two most popular streaming media technologies, produced by Microsoft and RealNetworks, respectively, offer radio services an easy cost-free optional copy-protection system that works reasonably well, and the Copyright Act requires radio services that take advantage of the Internet radio statutory license to utilize this technology if they otherwise choose to use streaming technology offered by RealNetworks or Microsoft.

Additionally, acting in their own self-interest, some webcasters take steps intended to inhibit streamripping, including terminating user accounts on very rare occasions when streamripping evidence is substantial.

Developing and integrating software to inhibit streamripping is expensive and technically challenging, and almost guarantees a significantly diminished experience for Internet radio listeners.

In the recent CRB proceeding, a recording industry witness listed several dozen available streamripping programs. With so many programs available and no empirical evidence of which (if any) are more popular, it seems unfathomable that any cost-effective solution is available.

To effectively inhibit several dozen programs' effectiveness, each would have to be analyzed and then broadly applicable content protection software would need to be developed. This protection software would have to work elegantly with a service's underlying streaming software, and would need to be efficient so that the radio service's bandwidth costs do not double or triple because of the size of the protection software. Constant updating would be necessary to ensure that new streamripping programs are addressed, and each update would require careful re-integration with the underlying streaming software, as well as a new media player software download for each of several million radio listeners to ensure that the most advanced software is actually being used.

The recording industry is familiar with the challenging complexities of content protection software. As a result of individual company efforts (e.g., Universal's Blue Matter software and SonyBMG's "rootkit" software) and joint industry action (e.g., the multi-year Secure Digital Music Initiative), RIAA and its members appreciate the difficulties of securing content, especially in the open internet environment where Internet radio lives. Moreover, the record industry's apparent abandonment of protection software in its own music distribution efforts seems to reflect that the cost of protection (including the costs of losing frustrated consumers to illegal content) exceeds its value. Some leading technologists believe that content protection will never be effective unless policing software is placed on consumers' personal computers and devices, but all Americans know how quickly that will lead to consumer rebellion and class-action lawsuits.

We are in an era of programmers trying to lighten software, enhance consumers' experience (for example, by quickening the time it takes the music to start playing) and reduce software downloads to consumers. Mandating content protection software in internet radio, where no demonstrable problem exists, will undermine these goals, and will diminish the consumer experience and hinder commercial services' efforts to win consumers away from piracy.

DiMA and SoundExchange have formed a joint industry technology committee to consider the problem of streamripping and possible solutions.

As evidence of our industry's commitment to addressing the potential streamripping problem, DiMA agreed almost one year ago to a SoundExchange request to form a joint industry technology committee. The Committee's charge is to consider the potential threat and jointly review technologies that could promote our industries' mutual interests. It is notable, however, that in the eleven months since this Agreement was signed, SoundExchange has not suggested that Committee members be identified or that an initial meeting be scheduled. If SoundExchange or its recording industry constituents were actually concerned about streamripping, or if there was any evidence that the industry is threatened by streamripping, this delay would not be continuing even to this day.

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DiMA appreciates the opportunity to submit this supplemental testimony on these two important issues, and again thanks the Committee for permitting our Board member, Joe Kennedy, to testify. We look forward to working with the Committee to further your goals of legislating royalty rate standards that are fair to all digital radio participants, and ensuring that music and creativity are respected by all who appreciate it.