Dissonance over US bid to cut Web radio royalties

October 14 2012, by Rob Lever

A banner for Pandora Media Inc., the online-radio company, hangs in front of the New York Stock Exchange in 2011. A push to lower music royalties paid by Internet radio has created political disharmony in Washington.

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The row began to heat up in September, when a group of lawmakers introduced the Internet Radio Fairness Act to equalize royalty payments paid per song for digital radio, whether it is transmitted over the Internet, cable or satellite.

The proposal was swiftly endorsed by Pandora Media, the biggest US Internet radio firm, which has complained of unfair treatment by the current royalty system.

Pandora said the bill would "establish a level playing field for Internet radio" and end a "fundamentally unfair" system that requires it to pay some 50 percent of its total revenue in royalties.

That compared with less than 10 percent paid by satellite radio firm SiriusXM, which benefits from a preexisting rate allowed under a 1998 law.

Pandora stepped up its campaign in the past week, asking users to press lawmakers to act on the bill.

"As a musician myself, I believe artists should be fairly compensated, but the current system hurts everybody, including artists," said Tim Westergren, co-founder of Pandora, in a video appeal to its members.

Sponsors of the law say the current royalty system was established before anyone imagined the potential for Internet radio.

Royalty rates for Internet radio are set by a panel of three copyright judges who determine the "marketplace" rate. That differs from a standards of eight percent set for satellite radio and 15 percent for cable music.

A sponsor of the bill, Representative Jason Chaffetz, said the proposal is backed by organizations including the Digital Media Association, Computer and Communications Industry Association and the Consumer Electronics Association.

"Internet radio should be a boon to the entire audio market—from the creators, to the distributors, and of course to the consumers—but instead it is barely hanging on," Chaffetz said.

"Congress enacted the royalty rate standard for Internet radio 14 years

ago, when Internet radio was barely a concept."

But the measure is drawing fierce opposition from musicians and others who could see royalties slashed.

Ted Kalo, executive director of musicFirst, a coalition of record labels and artists, said musicians would pay the price for the bill.

"The current law reflects the free market rate," Kalo said. "We should not impose a government-mandated below-market rate, which would require artists to give up the fair market value of their work."

If any change is made to law, Kalo said those benefiting from a lower "grandfathered" royalty "should be brought up to the market rate" and that traditional radio—which is not covered in the proposal—should lose its loophole on royalties.

Hal Ponder of the American Federation of Musicians said the bill "would slash paychecks to artists and labels simply to line Pandora's pockets."

But Pandora's Westergren said the bill "will drive massive investment in the space," and create a wider audience for Internet radio, helping artists in the long run.

"Imagine the impact on artists if this industry grew to become 25 percent or even 50 percent of radio listening," he said in a blog post.

A report by the research firm Trefis said that without the bill, Pandora's business model could become unsustainable but that if the measure passes, its value could double.

Trefis said Pandora "cannot leverage a higher base to negotiate favorable

rates directly with the copyright owners" and "may not become profitable unless it finds a way to offset these costs."

John Villasenor, a senior fellow at the Brookings Institution's Center for Technology Innovation, said there is a rationale for ending the "onerous rates" for royalties which "have risked driving innovative companies out of business."

Villasenor said in a research report that cutting royalties could help Internet radio thrive, driving more customers to listen to digital music broadcasts.

"This would lead to more revenue for broadcasters, songwriters, recording artists and record labels," he wrote.

But analyst Richard Greenfield at BTIG Research, said Pandora should not get a special deal in Congress for a model that protects its "user experience" by limiting ads.

"The 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," he said.

"Pandora is effectively asking the government to intervene and reduce its cost structure, helping it remain a viable business because it knows its business model only works while running limited advertising."