Testimony of

Ms. Hilary Rosen

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I am Hilary Rosen, Chairman and CEO of the Recording Industry Association of America, Inc. ("RIAA"). I would like to thank Chairman Leahy, Senator Hatch and the other members of this Committee for affording me an opportunity to testify and to clear up some of the confusion about the recent Copyright Arbitration Royalty Panel ("CARP") proceeding involving webcasters. As you know, RIAA members own the copyrights in over ninety percent of the legitimate sound recordings produced in the United States, and RIAA participated on behalf of those members in the recent arbitration. We also have helped to establish SoundExchange, a collecting agency whose board is composed evenly of record labels and recording artists and their representatives. SoundExchange, which will soon be incorporated as a separate legal entity, and will collect and distribute the royalties paid by webcasters and others for the digital performance of sound recordings.

We want webcasters to succeed. This application of technology is exciting. It has energized music lovers and fans, some of whom have turned themselves into webcasting entrepreneurs, and it has also provided a new business opportunity for some of the world's largest and most innovative media companies. If webcasters don't succeed artists and record companies stand to lose an important new revenue stream. For years, artists and record companies have been denied the performance rights that other copyright owners enjoy in the United States and that artists and record companies enjoy in other countries - a situation that has been well documented for its inequity. New revenue streams are more important than ever in a world where new technologies are dramatically changing the way people get and listen to music.

The fact that we worked closely with this committee and others in 1998 when Congress enacted legislation guaranteeing, in an unprecedented manner, that a new business called "webcasting" would have access to blanket licenses for sound recordings on a compulsory basis, is a testament to our commitment to the success of these businesses. We even invested millions of dollars creating a collection and distribution system that would significantly ease the webcasters' burden of using hundreds of thousands of different recordings in their programming. Artists and record companies engaged in this activity despite the risk that payment would not come for several years as rates were worked out in the marketplace or in a CARP proceeding.

We fervently believe now as we did then that webcasters can succeed while compensating the creators of the sound recordings upon which they have built their business. It is obvious that without sound recordings there would be no webcasting business. It is equally obvious to artists and record companies that webcasters were required to pay other costs from day one of their business: their rent, their bandwidth, their webmasters, their suppliers of computer hardware, software and office equipment, etc.

The issue of how much to pay for music is a complicated one. The compensation should be determined through a fair process and be based on the market value of the sound recordings. We believe that the recently completed CARP proceeding was fair. It was long, cumbersome and expensive. But now, three and a half years after Congress first created this new compulsory license we look forward to the implementation of the arbitrators' decision so that record labels

and artists can finally be compensated.

I am fully aware that the Committee has been hearing from some webcasters that the rates are too high or that the process was unfair. And so I am pleased that we all have the opportunity of this hearing to air our views. I believe that an analysis of the CARP process generally, especially after one of the most expensive and lengthiest CARP proceedings ever, will serve us all well in the future. And it is certainly within this Committee's discretion to change that process for future proceedings. But with respect to an analysis of the current proceeding, it is important to keep several things in mind as you listen to testimony today.

? The statute directed the parties to attempt to negotiate rates in the marketplace, and a CARP proceeding was a last resort. Because webcasters had a compulsory license and therefore didn't need to negotiate a rate, they could avoid paying royalties for several years by opting not to negotiate. Many webcasters took advantage of this and have avoided paying royalties while awaiting the final outcome of the CARP decision. In other words, they have already had a significant boost in starting their business.

? Nobody was "outgunned." Several large media companies, including AOL, Viacom and Clear Channel had many highly paid and skilled lawyers and consultants in the CARP proceeding fighting for as low a rate as possible. Many small webcasters also participated by presenting evidence and testifying, and no doubt benefited from the very able counsel and experts retained by the larger companies. Even if some smaller webcasters did not participate, their view was well represented.

? The arbitrators had access to a huge amount of confidential financial data about the webcasting and recording businesses. They did their homework. They looked at large and small companies, their costs, their financial projections, their forecasting statements, their IPO offerings, etc. In other words, the CARP had a lot more information about the webcasters' ability to pay than this hearing could ever unveil.

? The Librarian of Congress is currently reviewing an unredacted version (which I certainly haven't seen) of the arbitrators' decision. I am sure that review will be thoughtful and considered, and it should be based on the extensive record evidence. Congress set up this process. Let it work through to the end without judgment or interference.

I am pleased to be here today and look forward to your questions. We absolutely want to work productively with the webcasters on the implementation of this decision. And, of course, we want to work productively with this Committee as you determine the best course for these types of proceedings in the future.

Background: The Digital Performance Right and the CARP Process

To help understand the importance of this issue, some background is necessary. Because of a historical anomaly, for most of the twentieth century sound recordings did not have any performance right under U.S. copyright law. Congress sought to correct this inequity in part in 1995 when it enacted the Digital Performance Right in Sound Recordings Act ("DPRA"). The DPRA gave recording artists and record companies a limited performance right, applicable only to the digital transmission of their works. In 1998, Congress clarified in the Digital Millennium Copyright Act ("DMCA") that this right applies to certain Internet music services like webcasters, but granted the webcasters a compulsory license to help streamline the process of clearing rights and paying royalties for the use of sound recordings. Under a compulsory license, a webcaster does not need to negotiate for permission from the copyright owner to perform sound recordings, but must pay the royalty established by law. Congress made clear that one-half

of these royalties collected under this compulsory license would be allocated to the recording artists (including background vocalists and musicians) and one-half to the record companies.
After the DMCA, all a webcaster had to do to begin performing sound recordings to its listeners was to file a single piece of paper with the Copyright Office and pay a small filing fee of around $20. Because the royalty rate is to be set by negotiation or a CARP, webcasters accrue but do not have to pay any royalty until the rate is set. Indeed, in the three-and-one-half years since enactment, nearly all webcasters have not paid any royalties for their use of sound recordings while the CARP process has been ongoing. Many webcasters have come and gone in that time, and it is likely that no royalties will ever be paid for those services' use of sound recordings.
In light of these circumstances, RIAA found trying to negotiate the rates and terms for the statutory license to be quite difficult. Early on we were informed that the Digital Media Association ("DiMA"), a webcaster trade association, could not negotiate on behalf of its members as a group, and that we would have to negotiate individually with each webcaster over its rates and terms. Of course, because they could enjoy use of the recordings without payment under the compulsory license and negotiating with the copyright owners would mean paying immediately, most webcasters opted to sit and wait for the CARP to set the rates and terms, and never discussed a deal with us. Indeed, as we learned, there was a concerted effort to discourage webcasters from engaging in private negotiations and to instead join the "team" that was preparing for litigation. As a result, we unfortunately were unable to avoid a costly arbitration.
We were successful, however, in reaching agreement with 26 webcasters, large and small, and presented these agreements to the CARP as evidence of the marketplace rate. The CARP closely scrutinized all of that evidence, as well as the evidence presented by the webcasters and broadcasters and evidence that the CARP developed itself that neither party presented. Based on that extensive record, the CARP issued its proposed royalty rates. Both sides appealed the ruling to the Librarian of Congress, and he is considering those appeals now.

Correcting Some of the Myths About the CARP Process and Decision
The CARP decision was the result of a ten-month long proceeding that included more than fifty witnesses and thousands of pages of documents. We have asked the Librarian of Congress to modify the opinion because we believe the rates do not reflect the overwhelming evidence that fair market value for sound recordings is much higher. However, we have been careful to limit our arguments to the appeals process.
Some webcasters want Congress to change the rules of the game now that the time to start paying is finally at hand. In the end, if Congress believes a subsidy for webcasters is appropriate, it should not come on the backs of the individual creators and companies who provide the webcasters with the key component of their business. Perhaps other subsidies, such as tax breaks, would be more appropriate.
The purpose of the CARP process is to determine rates in a fair and efficient manner. The process should be respected, and efforts to have rates set by some ad hoc alternative method should be rejected. In any event, dialogue on this issue is often difficult because of confusion and misinformation surrounding the CARP proceeding and decision. We would like to address some of those issues now.

Myth #1: The proposed rates will bankrupt small companies and silence webcasting. In fact, under the CARP's decision a webcaster will pay at most around 2 cents to play one hour of recorded music to one of its listeners, and some (such as many college radio stations that put

their signal online) will pay about one-tenth of that amount. Some webcasters paint a very simple, but misleading, economic picture - they claim that the CARP's proposed 2 cents per listener hour rate leads to a royalty payment that is multiples of their revenues and therefore would bankrupt them. What they don't tell you is that nearly all of their other expenses - such as their bandwidth, hardware, software, marketing and employee costs - are many multiples of their revenues. New businesses are often "deficit-financed" where costs exceed revenues, and Internet music services are exemplars of this approach.

For example, in the CARP proceeding nine webcasters, big and small, presented data that showed that combined they would spend over a half-billion dollars on expenses for the 1998-2002 period. The CARP's proposed royalty for these companies would be only about 4 percent of these expenses (approximately $20 million). This data includes data for Live365, an aggregator of "small" webcasters, as well as other small webcasters.

The notion that the sound recording royalty is the cause of financial hardship for these companies is also belied by the reality of the past three years, when hundreds of webcasters launched and did not survive even though they never paid a cent in royalties for sound recordings. For example, NetRadio, one of the first webcasters, raised tens of millions of dollars in investment capital, but shut down last October before ever paying anything for the hundreds of millions of sound recording performances it made.

In essence, because of the compulsory license, artists and labels are "last in line" to be paid by webcasters, even though their entire business revolves around our creative product. No one would suggest that the webcasters' hardware vendors, bandwidth providers or employees be forced by Congress to give webcasters rebates, below market prices or agree to accept a percentage of a webcaster's revenue to help "preserve" the webcast industry, even though the webcasters typically spend more on those components of their business than they currently earn in revenues. There is no reason artists and record labels should be treated any differently and forced to subsidize webcasters.

Even so-called "smaller" webcasters vastly overstate the effect of the CARP's proposed royalty. A real world example demonstrates this. Hober.com is a webcaster from Takoma Park, Maryland who was recently mentioned in the Washington Post as a smaller webcaster who might be harmed by the CARP's decision. Hober.com specializes in what it calls "unvarnished music," which appears to include folk, bluegrass, blues and jazz. On its site Hober.com asks listeners to support its webcasts with donations. It claims that "[i]t costs a few cents an hour to broadcast to each person," and suggests "every day listeners" make a one time gift of $50 to $100 dollars, and that "if you want to be a saint," you should donate $20 a month.

To put the CARP's proposed rates in perspective, if one "every day" listener donated $50 to Hober.com, that donation alone would pay the royalty obligation for that listener to listen to Hober.com six hours a day for every day of a year. If Hober.com is willing to spend "a few cents an hour" to broadcast to each person, why should it not be willing to spend just 2 cents an hour for the creative work that forms the core of its service? In fact, Hober.com explains that the donations are used "to make sure that our children and grandchildren have continued access to this incredible wealth of natural music played by real humans." We agree - and that is why the 2 cents (at the very least) should be paid to the "real humans" who have created the "wealth of natural music" that Hober.com provides to its listeners.

Myth #2: The CARP process is unfair and prejudicial to smaller webcasters.

We understand that some webcasters who are not happy with the CARP decision after-the-fact

are claiming that the process was not fair to them. While the artists and record labels are not happy with the result either - the result is a lot closer to what the webcasters asked for than what we asked for - the process thus far has treated all parties and potential parties equally. Just as some smaller webcasters like XACT Radio and RadioAmp participated in the CARP proceeding and presented evidence, the artists and labels presented evidence based on agreements with smaller webcasters (characterized by webcasters' counsel in the proceeding as "chump change"). Some smaller webcasters claim that they could not afford to participate in the proceeding, but the same situation applied to hundreds of individual artists and independent labels that are depending on these royalties as an important source of income in the changing marketplace for recorded music. Indeed, this Committee has received written testimony from the American Federation of Independent Music that outlines the burdens on small record companies in their everyday business.

I would also like to debunk one of the rumors that has emerged after the CARP rates were announced: that RIAA somehow prevented smaller webcasters from participating in the CARP proceeding or would not agree as others did to subsidizing their costs. This unfortunate assertion is completely untrue. RIAA never had the authority to keep anyone from participating in the CARP process, and the case presented by the artists and record labels was also harmed by the inability of smaller parties to present their views without full CARP participation.

At one point the Copyright Office asked for comments on the possibility of establishing different procedures for smaller parties. RIAA suggested that the Office establish procedures that would allow consideration of amicus filings by smaller parties on a case-by-case basis, consistent with the procedures followed in federal court. The Copyright Office, however, decided that it could not adopt new procedures in the middle of CARP proceedings, in part because it did not have clear authority to do so. All parties, and especially smaller parties, would have been harmed if the Office followed invalid procedures that required the whole proceeding to be thrown out after a tremendous amount of time and effort was spent litigating the case. This decision applied equally to parties of all types, including artists groups that ultimately did not participate in the proceeding because of the ruling.

Moreover, the CARP heard substantial amounts of testimony about smaller webcasters from participants in the CARP proceeding. Live365, which has been vocal in leading the after-the-fact complaints about the rates on behalf of smaller webcasters, was a full participant in the CARP, as its chief legal officer testified at the hearing, noting that it had three well-known law firms representing it on statutory license matters. Live365 has also taken clear advantage of the process by having separate counsel file a separate appeal that purports to address issues of concern to smaller webcasters. Witnesses for other smaller webcasters such as XACT Radio and RadioAmp participated fully, explaining their services and their businesses to the CARP. It should be noted that these webcasters also testified that they use a substantial number of copyrighted sound recordings in offering their services.

In fact, the CARP actually ended up setting a lower rate for certain noncommercial parties that would generally be considered "small" webcasters. Many of the noncommercial college radio stations that are complaining about the impact of the rates may not be aware that they will be able to pay rates that are only about one-tenth the rates that will be paid by commercial webcasters for the webcasting of their over-the-air signal. That amounts to far less than one cent per hour of music - surely much lower than they are paying for their other expenses, even on a minimal budget.

Finally, the CARP process did not take place overnight. After about two years of preliminary

proceedings, the CARP hearing took place over six months, during which three independent professional arbitrators received dozens of volumes of written testimony, reviewed thousands of pages of exhibits, heard from more than fifty witnesses whose testimony was tested on cross-examination during forty days of evidentiary hearings, reviewed 15,000 pages of transcripts from those hearings, and reviewed close to 1,000 pages of legal briefs submitted by experienced counsel. The arbitrators also had access to sensitive business and financial data from virtually all the parties - data that is not available to any of us because of its highly confidential nature. The arbitrators weighed all of this evidence for months and wrote a 135-page report analyzing the evidence and setting the rates.
Thus, while the parties may disagree with the arbitrators' ultimate conclusion, the process was certainly fair.

Myth #3: A percentage of revenue rate makes more sense for smaller webcasters, but the RIAA fought against the adoption of such a rate in the CARP proceeding. Some webcasters are now saying that the CARP should have adopted a royalty rate based on a percentage of the services' revenues, rather than the "per performance" or per use rate it adopted. They argue that this would allow services to afford the royalty in the early stages when their revenues are low.
The reality is that the CARP exhaustively considered a percentage of revenue option because the RIAA (not the webcasters) proposed that a webcaster could choose to pay 15 percent of its revenues (with a minimum fee of 5 percent of its operating expenses). It was the webcasters who insisted upon a per use fee (except at the very end of the process after final rates were proposed), and several webcaster witnesses, including their principal economic expert, testified against the adoption of a percentage of revenue rate. In the end, the CARP (relying in large part on the webcasters' expert witness) concluded that a percentage of revenue metric was inappropriate for several reasons.
First, the arbitrators recognized that with a percentage of revenue rate, the devil is in the details. It is difficult to define exactly what "revenues" are covered by the rate, especially where the webcaster does many things on its web site that may be unrelated to music. Also, the arbitrators determined that webcasters should not be permitted to make extensive use of sound recordings and pay very little in royalties simply because their business structure provides for very little revenue in their webcasting operation. For this reason, RIAA proposed a minimum fee based on a percentage of the webcasters' operating expenses to guarantee that some value was paid for the use of the sound recordings. But this too has its complications, as one must define what "operating expenses" are covered.
The CARP also found that a percentage of revenue rate would be unfair because webcasters using the same amount of music might pay wildly different royalties if their revenues differed. In addition, the CARP noted that because webcasters are currently generating very little revenue, the percentage of revenue rate could result in very little royalty for an extensive use of sound recordings and thus deny record labels and artists fair compensation.

Myth #4: The rates for performance of sound recordings should be the same as the rates for performance of musical works. Some webcasters have also suggested that the proposed CARP rates are significantly higher than the rates paid to ASCAP, BMI and SESAC for the performance of musical works, and that the rates for musical works and sound recordings should be the same. This claim is really an attempt to reargue the CARP proceeding, as this issue was at the center of much of the arbitration, where the CARP considered an enormous amount of evidence presented

by both sides on this very issue.
The bottom line is that the comparison is really one of apples and oranges, on many levels. First, the sound recording business and the musical work business are very different, with different cost structures and revenue streams. After hearing substantial evidence on this point, the CARP concluded that it does not make sense to equate the two for purposes of rate setting. Second, even on the surface the rates cannot be accurately compared, as the CARP's rate is a "per use" rate, something ASCAP and BMI have never used in their dealings with services because they have negotiated variations of the percentage of revenues rate. In fact, ASCAP and BMI told the CARP that it would be inappropriate to convert their percentage of revenue rates to per use fees. Finally, the musical work rates were adopted for use in the analog world by broadcasters, and tell us very little about the value of sound recordings in the digital world of the Internet webcaster.

The Importance of a Meaningful Performance Right for Sound Recordings
To be sure, we understand that webcasters are struggling to figure out how they can generate enough revenue to support their businesses and earn a healthy return on their investment. That is a reality that our members face in their own business everyday. As the creators of recorded music, we would love to see as many webcasters as possible thrive in the marketplace, because it means more royalties and more outlets for our creative product. We strongly disagree, however, that the sound recording performance royalty is an obstacle to that success, and believe that webcasters should spend more time seeking a constructive solution with artists and labels to help both industries grow.
Congress created the digital performance right because sound recordings have been the lone exception to the bedrock principle of copyright law that creators and owners of copyrighted works should share in the benefits when others make commercial use of their works. Congress agreed that, with new digital technologies on the horizon, the rules of the road should be laid out in advance and this old injustice remedied. That's why artists and labels were awarded royalties from digital transmitters of music - because the historical anomaly of not paying performance royalties was unfair, inconsistent with the treatment of every other copyrighted work, and inconsistent with international norms.
As it happens, this decision was not only right, but also prescient. As you well know, new technologies are facilitating the widespread looting of recordings, eating away at the sales that have been the sole source of revenues underlying the entire recording industry.
This is not a piracy argument we are making. Rather, if, as everyone believes, technology is moving the consumer away from buying physical goods in the record store, new distribution systems must be available to spread out the risk and ensure a return to those who invest in the creation of sound recordings. In other words, for decades, artists and record companies have relied solely on the sale of physical product in the stores for their return on investment. As technology develops, there must be an incentive for labels and artists to license other forms of music delivery. Other owners of copyrighted works are able to spread their investment risk over multiple revenue sources. For instance, movie studios earn licensing fees from television broadcasters, from cable operators, from satellite services, from theaters and more. Similarly, music songwriters and publishers earn licensing fees from radio and television broadcasters, concert halls, satellite carriers, cable operators, and other entities that publicly perform their works.
Record labels are licensing their recordings to meet consumer demand for new products and services that go beyond the familiar compact disc; those efforts will go nowhere if below-market

rates like those proposed by the CARP are cut back even further. Congress should be doing everything possible to encourage the broadening of income streams available to the recording industry, so that a single technological development like peer-to-peer does not kill off an industry because it has no other sources of revenue.

As a matter of public policy, it would be terribly unwise to take away the digital performance right - and make no mistake, lowering the royalties beyond the minimal level proposed by the CARP is akin to taking away the right to be paid fair market value for our works. Cutting back on alternative revenues is the wrong policy, at the wrong time. Pre-judging the arbitration process also doesn't make any sense at this time. Support the implementation of the CARP decision and let everyone benefit from the advent of this exciting new application of technology - the creators of the works, the businesses who exploit those works and, most importantly, the music fan who will benefit most from us all working together.

We are grateful for this opportunity to present our views and I am pleased to answer any questions you may have.