Testimony of

Mr. N. Mark Lam

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U.S. Senate Committee on the Judiciary
Hearing on "Parity, Platforms and Protection: The Future of the Music Industry in the Digital Radio Revolution."
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Chairman Specter, Senator Leahy, and Members of the Committee:

On behalf of Live365 and the Digital Media Association, thank you for inviting me to testify today regarding digital radio, and particularly about the hardships that face Internet radio as we compete to offer consumers and artists a better experience than they enjoy on competing radio platforms.

Live365 and DiMA urge the Committee to accomplish the following:

(a) Legislate royalty parity and programming parity among all digital radio services, so that government is not picking winners and losers when broadcast, cable, satellite and Internet radio compete.
(b) Protect recording artists and copyright owners from radio services that promote and profit from consumer recording of their programming, and thereby exploit their performance license to engage in a more lucrative distribution business.
(c) Resolve the longstanding dispute over the meaning of "interactive service" so that consumers, online radio services and recording artists can maximize the benefits of blending Internet technology and radio programming.

In contrast to our competitors, Internet radio has always paid royalties to recording artists and copyright owners and has always taken reasonable steps to protect sound recordings. We are pleased, therefore, that the Committee is considering whether to ensure parity among competing services and enhance protection of copyrighted sound recordings, because we agree with the ideas behind Senator Feinstein's Perform Act of 2006 - parity and protection are necessary. Our industry also believes, however, that additional related provisions of Section 114 of the Copyright Act must be amended, particularly the "interactive service" definition that is also addressed in the testimony submitted by the Recording Artists Coalition. When digital radio legislation achieves parity, protection and clarity, it will unleash competition and innovation that will enhance consumer enjoyment, increase royalties to creators, and be a critical marketplace factor in the effort to reduce piracy. More Internet radio listeners means fewer music pirates, which benefits the entire music economy.

Live365, based in Foster City, California (just south of San Francisco) is one of the largest Internet radio networks. With tools we provide, individuals or organizations with a computer and a broadband connection can create their own radio station from their own music collection, and collectively we offer thousands of stations that are enjoyed by several million people every month. We are Arbitron-rated and a member of the largest network of advertiser-supported Internet radio services.

Live365 is also the largest Internet radio "pure play". You know of many of our Internet radio colleagues, such as Yahoo, AOL, MSN, MTV, and RealNetworks. Each of these companies is blessed with a variety of revenue streams

and internally generated capital that permits them time to develop their business. But Live365 is different - our 36 employees have only one business: Internet radio, and we have seen many of our competitors go out of business so we have very little time. We need your help to fix digital radio laws quickly so that our successful radio service can also become a successful business.

1. Legislate Royalty Parity - A Matter of Basic Fairness to Creators and Digital Radio Competitors

Since 1998 Live365 and other DiMA members have paid tens of millions of dollars in royalties to recording companies and recording artists. In part, these payments reflect widespread consumer adoption of Internet radio, which is regularly enjoyed by more than 30 million Americans. However, the very fact of and the amount of these payments underscores how the Copyright Act discriminates against Internet radio based solely on our choice to deliver music to consumers via the Internet, rather than broadcast, cable or satellite technologies.

Live365 and all Internet radio services compete directly against terrestrial radio for a limited universe of listeners and advertisers, and compete directly against cable and satellite radio for an even smaller universe of subscribers and advertisers. Paying higher royalties than our competitors requires Internet radio to reduce programming or performance quality, or increase advertising prices or frequency. Every option is unpleasant, and they unfairly inhibit Internet radio's growth and competitive opportunity.

Consider this comparison: Arbitron's audience measurements for Live365 suggest that we are comparable to a good-sized radio station in Harrisburg, Pennsylvania. That station would pay approximately 3.5 percent of its revenue to songwriters and music publishers; Live365 pays 6.5 percent. In contrast, the Harrisburg radio station and all radio stations pay nothing - absolutely zero - to sound recording copyright owners and recording artists; but in 2005 Live365 paid $1.2 million dollars to sound recording copyright owners and recording artists for U.S. performances alone - an astonishing 33.4 percent of our radio revenue.

Another comparison is satellite radio. XM Radio and Sirius Satellite Radio have confidential royalty rate agreements with the recording industry, so I can only tell you what I have heard and let them or the RIAA dispute it if they choose to. I have heard that satellite radio services, whose customers are subscribers, pay sound recording royalties of approximately 5-7 percent of their revenue, a significant discount from subscription Internet radio royalties, which are 10.9 percent of revenue. The situation is even worse for advertiser-supported free Internet radio, in which the royalties are set by music usage rather than revenue and so the royalties have to no relationship to revenue. As a result, many free radio services supported by advertising pay royalties that consume a large proportion of (or even exceed) revenues, as described above in the case of Live365. Remarkably, the recording industry is seeking to increase these rates in a pending Copyright Royalty Board proceeding by 250 percent.

How are these disparities possible? Because satellite radio services benefit from a very different royalty standard than Internet radio (17 U.S.C. § 801) which, the recording industry says, was the reason for these substantially lower royalties. Fortunately the PERFORM Act proposes to amend the royalty standard so that all digital radio services except broadcast will have royalties set according to the same "fair market value" formula. XM Radio will testify that the §801 standard has worked successfully since 1976 and that ironically it is preferred by RIAA when recording companies license musical work copyrights from songwriters, so Congress should leave it in place. DiMA agrees that the §801 standard is more applicable, but it is only appropriate if it applies uniformly to all digital radio services, and not just to the so-called "pre-existing subscription services" - a category comprised solely of satellite and cable radio services, with Internet radio on the outside looking in. Above all else Internet radio services deserve competitive parity - and this Committee should create a level playing field for digital radio services to compete against one another.

Unfortunately, the Perform Act would not extend the sound recording performance royalty to terrestrial broadcasters, not even for their high definition radio programming. Rather, broadcasters have asked to instead extend their terrestrial royalty exemption online and to thereby exempt all Internet radio webcasts transmitted within 150 miles of their towers. DiMA urges the Committee to reject this request, and to boldly consider enacting the fairest possible legislation, a sound recording royalty across all competing platforms and services.

2. Legislate Programming Parity and Clarity: Competing Radio Services Should Play by the Same Programming and Functionality Rules, including Reasonable Content Protection Requirements, and the Rules Should be Clear and Unambiguous so as to Promote Innovation and Not Litigation

a. Relax Digital Radio Programming Limitations That are Overly Restrictive and Outdated.

Several programming restrictions are imposed only on satellite, cable and Internet radio, and they highlight the disparate treatment of these competing services. Two examples are the prohibition against advance announcements of upcoming songs and the required playlist diversity, which is actually a regulation restricting the number of songs performed by any given artist within a three-hour period (the "sound recording performance complement"). See 17 U.S.C. § 114(d)(2)(c)(i) and (ii). While intended by Congress to ensure that the statutory license does not permit on-

demand music, in reality these provisions prevent Internet radio from engaging in many of the most common practices of radio broadcasters that have proved, over decades of experience, to promote rather than harm the interests of the record labels and performing artists.
For example, radio stations typically announce specific songs that are going to be performed either next or at an unspecified time in the near future, as an inducement to keep listeners tuned to their stations; Internet webcasters cannot. Or, when a famous artist such as Ray Charles or Patsy Cline passes away, radio stations have complete latitude to pay tribute by playing extended blocks of the artist's work; the sound recording performance complement limits the ability of Internet radio to honor the artist to no more than two songs consecutively, and four songs total over a three-hour period.
There is no evidence, however, that the broadcasters' pre-announcements of upcoming songs or performances of album blocks or artist blocks of music have harmed the record industry, or that webcasters' adoption of these practices would be harmful. Given the clear promotional benefits of webcasting to the recording industry and performing artists, there is no reason why webcasting should not also be permitted this additional programming latitude to better attract and maintain its audience against broadcast competition.
b. Legislate Content Protection Obligations, But Only on Those Whose Business Activities are Problematic.

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 so the law requires radio services to utilize this technology if they otherwise choose to use streaming technology offered by RealNetworks or Windows Media.

This content protection obligation has never been applied to satellite radio services, however, and as Warner Music CEO Edgar Bronfman has testified, XM has exploited this loophole by developing and offering for sale a portable device that will not only record music programming, but will also enable consumers to simply save only those tracks that they want and dispose of the remainder, and to add the saved tracks seamlessly into the content owners playlist in whatever order the consumers choose to listen. Essentially XM Radio is offering a distribution service to consumers, while seeking only a performance license from sound recording owners.

With regard to content protection, the PERFORM Act proposes an important equalizer by imposing an obligation on all digital radio services (except broadcast, of course). Reasonably, the PERFORM Act proposes that digital radio services which take affirmative steps to authorize, induce or actively encourage consumer recording of radio-like programming must also utilize digital rights management technology to ensure that consumers are unable to disaggregate individual songs in that recorded programming, because to do so would enable such flexible enjoyment of those recorded performances that consumers would never again need to purchase a sound recording or subscribe to a music service. This limitation appropriately recognizes that commercial radio enterprises with performance licenses should not exploit those licenses unfairly to create distribution businesses absent another license and royalty payment.

The PERFORM Act is overprotective, however, when it obligates all digital radio services to utilize content protection technology, even when the services is NOT taking affirmative steps or making a business associated with consumer recording. In contrast, the Supreme Court recognized in its Grokster decision that consumer policing obligations should appropriately be placed only on those who take affirmative steps - particularly for commercial reasons - to promote others' activities. Basic radio services that are merely performing music for consumers' listening enjoyment - like those who are merely offering technology that has legitimate purposes but can also be misused - are not making a business from or otherwise promoting consumer recording, and accordingly should not have a technological policing obligation imposed.

Internet radio companies succeed by maintaining continuing relationships with consumers, and encouraging them to return frequently and for long periods of time to our services. We have no incentive to promote uninhibited consumer recording and in fact our incentives are aligned with the record companies. There is no reason, therefore, and certainly no compelling justification, for imposing DRM technology mandates that will create financial and technological burdens on Internet radio services that take no affirmative steps to encourage and are not seeking to profit from consumer recording.
c. Resolve "Interactive Service" Confusion, which Inhibits Innovation, Stunts Internet Radio Growth and Reduces Recording Artists' Royalties.

Congress enacted the statutory Internet radio license to promote the growth of Internet radio as an innovative, competitive medium. Whether a particular Internet radio service qualifies for the statutory license is dependent on several statutory factors, including that the service is not "interactive" as defined in the statute.
Unfortunately, current law is ambiguous, and whether an Internet radio service is "consumer-influenced" and qualifies for the statutory license, or is "interactive" and does not qualify, has been the subject of two lawsuits and a Copyright Office proceeding and is not yet close to being resolved. As a result of this uncertainty, Internet radio innovation has stopped and audience growth is inhibited.

The "interactivity" dispute creates a very straightforward problem. Internet radio pays millions of dollars in royalties every year to artists and the recording industry. Broadcast radio - even digital broadcast radio - pays zero. If Internet radio is saddled by rules forcing our programming to be less interesting than broadcast radio, or forcing company-by-company negotiations regarding royalties that our broadcast competitors are not required to pay at all, then how are we to compete, succeed, and generate even more royalties for sound recording companies and artists?

The problem is fairly simple: In the 1995 Digital Performance Right in Sound Recordings Act and its 1998 amendments, Congress sought to promote Internet radio as a competitive consumer-friendly medium that benefits the recording industry by generating royalties and promoting sales of sound recordings. The 1995 Act limited the benefits of the statutory license by imposing programming restrictions on the radio services (e.g., limiting how many times a single artist can be played in a 3-hour period) and disqualifying "interactive" programming that essentially provided on-demand or near-on-demand service. There was no uncertainty nor any litigation regarding this standard.

The 1998 amendments modified the definition of "interactive" service, changing it from a fairly straightforward and objective test to one requiring a complex subjective analysis. Typically American law is comfortable with "reasonableness" standards and balancing tests, but in the copyright environment where there is strict liability with high statutory damages, uncertainty can chill innovation and destroy the entrepreneurial spirit.

Moreover, where an online music service provides on-demand streaming and digital download or subscription offerings alongside statutory radio offerings, the direct licenses necessary for the on-demand services provide the labels with significant leverage through which to enforce their view of the scope of the statutory license.

The Register of Copyrights and the RIAA (in public filings and its licensing practices) have agreed that services can benefit from the statutory license even if they permit consumers to express preferences as to genre, artists and specific songs. But the recording industry's litigation position has been markedly different, going so far in one instance as to assert that webcasts are not permitted to allow any level of individual consumer influence over a program to qualify for the compulsory license.

To compete against broadcast radio - which pays no royalties - and cable and satellite radio - which do pay, but pay less that Internet radio, Internet radio must be able to create innovative consumer-influenced offerings using the power of our technology. Instead of holding back the royalty-paying medium, we urge the recording industry and Members of Congress that believe sound recording companies should be paid, to consider unshackling Internet radio's programming restrictions and promoting the medium that pays.

And let's not forget the artists. The statutory license requires that 50% of royalties paid by statutory license Internet radio services be paid directly to recording artists. The recording companies' efforts to restrict the scope of the statutory license by defining all innovative services as "interactive" directly decreases the amount of royalties paid to artists by Internet radio services.

In furtherance of fully-licensed litigation-free royalty-paying online music, DiMA urges the Subcommittee to amend the "interactive service" definition to ensure that programming based on user preferences falls squarely within the statutory license, so long as the generally applicable programming restrictions for the statutory license are not violated and so long as users are not permitted to control how much a particular artist is heard, or when a particular song might be played. DiMA companies want to focus our energy on developing exciting royalty-paying products and services that combat piracy, rather than on lawyers and litigation.

3. Performance Royalty Inequity is Exacerbated by the "Aberrant" Ephemeral Sound Recording Reproduction Royalty that is Imposed only on Internet Radio.

As the Copyright Office noted in a 2001 Report to Congress, there is an imbalance between the legal and financial treatment of so-called ephemeral copies of compositions in the broadcast radio context, and similar copies of sound recordings utilized by Internet radio.

Since 1976 broadcast radio has enjoyed a statutory exemption to make reproductions of compositions so long as the reproduction remains within the radio station's possession and is used solely to facilitate licensed performances of the same music. Internet radio services also require ephemeral recordings to enable their webcasts, but while broadcast radio typically requires a single ephemeral copy, webcasters require several copies to accommodate competing consumer technologies (e.g., RealNetworks or Windows Media formats), services and access speeds (e.g., dial-up or broadband Internet access). Each of a webcaster's ephemeral recordings functions precisely like the copy exempted for radio broadcasts, but Internet radio is saddled with having to license and pay for these copies, rather than enjoying the benefit of an exemption. In the first Internet radio CARP, the recording industry was awarded nearly a 9 percent bonus on top of the performance royalty for the making of these ephemeral copies which add no independent value. They are simply a by-product of modern technology.

In its 2001 Section 104 Report to Congress, the Copyright Office stated that the compulsory license for sound recording ephemerals, found in Section 112(e) of the Copyright Act, "can best be viewed as an aberration" and that there is not "any justification for imposition of a royalty obligation under a statutory license to make copies that . . . are made solely to enable another use that is permitted under a separate compulsory license." Section 104 Report, p. 144, fn. 434. The Copyright Office urged repeal of this licensing obligation; DiMA asks the Committee to act on this request.

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Mr. Chairman and Members of the Committee, it is obvious to DiMA members and sponsors of the PERFORM Act that the Copyright Act treats Internet radio inequitably, but that platform parity and content protection are both achievable.

I appreciate the opportunity to testify today about how Live365 and Internet radio services suffer under today's inequitable legal regime, and to offer solutions that will benefit consumers, promote competition and increase royalties to creators.

Thank you.