

## The Deal: A Royalties Pain on the Air

### The Deal

08/27/13 - 04:16 PM EDT

NEW YORK ([TheStreet](#)) -- **Pandora Media**(P) is spending just \$600,000 to buy an obscure radio station in Box Elder, S.D. That six-figure investment, announced in June, continues to reverberate far beyond the Badlands, FM radio and streaming music services, of which Pandora is the biggest player.

Pandora admitted its expansion into terrestrial radio is designed to alter revenue sharing agreements with songwriters and publishers. It's part of an effort to bend or change standards Pandora believes harms its bottom line. That approach, in turn, has triggered multiple lawsuits and other legal maneuvering by publishers and their agents.

Litigation isn't only directed at Pandora, when it comes to digital streaming and music royalty disputes. On Monday, SoundExchange Inc., the organization charged with collecting and distributing digital royalties, filed suit in the U.S. District Court for the District of Columbia, against satellite radio service Sirius XM Radio Inc., alleging systematic underpayment of royalties.

But Pandora is attracting the most attention these days, and some of the most impassioned vitriol. Despite large jumps in revenue and more than 70 million listeners, there's both an in-your-face attitude and a whiff of desperation about Pandora's acquisition of a radio station. Pandora, which went public in June 2011, continues to lose money despite more and more advertising sales. Last week, the company reversed course on limiting listening hours for those mobile users who don't pay money to subscribe. That foreshadows a direct challenge to Pandora's current supremacy, when, next month, Apple Inc. is scheduled to launch its long-awaited iTunes Radio.

The transfer of the radio station license is pending with the Federal Communications Commission, according to a Pandora spokesperson.

Pandora's attempted move to terrestrial radio helps shed light as well on much larger issues related to the music industry, where rapidly changing technology and fickle consumer tastes clash with revenue sharing determined by legislative or administrative fiat. This kind of price determination shapes the value of an individual song and, by extension, music companies.

"In this supposed bastion of capitalism, there's price-fixing, as if this was World War II and we're rationing sugar and nylons," said David Lowery, an outspoken musician and lecturer in music business at the University of Georgia.

Lowery represents a band of industry personalities that questions the whole foundation of licensing regimes, which govern the broadcast of music. Pretty much unique to music, revenue sharing and royalties are determined by a hodge-podge of courts and administrators, including a board of judges appointed by the Librarian of Congress.

It's a system cantilevered on a copyright platform from the early 1900s. One pillar is the compulsory or statutory licensing of music recordings. Compulsory licensing allows radio stations to play recorded music whether the performer agrees or not.

Pandora opted to use this regulatory framework in return for building in certain limitations in its personalized delivery system, including the number of times per hour it can play an individual artist on a particular channel. That's why, for example, a personalized "The Monkees" radio station on Pandora also broadcasts the Four Tops, the Rascals, the Beach Boys, the Beatles and the Mamas and the Papas.

Some major competitors in Internet streaming music services, notably Spotify, can offer an entire album on demand, say, "The Best of the Monkees Volume Two." That's because they don't rely on compulsory licenses, but instead have negotiated directly with rights holders. iTunes Radio is expected to follow Pandora's model.

On June 5, Pandora bought South Dakota's KXMZ-FM. In a filing with the SEC, Pandora maintained the acquisition would enable the company to lower royalties it pays songwriters, and was made with that specifically in mind.

The two major American organizations that collect royalties on behalf of songwriters and publishing houses were not amused. The American Society of Composers, Authors and Publishers, known as ASCAP, filed objections with the FCC.

On June 13, Broadcast Music Inc., or BMI, petitioned in the U.S. District Court, Southern District of New York that Pandora should increase the royalties it pays songwriters, not decrease them. While the suit doesn't address KXMZ directly, the implication is there. "We expect Pandora to claim that it is no different than commercial broadcast radio," BMI lawyers stated in their petition. "This contention is wrong."

A BMI spokesperson said the company wouldn't comment beyond legal filings.

The preferential rates Pandora said it believes it now qualifies for came as a result of two 2012 settlements approved by a federal court judge acting as arbiter. (That mechanism is the result of a decades-old consent decree after the Justice Department sued ASCAP and BMI for anticompetitive practices.) These govern the amount of money terrestrial radio stations must pay ASCAP and BMI through 2016 and, in general, lower rates by 30% over the previous standard. They came after years of litigation between the organizations and the Radio Music License Committee, which represents most radio stations. The so-called rate court rulings apply as well to what are called "new media" revenue by radio.

The most prominent example is **Clear Channel Communications**, America's largest terrestrial radio network, which owns more than 800 stations in the U.S. In 2008, Clear Channel unveiled I Heart Radio as an alternative to Pandora. While Clear Channel claims by the end of last year I Heart Radio had more than 46 million unique visitors, it doesn't break out revenue figures, which are assumed to be minuscule compared to the company's more than \$3 billion in radio-related income last year.

Music publishers dismiss entirely the contention that Pandora qualifies for the same sort of rate reduction based on a single radio station in the middle of South Dakota.

"Pandora's [digital] service is like a whale, with a little tiny fish stuck to its bottom, and that's the radio station," suggested Donald Zakarin, a New York-based partner with Pryor Cashman LLP. Zakarin has represented both EMI Music Publishing Ltd. and Sony/ATV Songs LLC as outside counsel. "With something like Clear Channel, it's the exact opposite. The radio stations represent the whale and I Heart Radio the tiny fish."

During this protracted rates dispute, EMI and Sony/ATV did their own end-around maneuver. Earlier this year, they pulled out of ASCAP and BMI for licensing certain digital rights. The move forced Pandora to negotiate directly with the two giant publishers. According to BMI legal filings, this resulted in a 25% increase in fees over 2012. Pandora, in its response, called the withdrawals "shams."

Pandora's radio station acquisition followed efforts last year lobbying Congress to enact legislation that would have mandated a far-more beneficial rate sharing. Pandora spearheaded the Internet Radio Fairness Act, which despite its best efforts, appears to have died on the vine. That legislation would have reduced the percentage Pandora and other Internet streaming radio services pay to the same levels satellite and cable pay. According to a summary of the act, Pandora and other Internet radio services pay "five times the amount of royalties -- as a percentage of revenues -- as other digital broadcasters like satellite and cable."

In November 2012, Pandora filed a petition with a U.S. District Court judge on royalty rates paid to ASCAP. According to an e-mailed response by Christopher Harrison, Pandora's assistant general counsel, the petition for court intervention came after more than a year of negotiations. The implication is that ASCAP missed an opportunity for more money. "Pandora believed that it had an agreement with ASCAP's management at a rate that was actually higher than our previous agreement, but this agreement was not approved by the ASCAP board," Harrison wrote. "At the same time, ASCAP agreed to lower rates in 2012 with terrestrial radio broadcasters on a license that covers both broadcast and Internet radio usage."

The hearing is scheduled for December.

Pandora's acquisition of a radio station and the opposition to it represent yet another front in this protracted war. "Pandora really did put a stick in a hornet's nest," said Lowery, whose music blog, the Trichordist, slammed the proposed legislation and helped rally musicians against it. "When the hornets came out and stung them, they doubled down."

-- Written by Matt Miller

---

---

## Visit TheStreet for more great features

### THESTREET PREMIUM SERVICES

From the action-oriented investing ideas of *Action Alerts PLUS* by Jim Cramer to the expert technical trading strategies of Helene Meisler's *Top Stocks*, TheStreet offers a range of premium services to help boost your portfolio's performance. [View now.](#)

### EXPERT ADVISORS ALERTS DELIVERED TO YOUR INBOX

*Action Alerts PLUS*: Cramer's personal portfolio, emails before he acts.  
*Real Money*: 70+ experts share their top investing ideas and analysis.  
*Stocks Under \$10*: Alerts identify undervalued stocks with profit potential.

### FREE NEWSLETTERS

Get an edge on the market with the help of free email newsletters like Jim Cramer's *Daily Booyah!*. Learn about the day's major market events, companies that sizzled or fizzled and lots more that can help you make more profitable investing decisions. [Sign up.](#)