Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In the Matter of	)	
Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding	)	**Docket No. 2006-3 CRB DPRA**

TESTIMONY OF JONATHAN POTTER

1. My name is Jonathan Potter and I am Executive Director of the Digital Media Association ("DiMA"). I submit this testimony in connection with DiMA's Written Direct Statement in the above-captioned proceeding for setting rates and terms for the making and distribution of digital phonorecord deliveries ("DPDs").

2. At DiMA, I am responsible for day-to-day management and oversight of all activities, including public policy and legislative efforts, industry-wide royalty negotiations and CRB proceedings, marketing, communications and financial administration.

3. Before joining DiMA I was a lawyer for ten years in two law firms, including for seven years with the firm of Weil, Gotshal & Manges where I focused on public policy developments related to copyright issues associated with the development and marketing of innovative media products and services. I was also a lobbying and business development consultant for three years.

4. I make this statement on the basis of my personal knowledge, which I have acquired through my experience working on behalf of companies in the digital media industry. To the extent that the facts and matters set out in this statement are within my knowledge, they are true. To the extent that I have relied upon the information provided by others, my testimony is made to the best of my knowledge, information and belief. I identify the instances in this Testimony in which I rely on sources other than my own personal knowledge.

I. SUMMARY OF TESTIMONY

5. DiMA is a national trade organization devoted primarily to the online audio and video industries, and more generally to commercially innovative digital media opportunities (www.digmedia.org). We are at the forefront of business and policy debates affecting the growth and development of these enterprises, and are recognized by public and private sector leaders as the national association that best understands the complex policies and issues surrounding digital media, including copyright, competition and consumer rights.

6. DiMA was founded in 1998 by seven leading webcentric companies that agreed on a common principle -- that consumers' desire to enjoy digital entertainment should not be hampered by outdated laws, regulations and business models. At the time there were no trade associations representing companies whose core businesses depended on the distribution of digital entertainment content. The founding companies believed that webcasters, technology companies and online music and video retailers needed a stable legal environment in which to build ideas into industries, and inventions into profits. A list of our current members is attached at Exhibit A.

7. Most DiMA members' music business goal is simple -- to build or support innovative, fairly priced royalty-paying services that offer consumers every song they want and a way to explore and listen to more music more conveniently than ever before. More music means more consumers choose to use DiMA member company services, choose to pay for music, and choose to come back rather than rely on illegitimate Internet music sites. DiMA member companies in turn have the ability to promote a wider catalog than is available in traditional bricks-and-mortar stores, which broader catalog means more royalties for more songwriters, many of whom do not have any product stocked in traditional CD retail stores and therefore have limited ability to market, even to their existing fans.

8. In today's marketplace illegitimate Internet "black market" or peer-to-peer ("P2P") sites give music away without paying royalties and do not impose any music-usage or device restrictions on consumers, *i.e.*, consumers can make and redistribute unlimited copies of their illegal music acquisitions, and can store and enjoy pirated music content on any computer or portable music device. If the compulsory license is to meet its congressionally mandated objectives and help new royalty-paying markets to develop (because everyone involved in this proceeding assumes that Congress did not intend for this process to set a rate that favors pirate markets), then the rate set in this proceeding must help DiMA member companies against the existing competitive threat posed by Internet piracy.

9. The rates and terms we propose are intended to fulfil the statutory objectives applicable to the mechanical compulsory license in a manner sensitive to existing economic conditions. DiMA supports providing maximum benefit to the creators of copyrighted works and to consumers who enjoy music. Doing this requires rates and terms that recognize the

tremendous investments being made by DiMA member companies to make copyrighted works legitimately available to the public, to grow the market, to expand access to more music, and to enhance the music experience for consumers so they become and stay paying customers to the benefit of songwriters, publishers, and artists alike. A rate that is too high or imposes usage limitations through arbitrary minimum fees will make it harder to innovate, cause further exit, lead to abandoned investments, and harm creators and consumers.

II. THE MUSIC INDUSTRY IS UNDERGOING REVOLUTIONARY CHANGE DUE TO RAMPANT INTERNET PIRACY

10. The digital music services in this proceeding compete every day against unrestricted, free music available on black market networks. That is the reality of existing economic conditions. To successfully compete, DiMA companies must have a comprehensive catalog and be user-friendly, feature-rich and fairly priced. The rates we propose are intended to help create a sustainable business, maximize the availability of creative works and create value for all market participants.

11. DiMA opposes Internet piracy. That policy, as stated, is easy. The bigger problem is that piracy has many causes, and the solutions tried by content creators to date have not been effective. Despite the well publicized lawsuits and advances in content security, Internet piracy continues to thrive, with millions and millions of illegitimately acquired songs traded among users every day. Some estimates put the number at over a billion songs a month.

12. Some attempts have been made to get courts and the Congress to ban new technology, just as others tried to ban the VCR decades ago. Others have tried to manage technological innovation through aggressive, industry-wide standards. Self-help solutions

-- technological warfare with fingerprinting, spoofing and tracking technologies racing against decentralization and other technological countermeasures -- have also been attempted. But in each of these cases, the proposed remedies have been largely ineffective. Technology simply continues to move steadily forward, despite attempts at controlling particular innovations or applications. Private innovation and the pirate marketplace progress too quickly for legislative or industry-wide effort to catch up or keep up.

13. A well-known anti-piracy initiative that has appeared to be modestly effective in the United States is litigation against allegedly misbehaving companies and individuals. The Napster lawsuit was moderately successful against the particular, individual defendant, but was ineffective against piracy conducted by subsequent organizations as evidenced by KaZaa, Grokster, Blubster and others. Some copyright owners have also sued individuals who engage in illegal file sharing. At the very least, these suits against individuals served to show people that that the Internet is not anonymous, and that unlimited "sharing" of copyrighted content is unlawful and can be very costly in legal fees and settlements. In addition, public education has terrific potential. The music industry advertising campaign may be helping. At Penn State, tens of thousands of songs are being legally streamed and downloaded from Napster every day, and traffic on illegal file sharing sites such as KaZaa through the campus network has dropped substantially. Other universities are signing up for their own legal services.

14. In sum however, the most prominent anti-piracy efforts to date have been met with only mixed results. But that is not all we have in our anti-piracy arsenal. At DiMA, we have long believed that the most effective, least costly and most profitable anti-piracy solution is consumer choice. Legal, royalty-paying choices that offer quality music, flexible usage rules,

great personalization and first-class customer service, all for a fair price. Our member companies now have millions of songs available for under a dollar each because the music industry has come to realize that the sale of 99-cent singles is much better than having their products given away royalty-free. Consumers will pay for a better product even when the alternative is (or appears to be) available for "free." Bottled water is perhaps the best example of what I mean.

15. In order to compete most effectively against online black markets that distribute music without paying royalties and that offer no marketing or other benefits to creators, DiMA companies need access to all music at a price that ensures the legitimate, royalty-paying market can develop and the widest possible array of music will be available through those legitimate music services. If consumers can't find the song they want, when they want it, at a reasonable price, on our services or our companies' portable devices, they will use pirated music instead. A compulsory license priced to fight piracy is essential to growing this market and continuing to ensure compensation to all participants. If a music service does not have the one song a user wants, that user will go back to the online black market. If royalty-paying services are to compete more effectively with online black markets, the amount of available music must be competitive. This proceeding is crucial to making that happen. If rates are set too high, or minimum fees are imposed that kill services, the market will effectively cease to exist and the most important anti-piracy effort we have available will go away.

III. THE ENVIRONMENT FOR LEGAL DIGITAL MUSIC SERVICES IS FRAUGHT WITH HIGH COSTS AND LEGAL UNCERTAINTY

16. Piracy is not the only challenge DiMA member companies face. The marketplace today is hampered by high costs and riddled with legal uncertainty for legitimate music service

providers. The digital music services participating in this proceeding must pay incredibly high fees to secure all the rights necessary to engage in the legal distribution of music. In addition to high royalties and fees that make conducting a legal digital music service difficult, the providers of these services must also contend with legal uncertainty and resulting potential liability that is incredibly burdensome. Music publishers continue to assert the existence of "double-dip" royalties -- copyright owners and their agents seeking performance royalties in what are clear deliveries, and vice-versa -- that the Register of Copyrights has repeatedly said do not exist.

17. The Harry Fox Agency, the music publishers' in-house collective licensing agent for mechanical reproductions, is absolutely unable to license mechanical reproduction rights in a fashion that works for comprehensive digital services. First, HFA does not represent all or even nearly all publishers, and even those it represents can opt-out of any license that HFA agrees to. In addition, the HFA database indicating what songs are available for license is woefully inadequate. Even HFA is uncertain as to how many – and which – songs it is able to license. Publishers have refused to consent to HFA entering into new licenses beyond those already in existence in the market. For these reasons, licensing with HFA is not a complete solution for any company, and so the 115 license is a necessary solution that DiMA companies must utilize in order to compete effectively against piracy.

18. Moreover, using the 115 license is extraordinarily cumbersome, which makes it all the more difficult to run this business and makes the investment riskier, all of which should be reflected in the royalty rate. Every single track in catalogs containing millions of songs may have one or more writers, which in turn means one or more publishers. The information is not necessarily included with the tracks licensed from the labels, and when it is it is not necessarily

complete or showing how much of each song each writer/publisher controls. HFA recently estimated that it would take them more than two years, and ten million dollars, just to build a database to deal with this issue. This gives a sense of the magnitude of the problem many services face.

19. Moreover, music publishers do not always agree on the scope of rights needed by online services, including whether the compulsory 115 license provides all rights needed by subscription download services that our member companies offer or will soon offer. Notwithstanding that, the licensing process is still so expensive and inefficient that even the Copyright Office has asked Congress to authorize its repair.

20. The practical impact of this statutory and market failure is, for our industry, staggering. First, legal online music services have substantially less music than black market networks. Even with millions of songs, they have far fewer than illegal file-sharing sites have. Second, the balkanized licensing system creates inconsistencies among companies' own offerings that promote confusion and consumer disappointment. The most frequent complaints from those who try legal download and subscription services relate directly to music publishing problems: "Why can I hear a song on your radio service but I can't purchase it?" "Why can I purchase this song for 99 cents but I can't enjoy it as part of the portable subscription service that I am paying for?" "Why are five songs from a CD available for purchase or the subscription service, but five other songs from the same CD are not available?" "Why are these songs not available on your service at the same time I can buy them on a CD?" All of these problems are the result of an ineffective licensing system.

21. In addition, member companies are forced to operate with extraordinary legal and financial risk -- a risk that is recognized by investors and analysts. The ambiguity regarding whether an online radio performance implicates a licensable reproduction right should be no more than a law school exam question. These uncertainties, coupled with the Copyright Act's strict liability and statutory damages of up to $150,000 per work, a service of any size -- particularly if its offering is innovative -- presents a potential liability that is insurmountable for many companies. A liability that services can not avoid unless they agree to publishers' demands – in some cases including for double-dip royalties. Some companies have chosen instead simply to stop innovating, or to get out of the business altogether. It is particularly telling that since the inception of the subscription service concept by three companies in 2001, *not one additional entrant* has introduced a new, stand-alone subscription music solution into the marketplace.

22. Finally, from an operations standpoint, music publishing uncertainty imposes significant overhead requirements, legal fees, insurance and administrative costs. DiMA companies spend millions of dollars annually just administering music publishing rights, beyond payment of the royalties themselves. This absorbs funds that our companies instead should use to develop and market innovative products and services, which will in turn grow our services, help defeat piracy and generate more royalties.

IV. CONCLUSION

23. The legal digital music market can grow as more and more consumers seek comprehensive, safe, secure and advanced methods of accessing music. Legal services provided by DiMA member companies will expand the market. While this market emerges, an excessive

royalty rate could make it harder and perhaps impossible for companies to stay in business or make new investments required to compete or enter the market. Imposition of a per-song "minimum fee" would be particularly disruptive. A minimum fee makes no sense when the clear alternative for the average user is to get his or her music without paying copyright owners.

24. DiMA proposes a rate of 4.1% of payments made for digital phonorecord deliveries ("DPDs") resulting in a permanent copy without further restrictions and 4% of payments made for uses of digital phonorecord deliveries resulting in a copy the use of which is restricted by the licensee (so-called "tethered" or "limited" downloads). All copies made in the necessary course of making the digital phonorecord delivery through the particular service would be licensed. Attributable revenues would be defined as those received by the licensee for use of the DPD. The rate is based principally on the last application of the applicable statutory factors and the recognition that these innovative uses contribute immeasurably to the availability of creative works but require massive investment in an environment fraught with significant risk and uncertainty. These rates and terms are intended to satisfy the statutory objectives and ensure the development of a marketplace alternative to pirated musical works so that creators and consumers each benefit.

25. The evidence will show that higher rates, or more excessive regulatory intervention, at this time will be unduly disruptive and could lead to additional market exit to the detriment not only of consumers but to creators as well.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information and belief:

Jonathan Potter

11/21/06

Date

A

Exhibit A - DiMA MEMBERS

Amazon (www.amazon.com)

AOL (www.aol.com)

Apple (www.apple.com)

DMX Music (www.dmxmusic.com)

Gibson Audio (www.gibson.com)

Infospace (www.infospaceinc.com)

Live365 (www.live365.com)

LoudCity (www.loudcity.net)

Loudeye (www.loudeye.com)

Mercora (www.mercora.com)

Microsoft (www.microsoft.com)

Mixmeister Technologies (www.mixmeister.com)

Motorola (www.motorola.com)

MP3.com/CNET (www.mp3.com)

MTV Networks (www.mtv.com)

Music Choice Europe (www.musicchoice.co.uk)

MusicNet (www.musicnet.com)

Music Rebellion (www.musicrebellion.com)

Muzak (www.muzak.com)

Napster (www.napster.com)

National Geographic Society (www.nationalgeographic.com)

NativeRadio.com (www.nativeradio.com)

Nellymoser (www.nellymoser.com)

NetFlix (www.netflix.com)

Pandora Media (www.pandora.com)

RealNetworks (www.realnetworks.com)

Ruckus Network (www.ruckusnetwork.com)

Sling Media (www.slingmedia.com)

Sony Connect (www.connect.com)

Spacial Audio Solutions (www.spacialaudio.com)

Yahoo! (www.yahoo.com)