Giant of Internet Radio Nears Its 'Last Stand'
Pandora, Other Webcasters Struggle Under High Song Fees

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OAKLAND, Calif. -- Pandora is one of the nation's most popular Web radio services, with about 1 million listeners daily. Its Music Genome Project allows customers to create stations tailored to their own tastes. It is one of the 10 most popular applications for Apple's iPhone and attracts 40,000 new customers a day.

Yet the burgeoning company may be on the verge of collapse, according to its founder, and so may be others like it.

"We're approaching a pull-the-plug kind of decision," said Tim Westergren, who founded Pandora. "This is like a last stand for webcasting."

The transformation of words, songs and movies to digital media has provoked a number of high-stakes fights between the owners of copyrighted works and the companies that can now easily distribute those works via the Internet. The doomsday rhetoric these days around the fledgling medium of Web radio springs from just such tensions.

Last year, an obscure federal panel ordered a doubling of the per-song performance royalty that Web radio stations pay to performers and record companies.

Traditional radio, by contrast, pays no such fee. Satellite radio pays a fee but at a less onerous rate, at least by some measures.

As for Pandora, its royalty fees this year will amount to 70 percent of its projected revenue of $25 million, Westergren said, a level that could doom it and other Web radio outfits.

This week, Rep. Howard L. Berman (D-Calif.) is trying to broker a last-minute deal between webcasters and SoundExchange, the organization that represents artists and record companies. The negotiations could reduce the per-song rate set by the federal panel last year.

The two sides appear to be far apart, however, with Berman frustrated.

"Most of the rate issues have not been resolved," Berman said. "If it doesn't get much more dramatic quickly, I will extricate myself from the process."

"We're losing money as it is," said Westergren, a former acoustic rocker. "The moment we think this
problem in Washington is not going to get solved, we have to pull the plug because all we're doing is wasting money."

The digital reproduction of works in print, audio and video has provoked waves of lawsuits over who should benefit from copyrighted works distributed over the Internet.

The media company Viacom sued YouTube for running clips. Record companies have sought to punish file-sharers. And in radio, the digital transformation has recharged long-standing disputes over how much performers and their record companies ought to be paid when a song gets played.

By contrast to traditional radio, which broadcast only one song at any given time, Pandora's technology allows listeners to create their own stations, through which hundreds of thousands of song are played simultaneously.

For example, if a Pandora listener expresses a preference for "Debaser" by the Pixies, Pandora will search its catalog for songs that have similar musical qualities and create a station accordingly.

Soon after its launch, Pandora drew raves and listeners. Revenue at the growing company, which is supported by venture capital investors, was slated to rise above costs for the first time in 2009, Westergren said.

Then came the decision by the Copyright Royalty Board.

"I was on the bus when I get this message on my Treo," Westergren said. "I thought, 'We're dead.' 

SoundExchange, the organization that represents performers and record companies, said it supports the higher royalties for Internet radio because musicians deserve a bigger cut of Internet radio profits.

"Our artists and copyright owners deserve to be fairly compensated for the blood and sweat that forms the core product of these businesses," said Mike Huppe, general counsel for SoundExchange.

The Copyright Royalty Board last year decided that the fee to play a music recording on Web radio should step up from 8/100 of a cent per song per listener in 2006 to 19/100 of a cent per song per listener in 2010.

Multiplied by the millions of songs and thousands of listeners Pandora serves, that means the company will have to pay about $17 million this year, Westergren said.

The effect may be even worse for smaller outfits. Many small webcasters have said that the royalties as determined by the copyright board would be 100 percent to 300 percent of annual revenue, said David Oxenford, a lawyer who represents some of them.

"Obviously, that's not going to work," he said.

Even more galling to webcasters is the fact that they pay more for playing a song than traditional or satellite radio, a result of patchwork regulation created as each technology emerged.

Traditional radio pays nothing in performance royalties, though SoundExchange is pressing to change that. Satellite radio pays 6 or 7 percent of revenue. And then there are webcasters, which pay per song, per listener.
Using listener figures from Arbitron for XM Satellite Radio, it is possible to estimate that the company will pay about 1.6 cents per hour per listener when the new rates are fully adapted in 2010. By contrast, Web radio outlets will pay 2.91 cents per hour per listener.

SoundExchange officials argue that because different media have different profit margins, it is appropriate to set different royalty rates.

Moreover, they complain, Internet radio stations have done too little to make money from playing their songs.

Pandora makes advertising money only from spots placed on its Web page, not on audio ads that run between songs. Other stations are similarly struggling to persuade companies to pay for advertising in the new medium.

"We're taking this challenge very seriously," Westergren said. "When we have our board meetings, the central topic is the revenue trajectory, not how happy our users are."

He said Pandora has a 30-person ad sales operation, or about 25 percent of its workforce. The company will soon start running subtler ads similar to those on National Public Radio, too, he said.

"Something like 'The next half hour is brought to you by . . .' " he said.

Westergren and other webcasters argue that Web radio, which generally plays a far wider range of music than is offered by traditional radio, provides invaluable promotion for many independent musicians.

Matt Nathanson, a singer-songwriter who has recorded for both major and independent record labels, said he is worried that the demands placed on Internet radio could "choke" the industry before it gets its footing.

"Net radio is good for musicians like me, and I think most musicians are like me," he said. "The promotion it provides is far more important than the revenue."

Westergren, seemingly wearied by the constant haggling over the issue, signaled that Pandora's investors may also be impatient for an end.

"We're funded by venture capital," he said. "They're not going to chase a company whose business model has been broken. So if it doesn't feel like its headed towards a solution, we're done."