Before the
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Washington, D.C.

In the Matter of DIGITAL PERFORMANCE RIGHT IN SOUND RECORDINGS AND EPHEMERAL RECORDINGS	Docket No. 2009-1, CRB Webcasting III

CORRECTED REBUTTAL TESTIMONY OF ALEXANDER "SANDY" SMALLENS

I. BACKGROUND & QUALIFICATIONS

1. My name is Alexander "Sandy" Smallens. I am the Founder and Managing Director of Audiation, Inc., a digital media consultancy which provides leadership, strategy and business development for start-ups and multi-national media companies, including Oddcast, My Damn Channel, AdBlade, TuneGenie, Vibe Media and MyNet. Much of my focus with Audiation is selling digital solutions to brands and agencies, as well as developing and selling sponsorships for new digital radio channels. As a seventeen-year digital media executive,[1] I have had operational responsibility for divisions in the following industries:

   a) The Record Industry: I was the founder of Atlantic Records' multimedia department in 1995, one of the first fully-staffed such departments in the industry, which debuted the first full-length online streams of major artists such as Tori Amos. I was employed at Atlantic Records from 1993-1996.

[1] A copy of my curriculum vitae is attached as Exhibit 1.

b) Online Music Content: As a Senior Vice President of online music website SonicNet, and subsequently at MTVi (after their acquisition of SonicNet) in the last 1990s, I launched and oversaw the industry's first-ever audio-visual streaming radio product, Flash Radio, and oversaw the first-ever music video on demand site, Streamland. Later, as Executive Vice President of GetMusic (1999-2001), a joint venture of BMG Entertainment and the Universal Music Group which was eventually acquired by Vivendi and named Vivendi Universal Net USA, I created and oversaw Videolab, the first site to enable users to remix popular music videos, as well as GetMusic Karaoke, the first online karaoke application to feature major recording artists.

c) Broadcast Radio: In my capacity as Vice President for Interactive Sales & Marketing at CBS Radio (2005-2006), I was the corporate executive responsible for sales of all CBS Radio digital assets. Then, as Senior Vice President for the digital division at Entercom Communications (2006-2009), I had oversight of the entire digital platform, including the creation, operation and monetization of the company's streams, websites, podcasts and mobile products. At both CBS and Entercom, I engineered digital sales strategy, oversaw pricing and collateral, trained local sales staff and personally pitched multi-platform programs to hundreds of agencies and brands.

d) Digital Advertising: As Chief Operating Officer of Oddcast (2002-2004), a viral marketing agency and technology company, I sold complex branded entertainment solutions to advertising agencies and brands. I continue to work closely with the company.

2. At CBS, in particular, I was responsible for creating and selling digital asset sponsorship packages – including everything from station websites, streams, HD2 channels and podcasts – to companies such as DaimlerChrysler, Vonage, Verizon, AT&T, Quiznos, Monster.com, Motorola and many others. I also oversaw CBS's relationship with advertising networks like Yahoo! and worked closely to train ad sales teams in many of the company's markets to ensure fluency in online ad sales.

3. At Entercom, I had profit and loss (P&L) responsibility for the company's digital department, and had direct and dotted line responsibility for over 60 staff members, including a corporate operations team and webmasters and digital sales managers across the country. My team was responsible for all policies, decisions, deals, third-party vendor relationships and day-to-day operations of Entercom's digital assets, as well as all sales activities and ad operations. I reported to the CEO and was a member of Entercom's Operating Committee, a small team of senior executives charged with setting strategic priorities and policies for the company.

4. I have spoken at numerous digital conferences, including Radio Ink's Convergence, AdTech, Digital Hollywood, Streaming Media East, and several others. I was also involved in the development, testing and launch of TargetSpot, an online audio advertising network, in my capacities at both Oddcast and CBS Radio. Under my tenure, Entercom became the second major radio group to sign a partnership deal with TargetSpot, and I directly oversaw all aspects of that relationship.

5. I have been a songwriter and musician since high school, and from 1987 through 1994, I composed and performed with Too Much Joy, a Giant/Warner Brothers recording artist. Too Much Joy enjoyed Top 15 success on modern rock radio and toured nationally, performing with major acts such as The Go-Go's and The Flaming Lips.

6. I graduated from Yale University in 1987 with a B.A. in Political Philosophy. As a student at Yale, I was Editor-in-Chief of the campus' music magazine, *Nadine,* and concurrently interned at *Spin Magazine*, where I authored several articles.

7. The following testimony is based on my seventeen years of experience in the digital media industry, including five years in senior positions related to the digital space at top-tier terrestrial broadcasters; ongoing business development and sales responsibilities in the digital advertising space; extensive responsibilities at Atlantic Records; and my years as a recording artist.

II. OVERVIEW OF TESTIMONY

8. My testimony will rebut SoundExchange's rosy assessment of statutory webcasting that was presented at the direct hearing. Contrary to statements made in SoundExchange's direct case – and specifically by Dr. Pelcovits – statutory webcasting services are facing substantial economic challenges that point to a less-than-robust market, especially under the current royalty scheme. My testimony discusses the unique challenges that statutory webcasters face in attempting to maximize revenues for their product.

9. My testimony primarily addresses the following issues:

a) The growth of listenership in the statutory webcasting industry does not necessarily create a proportional growth in revenues. In fact, the glut of advertising inventory created by increased audience sizes exerts downward pressure on the revenue potential of statutory webcasters. Moreover, surplus advertising inventory is exacerbated by a unique set of challenges.

b) The marketplace for ad-supported music services is quite challenging, as witnessed by the failure and/or fire-sale of various entities in the space. For example, after Last.FM's sale to CBS Interactive, Last.fm has not yet achieved profitability, and has in fact scaled-back its ad-supported offerings.

c) Subscribers account for a small and dwindling amount of statutory webcasting listening. The vast majority of statutory webcasting – unlike on-demand interactive services – is based on ad-supported, *non-subscription* listening.

d) Pandora, the most successful "pure play" webcasting company in terms of audience size and revenue, would have to spend almost every cent of its 2009 revenues on the sound recording royalty if it were subject to the full statutory rate for 2009 that was determined by the Copyright Royalty Board in the Webcasting II proceeding. Therefore, a royalty rate that is *higher* than (or even close to) the current rates – as SoundExchange has proposed in this proceeding – would not represent what a willing buyer would agree to.

e) Statutory webcasters have inherent economic disadvantages compared with the National Association of Broadcaster ("NAB") and Sirius XM simulcasters with respect to operating, marketing and sales costs as well as revenue generation.

f) Statutory webcasting provides promotional benefits, increases album/download sales, and provides much-needed exposure to copyright holders.

III. DR. PELCOVITS' ASSESSMENT OF THE STATUTORY WEBCASTING MARKET IS FUNDAMENTALLY FLAWED

10. In Section 4 of his written testimony, entitled "The Statutory Webcasting Market," Dr. Pelcovits provided a lofty assessment of the statutory webcasting industry as "the backdrop for [his] analysis."[2] He relies upon various secondary and tertiary sources for his

2 SoundExchange Trial Ex. 2 (Amended & Corrected Written Direct Testimony of Dr. Michael Pelcovits ("Pelcovits ACWDT")), at 6-14.

premise of a "robust and evolving market for webcasting."[3] He makes this analysis without having spoken to any executives at any webcasting companies.[4] Instead, he cites growth in reported performances and listenership based on usage reports from SoundExchange, a report by Arbitron/Edison Research, as well as an examination of two recent market entrants, Last.fm and Slacker, which purportedly have been able "to succeed in the market."[5] In addition, Dr. Pelcovits points to the estimated growth of the overall advertising market for Internet radio as evidence of a "robust" market for webcasting.

A. Webcasting Listenership Has Flattened Over The Last Year

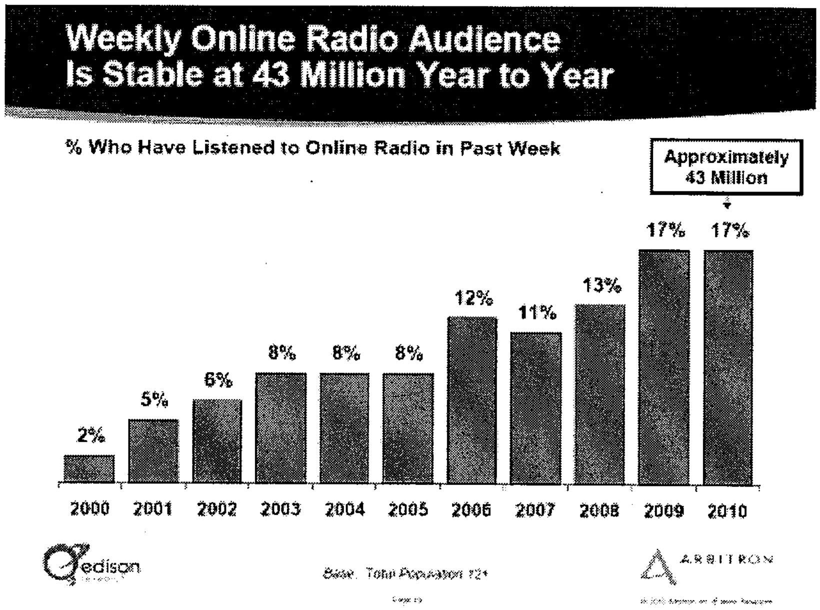
11. Dr. Pelcovits' assessment of the webcasting market is flawed in numerous ways. His finding that "the webcasting industry continues to grow" refers primarily to listenership, and does not take into account the difficulties in monetizing this growth. One of the main sources to support his growth assertion, the 2008 and 2009 "Infinite Dial" reports by Arbitron and Edison Media Research, combine both news/talk/sports and music formats, and does not provide a specific breakout. In my experience, for many terrestrial simulcasters, non-music formats – which do not have the same royalty obligations of Internet music services – dominate overall online listening and drive listenership growth. Therefore, Dr. Pelcovits' failure to take into consideration the allocation of listenership attributable to news, talk and sports formats, with respect to the report he cites, is a considerable flaw. In addition, as Internet penetration has leveled off, so too has online radio listenership. Since Dr. Pelcovits' testimony, the April 2010 Arbitron/Edison "Infinite Dial" study shows that listenership growth flattened from 2009-2010, as shown in the table below. Therefore, future growth of Internet radio listenership is uncertain.

[3] SoundExchange Trial Ex. 2 (Pelcovits ACWDT), at 11.

[4] Direct Hearing Tr., April 19, 2010, at 172:3-172:6.

[5] SoundExchange Trial Ex. 2 (Pelcovits ACWDT), at 10.

Table 1



B. Dr. Pelcovits Ignores Economic Realities Of The Webcasting Marketplace

i. Consolidation Of Listenership

12. Before addressing Dr. Pelcovits' disregard for industry economics, it is worthwhile to briefly examine the consolidation of listenership among Pandora and simulcasters (terrestrial and satellite). Specifically, the aggregate statutory webcasting market demonstrates that an increase in aggregate tuning hours and/or aggregate revenue of the entire industry is, in fact, heavily skewed by a few companies. According to Sound Exchange's 2009 usage reports, the top four entities in terms of aggregate performances are: Pandora ([redacted]% market share by volume); CBS Radio and Clear Channel ([redacted]% market share by volume); and satellite radio companies Sirius-XM ([redacted]% market share by volume). Combined, these four entities account for over 80% of 2009's aggregate yearly performances reported to SoundExchange.[6] The statutory webcasting market was not nearly as consolidated just a few years earlier, during which

[6] Live365 Trial Ex. 14 (SXW3_Native_0015 (RESTRICTED)), at 8.

time the top four entities represented only 50.58% and 53.82% of the aggregate performances in 2006 and 2007, respectively.[7] In his direct statement, Dr. Pelcovits did not break down the revenue growth, specifically for ad revenues, that are attributable to each company.

ii. Audience Growth Does Not Equate To Increased Revenues

13. An obvious point neglected by Dr. Pelcovits is that growth in webcasting listenership does not, in and of itself, translate to financial success or even viability – especially with the risk of increasing royalty rates. First, the overwhelming majority of statutory listening is ad-based, hence heightening the importance of advertising revenues. Second, every single song streamed triggers additional costs; however, ad-supported webcasters cannot recover these costs in the same per-song manner. Therefore, unless CPM (i.e., cost per thousand impressions) and inventory sell-out rates (i.e., the percentage of the total advertising impressions sold) keep pace with the growth in listenership, statutory webcasters – which are already saddled with increasing hosting, bandwidth and royalty costs due to this growth – are indeed penalized for the success of their increased listenership. However, given persistent industry trends, CPMs are subject to significant downward pressures. Consequently, the inverse relationship between costs associated with listenership growth and CPM revenues will likely continue. These findings are all consistent with my own observations in the industry.

iii. Dr. Pelcovits Disregards The Decline In Advertising Rates And Its Impact On The Economic Health Of The Statutory Webcasting Industry

14. Dr. Pelcovits' analysis of the statutory webcasting industry suffers from other deficiencies. Specifically, he failed to consider CPM rates, inventory sell-outs, and the impact of each factor on the statutory webcasting market. Again, these are important factors because the majority of statutory webcasting is ad-based listening.

[7] Live365 Trial Ex. 14 (SXW3_Native_0015 (RESTRICTED)), at 2, 4.

15. In addition to audience size, the most relevant factors are advertising *rates* (in the form of CPMs) – not aggregate advertising *revenues* – and inventory sell-out rates. In my experience, these metrics determine the revenue potential for ad-supported services (and, implicitly, the royalty rate they could afford to pay). Statutory webcasters can assess their revenue potential in a variety of ways. One manner is to assess the total impressions served over the course of a given time period and factor in average CPMs and sell-out percentage. Impressions can be determined by multiplying total monthly listening sessions by average spots served per listening session. In other words, if my station's listeners generally stay connected for 90 minutes (i.e., that is the station's Average Time Spent Listening, or TSL), and I serve six spots per hour, I know that each listening session generates an average of nine ad impressions. Put into practice, if I know my listenership generates a total of one million ad impressions over a month, and I generally sell 50% of that inventory at a $3 CPM, then I know the current revenue potential of this station is $1,500/month (500,000 impressions sold at a $3 CPM). No such analysis, which could have illustrated webcasters' ad revenue capabilities, was provided by Dr. Pelcovits.

16. In my experience with terrestrial broadcasters, CPMs for online audio ads have generally been stagnating or declining – especially for inventory that is sold via multi-market deals or ad networks (such as TargetSpot). Multiple sources confirm this stagnation and/or reduction in average statutory webcasting industry CPMs. Dr. Pelcovits, for example, acknowledged that there is no evidence of CPMs increasing:

> *Q.* *Sitting here today, you cannot say that CPMs have been rising, can you?*
>
> *A.* *Are you talking about CPM in terrestrial broadcasting or in webcasting?*
>
> *Q.* *Well, let's start with the webcasting market.*

A. I have not seen evidence of CPM increasing.[8]

17. Further, Live365's General Manager of Media, Johnie Floater, cites internal data that reveal a decline in CPMs since 2006 for streaming audio ads as well as CPMs for ad banners and video gateway ads (short, video-based ads that play automatically when a user clicks to listen to a stream).[9] And in his testimony, BIA/Kelsey Vice President Mark Fratrik, PhD, confirms that CPMs for audio ads have fallen steadily since 2005, citing figures from AccuStream iMedia Research released in 2009.[10] Even major streaming media destinations such as MySpace and YouTube are plagued by low CPMs and "low-value," excess ad inventory "that can only command weak CPMs, and they're not growing its value as quickly as content costs are growing."[11] All of these findings are consistent with my own observations.

C. Statutory Webcasters' Necessary Reliance On Ad Networks Results In Lower Yield And Higher Cost Of Sale

18. Non-interactive webcasters face a specific challenge in monetizing their audio ad inventory. Since there is theoretically no limit on a statutory webcasters' ad inventory – as opposed to the finite inventory of terrestrial radio stations, which can drive demand and command higher CPMs (as I observed during my experience at two of the largest terrestrial radio companies in the U.S.) – adding listeners does not necessarily drive more value creation. As Mark Mulligan of Forrester Research concludes, "many ad-supported content destinations are

[8] Direct Hearing Tr., April 19, 2010, at 177:15-20.

[9] Live365 Trial Ex. 29 (Corrected Written Direct Testimony of Johnie Floater, April 25, 2010 ("Floater CWDT")), at 5.

[10] Live365 Trial Ex. 30 (Corrected & Amended Written Direct Testimony of Mark Fratrik, April 26, 2010), Exhibit 3 at Section Three

[11] Mark Mulligan, "Paying for Success: When Audiences Grow More Quickly Than Ad Revenue." Forrester Research, April 17, 2009 (SXW3_00018073 – 00018079), at 3. *See* Exhibit 2.

not growing ad revenue effectiveness as quickly as their audiences are growing in size and level of engagement."[12]

19. Audience growth without complimentary growth in sell-out rate creates a "glut" of unsold inventory. To address this, non-interactive webcasters who do not have sufficiently-sized local audiences that can be targeted and who lack the robust, specially-trained sales forces of the NAB simulcasting entities, must rely on ad networks. Ad networks aggregate unsold advertising inventory from a variety of online entities and make it available to marketers. This inventory is commonly referred to as "remnant" – left-over advertising spots which generate a small number of ad impressions. By collecting this disparate inventory from multiple websites, ad networks hope to amass enough impressions to be able to sell it. Marketers generally expect to pay lower CPMs for ad network inventory because it is an amalgamation of remnant impressions. [redacted]

20. In addition, ad networks charge aggressive commissions to sell this low-priced inventory. These commissions are generally higher than the commissions that would be paid to an in-house salesperson for selling the same inventory. So webcasters that are reliant on ad networks yield lower revenues from their ad inventory and realize a much smaller percentage of revenue for every dollar made. For this reason, media companies generally consider ad networks to be a last resort, backfill for the less desirable inventory that their sales team cannot monetize. In fact, in December 2009, CBS Interactive – whose online properties contain highly trafficked

[12] *See id.* at 2.

content (including CBS.com, CNET, Gamespot and TV.com) – declared they would almost completely eliminate their reliance on third-party ad networks.[13]

21. Further, there are not enough streaming media advertisers making big enough buys to fill even this lower-priced inventory. As Johnie Floater has testified, "advertising orders consistently do not fill all of Live365's advertising inventory; therefore, increasing the number of ad spots her hour would not generate more revenues since Live365 already cannot fill all of its commercial availabilities."[14] I am not surprised by this comment. In my capacity at both CBS Radio and Entercom, most major online ad buys happened in the context of cross-platform deals (including on-air and online inventory). Marketers generally earmarked a small percentage (5-10%) of their total spend to online[redacted]. Frequently, the online portion of the buy would be the first thing to go if their budgets tightened up. This problem is exacerbated by the fact that many streaming network buys are "dayparted" – limited to airing during specific hours of the broadcast day, which means that weekends and overnight hours are vastly undersold. The shortfall of paid ads results in webcasters over-delivering for their existing advertisers or rotating "house" or promotional spots through the ad inventory, prompting a deterioration of the quality of the listening experience for the user. This can lower Average Time Spent Listening (TSL) and, therefore, reduce the number of ad impressions served per listening session, further reducing revenue generation. At the same time, the webcaster is incurring per performance costs for the listenership during the undersold non-daypart hours.

22. There is a variety of reasons for this shortfall in advertising sales. Streaming audio advertising is still relatively new to marketers, and commands a low single-digit

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[13] Michael Learmonth, "CBS Interactive Dumps Ad Networks," *AdvertisingAge*, Dec. 14, 2009, available at http://adage.com/digital/article?article_id=141054. *See* Exhibit 3.

[14] Live365 Trial Ex. 29 (Floater CWDT), at 4-5.

percentage of overall broadcast radio revenues. In addition, producing quality streaming radio ads requires a different expertise than producing, say, a compelling banner ad, and many marketers are reluctant to delve into this area. In many cases, webcasters display synchronized ad banners when a streaming audio spot plays, but it is difficult to determine if the listener is looking at their streaming web player when these banners display or has either minimized the player or buried it beneath other browser windows. It has been my experience that synchronized banner ads for streaming audio spots have historically generated low click-through rates for this reason, another discouraging factor in the eyes of media buyers.[15]

23. Also, as I explain below in my discussion of the differences between pure Internet radio services and broadcast simulcasters, Internet radio companies – which do not have mass audiences concentrated in a particular geographical market – have to rely on national advertisers as a source of revenue. These national advertisers are few, and have many other established outlets for their advertising (e.g., radio, television and cable networks; print, etc.) that offer larger audiences than Internet radio. Thus, it is not easy to cause these advertisers to change their practices to dedicate money to Internet radio. For these reasons, plus simply the amount of inventory that is available in the marketplace, webcasters generally have low CPMs and low sell-out rates that have not kept pace with their audience growth.

[15] Another factor leading to a misplaced view of the robustness in the online radio industry is Dr. Pelcovits' apparent reliance on inconsistent ad spending numbers, which seem to suggest a *decrease* in ad spending through 2011. On page 11of his Amended & Corrected Written Direct Testimony (SoundExchange Trial Ex. 2), he cites a $101 million figure in digital advertising spending for the radio industry *for the first quarter of 2009*. This suggests that digital advertising spending for the radio industry would be over $400 for the entire year in 2009. In the next sentence, he cites a different analysis that projects $350 million *for the entire year in 2011*. Note that the $350 million figure originally came from a report prepared by ZenithOptimedia, which revised its projections downward two times, and is now down to $286 million for its 2011 estimate.

D. Far From Dr. Pelcovits' "Robust And Evolving Market," The Ad-Supported Music Space Is Withering Under The Weight Of Royalty Payments To Record Labels; Last.fm Is Under-Performing

24. The Internet music space is littered with examples of failed and shuttered ad-supported music services (e.g., SpiralFrog, Ruckus Network) as well as once-promising music start-ups forced to sell themselves for a fraction of their previous value. imeem "raised above $50 million in funding over the last two years…with the valuation north of $200 million."[16] The company ended up selling to MySpace for "$1MM in cash" in December 2009.[17] Prior to its sale, the service had been "reportedly running out of money, especially because of how much it has to pay for music licensing deals it has with record labels."[18] Lala Media, Inc. ("Lala"), another popular music service, was recently acquired and then shuttered by Apple as of May 31, 2010.[19] Further, two of the largest companies subject to statutory rates and terms of Webcasting II – i.e., Yahoo! LAUNCHcast and AOL Radio – exited the webcasting business shortly after the Webcasting II determination by partnering with CBS Radio, who "powers" Yahoo! and AOL-branded offerings and provides all content licensing, programming and royalty payments.

[16] Rafat Ali, "Music Social Network Imeem In Play; Hires Bank; Laying Off 25 Percent," *PaidContent*, Oct. 22, 2008, available at http://paidcontent.org/article/419-music-social-network-imeem-in-play-does-25-percent-layoffs/. *See* Exhibit 4.

[17] Michael Arrington, "Ok, Now It's Done. MySpace Music Completes Acquisition of iMeem," *TechCrunch*, Dec. 8, 2009, available at http://techcrunch.com/2009/12/08/imeem-myspace-music-completes-acquisition/. *See* Exhibit 5.

[18] Eric Eldon, "Music startup imeem making money, not dying unless the labels kill it," *Venture Beat*, March 26, 2009, available at http://venturebeat.com/2009/03/26/music-startup-imeem-making-money-not-dying-unless-the-labels-kill-it/. *See* Exhibit 6.

[19] Lala had been losing money before its acquisition by Apple, and its value had declined precipitously. During the first quarter of 2009, Warner Music Group recorded a charge of $11 million to write-down its $20 million investment in Lala to its estimated fair value of $9 million. *See* SEC Form 10-Q, Warner Music Group Corp. (May 7, 2009). This write-down occurred only one year after Warner had made its $20 million investment in Lala. *See* SEC Form 10-K, Warner Music Group Corp. (Nov. 25, 2008).

25. Dr. Pelcovits points to the purported success of Last.FM, purchased for $280 million in May 2007 by CBS Interactive. Now, in 2010, Last.FM is a poster child for how difficult it is to create a successful, ad-supported streaming model – even with the backing of a major media company, such as CBS. According to Forrester Research, "Last.FM has struggled to find its new identity within CBS and its paymasters recently took the decision to turn off free-streaming outside of the major territories due to the inability to generate sufficient advertising revenue....further evidence of the challenges of making free pay."[20] *Digital Music News* acknowledges that "CBS appears to be struggling to properly monetize its $280 million investment."[21] Also, Last.FM's ability to attract subscribers has been lackluster to date. The CBS Interactive VP overseeing Last.FM recently admitted that it has only "tens of thousands" of paying subscribers despite self-reported traffic of about 10 million unique visitors per month in the U.S. alone, and hopes to be profitable (finally) by 2010.[22] These examples hardly paint the picture of a robust market.

E. Demographic Targeting Has Not Materialized In An Impactful Way

26. Dr. Pelcovits also touts "the ability of advertisers to obtain detailed demographics on listeners" as a revenue-driver for webcasters.[23] Beyond rudimentary IP-based geo-targeting, however, more detailed targeting is reliant on users voluntarily filling out registration forms. But most terrestrial simulcasters do not require user registration, nor do many statutory webcasters.

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[20] Mark Mulligan, "Last.FM's Fond Farewell to Streaming (Sort of)," *Forrester Research*, April 13, 2010, available at http://blogs.forrester.com/mark_mulligan/10-04-13-lastfm's_fond_farewell_streaming_sort. *See* Exhibit 7.

[21] "Last.fm Flips the Subscription Switch... In Smaller Markets," *Digital Music News*, Dec. 30, 2009, available at http://www.digitalmusicnews.com/stories/032409last/. *See* Exhibit 8.

[22] Robert Andrews, "Interview: CBS Thinks Last.fm Will Turn A Profit This Year," *PaidContent*, March 18, 2010, available at http://paidcontent.org/article/419-interview-cbs-thinks-last.fm-will-turn-a-profit-this-year/. *See* Exhibit 9.

[23] SoundExchange Trial Ex. 2 (Pelcovits ACWDT), at 11.

And for good reason: there is a plethora of "no registration required" options for listening to streaming music online; hence, requiring it makes a webcaster less competitive. "Consumers are...spoiled for choice for free music on streaming sites such as Last.FM, Pandora and YouTube."[24] Ultimately, in this competitive environment, requiring registration is still the exception, not the norm.

27. Moreover, I have observed that, while targeting may increase the CPM rate for a particular demographic, the net effect may still reduce overall per-performance revenue. By way of example, a service could obtain a CPM rate of $12 for men in the 24-35 age bracket in select major markets during certain hours of the day. The problem, however, is that much smaller revenue – or even no revenue – may be obtained for listeners who do not meet these restrictions, even though the per-performance royalty rate is the same for both. Consequently, demographic targeting can and does lead to further excess inventory and lower overall per-performance revenue. In sum, targeting has yet to have any material impact on overall online radio CPMs.

F. Dr. Pelcovits Ignores The Costs Associated With New Platform Launches, And Over-Estimates The Profit Potential

28. Dr. Pelcovits identifies new features, such as song skipping and mobile access, provided by webcasters and asserts – without any authority – that such features should yield copyright holders greater royalty payments. For example, Dr. Pelcovits states that mobility "in a free market would generate additional payments to the owners of the copyright in the sound recordings."[25] While it may be true that mobility will increase listening and overall revenue, the same issue of glut and low-bucket CPMs comes into play in the mobile space. Because the

[24] Mark Mulligan, "Paying for Success: When Audiences Grow More Quickly Than Ad Revenue." *Forrester Research*, April 17, 2009 (SXW3_00018073 – 00018079), at 1. *See* Exhibit 1.

[25] SoundExchange Trial Ex. 2 (Pelcovits ACWDT), at 13.

mobile audience is a fraction of the overall streaming audience, and because more expensive video pre-roll ads and display ads are even less relevant in the overall ad mix on a mobile device, webcasters face significant challenges in monetizing this mobile audience. Thus, merely increasing audience size through mobile application does not mean that there is any increase in revenue per listener. Again, this means that services are increasing their costs without any unique way to increase their per listener revenues.

29. Moreover, Dr. Pelcovits did not take into consideration the additional cost of developing and delivering these new features. For instance, Apple's successful new portable device, the iPad, requires many webcasters to develop a new, device-specific player. Also, any of these new features are the result of web services' significant investments in creating and maintaining these players. Therefore, even if one assumes that new features (such as mobility) increase revenues, Dr. Pelcovits still fails to take into consideration the services' additional investments and costs. Finally, Dr. Pelcovits also fails to consider whether his identified new features would ultimately increase revenue *per play*, the key metric for a license that is paid on a per-performance basis.

IV. EVERY DOLLAR OF REVENUE EARNED BY PANDORA, THE MOST SUCCESSFUL STATUTORY WEBCASTER, WOULD HAVE BEEN PAID TO COVER THE SOUND RECORDING ROYALTY IN 2009

30. Dr. Pelcovits' assessment of webcaster growth is heavily skewed by a single entity, Pandora, the best-known Internet radio service by a substantial margin.[26] The positive trajectory of the "Statutory Webcasters' Aggregate Monthly Performances 2006-2009" graph on page 8 of Dr. Pelcovits' Amended & Corrected Written Direct Testimony primarily reflects

[26] The Infinite Dial 2010: Digital Platforms and the Future of Radio, *Edison Research*, at 23.

Pandora's growth, as Dr. Pelcovits himself acknowledged.[27] This is further illustrated in Table 2 (below), which derives from graphs prepared in connection with Dr. Pelcovits' report.

Table 2

[redacted]

As Table 2 shows, the purported "popularity" of webcasting and the upward trend in aggregate performances is almost completely a function of one service's growth: Pandora's. Moreover, over this same time period, the amount of aggregate performances by other statutory webcasting services has been flat or declining over the past few years, again undermining Dr. Pelcovits' conclusion of a robust market. Indeed, removing Pandora from this consideration reveals a very different trajectory in terms of aggregated performances, as shown in Table 3 below.

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[27] Pelcovits Depo Tr. (Dec. 14, 2009) at 214:1-215:4.

Table 3

[redacted]

31. Further, Pandora, which "accounts for roughly 44-45 percent of total SoundExchange royalties for non-interactive streams,"[28] would not be able to sustain a viable business were they subject to the full statutory rates. From January 2009 through October 2009, Pandora reported [redacted] performances. Based on averaging the amount of monthly performances during those 10 months, one can conservatively estimate that the remaining two months of 2009 would amount to [redacted] performances. This is conservative because, historically, streaming hours rise significantly during the holiday season as people tune into holiday-themed channels and spend more time listening. Therefore, we can conservatively estimate that Pandora's total performances for 2009 were [redacted] If you multiply that

[28] "Pandora: These Numbers May Surprise You," *PaidContent*, March 18, 2010, available at http://paidcontent.org/article/419-pandora-these-numbers-may-surprise-you/. *See* Exhibit 10.

amount by the statutory royalty rate for 2009 – i.e., $.0018 – Pandora would have owed [redacted] for only the sound recording performance royalty! **This means that just about every dollar in reported revenue that Pandora earned in 2009 – and it's widely reported to have been about $50 million – would have gone to a single cost.** Pandora's founder and Chief Strategy Officer, Tim Westergren, put it in stark terms, stating that if Pandora had not entered into the Pureplay WSA agreement, "we [Pandora] would have been done."[29]

32. A 10-year old company, Pandora represents one of the most successful, most listened-to, and most established statutory webcaster in this space. No willing buyer – much less the biggest buyer in the statutory webcasting industry – could realistically ever agree to a rate that ate up all of its revenues, leaving no money to meet other expenses or to provide a return to investors. Expecting willing buyers to pay rates through 2015 that are substantially higher than the 2009 rate – as SoundExchange proposes – is utterly unrealistic and unsustainable for the statutory webcasting industry. Therefore, this reality check refutes Dr. Pelcovits' testimony that the proposed rates "fall within a reasonable range that would be paid by a willing buyer" as not even the biggest "buyer" could afford such rates.[30]

V. INTERACTIVE AND NON-INTERACTIVE MARKETS ARE HIGHLY DIFFERENT

33. The interactive and the non-interactive marketplaces are vastly different. First, interactive or "on demand" services like Napster, which enable users to pinpoint the exact song they want to hear, serve as a celestial catalogue for listeners. Essentially, people can hear what they want, when they want it. The experience is more akin to the experience of owning a CD or

[29] John Timmer, "Pandora lives! SoundExchange cuts deal on webcasting rates," *Ars Technica*, July 7, 2009, available at http://arstechnica.com/media/news/2009/07/soundexchange-cuts-deal-on-music-webcasting-rates.ars.

[30] Direct Hearing Tr., April 19, 2010, at 163:22-164:6.

digital track that can be played on demand than it is to listening to the radio. On the other hand, Pandora and other non-interactive webcasters are essentially more tailored versions of the traditional radio experience and can be considered a "passive" or "lean back" listening experience. Second, while on-demand interactive services have faced significant challenges in growing their subscriber base, adding subscribers to a non-interactive service is even more challenging due to the plethora of free sources, such as NAB simulcasters. Consequently, ad-supported listening is the primary business model in non-interactive webcasting. Moreover, the competitive landscape for non-interactive services is much more crowded.

A. Majority Of Statutory Webcasting Is Based On Ad-Supported, Non-Subscription Listening

34. Dr. Pelcovits assumes that comparing subscription figures in the interactive and non-interactive webcasting markets will provide a suitable framework for setting rates. The flaw with this assumption is that the vast majority of the statutory webcasting listening is *not* based on subscription listening. Subscription levels for statutory webcasters are small and not growing. Live365 reports that fewer than 2% of its users are subscribers.[31] As previously stated, Last.FM's subscription users number in the tens of thousands. Rhapsody's self-reported shrinkage from 800,000 subscribers in Q1 2009 to 650,000 subscribers in Q1 2010 further bear out the difficulty of subscription-based models for online music companies.[32] And, based on my experience and observations, subscription-based streaming by NAB entities and other simulcasters is non-existent or, at best, negligible.

[31] Live365 Trial Ex. 29 (Floater CWDT), at 5.

[32] Glenn Peoples, "Analysis: Subscription Model Takes Another Hit," *Billboard.biz*, May 10, 2010, available at http://www.billboard.biz/bbbiz/content_display/industry/e3i975b286fc2a9c455fe7816e39f48bd1b. *See* Exhibit 11.

B. Statutory Webcasting Services Will Likely Continue To Be Ad-Supported And Not Subscription-Based, Unlike Interactive Services

35. On a practical level, the assumption that the webcaster can increase subscription rates significantly simply does not make sense. The vast majority of music listeners are casual listeners, some using more than one Internet service interchangeably. They listen to music that they can get for free, on their radio or from other sources, and buy few CDs or digital music files each year. The subscription services cater to a limited percentage of the public that finds music more important, and is willing to pay for the interactive service to get access to that music. The non-interactive market for the most part serves the more causal listener, who may want to hear some music, but need not be involved in selecting exactly what they want to hear. There is nothing to indicate that this more casual audience, which traditionally has not spent significant amounts on music in the past, will suddenly want to spend more of their disposable income on a service where they cannot dictate what they want to hear. Thus, based on my observations within the industry (including the evidence cited above), it is my opinion that non-interactive streaming will continue to be a mainly advertising-supported medium.

VI. NAB AND SATELLITE SIMULCASTERS HAVE SIGNIFICANT ADVANTAGES OVER NON-NAB STATUTORY WEBCASTERS

36. There is no basis for Dr. Pelcovits' establishment of the WSA agreements as the "low end" of the range of market outcomes. This assertion ignores several advantages that NAB and satellite simulcasters have over statutory webcasters. It is an understatement to say that these the business of simulcasting has a different cost/revenue structure from the operations of pureplay statutory webcasting companies. On the cost side, NAB/satellite simulcasters do not need to invest in any "start up" costs to create content to stream – they merely require a small investment to encode and deliver their existing station signals through the Internet. Years of

marketing and developing audiences for their on-air personalities and programming present an instant competitive advantage in the world of webcasting. Their stations' appeal is broad-based and programmed to appeal to a mass audience. In contrast, many statutory webcasters have more specialized formats that are not available on over-the air radio/simulcast formats and that are meant to appeal to a niche audience via their more tailored offering.

37. Additionally, simulcasters do not need to invest in a new ad sales team – they already have a team of seasoned experts who have sold audio advertising for years to local (in the case of NAB simulcasters) and national marketers (in the case of both NAB and satellite simulcasters). Also, they have a built-in source to market and cross-promote their simulcast streams: promotional or programming inventory on their over-the-air signals and station websites. It should also be noted that NAB entities historically have not had to pay sound recording performance license fees for their over-the-air broadcasts given their promotional value – despite evidence that the Internet is quickly over-taking radio as a source for new music discovery. This year, 52% of people in the 12 to 34 year old bracket turn to the Internet first to discover new music; 32% turn to radio.[33]

38. Simulcasters have many other inherent cost savings. Unlike the statutory webcaster, who must pay all of its operating costs from the revenues derived from its operations, most of the costs of the simulcaster have already been paid by the revenues of its primary operations. The offices of the simulcaster are already paid for by the primary business. Computer systems for billing, traffic (i.e., the scheduling of advertising) and for other purposes are already on hand. Other personnel (e.g., receptionists, clerical personnel, technicians and engineers, etc.) and infrastructure already exist, being paid for by the primary business of the

[33] The Infinite Dial 2010: Digital Platforms and the Future of Radio, *Edison Research*, at 16.

simulcaster. As these costs do not need to be spent on the streaming, the simulcaster can afford royalties that its webcasting competitors cannot.

39. On the flip side, the NAB simulcasters can derive higher CPMs for their inventory than can statutory webcasters. The radio groups' streams are primarily sold locally by a seasoned team of experts to an audience of buyers who have been buying inventory on their stations for years. In addition, streaming spots are frequently packaged with over-the-air inventory to maximize value for the marketer, increase online inventory-sell out rates, and command a greater piece of the marketing spend, boxing out other online radio entities. To the extent that broadcasters rely on ad networks such as TargetSpot, it is as a last resort when inventory remains unsold. TargetSpot accounted for a very small portion of total streaming revenues in my terrestrial radio experience. NAB simulcasters' selling is fundamentally local, and because it is targeted as such (and further refined by the established demographics of a station format's audience), their sales teams can and do extract higher CPMs. Statutory webcasters, in general, lack this local edge and are much more reliant on advertising agencies and networks, which take enormous commissions. In the competitive landscape of Internet radio, the business of pure play and other webcasters are clearly disadvantaged in relation to the NAB and satellite simulcasters, and thus less able to meet royalty rates. Thus, rates paid by statutory pureplay webcasting companies, not those paid by NAB stations or satellite simulcasters, should be considered the "low end" of the market outcome.

VII. STATUTORY WEBCASTING PROVIDES PROMOTIONAL BENEFITS TO COPYRIGHT HOLDERS

40. Numerous studies have confirmed the positive sales impact and promotional benefits of statutory webcasting for recording artists. NPD Group's Russ Crupnick was quoted in February of this year as stating that "online radio services lead to a 41% increase in paid

downloads."[34] In addition, Pandora CTO Tom Conrad stated in May of this year that Pandora was driving sales of 1 million songs a month, and that "for every song purchase Pandora drives, users are likely to buy 3 to 5 more songs on top of the one they found."[35] According to written testimony that was submitted by Timothy Quirk (Vice President of Programming for Rhapsody) in this proceeding, Rhapsody's internal data proves that "More non-interactive plays of a particular track correlate clearly and directly with more MP3 sales of that track."[36]

41. The above-referenced statistics directly contradict Dr. Pelcovits' assertion that "there is even more reason to believe that non-interactive (i.e., statutory) services would be as much of a substitute for purchasing music as interactive services."[37] These statistics also mitigate against Warner Music Group's W. Tucker McCrady's stated concern about webcasting becoming a "substitution" for digital sales, because statutory webcasting is clearly additive.[38] This advantage is unique to statutory webcasters versus on-demand services like Napster, Rhapsody and Spotify, which, according to the NPD analysis cited above, drives digital download sales lower by 13%.[39]

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[34] Greg Sandoval, "Pandora spurs music sales, Spotify not so much," *CNet News*, Feb. 26, 2010, available at http://news.cnet.com/8301-31001_3-10459568-261.html; *see also* Eliot Van Buskirk, "Of Course On-Demand Music Replaces Sales – It's Supposed To," *Wired Magazine*, Feb. 25, 2010, available at http://www.wired.com/epicenter/2010/02/of-course-on-demand-music-replaces-sales-its-supposed-to/. *See* Exhibits 12 & 13.

[35] MG Siegler, "The iPhone Is Accelerating Music Sales For Pandora," *The Washington Post*, May 7, 2009, available at http://www.washingtonpost.com/wpdyn/content/article/2009/05/07/AR2009050703545.html. *See* Exhibit 14.

[36] Written Direct Testimony of Timothy Quirk, Sept. 29, 2009, at 4 ("Quirk WDT").

[37] SoundExchange Trial Ex. 2 (Pelcovits ACWDT), at 35.

[38] SoundExchange Trial Ex. 7 (Written Direct Testimony of W. Tucker McCrady, Sept. 23, 2009), at 2.

[39] Greg Sandoval, "Pandora spurs music sales, Spotify not so much," *CNet News*, February 26, 2010, available at http://news.cnet.com/8301-31001_3-10459568-261.html. *See* Exhibit 12.

42. Most importantly, as a songwriter and performer, I am keenly aware of the promotional value of statutory webcasting – especially in a time where most terrestrial radio stations have been reduced to playlists of 250 or fewer songs in established musical formats. AM/FM radio's appetite for new music outside of the established formats has dwindled. In fact, only a handful of "alternative" commercial stations and formats that used to play bands like mine still exist. For the most part, the only stations that still play bands like Too Much Joy, and more obscure alternative bands, are online. The value of this exposure far outweighs the small digital performance royalties that are accorded to performers at any level.

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

Alexander "Sandy" Smallens

Exhibit 1

ALEXANDER "SANDY" SMALLENS

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email: sandysmallens@gmail.com

Summary: Digital media pioneer who has built and run profitable divisions for top media companies and start-ups in the social media, broadcast, music/entertainment and media technology industries. Flawless track record of success in revenue generation, creative innovation, cross-discipline general management and multi-platform sales. Acknowledged leader, team builder and change agent.

PROFESSIONAL EXPERIENCE

Audiation
6/09 – Present

Founder & Managing Director

- Boutique consultancy which provides top-level leadership to start-ups and seasoned companies in the Digital and Broadcast space. Clients include the leading Social Media/Viral Marketing Agency Oddcast; the leading online branded entertainment company My Damn Channel; the largest premium ad network, AdBlade; leading urban lifestyle outlet Vibe; Turkey's largest Internet portal MyNet; music media innovators Tune Genie; and others.

Entercom Communications, Corp.
6/06 – 6/09

Senior Vice President, Digital

- Head of Digital division for top 4 radio broadcaster, reported to CEO; member of 8-person Operating Committee, which drives all corporate decisions.
- Drove Digital revenues 500% in three years, creating an 8-figure business; grew all digital traffic exponentially (sites, streams, videos and podcasts).
- Oversaw operations, staffing, strategy, business development, creation, development, sales and execution of entire business, including supervising a staff of 100 and managing 120 station websites and 90 streaming stations across 23 markets.
- Innovation milestones:
    - First radio group to launch cross-platform mobile streaming (iPhone/BlackBerry/Google phone)
    - First radio group to create a stand-alone regional sports portal which is experiencing explosive growth (weei.com)
    - First radio group to adapt open source CMS tools (Drupal, WordPress)
    - Deep integration with EveryZing (audio search engine), effectively making our audio programming searchable
    - Aggressive social networking strategies and training
    - First non-owner radio group to make their inventory available to TargetSpot (automated self-service advertising)
    - Various rich media applications and cutting-edge content development across all station formats

CBS Radio/Viacom
1/05 – 6/06

Vice President of Interactive Marketing and Sales

- Senior-most Interactive executive for largest major market radio broadcaster; reported to President.
- Directly responsible for creating and executing digital sales and business development strategy for entire 180 station portfolio, including streaming network, podcasting (including KYOU-AM, the nation's first all podcast station) and all web assets.
- Negotiated and executed category-level relationships and cross-media sponsorships with technology companies (Microsoft, Yahoo!,

Google, Real Networks, AOL), major brands and advertising agencies.

- Generated 6- and 7-figure deals with clients such as DaimlerChrysler, Monster.com, Motorola, Quiznos, Verizon and others.
- Negotiated first-ever mobile agreements for radio company, including: streaming stations over Sprint and Cingular phones; 25-station site license of SMS/MMS marketing platform; and a 'make your own ringtone' application.

Oddcast
1/02 – 12/04

Chief Operating Officer

- Number two executive at privately-held viral marketing technology company of 25, with direct responsibility for sales, marketing, PR, and general management; reported to Founder/CEO.
- Company increased year-over-year revenue 50% in 2002 and 2003.
- Conceived, pitched products, and managed all aspects of accounts with major advertising agencies and brands such as Coca-Cola, McDonalds, MTV, Unilever, ESPN, Washington Mutual, ConAgra, Vivendi Universal, BET and L'Oreal.
- Led the successful development and launch of new products, mini-sites and initiatives in a short timespan, while managing P&L.

Vivendi Universal Net USA
11/99 – 12/01

Executive Vice President

- Number two executive at Vivendi's consumer music portal. Managed staff of 40, reported to President/CEO.
- Oversaw creation, development, licensing, marketing and delivery of all content for GetMusic, RollingStone.com and Farmclub.com.
- Properties experienced 550% growth in unique users and traffic, and became the number two music content destination.
- Launched and successfully marketed several groundbreaking programs, including "GetMusic Karaoke"; "Videolab," which enabled users to mix their own music videos (hailed by *NY Times*, *LA Times*, *Entertainment Weekly* and many others); and "The A List," an interactive show hosted by Rolling Stone/VH1 veteran Anthony DeCurtis (guests included Michael Jackson, Kid Rock, Alicia Keys and Lou Reed).

SonicNet, Inc. /MTV
1998 - 1999

Senior Vice President

- Managed staff of 15; reported to CEO.
- Charged with growing company from scrappy bulletin board focused on indie artists to full-blown, multi-media destination site featuring major and upcoming stars.
- Oversaw creation, development, delivery and marketing of all content for the largest online music network, recipient of 1999 Yahoo! Internet Life Award for Best Music Site, as well as three nominations for 2000.
- Produced all events, and supervised all media applications including the web's first music videos on demand site (streamland.com) and visual radio station (flashradio.com).
- Primary point person for all recording artist/record label relationships, as well as key relationships with: AOL; Yahoo!; Microsoft; Real Networks; the Vans Warped Tour; and the DMX/Jay-Z Tour.
- Acquired by MTV; member of 3-person team that transitioned company, and served as SVP at MTV following transaction.

Prodigy Internet
1996 - 1998

Vice President and General Manager

- Managed staff of 13; reported to SVP, Content.
- Responsible for the majority of content areas on the nation's third largest ISP including music, entertainment, lifestyles, hobbies, cultures, family and education.

- Brokered all deals, negotiated contracts, developed dynamic content areas via partnering/marketing relationships and built community sites from the ground up.
- Executed high profile co-marketing deals with Warner Bros. and Atlantic Records to distribute Prodigy software on prominent music CD releases. Pioneered successful content-based retailing in such areas as cigars, music and pets.

Atlantic Records
1995 - 1996

Senior Director, New Media

- Managed staff of five; reported to SVP, Marketing.
- Built the record industry's first comprehensive New Media dept. from the ground up.
- Developed label and artist web sites from scratch. Executive Produced groundbreaking mixed-media CD/CD-ROM.
- Pioneered music industry use of streaming audio with history-making Tori Amos single. Strategized for the label in the digital frontier, negotiated all deals.

1993 - 1995

Director, Media/Interactive Services

- Oversaw staff of four; reported to VP, Artist Relations.
- Responsibilities included overseeing all online activities; creating and executing campaigns for artists on the commercial online services; and producing sites for artists.
- Created and edited all label-related media communication.

Set To Run Public Relations
1990 - 1993

Vice President, Marketing/Creative Service

- Conceptualized and directed media campaigns and strategies for wide array of recording artists, such as: Beastie Boys, New Order, David Bowie, B-52's, the Cure, LL Cool J, and Public Enemy.

Too Much Joy
1987 - 1994

Founding Member, Composer, Bassist/Vocalist

- Co-Founded, wrote, recorded, performed and toured with Giant/Warner Bros. four-piece satiric punk-pop band Too Much Joy. Released four major label albums and several independent ones, toured nationally as a headlining act and opening for the Go-Go's, Love Tractor, the Mekons, Violent Femmes, Gang of Four, Flaming Lips, Barenaked Ladies, Orchestral Maneuvers in the Dark, and many others. Billboard Top 15 Modern Rock act with MTV exposure.

Media Writer
1987 - 1990

- Wrote features and reviews for *Spin Magazine* and promotional materials including advertising copy, artist biographies, press releases, pitch letters and think pieces.
- Clients and artists included: John Mellencamp; Billy Idol; Soul Asylum; Sony Music Entertainment; Martin Bandier (CEO; EMI Music Publishing); and Relativity Records among many others.

EDUCATION

Yale University

B.A. Political Philosophy, *cum laude*

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Exhibit 2

April 17, 2009

Paying For Success: When Audiences Grow More Quickly Than Ad Revenue

by Mark Mulligan
with David Card, Nick Thomas, Sonal Gandhi, and Erik Hood

EXECUTIVE SUMMARY

"Free" has always been the cornerstone of digital content, but the repeated failure of paid content to break out of a niche has left many content genres focusing even more keenly on ad-supported strategies. Audiences are responding in kind, spending more time with more content at more online and mobile destinations than ever before, in turn driving more content license fee payments. But content providers are increasingly finding themselves unable to square the circle of ad monetization, failing to keep pace with increased content costs. Things are coming to a head, with many content owners now seeking an even larger share of revenue just as the economic downturn starts to weaken the online ad market. To navigate through these troubled waters, content owners are having to reassess core strategic objectives and in some cases pursue counterintuitive strategies.

THE FREE CONTENT MODEL IS FACING ITS STERNEST TEST YET

From its inception, the Internet has been a predominately free content platform, and there is no indication that is about to change any time soon. In fact, the outlook for many online paid content sectors is weaker now than it was a few years ago. Against this backdrop, it is little surprise that content owners are looking more strongly to advertising revenue than ever before. But as online content audiences grow, effective monetization is becoming increasingly problematic.

- **Media industries have been infected by the contagion of "free".** The Internet has already fundamentally changed the news and music industries, and it's beginning to do the same for other sectors. Most Internet users do not and will not pay for content — it's that simple. Buyer penetration across most online content genres is in low single-digit percentage ranges. Content providers across the board have already recognized this and have embedded "free" at the core of their digital strategies.

- **Free content strategies dominate online.** For all but a few content sectors, "free" is becoming the common currency of the online experience. Virtually all news is free online, and consumers are similarly spoiled for choice for free music on streaming sites such as Last.fm, Pandora, and YouTube (not even considering the multitude of illegal alternatives). TV broadcasters are, for the moment at least, firmly on the "free" bandwagon with numerous highly successful destinations including ABC.com, Hulu, and iPlayer. Even online games providers — a relatively robust paid segment — are getting in on the act, using free casual games to entice noncore gamers. Only the movie industry continues to turn a cold shoulder to "free", though nobody has told the growing number of consumers who are downloading and streaming movies illegally.

Headquarters
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[illegible] • www.forrester.com

- **Revenue models are struggling to keep up with demand.** With consumers shunning paid-for content, advertising is the key revenue source for most online services. Some of this is relatively new, some is not. But what *is* changing is the ability of monetization to keep up with audience growth. More consumers are becoming more engaged with more digital content than ever before. Consumers are watching more shows, listening to more songs, and playing more games. This is great news if your core focus is building scale, but not so great if you're focused on building sustainable business models. The simple fact is that many ad-supported content destinations are not growing ad revenue effectiveness as quickly as their audiences are growing in size and level of engagement.

Online Content Providers Are Caught Between A Rock And A Hard Place

Growing online content audiences should be something to sing about. But for many content providers, it is putting increasing pressure on the viability of their business models; they simply can't afford all of their new customers. Costs are often rising more quickly than revenue is. For example:

- **Technology costs grow as consumption grows.** For music and video providers, the more their audiences stream content, the higher the costs for streaming and — should increased demand require greater streaming capacity — also for hosting. More streams equal more, directly correlative, cost.

- **Content costs grow as consumption grows.** For content aggregators in most content genres, each time a piece of content is consumed, an extra license fee is generated. Each time a music track is streamed or a video is viewed, at least one license fee is paid. So again, more streams equal more, directly correlative, cost. The bigger your audience is, and the more they're interacting with your content, the more it costs you. At time of writing, one major streaming content provider is facing the threat of closure because its ad revenue is not high enough to support the content license fees its multimillion-user base generates. Even YouTube, with more than 300 million global users, is currently struggling to meet the financial demands of rights owners.

- **Many content owners can't afford greater audience engagement.** Great audience engagement is a key strategic objective for digital content providers, and the rise of social media has been an invaluable boon for the strategy. For those content owners that do not have per-usage license fees — e.g., most online publishers — increased engagement is a positive metric, facilitating greater loyalty and ad income. But for the destinations that pay incrementally for content consumption, greater engagement is cost straight to the bottom line. These destinations now must reconsider how to increase audience time in a more cost-effective manner, using tactics such as creating their own written editorial, forums, and user profile pages.

- **Rights owners want a bigger part of the action.** Larger players, such as MySpace.com and YouTube, have leveraged their scale to negotiate better deals that either partially or wholly leverage share of revenues to cover license costs (i.e., reducing dependency on per-stream fees). Most content providers, though, do not have this luxury. Also, revenue share and flat-fee models are coming under pressure from content owners wanting to see more money for the increased consumer activity, as illustrated by the PRS for Music's license dispute with YouTube in the UK. Content owners see strong growth in consumption of their content online, and they don't see why they shouldn't benefit from the exploitation of their intellectual property. At an extreme, some content owners feel that they are effectively being asked to fund startups with nonviable business models.

- **Improvements in ad monetization are not keeping pace with usage growth.** Many streaming destinations are cluttered with low-value, remnant ad inventory that can only command weak CPMs, and they're not growing its value as quickly as content costs are growing. This applies even for the big gorillas of the piece: Google has yet to develop a vibrant video ad business on YouTube, and it and MySpace.com both have fragmented audiences. For TV broadcasters, low consumer receptivity to video ads can restrict video ad spots in online TV shows to as little as one 30-second preroll in the UK, though this rises to four or five spots in the US. This compares to typically more than 15 minutes of ad inventory for the same show when broadcast. (though the online ads benefit from better targeting and not being skippable via DVR). Then to compound matters, the economic downturn is softening the online ad market just when these destinations don't need it.

Responses To The Challenge Are Inconsistent

All of these ingredients combine to create a toxic recipe for many online content providers. They are facing the paradoxical situation of strong audience growth threatening the sustainability of their businesses. Yet at the same time, content owners see the increased consumer engagement and seek better compensation for the exploitation of their works. Content providers are responding in diverse ways:

- **Pursuing sustainable growth.** We7 — the UK's free on-demand streaming music service — is taking a measured, comparatively low-key approach to audience acquisition, prioritizing revenue sustainability over audience growth.

- **Growing audience first.** Spotify — another European free on-demand streaming music service — has focused on aggressively growing an audience and is now expanding its ad sales team to ramp up its ad revenues.

- **Responding to market realities.** Last.fm — the social music destination — announced in March that it will start charging listeners in the noncore geographies (i.e., those countries where ad revenue does not support costs) for the previously free service.[1] A more extreme example is ad-supported music download service SpiralFrog, which closed down its service in March, unable to reconcile its license fees with ad revenue.

- **Pulling content.** Some TV broadcasters are pulling content from online services in an attempt to protect core ad revenues, such as FX Networks pulling its *It's Always Sunny in Philadelphia* from Hulu.

These trends are not about to go away. In fact, over the coming 18 to 24 months, most content services will feel even greater pressure of the audiences growing more quickly than ad revenue. Navigating through this period will require strong understanding from both services and content owners.

RECOMMENDATIONS

HOW TO WIN WITH AD-BASED CONTENT

Illegal file sharing and streaming has helped shatter recorded music sales and could yet do similar damage to TV, movie, and games revenue. Consumers want free content, and if legitimate content providers don't give it to them, then they'll get it elsewhere. As media sales and ad spending start to feel the effect of the economic downturn, it is imperative for the content owners and aggregators to work together to ensure that the illegal sector doesn't get the upper hand during these challenging times.

- **Build sustainable audiences.** Weakened consumer spending during the downturn will create the double effect of people spending more time at home and online with more demand for free content. But product strategists — especially those who do not have extensive financial resources, are not revenue-positive at a per-user level, or who are not currently mapping to be —— should treat this opportunity with caution, and prioritize monetizing the core audience over audience acquisition. Many services will need to make the tough decision to moderate audience growth, using tactics such as trimming marketing initiatives and allowing subscribers to churn.
- **Moderate content consumption only as a last resort.** Placing restrictions on an audience's content consumption is not an option for many types of content providers, and for those that can do it, it is a strategy that should be implemented with utmost care. Essentially an alternative to moderating audience growth, this approach, done well, enables product strategists to continue to grow audiences (and therefore reach for ad revenue) and reduce the content license fee costs per user, thus enhancing margins. In addition to tactics such as placing restrictions on numbers of plays per user in given periods, content providers seeking to protect their core offerings can be more selective with releasing content online. This way, TV broadcasters can delay the arrival of shows online and limit their appearance there. Record labels can similarly delay the arrival of new releases to ad-supported services.

- **Increase audience engagement with cheaper content.** If restricting consumption is the stick, encouraging consumption of other, cheaper content is the carrot. Product strategists should reconsider how to increase audience time in a more cost-effective manner, using tactics such as creating their own written editorial, forums, and user profile pages. The content experience cannot be only about consuming content with variable licenses. Media products must bulk up on cheaper engaging content such as cheaper to license complementary info, "free" user-generated content (UGC) polls, games, etc.
- **Change business relationships.** If MySpace.com was paying a penny a stream on the 1 billion streams it reported six days after the launch of its music streaming service, it would have a monthly burn rate of about $50 million.[2] Such costs would not have been sustainable. Instead, MySpace.com created a joint venture with the record labels that ensured sustainable license fee rates and large-scale consumption. Content owners should pursue similar strategies with smaller destinations, also. A more level playing field will ensure healthier competition and better consumer choice. If destinations cannot make money, the losers will ultimately be the content owners as consumers will invariably seek out illegal alternatives. Joint ventures may not be the ideal choice for many, but they are well-suited to the current climate. They give both sides insurance: Content owners have collateral against sites' inability to drive strong ad revenue growth, and the sites know that content owners have a vested interest in ensuring that the services are successful. It sacrifices control for the sites, but if the alternative is losing content or business sustainability, then it is often a price worth paying.
- **Innovate with ad models.** As ad budgets tighten, advertisers will be increasingly cautious ,but they'll also want more bang for their buck. Smaller content destinations should use the agility their smaller scale enables and provide full-service solutions to advertisers for a high premium. For example, We7 did a full site takeover for the Gwen Stefani perfume range campaign. Providing greater flexibility and innovation, coupled with highly targeted audiences, are assets that ad-supported content destinations must leverage. Marketers should work directly with advertisers to give more exposure and engagement with their audiences than the advertisers would be able to afford, or even reach at all, on larger sites. Rich consumer data will also help provide cost-conscious advertisers with strong value for money. Product strategists whose services do not yet have audience signup functionality should encourage, though not necessarily force, their audiences to register. This can be done to provide a greater degree of free functionality to the end user, such as playlists, profile pages, bookmarks, and so on. These registered users should also be invited to participate in regular short surveys with sweepstakes prizes, both to drive richer data, but also to provide a venue for advertiser conversations with them.
- **Increase ad inventory.** Many sites underestimate their audiences' tolerance levels for advertising. If sites find advertisers that insist on paying less for ad space, then increasing the amount of ad inventory is a key means to balance the equation. Some TV broadcasters are already actively experimenting with significantly increased frequency of video ads in online

streams. Speaking on a panel at the National Association of Television Program Executives (NATPE) in January, ABC.com's Albert Cheng said that his own testing revealed that viewers could bear twice as many ads without walking away from the shows.[3] Ultimately, consumers who seek out free content accept paying something in return, whether that means viewing ads or having to use illegal sites. During the economic downturn, many consumers will spend less on media, seeking it out for free instead. Their tolerance for increased ads will to some degree inherently increase. Watch out for clutter — that devalues inventory. If sites are careful to manage ad clutter and don't show too many ads per page, they can also get away with a lot more intrusiveness (e.g., prerolls, audio ads, etc.)

WHAT IT MEANS

"FREE" WILL REMAIN THE COMMON CURRENCY OF DIGITAL CONTENT

TV broadcasters' online video strategies illustrate an industry getting smart, learning lessons from the mistakes made by the music companies. The broadcasters knew that growing audience would be much easier than effective monetization, but they equally recognized that simply not doing anything was not an answer. They recognized that giving their audiences compelling free content online would enable them to participate and even drive an otherwise disruptive process of audience fragmentation and infection by "free". This kind of long-term vision is crucial to the future of media businesses and must not be derailed by the mid-term pressures of an economic downturn.

- **Paid content audiences will be a minority.** The collective failure of the paid digital music market to grow much further than a subset of the installed base of iPod owners illustrated that it was not about to drive some format replacement cycle. It also focused the record labels' attention on alternative business models, including various ad-supported ones.[4] The record labels have recognized that services that are either free (e.g., Pandora) or that *feel* free (e.g., Comes With Music) are the most likely ways of converting the mass-market digital opportunity. These services inherently infer a lower average revenue per user (ARPU) than premium alternatives such as Rhapsody and even iTunes. But the much larger addressable audiences of free and nearly-free services means that overall revenue opportunity can be higher. But labels, publishers, and collection societies alike must recognize that current license fee rates may not be the finished article — they may require near-term tweaking to get through the economic downturn, and even longer-term changes to enable long-term economic viability. It is in the interest of all value chain stakeholders to enable these services to operate profitably and to compete with piracy.

- **Ad-supported content models will mature.** These may be challenging times for the ad-supported content sector, but business models will mature. Increased innovation will ultimately drive higher revenue per user, driving increased margins for services and stronger revenue for content owners. But the process requires patience and a better understanding from all parties of each other's needs and strategic objectives. Content owners need ad-supported services more in a recession than at any other time. Paying customers will tighten their belts, buy fewer CDs, go to the movies less, even cancel cable subscriptions or cut back on the number of channels. Free, ad-supported alternatives provide a vital revenue safety net for those same content providers that will help them navigate through troubled waters.

ENDNOTES

[1] Last.fm announced that it will start charging listeners in all countries except Germany, the UK, and the US. Source: Richard Jones, "Last.fm Radio Announcement," *Last.HQ*, March 24, 2009. (http://blog.last.fm/2009/03/24/lastfm-radio-announcement)

[2] In comparison, it took iTunes nearly three years to get 1 billion song downloads. Source: Michael Arrington, "MySpace Music Streamed Its Billionth Song 'A Few Days' After Launch," *TechCrunch*, October 5, 2008. (http://www.techcrunch.com/2008/10/05/myspace-music-streamed-its-billionth-song-a-few-days-after-launch/)

[3] Source: Jay Baage, "ABC Says Web Viewers Can Tolerate Twice The Ads," *Digital Media Wire*, January 30, 2009. (http://www.dmwmedia.com/news/2009/01/30/abc-says-web-viewers-can-tolerate-twice-ads)

[4] The music industry is moving away from the distribution paradigm to the consumption era. Licensing from sources such as social music and subsidized subscriptions, which predominately provide consumers with music for free, will generate a further €1.2 billion in digital revenues for rights owners by 2014. See the January 20, 2009, "How Digital Licensing Will Help Save the Music Industry" report.

Exhibit 3

AdvertisingAge®

CBS Interactive Dumps Ad Networks

An Old Debate Revived: Are Networks Good or Bad for Online Media?

By Michael Learmonth

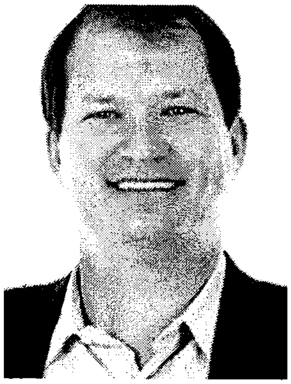
Published: December 14, 2009

NEW YORK (AdAge.com) -- Hoping to get an ad on CBS.com, Gamespot, TV.com or CNET? Better call CBS. CBS is expected to announce Dec. 14 that it will no longer do business with third-party ad networks, and will instead sell all of its considerable online inventory on its own.

In doing so, CBS re-opens a debate that raged mostly before the economy declined: Are ad networks good or bad for online media and advertising?

Former Yahoo and Martha Stewart Living exec Wenda Harris Millard splashed gasoline on the fire nearly two years ago when she admonished publishers not to allow third-party re-sellers to treat their inventory like "pork bellies." Publishers such as ESPN, Weather.com, Turner Networks, Forbes and Gawker were among the more vocal publishers to stop doing business with ad networks.

But then the economy got bad, and the debate subsided as publishers scrambled for revenue, any revenue. Now, a host of publishers are looking at the downturn as an opportunity to wean themselves off the drip-drip-drip of revenue from networks in hopes they will be better-positioned when the economy gets better. With 60 million unique visitors a month, according to ComScore, CBS is the largest single publisher to publicly make the move.



CBS
Neil Ashe
"We are prepared to take a step back on revenue if we have to, but over time we will monetize at a much better rate than ad networks do," said CBS Interactive CEO Neil Ashe.

'Madison'
Like a lot of publishers trying to decrease their dependency on third-party ad networks such as Ad.com, ValueClick or 24/7 Real Media, CBS is launching its own internal ad network so it can service advertisers that want to buy demographics or remnant display advertising across CBS sites. The company said its internal ad-serving platform, Madison, can offer audiences based on demographics or online behaviors, within CBS properties.

Mr. Ashe said CBS will also pull its inventory from some, but not all, online ad exchanges. CBS will continue to offer inventory to Yahoo's Right Media Exchange, Google's DoubleClick and demand-side exchanges such as Publicis Groupe unit Vivaki's Audience on Demand. "What we are careful not do is open our inventory to third parties that may have data interests not aligned with our own," Mr. Ashe said.

Ad networks arose en masse during the past decade in response to one problem: Publishers were generating many more ad impressions than they could profitably sell. Networks came in and offered to take that inventory and write publishers a check; they then turned around, chopped up the inventory and resold it largely to advertisers that paid by response or click.

Ad networks monetized by acquiring the inventory at as low a rate as possible, then adding sophisticated data and analytics to get a higher return. Because these were capabilities most publishers didn't have, taking the check seemed prudent. But then publishers started blaming the industry -- which grew to an estimated 400 ad networks -- for depressing ad rates across the web. Why should a marketer pay $10 for 1,000 impressions when 30 cents can probably get the same sites?

But in the meantime, much of the technology became ubiquitous -- anyone with a computer and a phone can, in effect, become an ad network. Publishers, too, could launch their own networks, and many have. Those publishers with scale, such as Yahoo, Google and Microsoft, acquired their own networks over the past decade.

Important function
Time Inc. launched its own internal network earlier in the year, and has been steadily turning off third-party networks ever since. Now it works with only one, former corporate sibling Ad.com. "Publishers have gotten smarter. We don't need to have 400 ad networks trying to do this; it only adds confusion, not clarity," said

Time Digital President Kirk McDonald.

In truth, few individual publishers alone have the scale to impact the overall market, and networks are a key part of the online ad economy. For marketers and agencies, networks perform an important function by allowing them to get huge scale and efficiency without dealing separately with dozens of publishers.

Because the first big publishers made a show of dumping networks a few years ago, "the ad network marketplace has gotten bigger," said Mike Cassidy, CEO of Undertone Networks.

As for CBS taking its inventory out of the network market, Mr. Cassidy said, "It's not that big a deal, to be honest with you; it doesn't move the market." What will, he said, is if Yahoo follows through on its promise to kick networks off its Right Media exchange that don't add significant value with data or advanced targeting.

As publishers launch their own networks, this has added some new opportunities for third-party networks both as data and technology vendors, as well as additional sources of volume when a publisher needs more reach. That, and agency buyers start with a target audience first, the publisher or website second. If a certain campaign doesn't require a specific site (say, iVillage vu.s Babycenter), then the networks are going to be part of the buy.

"If you want to do something cool with a publisher, then buy directly," said Andy Atherton, CEO of Brand.net. "If you're buying standard media, networks offer a more efficient way to transact, regardless of your objective."

Exhibit 4

paidContent.org
THE ECONOMICS OF CONTENT

Music Social Network Imeem In Play; Hires Bank; Laying Off 25 Percent

Rafat Ali @rafatali

Oct 22, 2008

imeem Online music-focused social network **Imeem** is on the block, according to our sources, and has hired investment banker Montgomery and Co. to lead the sale. Coincidentally, we have also learned that the company is announcing some layoffs internally today—as much as 25 percent of its around 80-strong workforce. These layoffs are mainly on the technical back end and services side.

The company has done its on-demand streaming music deals with all four majors, and has also been working with a slew of indies. As it has built out its platform (**it recently relaunched** its site/service), and done most of the biz dev deals, the focus now is on growing audience and monetizing the platformit won't be needing as much technical expertise going ahead, the sources say, and hence the layoffs. Of course, Imeem is a Sequoia-portfolio company, which means it is all but obligated to heed to the VC firm's recent call of cost and employee cuts.

Lots more after the jump...

Why sell? On the sale, the company's thinking is that despite the economic troubles and music industry's continued troubles, the time is right with lots of activity in the sector—the hype around MySpace Music's launch, the imminent launch of Facebook's own music service (and for now, iLike's dominance there), and music becoming part of a bigger social media play—and the company would do well as part of a bigger one. It has been in the process of raising more money from strategic investors, some of whom have expressed an interest an acquisition. **The company has previously said it has about 30 million registered users, and 100 million users across its network** of widgets/apps and through usage on other social sites. On the actual making money side, its efforts are more recent, and it has been focusing on branded experiences with advertisers, something similar to what Pandora also does.

Imeem has raised above $50 million in funding over the last two years, including a $15 million round from Warner Music Group (**NYSE: WMG**) **earlier this year**. Other previously disclosed investors include Sequoia Capital and Morgenthaler Ventureswe **have also learned that DAG Ventures was the last one to invest in the company this summer, with the valuation north of $200 million.** They would probably like more than that, but with the current market, anything in nine figures would be, well, reality-rational.

The Palo Alto-based company earlier this year acquired **Snocap**, the digital music start-up founded by Shawn Fanning. Last year, it resolved a copyright infringement lawsuit brought by WMG by striking a rev share deal.

While we're at it, who is going to **put Pandora out** of its streaming-royalty misery?

Related

- **Music Social Net Imeem Gets More From Sequoia**
- **Social Net Imeem Buys Struggling Music Service Snocap**
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- **Facebook Wants Music, But Doesn't Want To Tangle With Labels**
- **MySpace Music: First (Real) Look: For Once, You**

Can't Blame The Lawyers

Exhibit 5

TechCrunch

Ok, Now It's Done. MySpace Music Completes Acquisition Of iMeem

by **Michael Arrington** on Dec 8, 2009

MySpace Music has completed its acquisition of most of the assets of music service iMeem.

We first broke the news that MySpace was close to **acquiring iMeem** last month. Two days later, we reported that an **agreement was signed** to purchase the assets of the company for $1 million in cash.

The deal didn't close, however, because some of the assets MySpace Music was going to buy (namely, servers) were actually being leased. So that had to be **worked out**. And the final price ended up being less than $1 million, meaning MySpace Music is getting the iMeem brand and users for next to nothing. An additional earnout is also part of the deal, but it's not much.

Unlike the iLike acquisition, iMeem is being acquired by MySpace Music, not MySpace. MySpace Music is a **joint venture** between MySpace and the music labels.

But now it is **official** . MySpace Music will be acquiring some of iMeem's remaining assets and transition its 16 million monthly users over to MySpace Music. All of their playslist swill be migrated over, for instance. Founder Dalton Caldwell, CTO Brian Berg, COO Ali Aydar, and VP of Sales David Wade will oversee the transition on a consulting basis. It is not clear what will happen to IMeem's other employees. Imeem now redirects to this **landing page** .

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Exhibit 6

Music startup imeem making money, not dying unless the labels kill it

March 26, 2009 | Eric Eldon
3 Comments Share

Sure, the music industry — including music startups — are having trouble coming up with significant online music business models, but recent rumors circulating about imeem's money problems appear to be exaggerated. The San Francisco company, which lets users create and share streaming song playlists, has been reportedly running out of money, especially because of how much it has to pay for music licensing deals it has with record labels.

Imeem isn't commenting on finances. It says it's not profitable. So far, it's been focused on advertising, but now it is also focusing on e-commerce revenue from things like digital song sales, ticket sales, and other non-advertising services. But I also hear the company's advertising effort has been working to some degree. It is getting "much higher" rates for banner ads than MySpace Music and other competing web sites, one source says, because its users are focused on music, not on more general social networking features. Recession-driven advertiser cutbacks have hurt imeem, but the results so far of its direct sales team could mean more money down the road. Meanwhile, a new feature for letting users buy entire imeem playlists through iTunes has doubled the company's iTunes revenue. Other features, like its VIP, freemium and ticket sales services are still too new to judge the results of.

But what about paying the bills now? Imeem was one of the first online music companies to work out a licensing deal with all four major record labels, and the terms are onerous, with the company possibly having to pay up to a penny to the labels for each song its millions of users stream. Rumors have been going around Silicon Valley and the music industry about immediate financial issues, with one being that they owe labels up to $30 million. Both the company and our sources say it is far less — in the single-digit millions. Imeem also periodically restructures its deals with the labels,

There are a truly impressive number of rumors going around about the company. One I've heard is that its valuation has fallen from what was (or still is?) "north of $200 million" to something far less; the company isn't commenting on that. Another is that its investors, including its venture capitalists like Sequoia Capital as well as record labels, now own a very large portion of the company.

So either because of licensing alone or also equity, the labels hold power over imeem. More on what that might mean, from Wired:

> *When we asked, Warner Music Group would not comment on whether it would consider dropping the per-song rates it charges imeem. However, we've also heard indication that the labels could ultimately decide to let various online businesses perish under these on-demand rates, in the hope that eventually, one of them will be able to sustain the high on-demand music licensing rates they require regardless of the economy. For imeem, the day of reckoning could be approaching, although nobody we spoke to could envision imeem disappearing any time soon.*

Imeem has up until this point had one of the most comprehensive streaming deals with labels; rivals like Project Playlist are still working to get approval from some of them. Which just goes to show that the music labels are providing the wrong mix of incentives here. They make fickle and costly licensing deals with only som companies, then tax them as they try to operate. The labels might be able to get more entrepreneurs invested in music startups again (yes, many have moved on) if they make a clear set of rules for licensing, then minimize or drop the tax while imeem and other music startups try to figure out their products and business models.

[Update: MediaMemo reports that imeem has reached a new agreement with some of the labels, including Universal Music Group but not Warner Music Group. TechCrunch has a good analysis of the state of the industry -- which is that labels are more or less killing streaming music startups.]

[Update II: The company has recently had a recent management shakeup, with top business executives departing.

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Overview

LOCATION: San Francisco, CA, United States

INDUSTRY: Consumer Internet

EMPLOYEES: 30

TAGS: Video, Playlist, music, Web 2.0, Community, discovery, Snocap, anywhere.fm, internet

Financials

LATEST FUNDING: Debt - $6M (09/2009)

INVESTORS: Morgenthaler, Warner Music

Market

COMPETITORS: Pandora, blippr, BuzzNet, Maestro Music, Inc., Oosah, Mixwit, Listal, Qloud, thesixtyone, The Hype Machine, MySpace, Yoogli Music, Hyves, Shastic, iSound, Jamendo, Music.com, MusoCity.com, Music Nation, Jogli, Bandcamp, Anywhere.FM, JukeFly

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NOV 18, 2009
MySpace Acquires imeem Social Music Service for a Song

NOV 18, 2009
MySpace Signs Agreement To Acquire iMeem

Exhibit 7

Published on *Forrester Blogs* (http://blogs.forrester.com)

Last.FM's Fond Farewell to Streaming (sort of)

By *Mark Mulligan*
Created *04/13/2010 - 08:16*

Last.FM have announced that they will stop streaming full on demand songs to users, instead providing integrated streaming from 3rd parties. [1] Though this certainly highlights some of the challenges in today's on-demand streaming music business it says less about the fundamentals than it might first appear to do.

This is one more chapter in the Last.FM / CBS integration story. Last.FM was an early mover in the streaming music and had tens of millions of users when Spotify was just a twinkle inn Daniel Ek's eye. Many – myself included – were surprised by the $280 million that CBS paid just under three years ago to acquire Last.FM. Since then Last.FM's fortunes have been a mixed bag. Though user numbers are at an all time high, Last.FM has struggled to find its new identity within CBS and its paymasters recently took the decision to turn off free-streaming in outside of the major territories due to the inability to generate sufficient advertising revenue.

CBS are doing what you would expect a major media organization to do with an expensive start-up acquisition: they are trying to make it contribute to the bottom line. These objectives often do not align closely with the innovative vision that drive start-ups to scale and market profile, though usually not to profitability.

Profitable streaming requires the long view. Making streaming music profitable is a long term market-level play that requires patience and value chain partnership. Streaming services say rights holders need to drop their fees further than they have already done so. Rights holders say they need to see streaming services deliver revenue more and threaten sales less. CBS have decided that they are not willing to wait for the music industry to get its house in order and pay the expensive mortgage whilst doing so. Instead they've opted for rented accommodation in the form of supporting links from approximately 600 streaming partners, including Spotify, the Hype Machine and Vevo.

Some revenue will now slip through the cracks. It's worth noting that not all of the content from all of those partners will be 100% legal. For example the Hype Machine collates links from numerous blogs, many of which post unlicensed content. So a portion of Last.FM's streaming revenue will simply disappear rather than migrate to other services.

The bottom line is that CBS has made the call that Last.FM does not need to host streaming to deliver a differentiated music discovery experience. Is a hosted solution likely to deliver a better quality experience than relying on partners? Absolutely, but not better enough to justify the much higher expense for CBS.

When streaming rates and streaming revenues become better aligned (and they will, eventually) CBS may decide to buy back into the streaming music game. Until then it has the opportunity to focus on going back to its roots and strengthening its core value proposition: social music discovery. This isn't a nail in the coffin for free but it is further evidence of the challenges of making free pay.

3

Recommend this post [2]

Cloud Services Last.FM Mark Mulligan Music Music Industry Meltdown Record Labels Social Music Streaming Music Consumer Product Strategy

---

Source URL: http://blogs.forrester.com/mark_mulligan/10-04-13-lastfm%E2%80%99s_fond_farewell_streaming_sort

Links:
[1] http://blog.last.fm/2010/04/12/yes-it-does
[2] http://blogs.forrester.com/plus1/vote/4139

Exhibit 8

digital music news

Flat

Last.fm Flips the Subscription Switch... In Smaller Markets

Author Info

Wednesday, December 30, 2009

Last.fm is finally spinning a subscription-based offering, at least outside of the US, UK, and Germany. In smaller markets, access to the custom-tailored, Last.fm radio service will soon cost 3 euros ($4.05) per month, according to the company. The rest is free, including recommendations, scrobbling, and networking, core components of the Last.fm model.

In the bigger markets, that same charge removes ads from the radio service, one that contains roughly seven million songs. Just like Pandora or Slacker, the Last.fm radio station fine-tunes over time, based on the tastes and preferences of the user. Sounds fun and engaging, though Last.fm disclosed that sales were simply not generating enough capital outside of its core markets.

Or, perhaps within the core markets. Increasingly, ad-supported, online media companies are struggling against bottom-scraping valuations, including YouTube. Whether Last.fm has better targeting remains unclear, though its concept is a bit more focused. Still, Last.fm has nothing near the traffic volumes of YouTube, and CBS appears to be struggling to properly monetize its $280 million investment. The changes go into effect March 30th.

View Comments Flat

Exhibit 9

paidContent.org
THE ECONOMICS OF CONTENT

Interview: CBS Thinks Last.fm Will Turn A Profit This Year

Robert Andrews @robertandrews

Mar 18, 2010

After its 2007 acquisition, it doesn't seem like CBS (**NYSE: CBS**) has been able to get the most from its $280 million Last.fm outlay. There's been no TV scrobbling, no profit, the site's key execs have left and fitting the trendy Silicon Roundabout, London, startup in to a U.S. megacorp appears to have been a challenge generally.

But now CBS has reined Last.fm in to its interactive music group, with direct oversight from president David Goodman. **Speaking to me** after we came off a panel at MediaGuardian's Changing Media Summit on Thursday, the unit's product VP Fred McIntyre offered some new insight**Listen!**

The subscription business drives about a quarter of Last.fm's revenue. **It has paying subscribers in the high tens of thousands, McIntyre said** - that's way low compared with Spotify's 320,000, gained after just a year and a bit.

Our plan is to be profitable with Last.fm in 2010. We're very bullish on the subscription service. We'll be rolling out some new features around the subscription service in Q2. The U.S. is now a quarter of Last.fm's overall audience.

Expect upcoming announcements about incorporating Last.fm's scrobbling feature, which notes users every track listen, on other sites. Last.fm has recently done this with Shazam and We7.

Exhibit 10

paidContent.org
THE ECONOMICS OF CONTENT

Pandora: These Numbers May Surprise You

Digital Music News

Mar 18, 2010

For years, Tim Westergren was on the front lines of a difficult royalty battle. But instead of becoming a casualty, **Pandora** and other internet radio providers managed to forge a workable rate structure - at least one that kept the lights on.

But this is still one huge royalty bill, and Pandora is now one of the biggest contributors. Just recently, Westergren disclosed top-line, 2009 revenues of $50 million, but royalty obligations to SoundExchange alone (a cost that does not include publishing) topped $28 million, according to Westergren.

The bigger Pandora gets, the bigger its royalty bill, a variable cost structure that makes it difficult for many content-based business to scale.

Either way, Pandora is a serious chunk of total SoundExchange royalty revenues from online radio. Despite all of the wrangling over non-interactive royalties on recordings, Pandora now accounts for roughly 44-45 percent of total SoundExchange royalties for non-interactive streams, according to details confirmed by both companies. We're about 44 percent of internet radio, Westergren told Digital Music News.

Beyond that, Pandora represents a very important one-percent of broader radio royalties. We're a shade over 1 percent of the overall radio marketplace, Westergren relayed. Multiply that by 100, and you get the found revenue flowing to labels and artists if we were in an internet radio world instead of a broadcast world.

This story has been provided by our content partner **Digital Music News**.

Exhibit 11

Analysis: Subscription Model Takes Another Hit
May 10, 2010 - Digital and Mobile

By Glenn Peoples, Nashville

If music subscription services were easy, everybody would be doing them and millions of Americans would be paying. Numbers from RealNetworks' latest earnings show subscriptions are still one of music's greatest paradox: so much potential but so few paying customers.

Rhapsody finished Q1 2010 with 650,000 subscribers, according to its earnings release last week, a 3.7% decline from 675,000 at the end of Q4 2009 and down 18.8% from 800,000 in Q1 2009.

It's a familiar refrain. **Napster** was losing subscribers before it was acquired by Best Buy in September 2008 and hundreds of thousands more were lost when AOL shut down its subscription service. (Napster paid for AOL's 350,000 subscribers in January 2007, bringing its total to about 900,000. Since Napster's subscriber count stood at just over 700,000 in June 2008, it can be reasoned most of them didn't stick around.)

Not long ago, Rhapsody was gaining subscribers. At the end of Q4 2007, according to a RealNetworks SEC filing, Rhapsody had 775,000 subscribers after adding 150,000 net new subscribers in Q3 and 25,000 in Q4. In 2008, the company launched a multi-million-dollar advertising campaign around its Music Without Limits initiative that included a new MP3 store, a partnership with Verizon (VCast) and full-song previews at iLike. By the end of Q3 2008, Rhapsody had competed a one-time migration of customers from Yahoo! Music's shuttered subscription service.

Now, media darling **Spotify** has 300,000 paying subscribers and over seven million users of its free service in six markets. It's a good start, but nothing more. To put it in perspective, Spotify has fewer paying customers than Rhapsody and Napster have lost in recent years. The game-changing gains have been made by only one company: **Pandora**.

The timing of Rhapsody's Music Without Limits campaign couldn't be more coincidental. In the same month, Pandora launched its hugely successful iPhone app. It can't boast eight million on-demand tracks, but it obviously has enough music for a large section of the market. Most impressively, Pandora achieved a rare feat by the end of 2009, less than a year and a half after it launched its iPhone app: it turned a profit. In contrast, competitors are struggling to acquire users to scale to profitability.

The final verdict on the current subscription model has not been delivered, but its outlook is grim. New competitors are needed in the U.S. market to breathe life into a staid situation and, for a change, excite consumers. Given consumers ambivalence about today's subscription market, it's no wonder labels and publishers are desperately hopeful that partnerships with ISPs and device manufacturers will bring new life to subscriptions.

Pandora, however, provides reason for caution on subscriptions. The runaway success of a service with a small catalog and no ability to grant on-demand access – the exact opposite of the services most favored by content owners – shows people may be overestimating the demand for a celestial jukebox.

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Exhibit 12

CNET News
Media Maverick
February 25, 2010 6:39 AM PST

Pandora spurs music sales; Spotify not so much

by Greg Sandoval

Update 2-26-10, 6:17 a.m. *To include quotes from Spotify and to clarify that NPD's numbers were for U.S. only.*

NEW YORK--Free on-demand music sites haven't fared very well when it comes to driving song sales.

Russ Crupnick, an analyst with market researcher NPD Group, told a crowd of music and tech executives here Wednesday that free streaming-music sites, which enable people to listen to any song at any time free of charge, lead to a 13 percent decrease in paid downloads.

Speaking at the Digital Music Forum East conference, Crupnick sized up the situation this way: "We're eating our young. For some people, more listening just means more listening and tends to lead to less purchasing."

By contrast, online radio services lead to a 41 percent increase in paid downloads, Crupnick said.

PANDORA® internet radio

Pandora, the best-known Web radio service, doesn't enable people to choose songs but plays ad-supported music randomly.

NPD's figures, which covered the U.S. only, are just the latest bad news for the ad-supported music sector. Very quickly, the concept of free music is losing credibility as a business model with the record companies.

This is what they see: a long list of failed attempts. Last year, SpiralFrog and Ruckus closed their doors, while Imeem avoided such a fate by selling itself for peanuts to MySpace.

Only Pandora has shown a profit, and that's just for one quarter.

By all appearances, what this means is that the ability to log on to a site and listen to any song without paying a cent appears to be in jeopardy.This also means Spotify, the on-demand service that has taken Europe by storm, and is planning a U.S. launch sometime in the spring, may struggle to get some of the labels on board--at least if it's pitching an on-demand, ad-supported service.

Edgar Bronfman, Warner Music Group chairman, very publicly voiced his skepticism about the ad-supported model earlier this month when he said: "Free streaming services are clearly not net positive for the industry."

Thomas Hesse, Sony Music Entertainment's digital chief, said at the Digital Music Forum that he was pleased with Spotify's efforts to convert customers from the company's free service to a subscription offering. He said Spotify is getting double-digit conversions in some areas. As for a U.S. launch happening this year, Hesse said, "I'd bet $10 for Spotify launching in the US...they have a lot going for them."

"We've (got) a long way to go, that's for sure," said Jim Butcher, a Spotify spokesman on Friday. "Having only been around for just over a year we're not going to be providing overnight answers to a longer-term decline--but we're confident we have both the model and the service to make Spotify a success and combat the fundamental problem here--that of music piracy and how we as an industry convince music fans to enjoy music in a legal environment."

Whether Spotify launches next year or next week, such services one day soon will need to figure out how to make money, said Kevin Bacon, owner of Artists Without A Label.

Bacon, whose company has worked with Radiohead's Thom Yorke, Moby, and the Arctic Monkeys, said during a panel discussion that he loved Spotify's platform as did many of the acts he represents. But he lamented that, for all the company's neat technology and huge following, it passed very little compensation back to the artists.

"As far as revenue, it's not really meaningful at all," Bacon said. "It's frustrating. The artists see Spotify and get excited. But when they see the revenue from it, it's insignificant."

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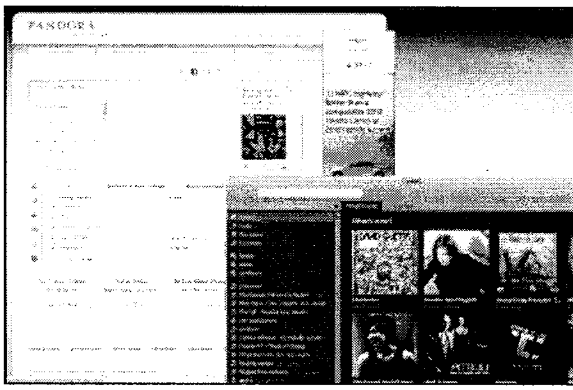
Exhibit 13

Of Course On-Demand Music Replaces Sales – It's Supposed To

By Eliot Van Buskirk February 25, 2010 | 5:12 pm | Categories: Media, Social Media



At the Digital Music Forum East in snowy New York, executives gathered to hear new data comparing what happens to music sales when people use interactive radio services such as Pandora as opposed to subscribing to unlimited streaming services such as Rhapsody and Spotify.

The Pandora-like radio model has a promotional effect on music sales, increasing them 41 percent, according to NPD's data. Meanwhile, streaming services that let users hear just about any song they want, such as Spotify, cause people to buy 13 percent less music.

This is understandable — after all, the whole point of an on-demand music service is that you can hear whatever you want, whenever you want, without buying anything. However, senior industry analyst for NPD Group Russ Crupnick drew a surprising conclusion from the data:

"We're eating our young," Crupnick told attendees, according to CNET. "For some people, more listening just means more listening and tends to lead to less purchasing."

The key here is that Pandora $\neq$ Spotify. One is a radio, the other a record collection.

But it's not a bad thing for the industry that on-demand services like Spotify and Rhapsody replace sales — that's what they're designed to do. It's no accident, and neither is the much-higher premium — a penny per stream — that labels and publishers extract from them, which is ten times more what streaming radio sites pay.

If everyone paid a penny every time they played a song on their computers without buying a single song, the record industry would be in far better shape than it is now. More listening doesn't need to mean less money, even if it means less purchasing. But for some reason, that model is seen as "eating our young," when compared to the pay-per download model, which is essentially the electronic version of buying an unbundled

CD, cassette, or 8-track tape — all formats that have become considerably less attractive to most people as they increasingly listen on connected devices, if they listen at all.

Among ad-supported websites, only YouTube and a few others can afford to offset those high on-demand music rates, in part because they show video ads. Another option is to charge for a monthly music subscription. That's tough to do, which is why Napster has struggled and Rhapsody seems to have plateaued around 700,000 subscribers — respectable, but not a homerun.

The key here is that Pandora ≠ Spotify. One is a radio, the other a record collection.

The record industry's only problem with Spotify is where it draws the line between the free version, which lets you hear almost anything whenever you want if you put up with a few ads, and the paid version, which costs 10 Euros per month and lets you store songs in a mobile app — comparable to Rhapsody in the states, but more expensive than MOG, neither of which offers as much for free as Spotify does.

What will be interesting, if Spotify launches in the U.S. later this year, will not be its effect on sales, but rather how restrictive its free version is compared to the one currently available in Europe. Either way, it's no emergency for the music business that on-demand listening has been shown to replace music purchasing, even though other digital music services increase sales. It's all in how they're designed, and the copyright holders get paid either way.

Consumers have shown that they increasingly want to stream music more than they want to download it, and will continue to move in that direction as more of our devices become connected. In light of that, the industry's idea that the music download market must be protected at all costs could hamper a move to cloud-based music that could ultimately give more people more reason to pay, even if they purchase less. Besides, they're not even purchasing much music as things stand anyway.

The full version of Spotify costs the equivalent of $13.50 per month, while the average U.S. consumer typically spends less than twice that on all music products in a full year. Meanwhile, MOG's lower-priced streaming subscription (which it is able to offer by having to offset an unlimited free version the way Spotify does), charges $60 per year. A move away from purchasing doesn't have to be a move away from spending, but it can be a move away from profits.

See Also:

- Google's Music Strategy: Past, Present and Future
- Music: Too Expensive to Be Free, Too Free to Be Expensive
- Free, Ad-Supported Music ... With a Twist
- MOG's $5 Monthly Music Service Highlights Spotify Obstacle

Tags: mog, music sales, on-demand music, pandora, spotify
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Posted by: mystixa | 02/25/10 | 8:40 pm |

Exhibit 14

The Washington Post

The iPhone Is Accelerating Music Sales For Pandora

MG Siegler
TechCrunch.com
Thursday, May 7, 2009 1:53 PM

Pandora is a company that mainly makes its money through advertising deals on its streaming Internet radio service. But a growing portion of the business is also affiliate downloads of songs that users hear on Pandora and want to buy on either iTunes or Amazon's MP3 service. And the biggest mover accelerating growth in that regard are downloads taking place on the iPhone.

Users are buying about a million songs a month now from these affiliate links on Pandora, CTO Tom Conrad tells me. Of those, a solid 20% are coming directly from Pandora's iPhone app, which includes an easy link to open the iPhone's iTunes app, and buy a track. That's really impressive considering that it's just one phone that a relatively small percentage of their users use.

But really, I'm not surprised by this at all, because Pandora has always been a brilliant music discovery service. And when paired with the iPhone, you have an all-in-one new music machine. And Pandora was actually the top downloaded app on the iPhone for all of 2008. But last month, when Apple completed removing DRM from all its iTunes tracks, it created an even a greater incentive to buy music that way. Now, I can buy music on the go, sync it back with my computer when I get home, and listen to it anywhere.

Another feature driving affiliate sales is the bulk music purchase option. This allows you to bookmark songs on Pandora, and with one click buy them all on either iTunes or Amazon. 10% of web users who are buying music through Pandora are using this bulk buy feature, Conrad says.

Here's an interesting way to think about these affiliate sales. If Pandora is selling 1 million tracks a month, that's $12 million in sales a year (though Apple and Amazon make the majority of that). But Pandora is still only less than 1% of all radio when you take into account the terrestrial and satellite varieties. Say hypothetically that Pandora made up 100% of radio, the potential sales of these affiliate tracks would then by $1.2 billion a year, as Conrad notes.

That of course is very unlikely to ever happen, even in Pandora's wildest dreams, but still Conrad says that from Pandora's own research, they know that for every song purchase Pandora drives, users are likely to buy 3 to 5 more songs on top of the one they found. At this 100% model, that would make Pandora a $3.6 to $6 billion a year business.

Why play such a hypothetical? Well because the *total* recorded music industry revenue last year was only $4.6 billion. Affiliate links can be big business on the web and on mobile.

Even before the iPhone app, Pandora was one of the top affiliate purchase drivers for Amazon and iTunes. And amazingly, their main competition wasn't other online music sites, but instead was search and shopping engines like shopping.com. Given the boost Pandora is already seeing from the iPhone in this regard in just a matter of months, it seems pretty clear that mobile purchases could be a big deal down the road.

And just imagine if Apple one day lets apps access iTunes right from within the apps to ease the process even more. With in-app purchases coming in iPhone 3.0, something like that could be possible one day.

CERTIFICATE OF SERVICE

I, Rhea Lytle, a secretary with the law firm of Davis Wright Tremaine LLP, do hereby certify that copies of the foregoing "**Corrected Rebuttal Testimony of Alexander "Sandy" Smallens (Public Version)**" were sent via electronic email and via first-class, postage prepaid, United States mail, this 22nd day of July, 2010 to the following:

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