

# The Legalities of Pandora's Royalty Fees

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## Abstract

This paper will explore the concepts and legalities of royalty fees regarding Pandora's free personalized radio service. The paper will start off making sure the reader understands exactly what royalty fees are and what online media is. The paper will cover the different types of royalty fees and make sure that the reader fully understands the concept of each. Once the concepts of royalty fees are explained, the paper will tap into the legalities of copyrighted music. The paper will include a full definition and explanation of what copyright music is as well as the legalities regarding it. Once the copyrights are explained, the paper will then go into the legalities regarding Pandora's royalty fees and why musical artists want the fees to be higher. The reader by the end of the paper will understand the following: royalty fees, copyrighted music, and how companies (Pandora) work with royalty fees.

## The Legalities of Pandora's Royalty Fees

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Over the years, technology has changed dramatically and no longer are people listening to CD's or iPod's. Now people have started to listen to music digitally on the radio at home, work, in the car, or on their electronic devices. Over time, there has been a rise of new free radio services such as Spotify, Pandora and Sirius XM that have taken a stance. With these radio stations being free services for people, problems have arisen due to royalty fees. One has to take into account and think of the fact that all of these radio stations play music for free. When thinking of the fact that these stations are free, somebody has to pay the people whose music are being played repeatedly. Stations have to take into account the fact that these artists essentially hold the right to their music and have to be paid at a fair amount to compensate for them letting their work be played digitally. Radio stations have to pay royalty fees in order to use artist's music on their services. Not only do radio stations have to pay the artists for the songs that are played on their services, but they also have to pay them every single time their song is played. Now just think exactly how much that would be when Pandora and other stations have over a million subscribers and users listening to the same songs across the globe. With this, things can get very pricey for these radio stations. Radio stations that are free, want the royalty rates to be lowered. Keeping in mind that these radio stations are free, they do not get any money from their many users and subscribers. Due to these stations being free, one can see why radio stations want the royalty rates lowered because their revenue is being mostly spent on paying royalty fees for artists. Before the paper goes into detail about the legalities regarding Pandora wanting to lower the royalty rates, royalty fees and copyright laws need to be understood.

Royalty fees involve a charge that the owner of a business needs to pay to use copyright work of an artist. The royalty fee is usually a percentage of the overall or net sales of the payment that is required every week, month or quarter (What is a royalty..., 2015). The privilege

## The Legalities of Pandora's Royalty Fees

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of using an artist brand is covered in the fees (Belew, 2015). The music industry, such as record labels and artists, tend to generate a lot of profits from royalties each time a song is played. Royalties can be described as payments made to the legal owner of a copyrighted piece of work. For artists, their money is collected when their music is performed publicly (Nath, 2014).

When it comes to music, the industry relies on royalties generated by the licensing of copyrighted songs and recordings as the main source of payment for musicians. In order to understand royalty fees and what they cover for an artist, copyrights must be first understood. Copyrights are legal devices that give the creator of artistic, literary, musical or other creative work the absolute right to publish and/or sell that work. Owners of copyright have the right to control the reproduction of their work, including the rights to receive payments for a reproduction of original work. The owner of a copyright also has the right to sell these rights to others such as publishers or recording companies. As a result of not having the allowance from the owner of a copyright to sell or publish their work, a violation called infringement occurs (Enimil, 2013).

In order to avoid such violations such as infringement, music licensing comes into play. Music licensing is the licensed use of copyrighted music. Music licensing is used to ensure that the owners of copyrighted works are compensated in some way for the allowance of their work (HFA, 2015). When it comes to holding the right to a copyright, there are different rights which include: reproduction, distribution, derivative work, public performance. Reproduction allows for the copyright owner to decide who can use a copy of their work. Distribution allows the copyright owner to decide who can sell their work. Derivative work gives the copyright owner the decision on who is allowed to make a new work based off of the original work. Public performance allows the copyright owner to control the performance of their work on radio, clubs,

## The Legalities of Pandora's Royalty Fees

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anywhere considered public (Enimil, 2013). Everything that is heard on the radio is licensed music. In order to have one's music licensed, one has to go through the registration process with the copyright office. The copyright office provides for copyright protection in sound recordings. Copyright in a sound recording, by law, protects a certain series of sounds against unauthorized revision, performance and reproduction. As soon as an artist creates a song; it is rightfully theirs so it is not necessary to go through the registration process. Though it is unnecessary, in order to be able to prove that it is rightfully theirs if someone else copies it, then registering at the copyright office is imperative (Brian, 2003).

For broadcast services to be able to showcase music content on their radios, a system was created called the Performance Right Organizations (PROs). PROs allow for companies to avoid infringement against copyright holders (Howard, 2012). When listening to music on the radio, one is hearing two different types of copyrights. There is one copyright for musical composition and the other is for sound recording. Music composition relates to any words accompanied in the song. Sound recording is the same as master recording, where the author of the sound recording is the performer. There are three main performance rights organizations (called PROs) when it comes to licensing for public performances which include: ASCAP, BMI, and SESAC. Licensing for sound recordings are handled by companies such as SoundExchange, who only deal with sound recordings that are performed publicly on non-interactive digital transmissions (Enimel, 2013).

SoundExchange acts as a clearing house on behalf of copyright holders and collects payment on behalf of master holders. Whether or not the master holder is affiliated with SoundExchange or not, SoundExchange still collects. Broadcasters such as Pandora, pay license fees to clearing houses for the right to publicly perform a copyright holder's music.

## The Legalities of Pandora's Royalty Fees

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SoundExchange and other clearing house agencies, work to determine the amount that is owed to rightful copyright holders. SoundExchange then pays out based on the formulas that take into account things such as the frequency of broadcast and type of broadcast. However much music is publicly performed and the more people who hear the music, the higher the fees are for service radios such as Pandora have to pay (Howard, 2012).

For music in legal terms, it's important to realize that there are two types of musicians which include songwriters and performing artists. These two types of musicians hold all the rights to their work including the lyrics and melody of the music. While performing, artists typically hold the rights to a particular recording of a song which is referred to as master recording. Master recording essentially means the first recording of a song from which the later copies are made. Both songwriters and recording artist assign their rights to a third party management, instead of attempting to track song's usage and seek unfair payment. The copyrights of songs are usually assigned to music publishers, while master copyrights are typically assigned to the record label. Songwriters are only allowed to seek the copyright for a full song and not the division of lyrics or melodies into separate rights (Music Royalties, 2015).

Essentially there are two main types of royalties which are mechanical and performance royalties. Performance royalties are fees that music users pay when music is performed publicly. The performance organizations listed previously (BMI, ASCAP, SESAC) collect songwriting performing royalties from music users which then use that money to pay songwriters and copyright holders. The performance rights organizations collect royalties for only digital performances. Digital performances refer to performances recorded on radio, cd's and etc. Digital performances such as Pandora pay a recording digital performance royalty to SoundExchange and also a songwriting digital performance royalty to the PROs.

## The Legalities of Pandora's Royalty Fees

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SoundExchange is not governed meaning that the company can negotiate on the free market.

Due to SoundExchange not being governed, recording artists are not paid when their songs play on AM/FM radio because there are no performance rights that are required for recordings on the radio. Though AM/FM radios do have to pay songwriters, it is at a royalty fee rate set by the courts. With this information, one can see how recording artists and songwriters are treated differently when it comes to being paid. On one hand, recording artists are still essentially paid at least five times more than songwriters because the recording artists get paid performance royalties for their music being performed digitally like on Pandora (Music Royalties, 2013).

The other type of royalty is a mechanical royalty which are paid royalties to songwriters and artists when music is linked and also streamed on que such as Pandora. Songwriting mechanical royalties are set up by the government which is called a compulsory license (Music Royalties, 2013). A compulsory license is where the copyright owner's permission is not required provided that the users follow set guidelines regarding the fees set by law. When a song has been recorded and distributed on recordings to the public, any person or group is allowed to record and distribute the song without having the copyright owners consent provided that they pay a fee and meet copyright law requirements. In order to be able to use the compulsory license, a notice must be sent to the copyright owner including a fee set up by the copyright office, better known as a statutory fee. Statutory fees are set at 9.10 cents per copy for songs five minutes or less and then 1.75 cents per minute or fraction over five minutes (Stim, 2015). Compulsory licenses for mechanical royalties authorize only the use of the song for nondramatic musical compositions such as operas. For there to be no problems with compulsory licensing, the license is permitted to make a new sound or arrangement of the composition as long as the basic melody has not been altered (Stim, 2015).

## The Legalities of Pandora's Royalty Fees

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Now that there is an understanding of the types of royalties, let's discuss who gets paid and for what. Recording artists do not earn royalties on public performances. The only time a recording artist is paid a royalty fee is when their work of music is played on non-interactive digital service such as a webcast or satellite radio according to the Digital Performance Rights in Sound Recording Act of 1995 (Obringer, 2003). The Digital Performance Rights in Sound Recording Act of 1995 requires digital radio services to pay for public performances of the music it streams publicly to subscribers (KNE, 2013). Due to this act, performers were able to earn royalties for their performance. Mechanical rights agency keeps track of them, making sure that the artist are paid and provide statements to the publishers. For their services, the mechanical rights agency charges a fee (Obringer, 2003).

Lately Pandora has found itself in a world wind of legality issues involving royalty rates. Pandora is a free internet radio service that allows its listeners to create their own station by identifying their favorite artists and genres they want to listen to. Though listeners get to choose their genres and artists they want to listen to, they do not have the choice to choose specific songs making the radio service non-interactive. Currently, Pandora has over 250 million users with 1 million songs in the Pandora music collection. As a user, one has the chose to use Pandora for free with advertisements or pay a premium fee for no advertisements (Nath, 2014). One of the issues involves the fact of the royalties that Pandora pays to artists when their songs are played on their service. The main underlying issue is that Pandora is planning to reduce the royalty rate that they have to pay artists whose music they stream on their services. In order to remain competitive, Pandora says they need the rates to be lowered. Not only artists, but others who collect on their behalf oppose the plan to reduce royalty rates (Howard, 2012). The first ten months of 2012, Pandora paid \$182.1 million in music royalties which accounted for 60 percent

## The Legalities of Pandora's Royalty Fees

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of their revenue (Fixmer, 2012). Pandora obtained \$652.8 million of revenue in the first nine months of 2014 from premium subscriptions and embedded advertisements. Though the amount of money listed above seems like a lot, Pandora explains that majority of the revenue must be paid in royalties to artists and recording companies. With the rapid growth and expansion of the internet music industry, controversy has risen from artists who feel as though there is a lack of compensation for their music being streamed (Nath, 2014).

For many years now, online services have complained that the standard royalty rate is unfair and that the rates are much higher than what satellite radio has to pay (Sisario, 2012). To end the complaining, congressman and senators worked together to propose a bill called the Internet Fairness Act which gives internet radio stations a fairer process for setting the price of their music. The bill was set to give internet radio the same standard fees that cable and satellite get and also to make sure that internet radio stations can keep digital libraries of music to broadcast without facing copyright lawsuits. The Internet Fairness Act was also set to make sure that the royalty judges are qualified to make the best decisions based on accurate information. The Act used by judges is called the "willing buyer/willing seller" tactic, which is used to set the rates for royalties. The "willing buyer/willing seller" in translation means whatever the market will bear (Stoltz, 2012). Though record labels and internet radio services made a deal in 2009 that set royalty rates for streaming music online, the deal is set to expire in 2015. Pandora founder, Tim Westergren, expressed his feelings toward the bill saying that he hopes the new bill will eventually lead to the lowering of royalty rates. He also expressed that he has empathy for musical artists and groups that are upset about him wanting the rates lower, but he hopes they will understand his point of view (Martinez, 2012).

## The Legalities of Pandora's Royalty Fees

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Pandora has shifted its focus on lobbying the Copyright Royalty Board instead of pursuing legislation. The Copyright Royalty Board is a panel consisting of three judges that sets the statutory rates for digital radio services like Pandora (Peoples, 2013). Pandora mainly wants the royalty rates to be lowered but the problem stands with the other side of the argument which is the record labels and artists. The record labels and artists believe that the rates are fair and they accuse Pandora and other services like it of wanting to deprive copyright holders of the income they deserve. Pandora pays a mere fraction of a cent each time a user listens to a song and the total must be a minimum of 25 cents of an annual revenue (Sisario, 2012). When looking at the bigger picture, music royalty fees comprise 50% or more of Pandora costs making the company lose the ability to gain a true profit (Schou, 2015).

There are three big recording labels that are fighting against Pandora that include: Sony Music Entertainment, Universal Music Group, and Warner Music Group. Along with the recording labels is the trade association Recording Industry Association of America (RIAA) who also joined the fight against companies like Pandora and Spotify. Acts such as the Songwriters Equity Act, Respect Act, and Protecting the rights of Musicians Act have been proposed to raise the royalty rates (Weber, 2014). Not only have major record labels been fighting against the low-royalty rates but also have artists. Celebrities such as Taylor Swift and Adele have taken a stance on free streaming services and piracy. Recently Adele released her new album and made sure that her album can only be heard if people actually purchase her songs. As another example, musical artist Taylor Swift has fought to have their music pulled off of streaming internet radio services such as Pandora and Spotify. Swift has been an advocate for artists who get a lack of compensation and how their music sales have been affected by the free internet streaming radio stations (Nath, 2014). Taylor Swift has become the main celebrity in the public eye for fighting

## The Legalities of Pandora's Royalty Fees

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for herself and other artists to be fairly compensated for their work. Taking a look from the artist's eyes, one can see that artists feel as though their work deserves to be compensated fairly and how the low-royalty rates are unjust. The hard work, long hours, and money that artists and record labels put into a song, let alone an album, deserves more than what free streaming services offer to artists. Not only do artists suffer from not being paid fairly, they also suffer from dramatic drop in album sales. Taylor Swift speaks out about how each song and album is a work of art and that art is valuable. Other artists such as The Black keys and Coldplay attempt to hold off their album's streaming release to encourage fans to buy their work before it's made available for free on streaming services (Linshi, 2014). With many targets, Pandora decided to pay legacy artists and major record companies \$90 million for streaming pre-1972 songs. The \$90 million settlement also covers the music through the end of 2016. In order to continue playing music from the old days, Pandora will have to issue another licensing deal with RIAA which stands for the Recording Industry Association of America (Mullin, 2015).

One thing to understand about these legalities is the fact that Pandora must pay, by law, the artists whenever they stream their music onto their service. The law indefinitely gives artists exclusive rights when they create a song. Before explaining the rights involved, the types of copyrights need to be explained. There are two types of copyrights involving music royalty fees. The first type of copyright is the copyright that is controlled by the person who wrote the song and the other is for the composition itself. The second type of copyright is controlled by the owner of the master recording of the song. This is typically the version of the song that makes it on a CD, vinyl or download. Pandora has to take into account that there are two copyrights to keep in mind for music and two royalty fees that need to be paid whenever a song is streamed on Pandora (Howard, 2012). There are two rights granted by the law regarding music and royalties.

## The Legalities of Pandora's Royalty Fees

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The first is the exclusive right of public performance. The second is the exclusive right of digital transmission. The term exclusive refers to the copyright holder being able to perform their own music and if anyone else performs the music it without the copyright holder's permission will be accounted for infringement (Feister, 2014). Chief Executive Officer for Pandora, Joe Kennedy, said that the company seems to be getting the raw deal on the fees the company has to pay because the royal setting system treats various radio formats differently. Pandora's main issue is the fact that because it is a non-interactive radio service, the company has to pay not only royalties to songwriters but also to record labels and performers unlike other traditional broadcasters (Fixmer, 2012).

To conclude, Pandora and other services like it have to, by law, pay artist for their work. For both sides of the argument, there are both pros and cons. For Pandora, they do not profit much from being free and having to pay over half of their revenue to artists. Keep in mind, that the more Pandora gains users, the more music is being listened to meaning that that is more money coming out of Pandora's pocket. On the other side of the argument, the artist has the right to fuss about not being compensated enough for the use of their work. Overall, companies such as Pandora made the choice to be free, and because of this choice they need to deal with it accordingly and professionally. Artist and record labels put a lot of hard work into their work and they deserve to be paid fairly for the use of their work. One has to think about the time, effort, producers, talent, production, advertising, and etc. that go into a song. Though some artists such as Adele and Taylor Swift do not really need the money from royalties, there are some artists who are not as fortunate. The artists who are not as fortunate have to make up for the loss of album sales due to free services such as Pandora and they cannot afford to be cheated out

## The Legalities of Pandora's Royalty Fees

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of the money they deserve. There needs to be a common ground and a reasonable fee amount that both artists and services such as Pandora can agree upon.

# The Legalities of Pandora's Royalty Fees

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## The Legalities of Pandora's Royalty Fees

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## The Legalities of Pandora's Royalty Fees

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