DISSECTING THE DIGITAL DOLLAR

Part One

How streaming services are licensed and the challenges artists now face

Section One: Executive Summary

The rise of digital has created both challenges and opportunities for the music industry. The challenges around piracy have been widely documented, but working with legitimate digital services has also been challenging for music rights owners, especially as we have seen a shift from downloads to streams, because licensing these platforms requires a new approach to doing business.

Over the last decade the music rights sector has been busy evolving new licensing models, and new industry standards are now starting to emerge. However, issues remain, and there is some debate as to whether both the fundamentals and the specifics of these new business models are the best possible solutions, and whether or not they have been created to be more beneficial to some stakeholders in the music community than others.

And even where standards are emerging, there remains much confusion in the wider music community as to how, exactly, streaming services are being licensed, how it is calculated what digital service providers must pay, and how that money is then processed and shared by the music rights industry.

There are various reasons for this confusion...

- The complicated nature of the streaming deals.
- The record industry and music publishers do not always license in the same way.
- The way services are licensed and royalties processed can vary from country to country.
- Most streaming deals are ultimately revenue share arrangements, making exact payments per usage less predictable.
- The specifics of many streaming deals are secret due to non-disclosure agreements in key contracts.
- Those who have led on the development of new licensing arrangements have often done a poor job of communicating them to other stakeholders.

In evolving these new licensing models, record companies, music publishers and collective management organisations have had to navigate copyright laws and other music industry conventions which were not specifically developed with the digital distribution of recorded content in mind.

In doing so, some assumptions have been made which perhaps, with hindsight, require more consideration, either by lawmakers, courts or the wider music community. Or, at least, a more unified approach across the industry, and across the world.

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In order to inform this debate, the UK's Music Managers Forum commissioned this report, to review and explain how music rights have been exploited in the past, how digital licensing has evolved, and what issues now need to be tackled. We spoke in-depth to over 30 leading practitioners from across the music, digital and legal sectors, and surveyed 50 artist managers in five markets who, between them, represent artists signed to all three major music companies and over 100 independent labels.

The way music rights work varies around the world, partly because of differences in copyright law, and partly because of different practices and conventions that have evolved in each market. This variation is in itself a challenge in a digital sector where so many services aspire to be truly global.

It also poses challenges in explaining how music copyright works on a general level, because different rules, technicalities and terminology may apply in any one country; and there are significant differences of emphasis between so called 'common law' jurisdictions, like the UK and the US, and 'civil law' systems, like France and Spain.

Although we have tried to be 'market neutral' in describing the basics of music copyright in this report, we are arguably starting from a common law and possibly UK perspective, but we will try to be clear where the key differences exist between different systems.

MUSIC RIGHTS & DIGITAL PLATFORMS: HOW IT WORKS

1. Copyright provides creators with controls that can be exploited for profit

Copyright is ultimately about providing creators with certain controls over that which they create, either as a point of principle, and/or to encourage and enable creativity by allowing creators and their business partners to exploit these controls for profit.

Exactly what controls a copyright owner enjoys varies from country to country, but they commonly include the exclusive right to make and distribute copies of a creative work, to adapt the work, to rent it out or communicate it, and to perform it in public.

Copyright makes money when third parties wish to exploit one of these controls, because the third party must get permission – or a licence – from the copyright owner. The licensor will usually charge the licensee a fee to grant permission.

2. The core music rights

The music industry controls and exploits various kinds of intellectual property, though the core music rights are the separate copyrights in songs (lyrics and composition) and sound recordings, what civil law systems might refer to as the separate 'author' and 'neighbouring rights'.

Both copyright law and the music industry routinely treat these two kinds of copyright differently. Within the business, music publishers generally control song

Which copyrights and controls are you exploiting?

You burn a copy of a track onto CD

You are exploiting the 'reproduction control' of both the song and recording copyright

(what music publishers call the 'mechanical right')

You perform a song at a gig

You are exploiting the 'public performance control' of just the song copyright

You play a track on the radio

You are exploiting the 'communication control' of both the song and recording copyright

You synchronise a track to a TV show

You are exploiting the 'reproduction control' of both the song and recording copyright when you actually synchronise the track...

and then the 'communication control' of both the song and recording copyright when the TV show is broadcast

You download or stream a track

You are exploiting both the 'reproduction control' and the 'communication control'* (probably the specific 'making available control') of both the song and recording copyright

*This can vary from country to country, for example in the US only a reproduction rights licence is required for downloads, while only a performing rights licence is required for personalised radio services.

copyrights while record companies control recording rights.

This is important for anyone wishing to license a recording of a song, because it means they will need to do separate deals with both record companies and music publishers, and the labels and publishers may have different ways of doing the deal.

3. The licensing process will differ depending on usage

How labels and publishers go about licensing any one licensee will often depend on which of the aforementioned 'controls' said licensee wishes to exploit.

For example, if they wish to exploit the reproduction and distribution controls – what might be called the 'reproduction' or 'mechanical rights' – they may be licensed in a different way than if they wish to exploit the performance or communication controls – what might be called the 'performing' or 'neighbouring rights' (this being an different use of the term 'neighbouring rights').

Sometimes rights owners license 'collectively', as opposed to individual rights owners and licensees having a direct relationship. When this happens all labels or all publishers appoint a 'collective management organisation' (CMO) to license on their behalf. This may be done for practical reasons, or because copyright law instigates a 'compulsory license', meaning that a rights owner cannot refuse to license in a certain scenario, even though licensees are still obliged to pay royalties. Collective licensing is usually subject to extra regulation with a statutory body or court ultimately empowered to set royalty rates.

In the main (there are exceptions, for example in sync), labels commonly license reproduction rights directly but performing rights collectively, whereas publishers often license both sets of rights through their CMOs, but possibly different CMOs (in the UK, MCPS and PRS respectively).

4. It is important to know who controls each copyright

Unlike other kinds of intellectual property, copyright is not usually registered with a statutory authority, which can make identifying owners tricky.

Copyright law usually defines 'default' or 'presumed' owners of new works, though these rules vary from country to country, and can be different for songs and recordings. Default owners can also usually transfer ownership, or at least control, to another party – usually in return for money – through so called 'assignment' or 'licensing' agreements.

As a result, whatever default ownership rules may say, most songs are either owned or at least controlled by music publishers, and most recordings are either owned or at least controlled by record companies. Singer songwriters, involved in creating both songs and recordings, will usually have separate deals with separate companies covering their respective song and recording rights.

Though there is an important distinction to make when it comes to songs, in that a songwriter may actually directly appoint a CMO to control some elements of their copyright and a music publisher to control the other elements. So in the UK, a songwriter assigns performing rights to PRS but all the other rights to their publisher. The publisher then has a contractual right to share in performing rights revenue, but does not actually control that element of the copyright.

Who controls the different music rights?

A label sends artists into the studio to write and record new music ... a song and a recording is created

SONG COPYRIGHT

WHO OWNS THIS?

By default, usually the songwriter or songwriters, though they will often transfer ownership and/or control to other parties.

WHAT RIGHTS? The copyright provides a number of 'controls'. The songwriter commonly transfers some controls to a 'collective management organisation' and the other controls to a publisher. In the UK: 'performing rights' to CMO, other rights to the publisher.

PERFORMING RIGHTS OF THE SONG COPYRIGHT

→ **CMO** (PRS in the UK)

→ CMO handles licensing

→ CMO passes 50% of income to publisher and 50% to songwriter

OTHER ELEMENTS OF THE SONG COPYRIGHT

→ **MUSIC PUBLISHER**

→ Publisher either licenses direct or via a CMO (MCPS in UK)

→ Publisher pays royalty to songwriter according to publishing contract

RECORDING COPYRIGHT

WHO OWNS THIS?

Default owner varies according to local copyright law – could be label or artist – though artist will often transfer ownership and/or control to another party.

WHAT RIGHTS? The copyright provides a number of 'controls', all of which will usually be transferred to a record label. However, the artist's separate right to 'equitable remuneration' (ER) on performing rights revenue cannot usually be transferred to the label.

ALL ELEMENTS OF THE RECORDING COPYRIGHT

→ **RECORD LABEL**

→ Label either licenses direct or via a CMO (PPL in UK)

→ Label pays royalty to featured artist according to record contract

ARTIST'S 'ER' RIGHT ON PERFORMING RIGHTS INCOME

→ **ARTISTS' CMO** (PPL in the UK)

→ CMO collects Performer ER

→ CMO passes Performer ER income to both featured artist and sessions musicians

*Default ownership and equitable remuneration rules, and the way the different elements of the song right are split, varies from country to country. And, of course, artists and songwriters don't only create when sent into the studio by a label!

Finally, copyrights can be co-owned. This is particularly common with song copyrights, because collaboration is common in songwriting. Where a song is co-owned, a licensee will usually need permission from each and every stakeholder to make use of the work.

5. Creator & Performer Rights

Artists and songwriters often assign – or as good as – the copyright in their recordings and songs to record labels and music publishers; this is especially true with new talent who need their corporate partners to make risky investments in their careers in the form of artistic development, content production, marketing and cash advances.

But artists and songwriters will still retain some rights in relation to those recordings and songs through their record and publishing contracts, in particular the right to share in any revenue generated by their work, and maybe also rights to consultation, approval or veto.

In addition to these contractual rights, artists and songwriters may also enjoy other rights directly from copyright law, commonly called moral and performer rights. For recording artists, the most common performer rights relate to 'approvals' and 'performer equitable remuneration'.

Approval must usually be gained to record an artist's performance and to then exploit that recording. Artists may also often enjoy an automatic (ie non-contractual and non-waivable) right to share in certain (though not all) revenue streams associated with their recordings, most often performing rights income.

Licensees should be aware of these additional creator and performer rights, which co-exist with the actual copyright that will likely be controlled by a corporate entity.

6. Digital Licensing

In the physical product domain, a record company exploited its own sound recording copyright, and licensed the rights to exploit the accompanying song copyright from the relevant music publisher or publishers, usually via the collective licensing system. The CD was then provided to the retailer 'rights ready'.

With just a few exceptions, in the digital domain, download stores and streaming services need to have separate licensing relationships with both record companies and music publishers and/or their respective CMOs. Labels generally license all but online radio directly, though personalised radio services may also be licensed by the CMO in some territories (especially the US, where a compulsory licence applies). Publishers license most digital services collectively, though the big publishers now sometimes license Anglo-American repertoire directly, albeit via joint venture vehicles with the CMOs.

As an extra complication, downloads and streams exploit both the reproduction rights and the performing rights of the copyright.

On the publishing side, this is important because these two elements of the copyright are often licensed separately (remember, in the UK PRS controls the performing right and the publisher the reproduction right).

Outside the US, publishers usually try to provide digital services with 'combined rights licenses', which means that, where reproduction and performing rights are

controlled by different entities, those two entities need to work together. For example, where publishers license digital direct, they must do so in partnership with the CMOs which control the performing rights.

On the recordings side, the label is able to license both elements of the copyright, though by convention performer equitable remuneration was often due on performing rights income but not reproduction rights income, making the fact that both elements of the copyright are being exploited relevant. Except, most labels argue that a specific and separate performing right, first introduced in the mid 1990s and called the 'making available right', is what the digital platforms actually exploit, and that that is exempt from performer equitable remuneration. Not all artists agree.

7. The Streaming Deal

Most streaming services are licensed in more or less the same way. The deal between the rights owner and the streaming platform is ultimately a revenue share arrangement.

Each month the streaming service works out what percentage of overall consumption came from any one label or publisher's catalogue. It then allocates that percentage of its overall advertising and/or subscription revenue (after sales tax) to the rights owner, and pays them a cut based on a pre-existing revenue share arrangement. Every deal is different, and usually secret, though labels generally see 55-60% of revenue allocated to their catalogue whereas publishers see 10-15%. Overall the streaming service aims to retain about 30%.

In addition to the core revenue share arrangement, rights owners will usually seek to minimise their risk by having the streaming service pay minimum rates, for example per play, so that they are guaranteed certain income based on consumption oblivious of the streaming service's revenues. Rights owners will also often demand upfront advances from the streaming services, while labels may seek equity in start up services and other kickbacks.

8. Money Flow

Payment of streaming royalties can be complex. Streaming services generally assume that whichever label provided it with a track owns the copyright, and pays that label its share of the revenue, or the minimum guarantee, whichever is higher.

The label will then usually be obliged to share that income with the artist, subject to the terms of said artist's record deal. Most labels pay artists the same share on digital income as physical income, or maybe a few percent more. There has been much debate as to whether this is fair, while some artists with pre-digital record contracts argue this is an incorrect interpretation of their original agreements.

Every record deal is different, but usually artists will receive a minority cut of income – commonly 15-20% – and only after some or all of the label's initial and ongoing costs have been paid (exact terms are set out in the record contract). There is some confusion in the artist and management community as to what ongoing costs many labels are deducting from digital income.

On the publishing side, the streaming service does not usually know which publisher or publishers own the rights in any one song. Therefore the streaming service reports all consumption to each licensor. The rights owner then calculates what it is due and invoices the streaming service, which then needs to ensure it isn't

being invoiced twice for the same song (or that two licensors aren't both claiming to own 60% of a song).

Once the publishing sector has been paid, money then needs to be split between the performing and reproduction rights. What happens next depends on the country. In the UK, performing rights income goes to PRS, which pays 50% to songwriter and 50% to publisher. Reproduction rights income goes to the publisher (sometimes via MCPS) which will pay a share to the songwriter according to their publishing contract.

ISSUES

The interviews conducted as part of this research, coupled with our survey of the artist management community, identified seven key issues that the music industry must now address.

1. Division of streaming revenue

Is the division of streaming income between each of the stakeholders fair? This includes the split between the streaming services and the music community, between the recording and the song rights, between the reproduction and the performing rights, and between the artist and the label.

2. Performer equitable remuneration and making available

Performer rights in many countries say that all artists are due equitable remuneration when their 'performing rights' are exploited. However, as mentioned above, most labels argue that digital services exploit a specific and separate performing right called the 'making available right', and that equitable remuneration is not due on this income. Not all artists agree, while some acts with pre-1990s record contacts argue that labels cannot exploit this right anyway without their specific approval.

3. Digital deals and NDA culture

Labels, publishers and CMOs have created templates for streaming service deals, with revenue share arrangements, minimum guarantees, advances, equity and other kickbacks. Artists and managers are often kept in the dark about these arrangements; are rarely consulted on the merits of each component of the deal; and many feel artists are being unfairly excluded from profits generated by advances, equity and other benefits offered to corporate rights owners.

4. Safe harbours and opt-out services

While some streaming services only carry content provided by label partners, others – including YouTube and SoundCloud – allow users to upload content. Rights owners can then request that content be removed, or allow it to remain for promotional purposes, or in some cases – as with YouTube – choose to monetise it on the platform. These services rely on the so called 'safe harbours' in US and European law to avoid liability for copyright infringement while hosting unlicensed material users have uploaded. Some question whether the safe harbours were designed for this purpose, and whether the existence of 'opt-out' streaming services of this kind is distorting the wider digital music market.

5. Data

The music industry is now having to process unprecedented amounts of data, as revenues and royalties are increasingly based on consumption rather than sales. The lack of decent copyright ownership data also hinders efficiency, especially on the publishing side. There are almost

certainly 'big data' solutions to these problems, the challenge is who should lead this activity, and will labels, publishers and CMOs share the crucial copyright ownership data that is in their control?

6. Collective licensing

The labels license most digital services directly, while the publishers often use their CMOs. For various reasons, both artists and songwriters often prefer money to go through the CMOs rather than their labels and publishers, though there is an argument that this is not always the most efficient way to process revenue and data. Either way, artists and songwriters often feel excluded from the debate over the pros and cons of collective licensing.

7. Adapting to the new business models

One of the biggest challenges for everyone in the music community is simply adapting to a new way of doing business, where sustained listening rather than first week sales matter, and where successful tracks and albums will deliver revenues over a longer period of time, rather than via a short-term spike. Adapting to this new way of doing business is arguably just a fact of life, though some stakeholders may be shielded more than others from any short-term negative impact.

QUESTIONS

As we said, the aim of this report is to inform and initiate debate. From the seven issues we have identified, here we pose fifteen key questions for the wider music industry to discuss, consider and answer.

1. How should digital income be split between the music industry and the digital platforms themselves?

2. Of the 70-75% of streaming revenues paid to the music industry, how should these monies be split between the two copyrights, ie the recordings and the songs?

3. Downloads and streams exploit both the reproduction and communication controls of the copyright – ie both the reproduction and the performing rights. How should income be allocated between the two elements of each copyright?

4. Where a record label owns the copyright in a sound recording but pays a royalty to the featured artist under the terms of their record contract, what royalty should the label pay on downloads and streams compared to CDs?

5. What kind of digital services exploit the conventional performing rights and what kind exploit the specific 'making available right', and should copyright law be more specific on this point?

6. Should performer equitable remuneration apply to all streaming services, including those exploiting the making available right?

7. Do record labels need a specific making available waiver from all artists before exploiting their recordings digitally?

8. Should record companies and music publishers demand equity from digital start-ups, and if so should they share the profits of any subsequent share sale with their artists and songwriters, and if so on what terms?

9. Should record companies and music publishers demand large advances from

new digital services, and if so should they share any 'breakage' (unallocated advances) with their artists and songwriters, and if so on what terms?

10. Should record companies and music publishers demand other kickbacks from new digital services, and if so should they share the benefits with their artists, and if so on what terms?

11. Can it be right that the beneficiaries of copyright are not allowed to know how their songs and recordings are being monetised, and should a new performer right ensure that information is made available to artists, songwriters and their representatives?

12. Should the safe harbours in European and American law be revised so companies like YouTube and SoundCloud cannot benefit from them, however good their takedown systems may or may not be?

13. How is the music rights industry rising to the challenge of processing usage data and royalty payments from streaming services, what data demands should artists and songwriters be making of their labels, publishers and CMOs, and is a central database of copyright ownership ultimately required?

14. Are streaming services best licensed direct or through collective management organisations; if direct what is the best solution when societies actually control elements of the copyright; and are artists and songwriters actually told what solutions have been adopted?

15. Is the biggest challenge for the music industry simply adapting to a new business model which pays out based on consumption rather than sales, and over a much longer time period; and what can artists and songwriters do to better adapt?