Written evidence submitted by Christian Castle

November 16, 2020

Digital, Culture, Media and Sport Committee
UK Parliament
Inquiry on the Economics of Music Streaming

Thank you for the opportunity to comment on the economics of music streaming. This comment addresses a number of questions raised by the Committee including a discussion of dominant business models, the impact of algorithms, long term effects of the dominant business models, alternate approaches and specific recommendations for the role I respectfully suggest that government could play in approaching the problem.

I am a music lawyer in Austin, Texas and have been actively involved in the traditional music business as a musician and lawyer for many years at companies like A&M Records in Hollywood, Sony Music in New York, and in private practice. I have worked on these policy issues for the digital music business since its inception, which drew me to Silicon Valley in 1998 when I worked with clients such as the original Napster.[1] My biography is available on our firm website.[2]

While I do not address the Committee's question on piracy directly, I would respectfully say that the solid work of the European Parliament on the Directive on Copyright In the Digital Single Market should be supported in spirit and that the UK has the opportunity to lead the way in building upon that work to protect creators of all categories. For too long the various safe harbors available online have degenerated from well-meaning efforts at encouraging development of the Internet into mere alibis for what would otherwise be massive crimes.

The UK has led in many areas of piracy enforcement thanks to the proactive efforts of Parliament and the work of the City of London Police Intellectual Property Crime Unit that helps to protect both consumers and creators and is the gold standard the world over. I hope to see these excellent efforts reflected in UK policy and in the upcoming UK/US bilateral trade

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[1] Andrew Orlowski, The Music Wars from 30,000 Feet: Meet Chris Castle, The Register (Nov. 27, 2008) available at https://www.theregister.com/2008/11/27/chris_castle/

[2] Christian L. Castle, Attorneys, www.christiancastle.com. Asst1@christiancastle.com

agreements so that Silicon Valley does not attempt to sneak through the back door that which they cannot get through the front.

While the Committee did not ask the question, I commend to the Committee's attention the circumstances surrounding the Pledge Music Ltd. fiasco. A UK based crowd funding operation entered administration in London under rather unusual circumstances. UK Music and others have attempted to draw the government's attention to the situation. Pledge Music shut down after collecting but not paying out thousands of contributions from fans to artists who were not only left in the lurch but also in debt. There is significant reporting on the situation in the press,[3] but I am not aware of any resolution. While not directly related to streaming, the Pledge Music fiasco is directly related to sustainability for the creative sector and is entirely within the government's remit to regulate for the protection of fans and creators.

The following analysis addresses the Committee's other questions. I first consider the sustainability of the status quo methods of royalty accounting, the dangers of commoditization of music on culture, and the nuances of supervoting dual-class stock on corporate governance at Spotify. I then address the phenomenon of users paying for music they don't listen to and the evidence for the near mathematical certainty that the status quo will cause per-stream rates to decline over time in a Malthusian version of sustainability. Finally, I offer five recommendations that hopefully will shed some additional light on where we go from here.

The Mechanics of the Dominant "Revenue Share" Method of Royalty Payments

I address the core royalty accounting models of Spotify, Apple Music, Amazon Music and Google Play/YouTube. Of these, Spotify and Apple the two dominant on-demand streaming services from a competition point of view.[4] In particular, I will focus on the royalty rates payable to recording artists and performers based on a "revenue share" calculation.

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[3] See, e.g., my own writing on the subject available at https://musictechpolicy.com/tag/pledgemusic/, and Billboard Magazine's coverage by Colin Stutz, Pledge Music's Failed Promise Leaves Artists in Limbo and the Future of Crowdfunding in Jeapordy, Billboard (Feb. 8, 2019) available at https://www.billboard.com/articles/business/8497348/pledgemusic-music-crowdfunding-industry-artist-campaigns-regulation.

[4] Spotify has been the dominant streaming service for quite some time and currently is bigger than its two next largest competitors, Amazon and Apple. Billboard Magazine in the U.S. reported that Spotify's Chief Economist Will Page said in 2014 "While explaining how streaming 'is no longer an outlier in the business,' Page noted Spotify has launched in 32 of the 37 countries where streaming is the primary digital source of revenue. Page also point out that Spotify is half of the $1.5 billion global subscription streaming market. In the U.S. market, Spotify made up approximately 90% of last year's grown in subscription revenue, according to Page." Glenn Peoples, *Spotify was 10% of U.S. Label Revenue in First Quarter Says Will Page*, Billboard (May 13, 2015) available at https://www.billboard.com/articles/business/6561447/spotify-ten-percent-label-revenue-first-quarter-2015-will-page.

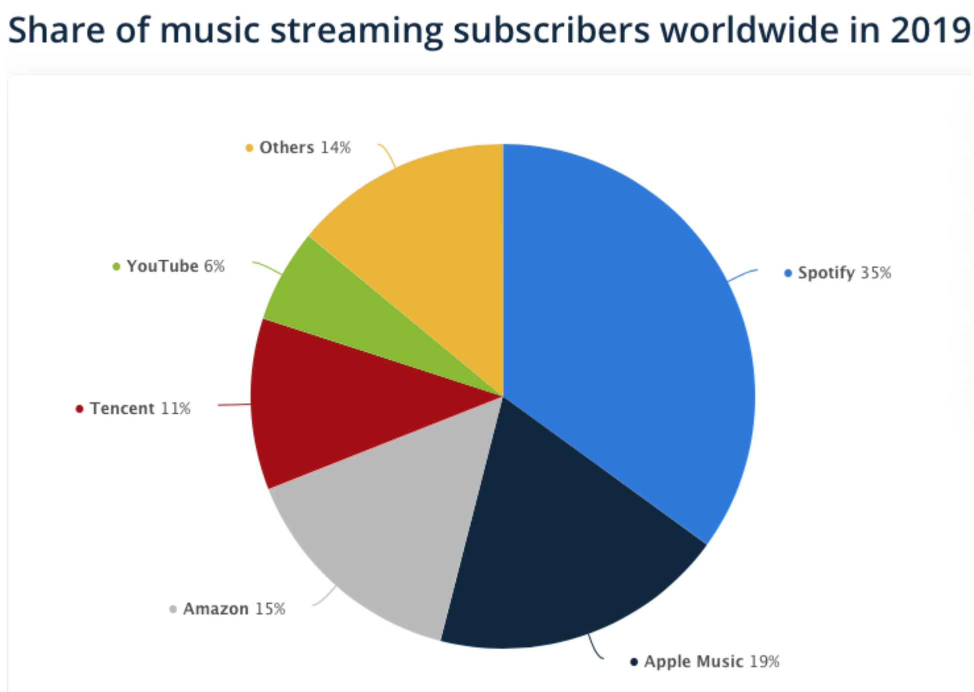

Figure 1 Statistica, Share of music streaming subscribers worldwide in 2019 by company https://www.statista.com/statistics/653926/music-streaming-service-subscriber-share/

It is this revenue share approach that I perceive as the gravamen of the first question of the Committee's inquiry that I am able to address. In the interests of time, I will not discuss songwriter payments in detail. I am sure others will, but let it be said that like the "frozen mechanical" problem in the United States,[5] the "revenue share" model for sound recording royalties casts a long shadow over all royalty payments in streaming.[6]

The Fallacy of the Pie

However, at the outset, it must be said that there is controversy about a perceived "allocation" of royalties payable by the services between record companies and music publishers, or recording artists and performers compared to songwriters at the creator level. I will not get into this controversy too far as I expect it will be addressed extensively in the comments, other than to say that I think a focus on "allocation" is the wrong way to look at the royalty issue from a policy perspective. The "allocation" focus presupposes there is an aggregate payment for music that is misallocated.

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[5] See., e.g., my discussion of the history of the U.S. government's freeze on mechanical royalty rates from 1909-1978 and the freeze on physical and permanent download mechanical royalties from 2009 to the present day available at https://musictechpolicy.com/2020/10/10/controlled-compositions-clauses-and-frozen-mechanicals/.

[6] See, e.g., Rate Charts, Harry Fox Agency available at https://www.harryfox.com/img/2019_s_p_s_mu.be010562.jpg (Detailed description of songwriter royalty calculations by Mechanical Licensing Collective's data vendor).

This allocation or "pie" fallacy is a very familiar argument in the U.S. that comes from broadcasters fighting equitable remuneration for recording artists on terrestrial radio by attempting to limit their total payment for both sound recordings and songs to the amount that they historically have paid for songs only. Instead of acknowledging the value of sound recordings, the platforms confound song performance royalties with "music". They say, "We pay $X for music, we don't care how you allocate it between songs and recordings." This is like comparing apples to oranges and producing a pomegranate.

I call this thinking the fallacy of the pie, a derivative of the fallacy of composition. It makes creative sectors fight each other in a kind of digital decimation.

There is nothing particularly sophisticated about this strategy. But the policy challenge is to how to grow the pie, not to cut smaller pieces for everyone. Growing the pie is particularly relevant when the platform or platform vendor seeks to monetize its *valuation* in the public financial markets, a point I will return to several times here.[7] This is front of mind as we see reports[8] of Believe Digital (owner of the independent pre-pay distributor Tunecore) contemplating a €2 billion IPO drafting behind the reported success of streaming and the Spotify public offering.[9] Respectfully, the Committee should consider what role the government should play in requiring a share of riches transferred from the public financial markets to be shared by those artists and songwriters who gave the issuer its valuation when the issuer did not invest in the creative community.

This is particularly true in any situation where the digital distributor pushes the distribution risk onto the artist in the "pre-pay" distribution model, then reaps rewards from the public markets not shared with the artists who actually wrote a check to cover their own distribution costs.

Revenue Share and the Commoditizer's Dilemma

In a prescient 2008 book review[10], antitrust scholar Jim DeLong gives an elegant

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[7] I distinguish platform or platform vendor IPOs from music company IPOs like Warner Music Group or the Hipgnosis Songs transactions. In those cases, the issuer had long invested in artists and songwriters and passed through the benefits of the IPO to their artists and songwriters, often directly.

[8] Arno Schuetze, *French Music Distributor Believe Targets 2 billion Euro IPO*, Reuters (Nov. 12, 2020) available at https://www.reuters.com/article/believe-digital-ipo-idUSKBN27S2B1. Round Hill Music, LLC recently sued Tunecore and Believe Holdings, Inc. for willful copyright infringement in New York, *Round Hill Music, LLC et al v. Tunecore, Inc. et al*, Case No. 1:20-cv-03466 (U.S.D.C. E. D. N.Y. July 31, 2020) complaint available at https://www.musicbusinessworldwide.com/files/2020/08/Dkt.-No-1-Complaint.pdf.

[9] Spotify's listing was not an "IPO" but rather a "DPO" or "direct public offering." The two differ in that an IPO issues new shares and a DPO sells the insiders formerly privately issued shares to the public, which directly benefits insiders. See, e.g., *Spotify Case Study: Structuring and Executing a Direct Listing*, Harvard Law School Forum on Corporate Governance (July 5, 2018) available at https://corpgov.law.harvard.edu/2018/07/05/spotify-case-study-structuring-and-executing-a-direct-listing/

[10] James DeLong, Google the Destroyer, Ideas in Action (Jan. 7, 2008) available at https://web.archive.org/web/20130602173654/http://www.ideasinactiontv.com/tcs_daily/2008/01/google-

explanation of the core nexus of near-piracy, actual piracy and commoditization facing creators:

> Google's incentives to reduce the costs of complements so as to harvest more eyeballs to view advertising are immense….This point is indeed true, ***and so is an additional point*. *In most circumstances, the commoditizer's goal is restrained by knowledge that enough money must be left in the system to support the creation of the complements….***
>
> Google is in a different position. Its major complements already exist, and it need not worry in the short term about continuing the flow. For content, we have decades of music and movies that can be digitized and then distributed, with advertising attached. A wealth of other works await digitizing – books, maps, visual arts, and so on. ***If these run out, Google and other Internet companies have hit on the concept of user-generated content and social networks, in which the users are sold to each other, with yet more advertising attached.***
>
> ***So, on the whole, Google can continue to do well even if leaves providers of its complements gasping like fish on a beach.***

Which brings us to the present day problem rather well. The COVID pandemic highlights what happens when there is no longer enough money in the streaming system to support creation of new recordings by new artists and other resources have tried up and artists don't have a day job to quit.

The revenue share method of royalty payments highlights these resource constraints. By convincing rights holders to accept a share of revenue as compensation, streaming services created a pie based on a metric other than a negotiated per-unit rate. The revenue share model allocated a pie based on how the service performed measured by a discrete revenue stream that creators were allowed to participate in regardless of the increase in enterprise valuation.

If the service's executives are rewarded based on IPO valuation but the artists are paid based on revenue, there is a disconnect. Why should the artists' royalty be limited to one revenue stream? Why would the total value transfer by artists to the enterprise valuation not also be taken into
account? [11]

Respectfully, I suggest that the Committee focus on which policy incentives best capture the value transfer to the platforms for all creators, not just in terms of profit but also market valuation. This fairness-making effort should take into account a comprehensive

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the-destroyer.html

[11] See, e.g., World Independent Network, *Fair Digital Deal Declaration* available at https://winformusic.org/fair-digital-deals/ ("Account to artists a good-faith pro-rata share of any revenues and other compensation from digital services that stem from the monetization of recordings but are not attributed to specific recordings or performances.").

policy-driven industrial strategy for streaming but also the corporate governance at platforms like Spotify that allowed unfairness to take hold in the first place.

The Impact of Supervoting Stock

The reader may ask why I focus almost entirely on Spotify in this document. It is appropriate to single out Spotify for one particular reason that makes Spotify unique in a non-obvious way. Daniel Ek and his co-founder Martin Lorentzon hold "super voting" stock (sometimes called "dual-class stock") that gives them control of over 80% of Spotify's voting shares for as long as they hold the shares.[12] The same supervoting structure is common at Silicon Valley companies, including Google where Larry Page, Sergei Brin and Eric Schmidt together hold a class of supervoting stock only available to insiders. The supervoting share structure itself is widely disfavored among regulators in the U.S.[13] and has come under increasing scrutiny in the US after the collapse of We Work (which also had supervoting shares)[14] as it perpetuates a cult of personality combined with corporate control. The Committee may not be aware of the Spotify supervoting stock issue.

So when we speak of "Spotify", we are really speaking of these two men, Daniel Ek and Martin Lorentzon, who can control the board of directors and every shareholder vote.

While Mr. Ek's shares in Spotify are currently worth approximately $11 billion, Spotify pays artists less than ½¢ per stream as we will see. While Mr. Ek has profited handsomely from the worldwide pandemic like few others besides Jeff Bezos, the

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[12] Spotify SEC Form F-1 (Feb. 28, 2018) at 46 available at https://www.sec.gov/Archives/edgar/data/1639920/000119312518063434/d494294df1.htm#rom494294_15 ("As of February 22, 2018, our founders, Daniel Ek and Martin Lorentzon, beneficially owned or controlled, directly or indirectly, ordinary shares and beneficiary certificates representing 37.3% and 43.1% of the combined voting power of all of our outstanding voting securities, respectively (***or 80.4% in the aggregate***".).

[13] See, e.g., SEC Commissioner Robert J. Jackson, Jr., *Perpetual Dual Class Stock: The Case Against Corporate Royalty*, Speech at University of California at Berkeley (Feb. 15, 2018) available at https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty ("Many have argued forcefully, however, that one-share, one-vote should be the rule for all public corporations. Whatever the benefits may be of permitting dual-class in a few well-known cases, these advocates argue, the costs for investors—***who are left with no way to hold management's feet to the fire while dual-class is in place***—outweigh those benefits."); Vijay Govindarajan, Shivaram Rajgopal, Anup Srivastava, and Luminita Enache, *Should Dual-Class Shares be Banned?* Harvard Business Review (Dec. 3, 2018) available at https://hbr.org/2018/12/should-dual-class-shares-be-banned (Argument for a "sunset clause" on supervoting stock at or near IPO); Investor Stewardship Group, Corporate Governance Principles (Sept. 4, 2019) available at https://isgframework.org/wp-content/uploads/2020/07/ISG-Corporate-Governance-Principles.pdf ("Boards of companies that already have dual or multiple class share structures are expected to review these structures on a regular basis or as company circumstances change, and establish mechanisms to end or phase out controlling structures at the appropriate time, while minimizing costs to shareholders.").

[14] Rani Molla, *The We Work CEO's Outsized Power is One Reason the Company is Imploding*, Recode (Sept. 24, 2019) available at https://www.vox.com/recode/2019/9/24/20882133/wework-adam-neumann-dual-super-voting-stock-shares-tech-ipo.

economic disparity was striking before the onset of the pandemic when his shares were worth billions but roughly half of their current value. Mr. Ek frequently styled himself as the savior of the music industry such as the famous Wired Magazine cover of Mr. Ek in a pose reminiscent of religious iconography.[15] Many artists and songwriters are not worshiping at the Spotify altar.

Spotify has also come under criticism as a loss-making company that uses the stockholder's money for stock buy-backs[16] rather than royalty distributions or even dividends. Spotify is able to buy back its stock much more easily when the biggest beneficiaries of the manipulated share price typically associated with a buy-back program are the company's two biggest vote holders.

The Committee may wish to consider the impact of supervoting stock structures on the issuer's artist relations and resource allocation. Spotify's decisions have produced the strange phenomenon of users routinely paying for music they don't listen to.

Paying for Music You Don't Listen To

The hallmark of music streaming's difficulty with artist and songwriter royalties derives from the revenue share method of royalty calculation, what is often called the "big pool". I suggest that this is the source of most of the complaints. Yes, songwriters have sued Spotify in two class actions and numerous copyright infringement lawsuits for failing to license songs after multiple warnings. Yes, the Spotify stock grants are an issue; yes, Spotify's embarrassing handling of competition between Spotify and Apple is an issue, and even Spotify's competitively dominant position in the streaming oligopoly is an issue, all true. But the core problem is the method of royalty calculation coupled with a sustained refusal by Spotify to exercise pricing power that compels an uncompensated investment in Spotify's valuation.

Because the "big pool" puts all of the *applicable* revenue in a hotchpot divided based on number of plays—remember, not all the revenue, but the defined revenue that is shared with rightsholders by the service—inevitably, a user will pay for music they do not listen to. That is counterintuitive, but I hope to show the Committee that it not only is true, it is inevitable. A feature not a bug. And remember—a feature that is effectively controlled by Mr. Ek and Mr. Lorentzon through their supervoting stock.

This feature is most observable in a subscription model where the user's monthly subscription fee goes into the defined revenue hotchpot for artist royalties. The typical subscriber pays a fixed fee and listens to a handful of artists relative to the tens of millions of tracks available on Spotify. Often this is entirely interactive and without regard to "discovery" algorithms or enterprise playlists.

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[15] David Rowan, *Daniel Ek: Europe's Greatest Digital Influencer Tops Wired 100* (May 14, 2014) available at https://www.wired.co.uk/article/wired-100-daniel-ek

[16] Todd Spangler, *Spotify to Buy Back Up to $1 Billion in Stock*, Variety (Nov. 5, 2018) available at https://variety.com/2018/digital/news/spotify-stock-buyback-1-billion-1203019607/#!

Even though the user only listened to certain artists, the user's subscription fee is divided with all the artists on the service who were played *by other users*. If our user were a classical music fan, she might never listen to the pop hits of the day. Yet in this common case, almost all of her subscription fee would go to artists she never listened to and probably would never listen to. "Almost all" may be 90% or more.

Because those artists typically lack the leverage to negotiate the downside protection of bigger labels, they may end up with less than they would if they received a share of their actual fans' subscription fees. We will return to "per stream" approximations, but that handy tool allows one to make certain assumptions that would otherwise be difficult to approximate.

The big pool model is, in many ways, a weapon of math destruction. The model in its most basic form is based on this formula for each accounting period (T^n):

> Monthly Service Revenue in $T^1 \div$ Total Streams in T^1= per-stream rate in T^1
>
> Per stream rate in T^1 x Your Streams in T^1 = Your Royalty at T^1
>
> And algebraically, can also be expressed as this value for T^1:
>
> Monthly Service Revenue x [Your Streams ÷ Total Streams] = Your Royalty

Over time, it should be obvious that if the rate of increase in Monthly Service Revenue from one month (T^1) to the next (T^2) is less than the rate of increase in the Total Streams, ***the value of Your Royalty will always trend downwards over time*** (T^n). We will come back to this downward trending royalties issue.

This is why a handful of the larger catalog licenses for on-demand streaming services have negotiated extensive downside protection. This downside protection typically takes the form of various "floors" such as per-subscriber and per-stream minimums, minimum numbers of adverts, as well as cash payments of minimum guarantees paid in advance which essentially gives the licensor the benefit of the present value of future royalty payments during the term of the license.

The minimum guarantee is recouped against earned royalties payable during the license term. If the minimum guarantee is recouped during the term, royalties are then payable prospectively. If the minimum guarantee is not recouped during the term, the unrecouped balance (sometimes called "breakage") is often retained by the licensor for its own account. The service then negotiates what is essentially a new license with a new minimum guarantee and the process is repeated.

Even though royalties are effectively pre-paid by the minimum guarantee, the service still accounts to the licensor for usage during the term.[17] This allows the licensor to account to the licensor's artists or songwriters depending on the copyright category concerned. For example, an artist whose recording is streamed by users 100 times during an accounting period will have that usage reflected on the licensor's statement (along with usage by all the other licensor artists). The licensor then credits the artist's royalty account with the corresponding payment as required by the artist's recording or distribution agreement. If the minimum guarantee has not yet been recouped as to the entire licensor catalog, no payment will be due to the licensor by the service on that statement, but the licensor will account to the artist concerned based on the minimum guarantee already received.

This is because the licensor has already received payment for those 100 streams for the period in the form of the minimum guarantee. Therefore, the licensor has the obligation to account to the artist for the 100 streams reflected on the licensor's statement, which reduces the amount of the minimum guarantee on the licensor's books by the offsetting amount of the royalty payment in the double-entry.

The downward trending royalty payable to copyright owners by streaming services is difficult to measure because there is no per-stream rate that can be compared across services and over tie. "Your Royalty" in the formula above fluctuates from month to month depending on at least three functions: Monthly Service Revenue, Total Streams and Your Streams. Consider each of these functions:

Total Streams: Generally, the aggregate number of plays of 30 seconds or more of all the licensed recordings on the service. The Total Streams is an unbounded number that constantly increases at some rate which likely varies directly with the number of licensed recordings on the service. The number of recordings on the services is also an unbounded number that constantly increases under the services output deals or catalog-wide deals with owners or distributors of sound recordings. Once a recording has been "ingested" or made available on a service, it is rarely removed.

Your Streams: The aggregate number of plays of 30 seconds or more of sound recordings owned or distributed by the recipient of the royalty payment. While this number is also unbounded, it is unlikely to increase at a rate that is greater than either the increase in Total Streams or Monthly Service Revenue.

Note that the larger the catalog, the more likely it is that "Your Streams" will be a larger number, particularly if the catalog owner is heavily marketing its artists, thus stimulating demand at the streaming service. The costs of recording, marketing and promotion are borne by sound recording owner, not the streaming service. This is the primary role of record labels in the digital era—investing in finding, recording, sustaining and marketing talent. Services bear none of these costs.

Monthly Service Revenue: This is not the gross revenue earned by the service, but is rather a negotiated amount that includes less than all earned revenue. It is then reduced

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[17] Even though a per-stream rate is not a negotiated deal point (other than downside protection minima), it is necessary for the licensor to determine a per-stream rate in order to account to their artists.

by certain "off the top" costs that are negotiated. Any revenue earned by the service that is not defined as Monthly Service Revenue is excluded. This could include data-related fees or sales of user data, for example, playlist branding fees, or other revenues. Monthly Service Revenue definitely excludes all monies related to the trading of the company's shares or the company's valuation. The applicable gross monies earned by the service are reduced by approximately 50% to be included in the Monthly Service Revenue, meaning the service retains approximately 50% of that revenue for its own account.

The revenue categories commonly *included* are cash or non-cash compensation for advertising payments and subscription fees from users but can also include "non-display" uses such as e-commerce and referral fees or bounties, a share of traffic or tariff charges, or revenue derived from the sale of data about users (including behavioral data).

The Per Stream Rate

Note that the big pool calculation results in an implied per-stream rate for the accounting period concerned. While licenses between sound recording owners and streaming services are never based on a fixed per-stream rate as a negotiated deal point, it is helpful to break down royalty payments by a service on at least a notional average per-stream payment in order to compare and rank services.

Deriving a per-stream rate requires making some assumptions. The Trichordist artist rights website famously derives the "Streaming Price Bible"[18] based on the annual earnings of an actual, but anonymous, independent label. Some artists such as Zoë Keating publish their royalty earnings. Comparing the Streaming Price Bible to other disclosed royalties reveals that it is consistent, and has been widely adopted as a reference point by artists and journalists.

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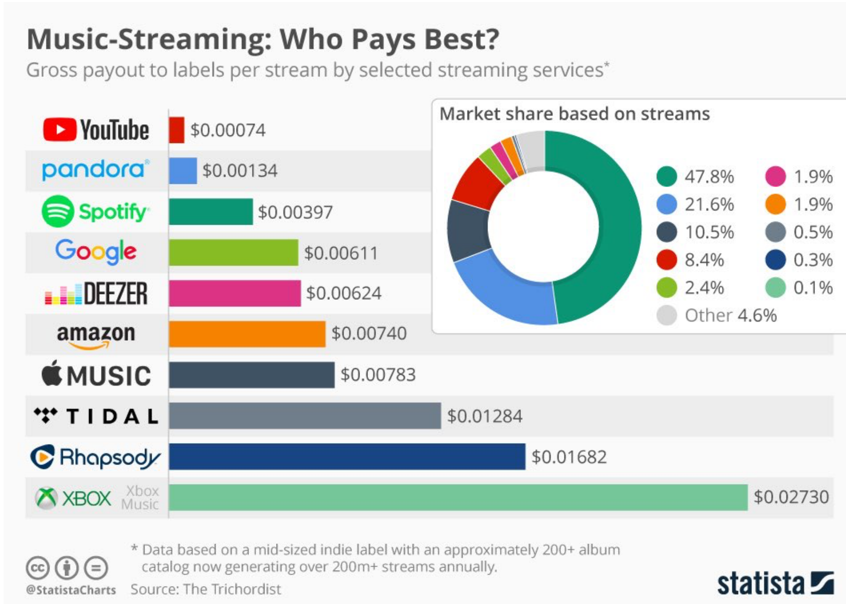
[18] *2019-2020 Streaming Price Bible*, The Trichordist (Mar. 5, 2020) available at https://thetrichordist.com/2020/03/05/2019-2020-streaming-price-bible-youtube-is-still-the-1-problem-to-solve/



As you can see from the chart, the streaming royalty is typically very, very low on a per-stream basis (so it should not be surprising that services do not like this metric). It is important to note that this is the gross payment to the label but does not typically include any payment to songwriters or music publishers who are paid in addition to and separately from the sound recording royalty. The label then shares this royalty with their artist. How this royalty is shared by the label with their artists is of some controversy, but it is typically no lower than a 70/30 split between label and artist and is often higher, but not greater than 50/50. Deep catalog artists may have less favorable arrangements depending on how their contract is interpreted.

The Streaming Price Bible has been released on The Trichordist for several years and offers a useful way to measure the Malthusian decline in streaming royalties accelerated by the "big pool" method of hyperefficient market share distribution. Taking Spotify as an example, The Trichordist notes:

> This is the first time [2019-20] we have not seen the Spotify per stream rate drop since the service launched a decade ago. The Spotify per stream rate has stabilized moving up just slightly to .00348 from .00331.

Independents are typically paid 100% of the streaming royalty as they act as their own label and own their own sound recordings. Artist Zoë Keating[19] (a frequent collaborator with UK artist Imogen Heap) also confirmed the decline in Spotify royalties in 2019 according to Digital Music News:

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[19] See www.zoekeating.com

> Artist Zoe Keating has announced on Twitter just how much she is earning through Spotify, which appears to indicate that streaming royalty rates from the company are declining sharply.
>
> Keating indicated that she earned $753 from Spotify in September of this year, which came from a little more than 200,000 streams of her music. This means that she earned about $0.0037 per stream.
>
> Last year, Keating reported that she was earning about $0.0054 per stream from Spotify. So, if she is indicative of a typical artist on the platform, this would mean that royalty rates on Spotify have declined considerably in the past year. It would also represent a continuing trend. Last year, royalty specialist Audiam reported that, ***while Spotify's own revenue rose, royalties paid to artists at the same time fell***.[20]

Ms. Keating confirms the findings in the Streaming Price Bible. I invite the Committee to inquire further as to the experience of other labels and artists.

It must be said that the per stream rate also reveals the stark reality of how little artists with even 200,000 streams actually receive in royalty payments. When a creator must look two and sometimes more decimal places to the right before finding a positive integer, something is not right. In fact, something is very wrong.

There is, of course, the question of cannibalization of physical sales by streaming. An independent artist might sell a CD for $10 to a single fan. To make up that $10 CD sale with streaming royalties in the big pool method on Spotify, an artist would have to have Your Streams of at least 2,800. One transaction compared to 2,800. It is easy to see where that calculation leads.

Companies like Spotify wrap themselves in the flag of innovation and try to pass themselves off as plucky startups. In Spotify's case, the company is still largely loss making and has been from its inception. Like its predecessor publicly traded Big Tech companies, when it comes time to pay royalties to the artists who make what has been until recently Spotify's only product, Spotify poor-mouths. To hear these companies tell it, they can't make a profit given their royalty obligations and certainly cannot pay more. This is the profit fallacy—I would go so far as to say that in Silicon Valley, profit is very 1980. These companies seek to capture valuation, and share price valuation implies growth and a belief in future growth.

If profit were really the target, one could make Spotify more profitable almost overnight by moving their U.S. headquarters to Syracuse, Cedar Rapids or even Austin rather than multiple floors of the World Trade Center in Manhattan. One could cut executive

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[20] Colin Cohen, *Zoe Keating Offers More Evidence That Spotify Royalties Are Declining,* Digital Music News (Dec. 6, 2019) available at https://www.digitalmusicnews.com/2019/12/06/zoe-keating-spotify-royalties-declining/

compensation, one could do many things to reduce their Selling, General and Administrative costs. But profit is not the issue for them. Valuation is the issue and valuation is driven by bets on growth. In Spotify's case, growth is often measured as subscriber growth and subscriber growth implies competing on price because Spotify offers more or less the same product as its competitors in a triumph of the commoditizer. Which in turn implies keeping retail prices down (and Monthly Service Revenue) in a race to the bottom on subscription price and to the top on share price. You may find that analyzing the economics of who wins in streaming is similar to who wins a gas war among price cutting petrol stations.

COVID has nearly destroyed the live music business that sustained the artists who previously tolerated their mils per stream Spotify royalties. Far from being harmed by COVID, COVID has been rocket fuel for Spotify which adds to the unfairness of the big pool royalty system. As the COVID Misery Index demonstrates, Spotify's growth in valuation has outpaced its fellow oligopolists:

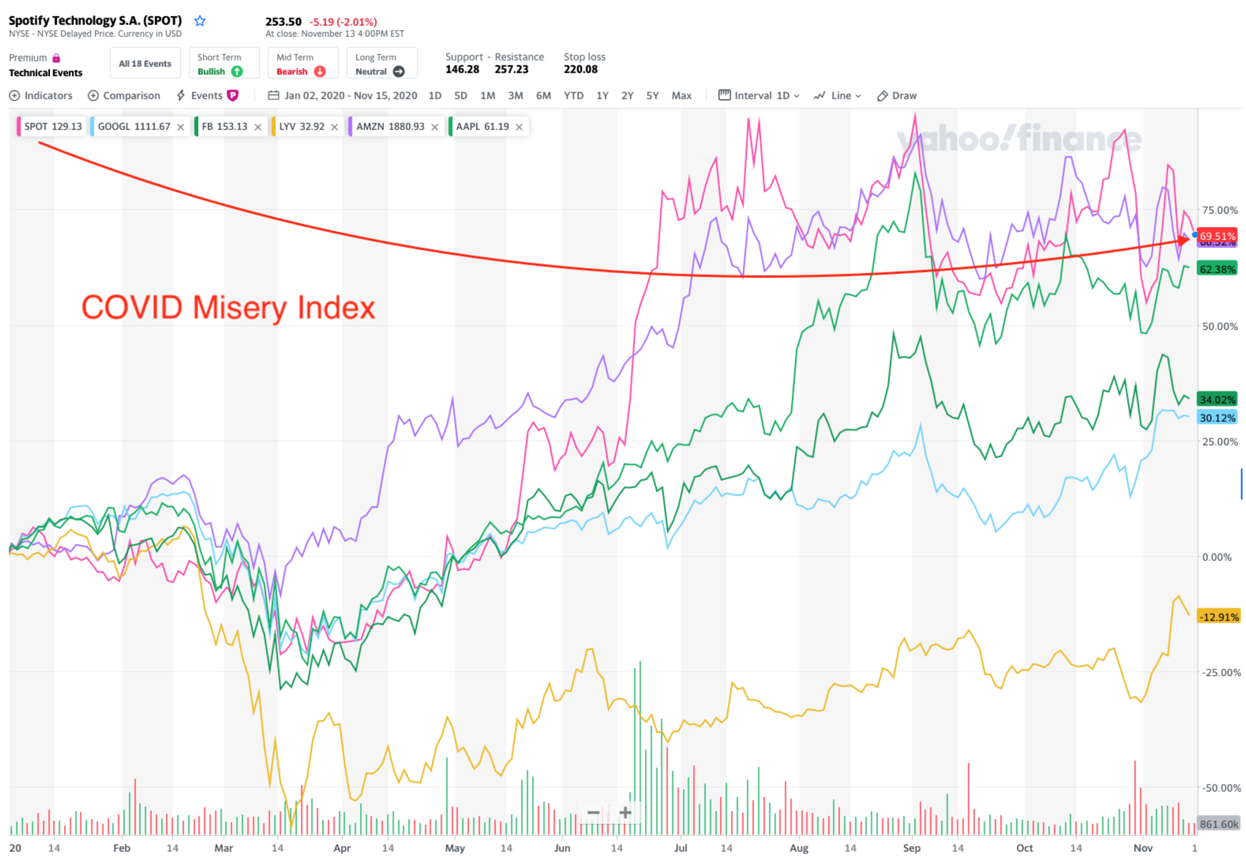

Figure 2 Spotify Valuation Growth Compared to Google, Facebook, Amazon, Apple and Live Nation 1/1/20 to 11/15/20

Spotify CEO Daniel Ek (who in 2011 appointed himself a lifetime employee of Spotify[21] due to his supervoting stock) is now a billionaire many times over. These inequities are

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[21] Spotify SEC Form 20-F (Dec. 31, 2019) at 88 available at https://www.sec.gov/Archives/edgar/data/1639920/000156459020004357/ck0001639920-

not lost on artists and performers. I suspect the Committee will soon hear directly from those creators.

Recommendations

I respectfully make the following recommendations for the Committee's consideration. I acknowledge that I have painted a rather woeful picture of the streaming recovery in the music business. It is very important that the recovery continue, but it is equally important that alternatives be offered, or even required, for those whom the recovery has largely passed by.

I am focused primarily on independent or niche artists who have little to no leverage and who seem to get the worst end of the deal. This is particularly of concern because it is almost always the case that this group is where artists start out. It is also of concern because broad categories of culture are included in the world outside of top pop hits, such as "Jazz", "Blues" or "Classical" and the like, genres that feel streaming cannibalization quite acutely. At this rate there may never be another Humphrey Lyttelton or John Mayall. If a highly trained soloist views getting included on a Spotify "Sleep" playlist as a career booster, something is really wrong.

We tell independent artists to use the Internet's wonders to find their audience which requires them to be both artist and record company, marketer and performer, promoter and personality. If they have found their audience but cannot sustain themselves due to Malthusian royalty rates—not paid by labels (who the services like to blame) but by the services themselves, then we have failed. If the only way the streaming recovery works is if you control vast catalogs and therefore are entitled to a big number of Your Streams, that may be a fine solution for those who do, but some alternatives needs to be in place for those who don't.

1. Valuation Fairness

Given the urgency of the COVID crisis, it is important to understand the difference between the creator community and other workers affected by COVID. For example, restaurants are not failing while some other entity succeeds in extracting value from their

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20f_20191231.htm#ITEM_7_MAJOR_SHAREHOLDERS_RELATED_PARTY_ ("In 2011, Mr. Ek entered into a new employment agreement that replaced his prior agreement. ***The employment agreement provides for an indefinite term that automatically expires upon Mr. Ek's retirement at age 65.***")

customers. As the COVID Misery Index demonstrates, Spotify's stock price has essentially doubled since the onset of COVID.

Again, Spotify's success is largely predicated on keeping both royalties and prices low and bargaining for special royalty treatment with shares of its stock with a limited number of rights owners. I have no objection to that. What I object to is the complete failure of Spotify to share its success with independent artists who make up a significant amount of its offering but who are doomed to scrap at the decimal point in search of a positive integer.
Instead of launching billion-dollar stock buy-back programs to juice their share price, it would be a simple thing for Spotify to credit the royalty accounts of independent artists and songwriters with a cash infusion not connected to the Your Streams numerator. They have a direct billing relationship with thousands of artists and songwriters and they could simply deposit some thousands in these accounts which overnight would help balance the inequities and also provide an alternative to government support payments. We have experienced government payments to creators in Austin, and one of the biggest problems was the mechanics of getting the money from the government's account into the creator's account. Spotify could just do it today as a thank you for doubling the value of their company while artists and songwriters suffered.

2. <u>The Ethical Pool</u>

The "user centric" alternative to big pool accounting has been discussed by companies like Deezer and certainly in artist circles. This would essentially match listening to payments, so that if a user paid $10 in a month and listened to five artists, those five artists would share in that $10.

User centric is often dismissed as overly complex. That is actually truer than some would like to admit if the plan was to replace the big pool entirely. I suggest a method I call the "ethical pool" which would be an in-between point.[22]

The ethical pool would not disturb the big pool but would add a separate pool that artists and fans could opt into. Those recordings would be removed from the big pool calculation and revenue would only be included from participating fans would only be divided between the participating artists.

This would essentially duplicate the big pool method but give artists and fans a chance to be rewarded without the big pool "weapons of math destruction".[23] Given that the choice is whether to leave the service altogether as the revenue is more trouble than it's worth,

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[22] I discuss the "ethical pool" in detail in a recent post, *Arithmetic on the Internet Revisited: The Sustainable Ethical Pool Solution to User-Centric Royalties*, Music Tech Solutions (April 30, 2020) available at https://musictech.solutions/2020/04/30/arithmetic-on-the-internet-revisited-the-sustainable-ethical-pool-solution-to-user-centric-royalties/; see also Stuart Dredge, Ethical Pool Idea Could Let Fans Choose User Centric Royalties, Music Ally (Oct. 9, 2018) available at https://musically.com/2018/10/09/ethical-pool-idea-could-let-fans-choose-user-centric-royalties/

[23] Cathy O'Neil, *Weapons of Math Destruction* (2016).

the ethical pool might be a first step toward a true user-centric model, which might include artists setting their own prices. It might even be more profitable for the services. As Guardian columnist Stuart Dredge said of the ethical pool, **"**While there are 'potentially some significant legal hurdles in separating the royalty payouts', it's something for any streaming service mulling user-centric payouts to perhaps consider…."

3. "Most Favored Nations" Royalty Terms

It is virtually impossible for independent artists to know what whether the terms of their digital distribution agreements are competitive. This is particularly true of digital distributors that require artists to bear a substantial part or all the cost of distribution in advance. I commend the work of Fair Trade Music and the World Independent Network to the Committee as a potential benchmark for a minimum royalty rate for artists and songwriters.

4. Payola-Driven Algorithms as Weapons of Math Destruction

The Committee may wish to look into Spotify's recent announcement regarding paid-for algorithmic steering.[24] The announcement states quite clearly that "[L]abels or rights holders agree to be paid a promotional recording royalty rate for streams in personalized listening sessions where we provided this service." This is a similar structure to "steering agreements" that were criticized to the Federal Communications Commission[25] as thinly disguised payola where the undisclosed consideration is paying less rather the notorious "$50 handshake". The bad old days are here again.

5. Nonfeatured Performer Compensation

I respectfully suggest that platforms should be required to make a payment in the nature of equitable remuneration for nonfeatured performers in the nature of the revenue share of webcasting royalties[26] that is paid to the AFM/SAG-AFTRA Intellectual Property Rights Distribution Fund.[27] This payment should not reduce anyone else's payments (label, artist, songwriter or otherwise).

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[24] Spotify Press Release, *Amplifying Artist Input in Your Personalized Recommendations* (Nov. 2, 2020) available at https://newsroom.spotify.com/2020-11-02/amplifying-artist-input-in-your-personalized-recommendations/

[25] Dr. David C. Lowery, *Comments of David Lowery In the Matter of Media Bureau Seeks Comments on Petition for Class Waiver of the Commission's Sponsorship Identification Requirements Filed by the Radio Broadcasters Coalition*, FCC Docket MB 15-52 (May 10, 2015) ("I respectfully suggest that "steering agreements" [with Pandora] are already creating a "payola lane" on both terrestrial and Internet radio to which the listener is none the wiser….")

[26] 17 U.S.C. § 114(g)(2)(B) and (C).

[27] The Fund maintains an extensive website at https://www.afmsagaftrafund.org

I appreciate the Committee affording me this opportunity to investigate the current state of play of music streaming and commend the Committee's work on the subject. Be assured that creators are grateful.

Sincerely,

Christian L. Castle