Written evidence submitted by Anthony Hamer-Hodges

The Economics and business models of music streaming

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I am submitting evidence to the DCMS inquiry as both an academic and as an experienced entertainment law & music management practitioner with experience of negotiating music licences as chief commercial officer of an alternative-model music streaming service.

I am the programme leader for music business courses at LCCM - the sector leading higher education institution for music and music business degrees in the UK according to student satisfaction (NSS 2019/NSS 2020). We pride ourselves in the calibre of our tutors, our connections with industry, our real-world focused teaching & assessment and our central london building - The Music Box - with dedicated recording studios, live music venue, practice booths and performance rooms as well as fully decked out Mac labs, classrooms and study spaces.

Our alumni include Brit award winner Tom Walker (signed to Relentless), pop star Rhys Lewis (Decca), top session musicians like Fabio De Oliveira (George Ezra), songwriters & vocalists who have worked with Dua Lipa, Sam Smith, Elton John & Ellie Goulding, the composer Nichola Morrish Rarity and executives at Universal, Warner, Live Nation amongst many others.

We teach all our students the fundamentals of the industry and what they need to do to get paid for their creativity in the modern streaming economy. I have written the newly validated degree in Music Business Management and a new Masters in Entertainment Science using my knowledge and experience gained from over 20 years in the music and entertainment sector with particular expertise in social media/streaming data insights & intellectual property licensing.

In my career I have been an artist manager for singers, bands and performers who have won awards and signed with all the major music companies. I have been a record label manager, for the leading independent recording company at the time and run DIY operations on behalf of my artists - one of whom was the 2nd best selling independent artist in the world in 2006 according to Billboard. I have seen the benefit for artists of working with established labels, usually in return for giving up ownership of their recording masters, or alternatively of keeping control of masters and releasing DIY to a more focused and niche audience.

As a qualified paralegal, with a Masters in Entertainment Law, I have been head of business affairs for a brand licensing agency responsible for a portfolio of consumer products licensees generating over £200 million p/annum at retail. Most relevant to this inquiry I served as Chief Commercial Officer for a music streaming startup, with circa £5 million in funding, where we developed an alternative fan-centric payment model and negotiated licences with major recording companies.

I shall set out in this submission the main features of the streaming music economy:

<u>The Rights Framework</u>

There are three sets of intellectual property rights contained in a streamable piece of music. They are of equal importance:

The original musical work:

1. Copyright in the original composition: music & lyrics;

The 'neighbouring' or 'related' rights:

2. Master Rights: protecting and rewarding the producer or record label that have invested in or arranged a recording;
3. Performer Rights: protecting and rewarding the performers whose unique performance of the composition has been recorded.

These three sets of rights are of equal importance, at least in theory - in that they are logically symbiotic - outside of live performance you can't hear a song without a recording and you can't make a music recording without a set of performers and a song. The law in the UK and industry practice do not however treat these three sets of rights as equals and this is the main reason there is widespread dissatisfaction within the creative community with the economics of music streaming. The imbalance between these stakeholders is however merely a historical quirk, due to a now largely obsolete business model and antiquated technological context. The law and industry practice must adapt to the new realities and respect & reward each of these rights with equal importance to bring prosperity to all creative stakeholders in the streaming economy.

The rights of songwriters in recorded music:

Copyright protection in sheet music was first formally recognised in UK law in the 1777 case of *Bach v Longman*. When sound recording technology was invented at the end of the 19th Century, songwriters were not protected by existing law - which only protected written music. Phonograph and piano roll manufacturers were free to use music without permission or payment. In an important parallel to where we are today it was therefore necessary to update the law to acknowledge the new technologies and protect creativity as originally intended.

The 1911 Copyright Act formalised rights for songwriters and composers if not to authorise, then to at least be paid for, every public performance or mechanical reproduction of their works. This would in turn lead to the creation of the Performing Rights Society (PRS) in 1914, to collect public performance royalties for songwriters, and the Mechanical Copyright Protection Society (MCPS) in 1911 - to collect the mechanical royalties due to songwriters from the growing number of record labels and manufacturers of recorded music cylinders and discs. As the record business and radio technology took off from the 1930s onwards public performance and mechanical royalties became significant income streams for songwriters. Income streams which at the time were dependent on the, not insignificant, investment in recording technology and distribution networks of recording companies.

Master rights owned by recording companies:

Recorded music company business models have largely stayed the same since the early 20th Century, although the distribution technologies have obviously changed. In the record company value chain labels identify, nurture and market music performers and recorded music artists - signing them to exclusive recording agreements or limited product-by-product or territory-by-territory licence agreements. With performers and songs as the raw materials, record companies create and then sell copies of, or licence access to, their master recordings.

Record labels, production companies or sometimes the artist themselves create Master Rights by paying for and organising recording sessions where a unique performance of a song is recorded or assembled (by editing, overdubbing, sampling or music programming).

When an artist signs an exclusive recording contract with a record company they essentially become employees of the label for an exclusive period and all recordings made during that time - regardless of who pays and organises the sessions - become owned by the record company as 'first owner of copyright'. Likewise, if a DIY artist pays a producer or studio engineer to record a session - the studio staff are the artist’s employees for the session - so legally the artist is the 'producer' and first owner of copyright. This is sometimes referred to as 'work for hire', which means any intellectual property created is automatically attributed to the person paying the creators’ wages.

Performer rights in sound recordings:

In order to make a recording and subsequently to sell or distribute the audio - as a digital file or physical product - the master rights holder needs the permission and consent of every performer. This includes the featured artists whose names are credited within the artist/title of the release and who are 'signed' to the record label or production company; and non-featured performers, who may include session musicians, backing vocalists and music programmers.

Part II of the *Copyright, Designs & Patents Act 1988* (CDPA) gives performers on a sound recording the right to authorise - usually in return for payment - the recording, distribution and broadcast of their captured performances. Some of these rights can be transferred or sold, for example for an ‘all-in’ session fee or, in the case of contracted featured artists, often in return for future royalties on sales and a share of licensing revenues.

Public performance of master recordings:

The 1934 legal case of *Gramophone Co. v Cowardine* established that record labels are, like composers for their original music, entitled to payment for the public performance of master recordings. Soon after this litigation, the leading British record labels at the time EMI and Decca joined forces to launch Phonographic Performance Limited (PPL) who continue to this day to issue licences and collect licence fees from broadcasters, retail and hospitality venues and anywhere else where recorded music is played in public.

The UK is a signatory to the 1961 *Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations*. Article 12 of the Rome Convention established the necessity of 'equitable remuneration' for performers' public performance rights. The PPL, which is of course owned by the recording companies, had been sharing public performance with performers on a voluntary basis, initially only 20% and later 32.5% was paid to featured artists, 12.% of which went via the Musicians Union (MU) to non-featured performers. In 1996 the UK eventually adopted the suggested 50/50 split between labels and performers which had been agreed by the world intellectual property organisation (WIPO) and intergovernmental negotiation following the Rome Convention.

It's hard to overstate the importance of public performance royalties for both songwriters and performers. The fact that PRS and PPL are mandated by law to distribute 50% of royalties direct to creators (and therefore not deductible by record labels or publishers) ensures at least some correlation between success and income. Outside of live performance, currently on hold due to covid-19, public performance royalties are sometimes the only income streams that all but the most successful creators can rely on.

Is streaming a mechanical reproduction or a public performance?

The exclusive controls and economic rights granted by the CDPA cover two main bundles of rights - the mechanical rights (to copy and distribute) and the performance rights (to broadcast, play or communicate to the public). There is disagreement within the industry over which bundle of rights is exploited by music streaming and this affects how creative stakeholders are paid.

Music publishers, representing songwriters, deem music streaming to be both a mechanical reproduction and a communication to the public. Songwriters' share of streaming revenue is therefore licensed and collected by multi-territory Performing Rights Organisations (PROs) like ICE (a joint venture between UK's PRS, Germany's GEMA and Sweden's STIM), and Mechanical Rights Organisations (MROs) like MCPS. Unlike PRS, MCPS pays all revenue through music publishers who may deduct songwriter payments from any unrecouped balance on each writer's royalty account. PRS instead, like PPL, pays 50% of streaming royalties direct to creators.

Record labels treat streaming as a mechanical reproduction which conveniently gives them full control over licensing and collections. By licensing streaming of their master rights direct to digital service providers (DSPs) - without any PPL style public performance distribution of equitable remuneration direct to performers - labels are able to keep more of the revenue for themselves. Label revenue from streaming is thus only shared with featured artists according to their recording contracts and subject to recoupment on the artist's internal balance sheet vis a vis recording costs, video content production, marketing and other artist advances.

Featured artists' sales royalties & licensing splits:

When recording artists sign to any of the frontline record labels owned by the major music groups and large independents they typically do so under an exclusive recording agreement. Such agreements often run for multiple albums or rights periods at the label's sole discretion. In exchange for giving up ownership of their masters, often for the life of copyright, artists receive a royalty share on future sales and a share of licensing revenue wherever that revenue is directly attributable to the artist's master recordings or the label's interest in any artist-led commercial partnerships. Typically artists receive a headline royalty share of around 13% - 20% of sales and a more generous share, often a 50/50 split, of licensing income.

The combined effect of the major record companies' investment in new talent and large back catalogues of master rights is huge bargaining power when it comes to negotiating music streaming deals for their catalogue. A music streaming service that didn't carry the majority of titles from all significant record labels would not be a compelling proposition for consumers. Whatever the big labels ask for, aspiring digital services must deliver. When negotiating with Spotify, the major labels and a coalition of independent record companies (MERLIN) were able to negotiate combined equity stakes of over 25% of the fledgling streaming service in lieu of or in addition to large upfront advances and minimum guarantees. For context 25% of Spotify 15 years later based on the share price in November 2020 would be worth $11.7 billion. As this market power is not attributable to specific artists or releases there is no obligation for such exchanges of value, and other 'black box' payments, to be shared with artists.

The cost of professional recording, despite the prevalence of digital audio workstations and 'bedroom' music programming technology, can still be prohibitively high. Even just to mix and master a home produced album would be beyond the budget of most young musicians and producers without the investment of an established recording company. What many don't realise however when they sign these recording contracts is that all the advances need to be paid back - not out of overall project revenue but out of the artist's small percentage. Successful artists end up paying for all the costs and yet often end up without any final ownership of what they paid to record.

In the physical era record labels could justify their lopsided artist payouts and recoupment of production costs by the level of investment and risk involved in the mass-manufacture and distribution of products of uncertain market demand. The record labels were not consumer facing organisations, their customers were radio stations and retailers. If they could get new music on the radio and physical stock on the shelves that was usually enough.

The digital era has transformed both labels and artists into B2C organisations. Success is more predictable as the size, location and engagement levels of audiences can be easily measured through streaming media and social media interaction. The art of finding and building an audience from scratch is still highly dependent on relationships with media tastemakers. Digital tastemakers - in particular streaming playlist curators - have taken over from radio controllers as the main gatekeepers to success.

The platforms for music promotion are thus also now the predominant channels for music consumption and exchange. Success can be instant, global and tracked in real time. Without the cost base of manufacturing and distribution it has never been so profitable to be a record label.

Using the mechanical controls of sound recording copyright to licence streaming services direct, labels earn from every stream and will continue to do so, all other things being equal, for the life of copyright. Only after 50 years following release are labels obliged to share a significant proportion of revenue with performers. For the remaining 20 years of recording copyright labels must pay featured artists their royalty share, regardless of recoupment and non-featured performers a pro-rata combined minimum of 20% of revenue. The question for policy makers who want to improve outcomes for creative talent is why should performers have to wait 50 years for an equitable share of streaming revenue?

The marginal cost for labels in providing these mechanical copies at a scale and speed that could not have been imagined when drafting the CDPA is of course zero. Labels provide DSPs with one master copy and the platforms do the rest. With much of the risk and resource previously required for music distribution falling away the shift from a product based business to a rights based industry means every new release with and the catalogue of the established record labels - are a licence to print money.

Market share & the ‘big pot’ payout model:

The identity and actual success of each individual artist or release is of zero concern to the major music companies. Big pot payouts from music streaming platforms are based on market share not real fan-to-artist connections. These market share payouts are both dynamic and static. Growth in market share due to a particularly successful month or quarter will result in higher payouts but contractual minimum guarantees ensure that the big labels get a fixed percentage of all platform subscriptions and revenue based on *historic* market share regardless of current success.

Historic market share is also used to guarantee high profile placement of major label artists in influential playlists and on-platform recommendations. These influential playlists can be self-reinforcing. Historic market share thus creates current market share regardless of who the artists are or what the new releases sound like. High profile placement on a new music playlist can propel a release immediately into algorithmic playlists based on ‘hits’ that have more listeners. Artists with more monthly listeners get more immediate traction with each release and so on in an upward self-perpetuating spiral.

Streaming platforms pass on approximately 70% of all revenue from subscriptions and advertising to rights holders. The per-subscriber and share-of-revenue minimum guarantees in the recording companies contracts with DSPs leaves little for songwriters and virtually nothing for performers. In the USA the Copyright Royalty Board set statutory all-in royalty rates for songwriters at around 25% of total content costs, leaving 75% for the recorded side.

Using this split for a UK subscriber:

From each £9.99 streaming subscription after the government takes £1.67 in VAT and the DSP £2.46 there is £5.86 for rights holders. PROs collect £1.46 on behalf of songwriters and their publishers whilst the record labels will be paid the lion's share at £4.40. With a market share of around 30% £1.32 of this will go to Universal Music, Sony's 22% share is worth £0.97 whilst Warner Music's 18% nets them £0.79. These contractual payments are due regardless of if the music fans paying £9.99 actually stream any music. What they listen to has no bearing on how much the DSPs pay out to rights holders nor the minimum share that each of the majors receive.

Based on the latest filed accounts for Q32020 we know that Universal Music's recorded music division received on average $10.783 million per day from streaming platforms in the quarter ($992 million overall). Sony Music's record labels meanwhile took in on average $8.06 million per day from streaming ($742.3 million over the Q320) whilst Warner Music averaged $6.5 million per day from streaming ($2.4 billion for FY2020) according to analysis by Music Business Worldwide. If Kanye West's recent leaked contracts are anything to go by, featured artists see less than 20% of these payouts and only then if they are unrecouped. Non-featured performers will receive nothing thanks to the interpretation of streaming as a mechanical rather than a public performance like traditional radio. It is no wonder that songwriters and performers think that the streaming economy is a #brokenrecord.

Antiquated business models in a digital age:

In the physical world record labels controlled both the 'carrier' technology and the distribution network and thus songwriters needed to accept mechanical royalties from the labels at the statutory rate. In the digital era all rights holders (except the performers) deal directly with the retailer/DSP. There is no obvious reason following this shift why songwriters should accept a lower share of revenues than the record labels. They are no longer dependent on the labels for access to the consumers and it is the DSP that is making mechanical copies to provide streams (if you agree it is a mechanical reproduction and not a public performance) not the record company. If songwriters (and performers) were to object and remove their rights from the DSPs there would be no music to stream.

A new voluntary settlement within the industry for equal recognition and remuneration for songwriters, performers and record labels is however unlikely.

Due to consolidation in the industry the three biggest music publishers who together control 70% of the market, and thus have the power to demand change, are owned by the same global music companies who own the three biggest recording companies. There is no motivation for Vivendi/Universal Music Group, Access Industries/Warner Music Group or Sony Corporation/Sony Music Entertainment to shift the balance of power in the streaming marketplace from the recorded sector where label margins are much higher (typically 80/20 in favour of the label) to their publishing divisions where revenue mostly goes to the creative talent (likely 80/20 in favour of songwriters).

Unintended consequence of the 'making available' right:

If forced to concede that streaming is in fact a public performance and therefore should trigger equitable remuneration to performers like offline radio, labels point instead to the specific clauses that were inserted into Part II of the CDPA in the early years of the internet regarding communication to the public via digital platforms. Here, inexplicably the CDPA states that the equitable remuneration owed to performers is not payable for the 'making available' of sound recordings *"by electronic transmission in such a way that members of the public may access it from a place and at a time individually chosen by them"*. Deleting this line from legislation would at a stroke rebalance streaming income for the benefit of creators who have always provided the justification for copyright and public policy in this sector.

Just like the addition of mechanical protection and licences in the 1911 Copyright Act in response to the new technology of sound recording it is necessary to adapt the law in response to the now dominant technology of streaming before songwriters and performers, especially non-featured performers, are left behind.

If no change is made and the shift from traditional radio to playlist driven 'lean back' streaming continues - or even just listening to the same Radio 2 show but via the BBC Sounds app rather than FM radio - we enter a world where the performers whose talent is captured in a sound recording are not considered worthy of payment and not because the DSPs aren't paying.

Not all radio plays pay the same, not even the same people.

A public performance of sound recordings on traditional radio pays out a roughly equal share of royalties to the three sets of rights holders identified earlier: songwriters, record labels and performers based on audience figures at the time of broadcast.

The same radio show listened to via BBC Sounds or a playlist-drive stream of the same hits, potentially listened to by a much wider audience, pays out 75% of royalties to the record company and 25% to the songwriters with potentially nothing going to performers. As consumers move to streaming platforms and broadcasters shift emphasis to a digital-first strategy, non-featured performers are left out in the cold whilst the labels celebrate the return of the golden years.

Policy options:

- Legislate for equal payment for songwriters out of total content cost/rights holders share of music streaming revenue. This can be set as a statutory mechanical licence just like the 1911 Copyright Act.
- Scrap the exemption for on-demand distribution by electronic means from the equitable remuneration clause in the CDPA.
- Bring forward the 20% minimum payment to non-featured artists. Why wait 50 years?
- Legislate to introduce a similar minimum 20% royalty rate (after deductions) for featured artists which should be collected by PROs like PPL

You will note that despite my previous role as Chief Commercial Officer for an alternative-model music streaming service I am not recommending as a policy option legislating for a fan-centric share of streaming subscriptions. With 70% of DSP revenue already being paid through to the music industry the best way of rewarding creative talent, as copyright originally intended, is to ensure an equitable share between the three main rights holders - songwriters, record labels and performers.