SUPPLEMENTARY WRITTEN EVIDENCE SUBMITTED BY SPOTIFY AB

19 March 2021

1. INTRODUCTION

(1) Spotify greatly appreciated the opportunity to appear before the Digital, Culture, Media and Sport Committee ("**DCMS Committee**") on 23 February 2021 regarding its inquiry into the economics of music streaming. In this supplementary submission, Spotify responds to the follow-up questions raised by Members of the DCMS Committee regarding Horacio Gutierrez's oral evidence and seeks to provide additional context on certain topics raised during the oral hearing.

(2) Spotify pioneered the transition of digital music distribution from the download model to the streaming model. It has since been an engine of enormous growth, providing a much-needed boost to the revenues of the music industry (and artists in particular) after years of declining revenue due to piracy and illegal file sharing presented an existential threat.

(3) Spotify's Founder and CEO, Daniel Ek articulated the company's founding mission when he stated "*The problem with the music industry is piracy.* […] *But what if you can make a better product than piracy?*" An important factor to Spotify's success against the use of pirated music was its ability to compete with "free". Spotify's ability to offer a Free (ad-supported) service tier, which gives access to the entire Spotify catalogue (albeit with some limitations, mainly due to ad interruptions) has been instrumental in this respect. While Spotify's ability to maintain its Free tier is fundamental, the Spotify business would not be financially viable based on the Free tier alone. Spotify needs the Free tier to function as an incentive for users to upgrade, by converting to the Premium (paid) tier. As explained further in this submission, the Free tier has been very successful in driving conversions to the Premium service, generating considerable value for music rightsholders, and the artists they represent.

(4) As streaming continues to grow in popularity globally, Spotify's mission continues to be to give a million creative artists the opportunity to live off their art and billions of fans the opportunity to enjoy and be inspired by it. Nevertheless, despite its important contributions to the music industry to date, Spotify remains at a relatively early stage in its development as a business. To keep growing, Spotify needs to continue offering tremendous value to the users and artists alike by continuing to innovate in the audio space – and Spotify strives to do so every day.

(5) Ensuring fair compensation for creators and helping them become commercially successful has been a priority for Spotify since its founding. A number of proposals have been advanced in this respect as part of the DCMS Committee's inquiry. These have included *inter alia* switching to a user-centric method for calculating payments

and treating streaming similarly to radio for purposes of sharing royalties between artists and labels.

(6) Spotify is open to a constructive dialogue on possible alternative methods for calculating the shares of streaming royalties to rightsholders, including user-centric payments. Spotify participated in a recent study on user-centric payments commissioned by the French National Music Centre ("**NMC**").[1] ..The results demonstrated that there is a measurable but very small impact of the user-centric model on pay-outs to various creators.[2] In any event, any switch to a different compensation model is not a decision that Spotify could take unilaterally. A switch would require consent from several categories of rightsholders globally (as was also highlighted in the NCM study), the alignment of a host of licensing agreements worldwide, and building new reporting systems to ensure that the appropriate metrics are recorded to guarantee compensation is paid out correctly.

(7) Music streaming is a nascent industry that carries considerable growth potential. Any recommendations for changes should take into account the dynamics of the industry and, in particular, the fact that pure play digital service providers like Spotify would be affected differently by these changes compared to music streaming services provided by large vertically integrated digital companies, such as Google, Apple or Amazon. The latter are able to subsidise their music streaming business through their other activities, contrary to pure play providers like Spotify, who need to be financially viable standalone, in a market that has always faced challenging margins due to the cost of licensing content from rightsholders. Changes that would overly disadvantage pure play providers would not only reduce competition and consumer choice, but would ultimately also lead to reduced overall revenue for creators.

(8) Spotify remains at the DCMS Committee's disposal as you proceed with your inquiry.

2. DCMS COMMITTEE MEMBERS' QUESTIONS

2.1 Of those of your members who use Spotify's free service, in any year what proportion of them upgrade to paying a subscription?

(9) At the end of December 31, 2020, Spotify had 345 million Monthly Active Users ("**MAUs**") across its Free (ad-supported) and Premium tiers globally. Spotify's current number of Premium subscribers globally is approximately 155 million.[3] These figures broadly indicate a ratio of Free users to Premium subscribers of 55% / 45%. These figures are consistent through the years: as of December 31, 2019, Spotify had 271 million MAUs and 124 million Premium subscribers (ratio of Free users to Premium subscribers: 54% / 46%) and as of December 31, 2018, it had 207 million MAUs and

[1] See Press Release: https://cnm.fr/wp-content/uploads/2021/01/20210121_UCPS_CNM_Pressrelease.pdf and relevant industry press coverage: https://musically.com/2021/01/28/french-study-offers-new-data-on-impact- of-user-centric-payouts/

[2] *Ibid.* One of the key conclusions of the study was that "*the transition to the User Centric Payment System ("**UCPS**") could favour a redistribution of income for the artists, titles and musical genres with the lowest audiences, but, **if the percentages of evolution seem, not negligible, the amounts in value actually remain limited, in the state of the market**: thus, beyond the 10,000th most streamed artists, all musical genres combined, the impact of the transition to the UCPS would be a maximum of a few euros per year on average per artist.*"

[3] Please refer to Spotify's publicly reported figures: https://investors.spotify.com/Home/default.aspx

96 million Premium subscribers (ratio of Free users to Premium subscribers: 54% / 46%).

(10) Spotify's ratio of Free users to Premium subscribers suggests that the Free tier is a healthy and successful conversion channel, which creates significant value for Spotify's partners, including creators. Spotify is continuously investing in new ways to add value and strengthen the incentives for even more users to become Premium subscribers.

2.2 What percentage of the music that customers listen to comes from the major record labels?

(11) In 2020, roughly two-thirds of Spotify's global streamshare came from music distributed by the major record labels. This includes content owned by independent labels that distribute their content through major labels.

2.3 Your oral evidence stated that the majors have very little influence over company decisions. There was a point in time when Spotify was struggling to get the attention of the major labels, and they took a stake in your company. Was that the moment when you came up with this model in terms of the distribution of revenues and is that reflective of their influence at the outset?

(12) As stated in Horacio Gutierrez's oral evidence, to the extent that major labels hold equity stakes in Spotify, this gives them very little influence over Spotify's commercial decisions. This statement is corroborated by the facts set out below.

(13) As per Spotify's Form 20-F,[4] as of December 31, 2020, none of the major labels owned more than 5% of ordinary shares and beneficiary certificates in Spotify Technology S.A.[5] The major labels' own SEC filings confirm this, as none of them has a sufficiently large equity stake in Spotify, so as to be required to make a 13G filing to the SEC.

(14) Further, written submissions by Warner Media UK ("**WMUK**"), Sony Music ("**Sony**") and Universal Music UK & Ireland ("**Universal UK&I**") to the DCMS Committee confirm the above. More specifically:

(a) WMUK confirms that Warner Media Group ("**WMG**") does not currently have an equity stake in Spotify, nor does Spotify have an equity stake in WMG.

(b) Sony stated that its shareholding in Spotify is nominal (less than 3%) and that it has "*absolutely no control over the business organisation and/or running of Spotify and do not have a place on its Board*"[6]; and

(c) Universal UK&I submitted that Universal Music Group ("**Universal**") holds some financial equity in Spotify, but states that Universal does "*not play a role in the company's governance;* [it does] *not hold any board seats and* [its]

[4] The Form 20-F is one of the annual reports Spotify is required to file with the US Securities and Exchange Commission ("**SEC**"), as a company listed in the NYSE.

[5] Spotify's Form 20-7 for the fiscal year ended December 31, 2020, Item 7.A (Major Shareholders and Related Party Transactions). Spotify Technology S.A. is the parent company of the Spotify group and is a public limited company incorporated and domiciled in Luxembourg.

[6] *See* Sony's written evidence, published on 23 February 2021, response to Question 13.

financial equity confers absolutely no influence over Spotify's licensing, playlisting or any other of Spotify's strategic and operational decisions."[7]

(15) Nevertheless, as critical business partners and licensors of content fundamental to the Spotify service, they indirectly exercise influence on Spotify's business through the terms and conditions of their licence agreements with Spotify. For example, their consent is required every time Spotify wants to launch the service in a new territory, and when Spotify adds new features to its streaming service that are not covered under the scope of the existing licenses. In addition, major music companies also own publishing companies that own rights over even larger catalogues of music than their sound recording rights, and the combined leverage of both sets of rights is quite considerable.

2.4 What safeguards are in place to ensure that the majors' shareholding remains passive?

(16) Only two of the major labels, Sony and Universal, currently have small minority stakes in Spotify. They are not represented on Spotify's Board and do not have any legal or other contractual rights giving them the ability to exercise decisive influence over the strategic corporate or commercial decisions of Spotify.

3. CLARIFICATIONS OF SPECIFIC POINTS RAISED BY THE DCMS COMMITTEE DURING THE HEARING OF 23 FEBRUARY 2021

(17) Spotify seeks to clarify certain points raised during the oral testimony of 23 February 2021.

3.1 Calculating the share of streaming revenues received by music publishers is a complex multi-faceted exercise

(18) Music publishers typically administer the music copyrights and literary copyrights in a song or composition (i.e., score and lyrics), rather than in a recording of a performance, which is the role of the music labels. They range from large multinationals, to smaller publishers who manage international exploitation through sub-publishing agreements with publishers in other jurisdictions.

(19) It is the music publishers who negotiate the split of receipts as between different contributors (e.g. composer, lyricist) and the publisher itself. There are many different types of publisher agreements and their terms vary. Collective licensing arrangements applicable to the relevant jurisdiction also apply.

(20) A number of witnesses have presented evidence on the share of streaming revenues received by music publishers. For example, Mr. Roberto Neri (Chair of the Music Publishers Association) testified that headline rates (which form the benchmark for negotiations) for the percentage of streaming revenues paid to publishers had increased over the past decade in the UK from a low of 8%, nearly doubling to 15% (ref: Q621). This estimate of 15% is consistent with what Spotify understands publishers claim to receive, but the exact share is subject to variations across digital service providers. The royalties Spotify pays to publishing rightsholders across Europe (and indeed globally) are the result of many factors. Publishing rights are generally fragmented and one

[7] *See* Universal UK&I's written evidence, published on 23 February 2021, response to Question 14.

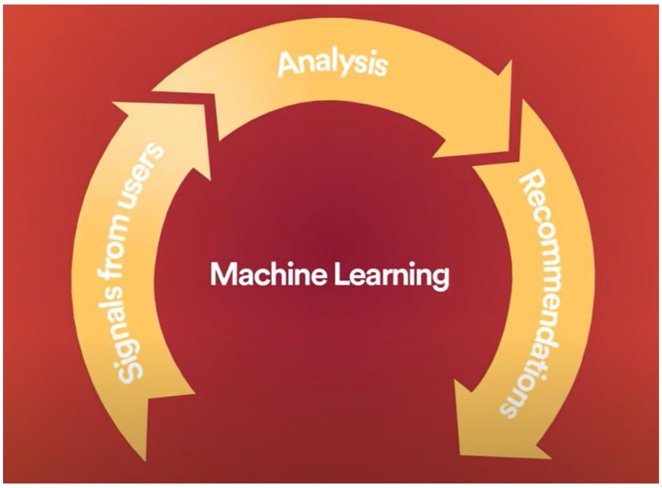
musical composition may require multiple licenses across territories and regions. Headline rates and effective rates (which are the result of the interplay between multiple commercial factors) are not the same thing. Offering multi-user, student or other account types in addition to single user accounts may cause the effective rate to deviate from the headline rate for such offerings. Different headline rates may be applied for ad-based models: the economics of such accounts may instead be volume-based, buyouts, or other economic structures. Different service providers may also use different definitions of 'revenue', such as including deductions from revenue for certain costs (including taxes, marketing or payment processing). Focusing on headline rate in isolation of other commercial considerations, may not be representative of the actual value of a particular deal.

3.2 Spotify's use of algorithms to personalise recommendations to users does not favour particular rightsholders

(21) Streaming services are democratising music demand. In 2015, only 16,000 artists made up 90% of streams; in 2020, 57,000 artists make up 90% of the streams, four times what it was just six years ago. This means that the number of the most listened to artists in the world is a growing and increasingly diverse group - an achievement previously impossible with the finite limitations of how much a radio station can play or a physical record store can supply.

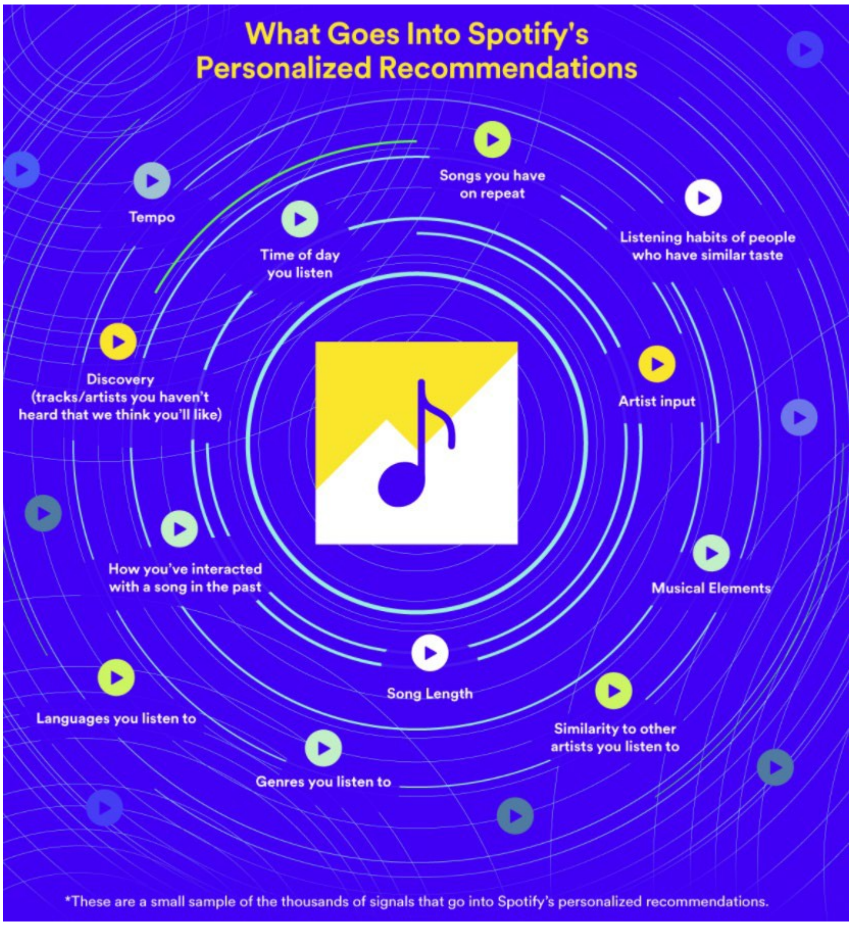
(22) Spotify is a key driver of this diversity in demand. Listeners enjoy Spotify because it introduces them to music they love, including music they might not have found otherwise. In fact, Spotify drives 16 billion artist discoveries every month, meaning 16 billion times a month, fans listen to an artist they have never heard before on Spotify. Spotify is actively refining its algorithms to enable even more fan discoveries of new artists each month.

(23) Spotify is able to make great personalised recommendations because of complex, dynamic systems that consider a wide variety of inputs about what the user likes— which Spotify refers to as 'signals' —and balance those signals in many possible different pathways to produce an output: the perfect song for the moment, for that particular user.



(24) Spotify's personalised recommendations take into account thousands of types of signals: what the user is listening to and when, which songs they are adding to playlists,

the listening habits of people who have similar tastes, and much more. In order to create algorithms that truly deliver the right song for the right time, Spotify is also taking into account less obvious factors like the time of day, the order in which the user is listening to songs or podcasts, or the release date of a song.



(25) Spotify only ever recommends music it thinks listeners will want to hear. The identity of the rightsholder is only one of thousands of factors that Spotify takes into account in making personalised recommendations to users and, by its nature, Spotify's algorithm does not show bias in favour of content licensed by major labels or any other rightsholder. Spotify does not guarantee placement – its user recommendations are driven solely by user satisfaction.

(26) In 2020, roughly two-thirds of programmed streamshare[8] belonged to majors (inclusive of music distributed by majors but owned by independent labels), almost exactly in- line with their streamshare elsewhere on Spotify's platform. This shows that algorithms do not skew recommendations in favour of major labels and to the detriment of independent labels, or vice versa. Spotify is committed to the promotion of independent talents. For instance, in Spotify's flagship personalised playlist "Discover Weekly", indie licensors account for the majority of tracks and approximately 60% of streams.

(27) As reported in the industry press, in 2020, independent labels and artists strongly over-performed the market, collectively growing at 27% and increasing their combined

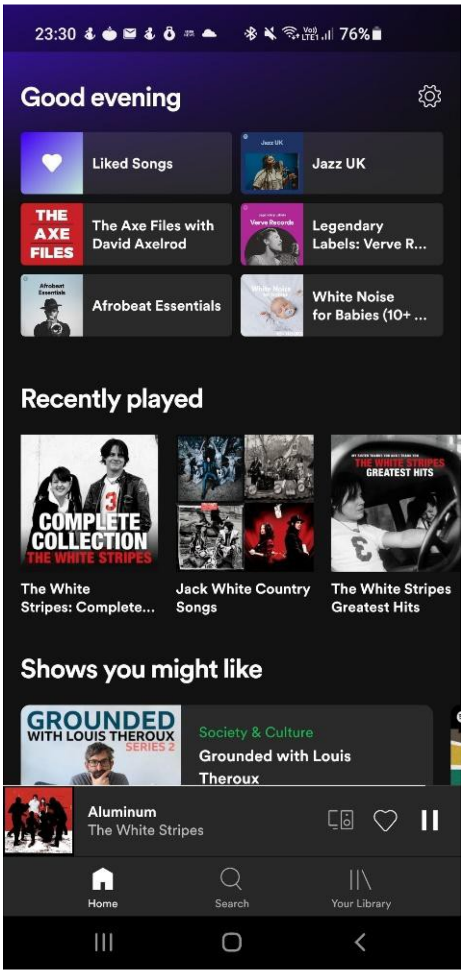
[8] Spotify defines "programmed stream" as those streams that come from Spotify-created editorial and algorithmic playlists, including radio and 'Autoplay'.

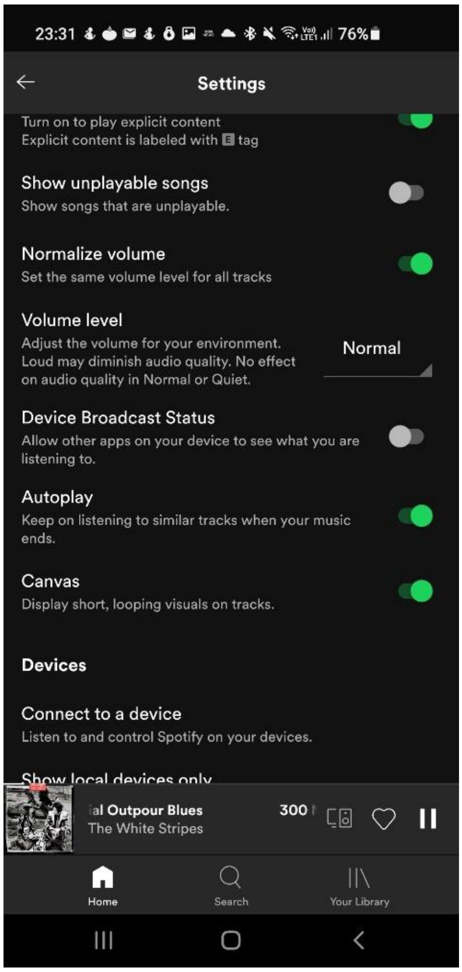
streaming market share to 31.5%. The collective share of the major record labels dropped from 66.5% in 2019 to 65.5% in 2020. Independent labels as a whole grew by 6.7% but smaller, newer indies tended to grow faster than the market.[9] The emerging generation of direct-releasing (DIY) artists in particular are reported as having outperformed the market in 2020, with the 'DIY' segment having grown a further 34.1% to break the billion dollar market for the first time. Market share increased by more than a percentage point, up to 5.1% in 2020.[10]

3.3 How to turn off the 'Autoplay' function in the Spotify app

(28) During the testimony of 23 February, Rt Hon Kevin Brennan asked Spotify to indicate how a user can turn off Spotify's 'Autoplay' function on the Spotify mobile app (ref: Q655-Q659).

(29) Opting out of the 'Autoplay' function is easily accessible on Spotify's mobile app and takes only two steps: (i) accessing the 'Settings' menu by tapping the 'gear' icon on the upper right-hand corner of the Home Screen; and (ii) disabling the 'Autoplay' function through the toggle appearing on the first page of the 'Settings' menu. Please see below screenshots from Spotify's Android app.





[9] *See* https://www.musicweek.com/labels/read/midia-research-indie-sector-and-self-releasing-artists-lead- streaming-growth-in-2020/082825
[10] *Ibid.*

3.4 Is music streaming more akin to renting or buying the music?

(30) One of the topics that arose during the testimony of 23 February was whether streaming is more akin to renting or buying the music. We believe DCMS Committee's question is best answered by reference to the internationally agreed rights framework, which recognises that streaming is not directly analogous to the physical world. The World Intellectual Property Organisation ("**WIPO**"), WIPO Copyright Treaty 1996 and the WIPO Performances and Phonograms Treaty 1996 provide the basis on which streaming services secure the rights they require to license in from rightsholders and their representatives.

(31) Copyright is a bundle of rights to carry out different forms of exploitation. Traditionally these have included rights such as the right to make copies, the right to issue (tangible) copies to the public (the distribution right) and, more recently, the right to authorise the rental of (tangible) copies.

(32) With the advent of the internet, with its global reach, it became clear that there was a need to have a consistent understanding internationally of the rights that are implicated when a member of the public accesses content online. This was debated and finally resolved in the WIPO Treaties. The UK is a contracting party to both treaties. It brought these new rights into domestic law as part of the implementation of the Information Society Directive (Dir 2001/29/EC).

(33) It is internationally agreed, and reflected in these treaties, that neither the distribution right nor the rental right were appropriate models, since both relate to the provision of physical copies. Agreement was reached that the appropriate model was a new right of "communication to the public", which includes making available for users to access on demand. For clarity, these rights are not solely for internet publishing and access, and are expressly stated to cover both wired and wireless access. The right applies to traditional works, including musical works and literary works (i.e., the rights administered by music publishers), as well as to sound recordings and fixations of performances.