

Digital Dilemmas: The Music Industry Confronts Licensing for On-Demand Streaming Services

By Jason Koransky

Jason Koransky is an associate at Pattishall, McAuliffe, Newbury, Hilliard & Geraldson LLP in Chicago, whose practice focuses on trademark, copyright, advertising, data privacy, and Internet law. He is the co-author of the book *Band Law for Bands*, published by Lawyers for the Creative Arts. Before transitioning into a career as an attorney, Jason worked as a journalist, and for 10 years served as editor of *DownBeat* magazine, an international music magazine devoted to jazz and blues. He can be reached at jmk@pattishall.com.

On September 22, 2015, the House Judiciary Committee held a roundtable with music industry officials at Belmont University in Nashville, Tennessee. On the agenda for this first stop of a listening tour organized by legislators to address potential copyright law revisions was a discussion of copyright issues affecting this industry.¹ The Nashville roundtable made international headlines when Kevin Kadish, the cowriter of Meghan Trainor's 2014 hit single "All About That Bass," said that he had earned only \$5,679 from 178 million digital streams of the song.² Kadish's alleged paltry royalties from digital streams of one of 2014's most popular songs brought into sharp relief a primary challenge for the evolving music industry: How can music composers and performers be sufficiently compensated when their works are played in new music platforms, while at the same creating a licensing framework that is not cost-prohibitive for digital music providers to offer services that consumers clearly want?

This will not be an easy task, as myriad legal issues exist that create what can appear to be a wide chasm between compensating artists and nurturing new technology. This article focuses on just a slice (albeit a large slice) of these legal issues—the licensing framework for rapidly expanding on-demand music services, such as Spotify, Apple Music, and TIDAL, and how the providers of these services, the owners of musical compositions and sound recordings, and lawmakers are navigating this new music terrain.

Shifting Tides in Music Consumption

Digital technology undoubtedly has upended and indelibly changed music industry business models. In 2000, revenues from U.S. music sales and licensing were reported as being approximately \$14.6 billion; by 2009, this total decreased by about 57 percent to approximately \$6.3 billion.³ This sharp decline corresponded with the introduction and expansion of legal and illegal digital music platforms and services. But today, while revenues in the music industry certainly have not risen to the levels they were at in 2000, revenues from digital music services are increasing and have become a potential bright spot for recorded music. In 2009, global revenues for sales of digital music were estimated at \$4.4 billion.⁴ By 2014, global digital revenues had increased almost 57 percent, to approximately \$6.9 billion.⁵

Two primary types of online music streaming services exist: noninteractive and interactive. A noninteractive service, such as Pandora or an Internet radio station, does not allow a user to choose the exact song he or she wants to hear. On the other hand, an interactive, on-demand service allows a user to choose a particular song or album in the service's catalog to listen to. On-demand services like Spotify have played a significant role in the recent growth of digital streaming services. For example, in 2011, paid subscriptions in the United States for these services were estimated at approximately 1.8 million.⁶ By 2014, paid subscriptions in the United States for on-demand services more than quadrupled, reaching approximately 7.7 million, with paid subscription revenues growing to approximately \$799 million.⁷ Significantly, revenues from all streaming services (which would also include noninteractive services like Pandora) accounted for 27 percent of total U.S. music industry revenues in 2014.⁸

All signs point to revenue numbers for on-demand music services only continuing to grow. Apple Music launched in June 2015, and in three months managed to sign up about 15 million users.⁹ Apple's involvement in this field, however, will certainly increase the percentage that streaming services account for in total U.S. music revenue. Further, Spotify has announced goals to reach 100 million subscribers globally by the end of 2015—albeit, the majority of these subscribers are for the free, ad-supported version of the service.¹⁰

These numbers represent just a small sample of the data proving massive changes in the music industry. Overall, they reflect an irreversible shift in music distribution, with consumers willing to spend about \$9.99 a month to have unlimited access to huge catalogs of recorded music, instead of \$12.99 or more for just one album. As sales of tangible products decrease, users and revenues of digital streaming services increase. Simply put, on-demand services appear to represent the future of the recorded music industry, but the services currently operate in a copyright system designed before the concept of any music, on any device, accessible anywhere you choose had been contemplated or conceived.

Current Licensing Framework

Current U.S. copyright law was not written to address the myriad licensing issues involved with on-demand digital music services. Much of the tension and difficulty exists with these services due to the complex licensing system for compositions and sound recordings in the digital realm, and the disparate treatment these works receive under the law. As with most discussions involving music copyright law, here it is likewise crucial to remember that two distinct copyrights exist in every recorded piece of music—one for the actual sound recording, and another for the underlying composition.¹¹ The methods by which digital streaming services obtain rights to perform and make copies of the sound recordings and compositions require different negotiations and licensing processes.

First, owners of sound recordings fixed on or after February 15, 1972,¹² enjoy federal rights in digital streams of their recordings that do not exist when these sound recordings are broadcast through terrestrial radio, as the Copyright Act provides the owner of a sound recording the exclusive right to perform the work through a digital audio transmission.¹³ Further, no compulsory license or set licensing rates exist to obtain the right to perform or make copies of sound recordings through an on-demand digital service. As such, on-demand digital music services must negotiate directly with the owners of sound recordings—such as record labels or individual artists—to obtain the right to offer their recordings on

the service. (On the other hand, statutory licenses exist to perform and make ephemeral copies of sound recordings through noninteractive services such as Pandora,¹⁴ the royalties from which are collected and administered by SoundExchange.¹⁵) Because these licenses are negotiated privately and are confidential, the standard rates for these licenses are not generally known to the public.

If artists who own their sound recordings do not want to make their recordings available through Spotify or another on-demand service, they can simply opt not to sign a license with the service. In doing so, however, they risk less exposure for their music. For on-demand music service providers, the lack of a statutory compulsory license creates significant challenges to acquire the rights to perform and make the necessary copies of sound recordings.

An entirely different situation exists for compositions. A digital streaming service must secure both a public performance license and a mechanical license to stream a composition. Public performance licenses are blanket licenses that a digital streaming service obtains from performing rights organizations (PROs) like ASCAP, BMI, and SESAC. If a musical work is listed in the database for one of these PROs, so long as the on-demand service has obtained a blanket license from one of these PROs, it has the right to perform the work publicly. Obtaining these licenses tend to be fairly straightforward transactions, and the rates that ASCAP and BMI charge for these licenses are dictated through consent decrees with the U.S. government.

Mechanical licenses, on the other hand, are statutory licenses obtained from separate organizations—such as the Harry Fox Agency—that administer the compulsory licenses set forth in 17 U.S.C. § 115. Under the statutory mechanical license framework in the Copyright Act, once a composition has been distributed in the United States, another party may distribute and make a copy of this composition, so long as it follows the procedures to obtain a compulsory mechanical license.¹⁶ An on-demand music service must obtain a mechanical license for a composition because streaming services make copies of the compositions on their servers in order to provide the works to listeners.

Pursuant to chapter 8 of the Copyright Act, the Copyright Royalty Board (CRB) sets the rates for these statutory licenses. In 2009, the CRB set the first rates for compulsory mechanical licenses for digital music services.¹⁷ As discussed later, composition owners appear to believe that the rates the CRB has set for mechanical licenses for on-demand services are too low, and efforts are underway that would allow owners of compositions to present evidence to the CRB that would help bolster arguments that these rates should increase.

One potentially burdensome component of acquiring a mechanical license is that the licensee must inform all owners of the composition that it intends to acquire this license. Oftentimes, all owners of a composition have their works registered with the Harry Fox Agency, which streamlines and simplifies the process of obtaining a mechanical license. For some musical works, however, the identity of the composers may not be readily attainable, or it may be difficult to locate the owners of the musical work. Contrary to the situation in which an on-demand service may obtain a blanket public performance license from a PRO for all works in a PRO's catalog and be assured that it has rights to perform the composition, an on-demand music service provider cannot be assured that it has properly obtained a

mechanical license if it is unsure whether all composition owners have received notice of the license. This creates an inherent risk in including such a composition in an on-demand service, as the service provider has technically violated the exclusive rights of the owners by not following the statutory formalities of obtaining the mechanical license.

Copyright law as it currently exists has allowed on-demand services to develop and grow. But sentiment is increasing from all parties with interests in these services that the law needs to be amended to address both the technological and marketplace realities of these services.

Artists Revolt against Current System

In June 2015, Spotify received a valuation of more than \$8 billion after it engaged in another round of funding.¹⁸ Clearly, investors believe that on-demand digital streaming offers significant revenue potential. Some artists, on the other hand, have taken a more skeptical approach to these services. Most famously, Taylor Swift pulled her recordings from Spotify in November 2014.¹⁹ (Interestingly, though, she cannot control uses of her compositions on Spotify, as shown by the fact that Ryan Adams's cover version of Swift's album *1989* is available on Spotify.) Prior to pulling her music from the service, in a story published in the *Wall Street Journal*, Swift wrote, "Piracy, file sharing and streaming have shrunk the numbers of paid album sales drastically, and every artist has handled this blow differently."²⁰

Of course, being one of the most popular recording artists in the world allows Swift to have the autonomy to take such an action, and to receive publicity for it. But criticism of Spotify or other digital streaming services is not confined to her. For example, Thom Yorke, lead singer of the band Radiohead, once called Spotify "the last desperate fart of a dying corpse."²¹ Significantly, it is close to impossible to find any commentary that musicians are overpaid by these services. Rather, the common refrain is that artists are grossly underpaid when their compositions and sound recordings are streamed through on-demand services.

One recent report that took a pro-artist stance came from the Rethink Music Initiative, which was a project from the Berklee College of Music Institute for Creative Entrepreneurship.²² Released on July 14, 2015, the report was the result of a year-long study to gain a deeper understanding on the contours of the digital music marketplace, locate inefficiencies, and make recommendations to cure these inefficiencies and level the playing field for all parties in the industry.

The Rethink Music report provided several recommendations, including the creation of a Creator's Bill of Rights, a "fair music" certification of transparency for digital services, and creating a decentralized database for rights holders of compositions and sound recordings.²³ The proposed Creator's Bill of Rights essentially calls for music not to be undervalued in the digital realm, and for artists to have a greater voice in how their works are used. Key provisions of these standards would include:

- Every creator deserves to be fairly compensated for the use of his/her works.
- Every creator deserves to know exactly where and when his/her work is used or performed.
- Every creator deserves up-to-date reporting on the uses of his/her works (no more than 30 days in arrears for digital uses, 90 days for other uses).

- Every creator deserves to be recognized for the creation of his/her works via identification on digital performances or uses.
- Every creator deserves to know the entire payment stream for his/her royalties (e.g., which parties are taking a cut and how much).
- Every creator deserves the right to set the price for his/her works based on fair-market value.²⁴

Implementing some of these proposals would involve changes to U.S. copyright law, while others would simply be standards that would be adopted by the industry. Interestingly, the Copyright Office has set forth proposals that closely resemble some of Rethink Music's recommendations.

The Copyright Office Offers Positions on On-Demand Streaming

In February 2015, the Copyright Office issued a report titled *Copyright and the Music Marketplace*.²⁵ The report emphasized that compositions and sound recordings should be regulated in a more consistent and equal manner in the digital realm, and emphasized that owners of compositions should be allowed to opt-out or withdraw rights to use their compositions in interactive streaming services.²⁶ Such a development would surely be applauded by composers who want recourse if they feel that they are not being properly compensated for their works.

The Copyright Office also recognized the inefficiencies that exist in the current licensing system for interactive digital music services to obtain rights to use musical compositions in their services, and made several specific recommendations to help streamline the licensing process. First, the report suggested that a bundled mechanical and performance rights license should be created, so that both licensors and licensees would not have to engage in the redundant process of licensing these rights.²⁷ Second, the report recommended amending § 115 of the Copyright Act to establish a blanket mechanical license for digital uses, which would allow a licensee to obtain a repertoire-wide mechanical license from a management rights organization such as the Harry Fox Agency.²⁸ The report, however, recommended adding an opt-out provision should publishers or other composition owners not want their works to be included in such a license for an on-demand service. Further, the report also recommended an opt-out provision for PROs for public performance licenses for interactive streaming services.²⁹

Overall, the Copyright Office report struck a balance between protecting content creators' rights and establishing an environment in which on-demand services could operate efficiently.

Spotify's Proposals

Submitted in response to the Copyright Office's notice of inquiry for what became the *Copyright and the Music Marketplace* report, Spotify submitted comments that detailed its proposed revisions to copyright law.³⁰ Spotify acknowledged that any revisions should ensure that "[a]uthors and performers receive fair compensation for their creative works."³¹ It also made some interesting proposals that would help mitigate risks and bring efficiencies to the mechanical licensing process. As detailed above, on-demand streaming services must obtain a mechanical license prior to streaming any composition and must comply with the formalities for this statutory compulsory license, including notifying rights holders that it intends to acquire this license. Spotify made two proposals regarding mechanical licenses. First, it proposed allowing it to provide a notice of intent to use a composition within a reasonable time after distribution on the service, rather than prior to use.³²

Second, Spotify also proposed creating a blanket license for § 115 licenses for musical works similar to the mechanism that exists for § 114 licenses for digital transmissions of sound recordings on noninteractive services.³³ Spotify identified the seemingly illogical disparate treatment of sound recordings and compositions in the digital music realm, and made a strong argument that treatment should be equal:

If Congress has already determined that certain uses of musical works are covered by a statutory license, then it would seem unnecessary to provide each and every copyright owner with notice of use in advance of such use so long as the copyright owner is being paid for a use. For example, Section 114 does not require a noninteractive streaming service to notify each sound recording copyright owner of a use of a sound recording. Rather, a single Notice of Use of Sound Recordings Under Statutory License is filed with the United States Copyright Office. Spotify sees no reason why notice to copyright owners under Section 115 should be different than notice to copyright owners under Section 114.³⁴

Spotify recommended that a single organization, similar to SoundExchange, be created to collect these new blanket royalties.³⁵ Spotify did argue, however, that the rate-setting procedures for mechanical licenses before the CRB were “probably appropriate” and should not be modified significantly.³⁶ If current legislation before Congress passes, however, these rate-setting procedures will likely change significantly.

Legislation Proposed

On March 4, 2015, a bipartisan group of legislators introduced the Songwriter Equity Act of 2015.³⁷ The bill has two primary components. First, the bill would allow the CRB or any other administrative or judicial body to consider the license rates set for digital public performances of sound recordings under 17 U.S.C. § 106(6) when determining the appropriate § 114 compulsory license rates for composition. This change would impact the license rates for noninteractive music services.

The second proposed revision would impact on-demand services. Currently, in rate-setting proceedings for § 115 mechanical licenses, the CRB cannot consider as evidence in setting rates other licensing deals. Essentially, the CRB cannot determine how the current marketplace would guide the rates for these compulsory mechanical licenses. The Songwriter Equity Act changes this, by amending 17 U.S.C. § 115(c)(3)(D) to include the following:

The Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller. In establishing such rates and terms, the Copyright Royalty Judges shall base their decision on marketplace, economic, and use information presented by the participants. In establishing such rates and terms, the Copyright Royalty Judges may consider the rates and terms for comparable uses and comparable circumstances under voluntary license agreements.³⁸

Simply put, the legislation would likely lead to an increase in mechanical royalty rates for using works in on-demand services. While this change may not eliminate stories such as Kadish's small checks for being the cowriter of an international hit song, it could at least help provide compensation for songwriters more commensurate with how their works are used. Certainly, the change could result in costs for music through on-demand streaming services rising.

Conclusion: Legal Reforms Aim to Find Appropriate Value for Music in New Digital Realm

As shown above, all parties seem to be in agreement that musicians need to get sufficiently paid for their works when streamed on platforms such as Spotify and Apple Music. Further, all parties agree that the current licensing system needs to be updated. But what these updates will be remains to be seen. While some radical changes have been proposed, actual change will likely be slow and incremental.

Proposals such as those in the Songwriter Equity Act to amend the Copyright Act to allow parties to present more evidence to the CRB in mechanical license rate determination proceedings may prove easier to implement than a new blanket license for mechanical licenses. Yet as the marketplace continues to push for on-demand music and artists see the potential to reach their fans and make money through these services, music distribution will continue to move away from physical products and become predominantly digital. While this occurs, the laws will likely change to allow these services to proliferate, while at the same time giving artists the financial incentive to make and distribute their music.

Endnotes

1. See Nate Rau, "All About That Bass" Writer Decries Streaming Revenue, TENNESSEAN, Sept. 22, 2015, <http://www.tennessean.com/story/money/industries/music/2015/09/22/all-bass-writer-decries-streaming-revenue/72570464/>.
2. *Id.* Kadish did not distinguish what percentage of these streams were from noninteractive digital music services, such as Pandora, SiriusXM, and Internet radio, and what percentage were from interactive, on-demand services like Spotify.
3. See David Goldman, *Music's Lost Decade: Sales Cut in Half*, CNN MONEY (Feb. 3, 2010), http://money.cnn.com/2010/02/02/news/companies/napster_music_industry/.
4. See IFPI, IFPI DIGITAL MUSIC REPORT 2015: CHARTING THE PATH TO SUSTAINABLE GROWTH 6 (2015), <http://www.ifpi.org/downloads/Digital-Music-Report-2015.pdf>.
5. *Id.*
6. See JOSHUA P. FRIEDLANDER, RECORDING INDUS. ASS'N OF AM., NEWS AND NOTES ON 2014 RIAA MUSIC INDUSTRY SHIPMENT AND REVENUE STATISTICS 1 (2014), <http://riaa.com/media/D1F4E3E8-D3E0-FCEE-BB55-FD8B35BC8785.pdf>.
7. *Id.* at 1–2.
8. *Id.*
9. See Claire Atkinson, *Apple Music Has Been a Surprising Success*, N.Y. POST, Sept. 21, 2015, <http://nypost.com/2015/09/21/apple-music-has-been-a-surprising-success>. Many of those people certainly signed up for the initial three-month free trial period, and these numbers likely decreased significantly after the trial period ended on Sept. 30, 2015.

10. See Max Willens, *Spotify Launches All-Out Blitz on Advertisers in NYC as Streaming Music Heats Up*, INT'L BUS. TIMES, Sept. 29, 2015, <http://www.ibtimes.com/spotify-launches-all-out-blitz-advertisers-nyc-streaming-music-heats-2117378>.
11. See 17 U.S.C. § 102(a).
12. No federal copyright protection exists for sound recordings made prior to this date. In 1971, Congress passed the Sound Recording Amendment, which provided the owners of sound recordings made from February 15, 1972, onward the exclusive right to reproduce their works. See Pub. L. No. 92-140, § 3, 85 Stat. 391, 392 (1971).
13. 17 U.S.C. § 106(6).
14. *Id.* §§ 112, 114.
15. See *About*, SOUNDEXCHANGE, <http://www.soundexchange.com/about/> (last visited October 15, 2015).
16. 17 U.S.C. § 115(a).
17. See Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding, 74 Fed. Reg. 4510, 4514–15 (Jan. 26, 2009) (codified at 37 C.F.R. §§ 385.1–.17).
18. See Kasper Viita & Matthew Campbell, *Spotify Value Tops \$8 Billion as Investors Bet on Streaming*, BLOOMBERG BUS. (June 10, 2015), <http://www.bloomberg.com/news/articles/2015-06-10/spotify-valued-at-8-2-billion-as-teliasonera-buys-stake>.
19. Swift was also quick to condemn Apple for its initial decision not to pay royalties to artists during the three-month free trial period when Apple Music launched in the United States. See Taylor Swift, *To Apple, Love Taylor*, TUMBLR (June 21, 2015), <http://taylorswift.tumblr.com/post/122071902085/to-apple-love-taylor>. Shortly after Swift wrote this post, Apple decided to pay artists during the trial period. See Tim Bajarin, *How Taylor Swift Saved Apple Music*, TIME (June 30, 2015), <http://time.com/3940500/apple-music-taylor-swift-release/>.
20. See Taylor Swift, *For Taylor Swift, the Future of Music Is a Love Story*, WALL ST. J., July 7, 2014, <http://www.wsj.com/articles/for-taylor-swift-the-future-of-music-is-a-love-story-1404763219>.
21. See Stuart Dredge, *Thom Yorke Calls Spotify “The Last Desperate Fart of a Dying Corpse”*, GUARDIAN, Oct. 7, 2013, <http://www.theguardian.com/technology/2013/oct/07/spotify-thom-yorke-dying-corpse>.
22. RETHINK MUSIC, FAIR MUSIC: TRANSPARENCY AND PAYMENT FLOWS IN THE MUSIC INDUSTRY (2015), http://static1.squarespace.com/static/552c0535e4boafcbcd88dc53/t/55d0da1ae4b06bd4bea8c86c/1439750682446/rethink_music_fairness_transparency_final.pdf.
23. *Id.* at 25.
24. *Id.*
25. U.S. COPYRIGHT OFFICE, COPYRIGHT AND THE MUSIC MARKETPLACE: A REPORT OF THE REGISTER OF COPYRIGHTS (2015), available at <http://copyright.gov/policy/musiclicensingstudy/copyright-and-the-music-marketplace.pdf>.
26. *Id.* at 2.
27. *Id.* at 5.
28. *Id.* at 6.
29. *Id.* at 4.
30. See Comments of Spotify USA Inc., Music Licensing Study, Docket No. 2014-03 (U.S. Copyright Office May 23, 2014), available at http://copyright.gov/docs/musiclicensingstudy/comments/Docket2014_3/Spotify_USA_Inc_MLS_2014.pdf.

31. *Id.* at 3.
32. *Id.* at 6.
33. *Id.*
34. *Id.* at 8 (footnote omitted).
35. *Id.*
36. *Id.* at 6–7.
37. H.R. 1283, 114th Cong. (2015).
38. *Id.* § 5.