PLAY IT AGAIN, SAM:
THE FREE-MARKET CASE FOR GOVERNMENT INTERVENTION IN THE MUSIC STREAMING SECTOR

It's no secret that record labels wield outsize influence to dictate streaming royalty payments. For every dollar paid to publishers in streaming royalties, major labels in 2021 are slated to take home four.[1] This discrepancy is a byproduct of the exceedingly complex structure of music licensing, which has more facets than a cut diamond—and music streaming, which accounts for 80% of music consumption domestically,[2] touches nearly all of them.

To stream a song into a consumer's laptop or smart phone, a service like Spotify must (generally) secure four separate licenses: two for the recording, and two for the musical work embodied in it.[3] Record labels have a free hand to negotiate whatever rate they can extract from the streaming services to license their recordings. Publishers don't have this ability; since 1941, the consent decrees governing ASCAP and BMI require them to offer mechanical licenses at a rate set by the Copyright Royalty Board (CRB), a panel of three federal judges with experience in copyright law and economics.[4]

In addition to the mechanical licensing rate, the CRB also sets the total amount a streaming service must pay to secure both mechanical and performance licenses for all musical works on its platform.[5] This "all-in" amount is defined as the greater of two figures: a percentage of the streaming service's total revenue, or a percentage of the service's "total content cost" (TCC), which is the combined amount the service must pay to license all sound recordings offered on its platform.[6] Whichever number is larger is the total amount owed to publishers.[7] How it's divvied up between mechanical and performance royalties depends on the price of public performance licenses, which are set by the Performing Rights Organizations (PROs) or in a rate court.[8] In other words, the mechanical royalty rate paid by streaming services to publishers and songwriters is calculated as follows:

["all-in" rate set by CRB] minus [public performance license rate set by PROs/rate court] = streaming service's total mechanical royalty obligation.[9]

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[1] 37 C.F.R. § 385.21 (2019); *See also* Bill Hochberg, *DOJ Sparks Fight Between Record Labels and Music Publishers Over Streaming Money*, FORBES (June 25, 2019), https://www.forbes.com/sites/williamhochberg/2019/06/25/doj-surprise-announcement-triggers-music-biz-clash/#7a206f9e8714.

[2] Joshua P. Friedlander, *Mid-Year 2019 RIAA Music Revenues Report*, RECORDING INDUSTRY ASS'N OF AM. (Sep. 5, 2019), https://www.riaa.com/reports/2019-mid-year-music-industry-revenue-report-riaa/.

[3] Meredith Filak Rose, *Spotify's Copyright Royalty Board Appeal, Decoded*, PUB. KNOWLEDGE (Apr. 10, 2019), https://www.publicknowledge.org/blog/spotifys-copyright-royalty-board-appeal-decoded/.

[4] *Id.*

[5] Royalty Rates & Terms for Making & Distrib. Phonorecords, 84 Fed. Reg. 1918, 1918 (Library of Cong. Feb. 5, 2019) (determination).

[6] *Id*.

[7] Meredith Filak Rose, *Spotify's Copyright Royalty Board Appeal, Decoded*, PUB. KNOWLEDGE (Apr. 10, 2019), https://www.publicknowledge.org/blog/spotifys-copyright-royalty-board-appeal-decoded/.

[8] *Id.*

[9] 37 C.F.R. § 385.21 (2019).

Given the chronic unprofitability of streaming services, the "percent of revenue" figure is nearly always lower, and thus the "percent of TCC" method is, for all intents and purposes, the dominant one.[10]

To illustrate, in 2020 Spotify will have to pay publishers 24.1% of whatever it spends on TCC.[11] If TCC is $1 billion, for example, publishers and songwriters get $241 million; this means labels will rake in over 80% of what Spotify pays out in licensing fees this year. Moreover, in 2018 the CRB removed a cap on the TCC-linked calculation method, which previously had limited the TCC figure to a fixed per-subscriber royalty.[12] In other words, as of now, labels are not restricted to a TCC ceiling.[13] This creates a risk that the three biggest major labels, who control three-quarters of the recorded music market and are free to use that leverage in negotiations, will insist on rates exceeding those previous limits.

Songwriters and publishers stand to benefit from this. If and when labels demand higher rates from streaming services, it will drive up the services' TCC, thereby increasing the royalties paid to publishers and songwriters. It sounds great in theory—sort of a rising-tide-lifts-all-boats principle—and songwriters are understandably jazzed by it, because the current CRB rate structure represents a 44% raise from what they were being paid prior to 2018.[14]

From a consumer standpoint, however, this arrangement sets the stage for anticompetitive tomfoolery by the major record companies, who just so happen to own three of the four largest publishing companies.[15] This means they can increase royalty payments to their publishing arms––and effectively double dip into streaming revenue—simply by nudging up their own rates.

This is a problem for three reasons. First, if the labels act in concert, they could use their combined market power to drive up streaming costs unilaterally, leading to runaway rate increases across the board. Second, now that TCC-linked royalties have been uncapped by the CRB, major labels could demand a higher and higher percentage of a streaming service's revenue, thereby rendering them perpetually weak against the labels' collective bargaining power. Third, this lopsided environment will suppress competition in the streaming sector by artificially raising the bar to entry; it's not hard to imagine the difficulties a streaming startup would face trying to unseat services like Apple Music, Google Play, and Amazon Prime, whose losses are backstopped by the richest corporations on the planet.

An analogous situation in the publishing sphere is instructive, and provides a glimpse into how the ASCAP and BMI consent decrees preserve competition there. As of March 2019, Universal Music Group, Sony Music Entertainment, and Warner Music Group control about three-

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[10] Meredith Filak Rose, *Spotify's Copyright Royalty Board Appeal, Decoded*, PUB. KNOWLEDGE (Apr. 10, 2019), https://www.publicknowledge.org/blog/spotifys-copyright-royalty-board-appeal-decoded/.

[11] *See* Royalty Rates and Terms for Making and Distributing Phonorecords, 84 Fed. Reg. at 1918.

[12] *See* Pub. Initial Brief for Appellants/Intervenors Pandora Media, LLC et al. at 10, Johnson v. Copyright Royalty Bd., No. 19-1028 (D.C. Cir. Sept. 18, 2018).

[13] *See id.* at 14. This ruling is currently on appeal before the D.C. Circuit.

[14] Tim Ingham, *Apple Wanted to Revolutionize the Way Streaming Pays. Here's Why it Wasn't Allowed*, ROLLING STONE (Sep. 6, 2019), https://www.rollingstone.com/music/music-features/apple-spotify-streaming-song-royalties-880552/.

[15] Lennon Cihak, *The Latest Ranking of Music Publisher Gold & Platinum Certifications*, DIGITAL MUSIC NEWS (May 31, 2018), https://www.digitalmusicnews.com/2018/05/31/nmpa-music-publishers-songwriters/.

quarters of the recorded-music market.[16] Likewise, Universal Music Publishing Group (UMPG), Sony/ATV, and Warner/Chappell Music account for well over half of the music publishing market.[17]

This market power was on display in 2013, when Sony/ATV, UMPG, and ASCAP colluded to extract above-market licensing rates from Pandora.[18] The story began when Sony announced its decision in late 2012 to withdraw its "new media" rights from ASCAP on January 1, 2013.[19] Concerned about impacts to its licensing costs, Pandora filed a petition in the ASCAP rate court in November 2012 seeking redress pursuant to Article IX of the ASCAP consent decree.[20] This angered the major publishers, including UMPG, which had planned its own withdrawal of its new media rights from ASCAP.[21]

This withdrawal of new media rights from the PROs meant that Pandora would have to negotiate with the publishers directly, without oversight by a rate court. During these negotiations, Sony refused to provide a list of its songs to Pandora, preventing Pandora from knowing exactly which songs on its platform were subject to negotiations.[22] At the time, Sony's catalog represented about 30% of Pandora's offerings.[23] As the settlement deadline neared, Pandora was forced into a tight spot; either accept Sony's unfavorable terms, or risk copyright infringement for streaming Sony's content without a licensing agreement, which would have subjected Pandora to statutory damages of $150,000 *per infringement*.[24] To avoid the impending catastrophe, Pandora reluctantly accepted Sony's rates—about 25% above market. [25]

Despite a confidentiality agreement, Sony leaked key details of the settlement, providing a blueprint to UMPG, which was set to begin negotiations with Pandora following its own withdrawal of new media rights.[26] UMPG subsequently extracted a similar rate for its own mechanical licenses.[27] To cap it all off, both publishers then sought to use these inflated rates as benchmarks in the rate court proceedings.[28]

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[16] Mark Mulligan, *2018 Global Label Market Share: Stream Engine*, MIDIA RES. (Mar. 13, 2019), https://www.midiaresearch.com/blog/2018-global-label-market-share-stream-engine/.

[17] Ed Christman, *Publisher's Quarterly: Marshmello Sweetens UMPG's Market Share as Sony/ATV Keeps No. 1 Spot in Q4*, BILLBOARD (Feb. 8, 2019), https://www.billboard.com/ articles/business/8497327/music-publishers-quarterly-q4-sonyatv-kobalt-umpg-warner-chappell.

[18] *See* In re Pandora Media, Inc., 6 F. Supp. 3d 317 (S.D.N.Y. 2014).

[19] *Id.* at 340–41.

[20] *Id.* at 320.

[21] *Id.* at 347.

[22] *Id.* at 344–45.

[23] *See id.* at 345.

[24] *See id.*; *see also* 17 U.S.C. § 504(c)(2) (2018).

[25] In re Pandora Media, Inc., 6 F.Supp.3d 317, 346 (S.D.N.Y. 2014).

[26] *Id.* at 346–47.

[27] *Id.* at 350.

[28] *Id.*

In her opinion, Judge Denise Cotes noted that "ASCAP, Sony, and UMPG did not act as if they were competitors."[29] Instead, "[b]ecause their interests were aligned against Pandora, and they coordinated their activities with respect to Pandora, the very considerable market power that each of them holds individually was magnified."[30]

This state of affairs bears a striking resemblance to that of the 1930s, when ASCAP and BMI, the biggest players in the dominant form of music consumption at the time—public performance of musical works—engaged in similar collusive conduct.[31] This attracted the attention of antitrust regulators, which ultimately gave rise to the consent decrees still in effect today.[32] These decrees restrict ASCAP and BMI from engaging in certain conduct, such as withholding licenses to certain works as leverage to charge more for blanket licenses,[33] and basing a license fee on a percentage of income from the use of songs *not* contained in the PRO's catalog.[34]

The purpose of this paper, therefore, is to propose a solution to the problem of near-certain anticompetitive conduct by the major labels in the streaming space. That solution is to impose restrictions on the major labels which mirror those in the consent decrees governing ASCAP and BMI. This would accomplish four things.

First, it would stabilize the current uncertainty in the wake of the CRB's 2018 rate determination. Armed with an uncapped TCC and enormous market power, labels have an opportunity to solidify their dominance over streaming royalties at the expense of consumers, songwriters, and streaming services alike; and it is unclear exactly how they might react.

One possibility is that labels could raise prices in lockstep to drive royalty payments artificially high. While services could in turn raise prices to compensate, culturally it has become somewhat entrenched that music should be widely available at a low cost. If Spotify raised its prices to, say $50/month, how would Apple respond? If it follows a similar playbook from past dust-ups, it will accuse Spotify of price gouging,[35] issue a statement about how deeply it cares about musicians,[36] and use its $245 billion in cash reserves to keep Apple Music afloat as Spotify users jump ship. This "Wal-Mart Effect" will ultimately reduce competition in the streaming sector and provide powerful disincentives to enter the marketplace.

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[29] *Id.* at 357–58.

[30] *Id.*

[31] *ASCAP-BMI Consent Decrees*, FUTURE OF MUSIC COALITION, https://futureofmusic.org/ article/fact-sheet/ascap-bmi-consent-decrees. (last visited Dec. 30, 2019).

[32] *Id.*

[33] *See* U.S. v. Am. Soc'y of Composers, Authors, & Publishers, Civ. Action No. 41-1395 at 7 (S.D.N.Y. June 11, 2001).

[34] *See id.* at 8.

[35] Dani Deahl, *Here's Why Apple is Saying Spotify is Suing Songwriters*, VERGE (Mar. 15, 2019), https://www.theverge.com/2019/3/15/18267288/apple-music-spotify-suing-songwriters-eu-antitrust (accusing Spotify of "suing music creators" when it appealed the CRB ruling, but would stand to benefit from any favorable outcome Spotify obtained).

[36] Tim Ingham, *Apple Wanted to Revolutionize the Way Streaming Pays. Here's Why it Wasn't Allowed*, ROLLING STONE (Sep. 6, 2019), https://www.rollingstone.com/music/music-features/apple-spotify-streaming-song-royalties-880552/ (proposing a per-stream rate unconnected to a percentage of streaming revenue, which only Apple with $245 billion in cash on hand could afford to pay).

Another possibility is that labels might simply buy a controlling stake in a streaming service, and accept payment in equity instead of cash.[37] This would allow labels to give sweetheart deals to its own service, such as a discounted rate to license the label's content.[38] This would harm music creators, as it would drive down TCC and thereby reduce royalty payments across the board. Consumers and creators alike thus have an interest in curbing the major labels' ability to capitalize on this uncertainty.

Second, such intervention would liberate songwriter royalties from the five-year plan contemplated by the CRB.[39] This would allow for an even faster increase in streaming royalties for songwriters, who, despite the recent increase, still have to bicker with Spotify over the crust after labels take home the pie.[40] Third, it will ensure that consumers have uninterrupted access to the wide-ranging catalogs they've become accustomed to, all in one place. Finally, and most importantly, it will promote long-term stability and predictability in the streaming sector by preventing the sort of anticompetitive shenanigans on display in *Pandora*.

The first and most obvious question is, why impose *more* government control over the price of music licenses? Instead of tying labels' hands to negotiate favorable rates for its artists, why not eliminate or modify the consent decrees, and thus free up publishers to do the same?

The answer is simple. It's because the consent decrees, as a practical matter, aren't going anywhere.

For one thing, they've already passed constitutional muster.[41] Second, the Department of Justice undertook a broad evaluation of the consent decrees in 2014, only to decline to take any substantive action two years later, concluding that the decrees' substantial benefits to music consumers and creators alike outweighed any drawbacks.[42] The DOJ since re-opened its evaluation, but has been met with resistance on many fronts, including, ironically, a dozen or so staunch free-market groups who recognize the music business as "inherently anticompetitive."[43]

If that weren't enough, the DOJ's decision to reopen debate on the subject was met with swift rebuke by the leaders of both the House and Senate Judiciary Committees, who drafted a joint letter to Assistant Attorney General Makan Delrahim, unanimously urging the DOJ not to modify or terminate the consent decrees.[44] Their reason? Much of the Music Modernization Act

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[37] Meredith Filak Rose, *Spotify's Copyright Royalty Board Appeal, Decoded*, PUB. KNOWLEDGE (Apr. 10, 2019), https://www.publicknowledge.org/blog/spotifys-copyright-royalty-board-appeal-decoded/.

[38] *Id.*

[39] 37 C.F.R. § 385.21 (2019).

[40] Jem Aswad & Chris Willman, *Spotify, Google, Pandora, Amazon Go to U.S. Appeals Court to Overturn Royalty Increase*, VARIETY (Mar. 7, 2019), https://variety.com/2019/music/news/ spotify-google-and-pandora-go-to-u-s-appeals-court-to-overturn-royalty-increase-exclusive-1203157697/.

[41] *See* Broad. Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1, 13 (1979).

[42] *Statement of the Dept. of Justice on the Closing of the Antitrust Division's Review of the ASCAP and BMI Consent Decrees*, DEP'T OF JUSTICE (Aug. 4, 2016), https://www.justice.gov/atr/antitrust-consent-decree-review-ascap-and-bmi-2015.

[43] Anne Cullen, *DOJ Urged to Leave Intact Music Licensing Orders*, LAW360 (Aug. 7, 2019), https://www.law360.com/articles/1186221/doj-urged-to-leave-intact-music-licensing-orders.

[44] Letter from Senators Chuck Grassley and Dianne Feinstein, and Representatives Bob Goodlatte and Jerrold Nadler, to Hon. Makan Delrahim, Assistant Attorney General, Antitrust Division, United States Dep't of Justice (June 8, 2018), https://src.bna.com/zyr.

(MMA) was drafted on the presumption that the consent decrees would remain in place.[45] If the DOJ terminated or substantially modified them, the resulting "destabilization of the music marketplace would undermine our efforts" to implement the MMA.[46]

That such partisans can come together so seamlessly on an issue speaks to its self-evidence. Moreover, given the considerable disruptiveness terminating the consent decrees could undoubtedly cause,[47] it seems unlikely that the industry would plunge itself into a dark pool of uncertainty at precisely the moment when the MMA is bringing some welcome relief—this is especially true in light of the MMA's unanimous passage in Congress and warm, nearly universal embrace by the industry.[48]

Admittedly, more government intervention on an industry already under a substantial regulatory burden is a heavy proposition. Isn't there a better way? The answer is yes, and no. A grand solution to the problem of royalty disparity between labels and publishers has already been proposed by Richard Stumpf, CEO of Atlas Music Publishing. In an op-ed published in Billboard earlier this year, Mr. Stumpf set forth a comprehensive, fair, elegantly simple compromise to settle the issue not just of streaming royalties, but of *all* music royalties. From the simple premise that "[n]obody can answer the question who is more important to the song, the writer or performer," Richard proposes a grand compromise: split everything—streaming royalties, synch royalties, terrestrial radio royalties, everything—right down the middle.[49]

While Mr. Stumpf might be the last great pragmatist in the music business—and his proposal the fairest of them all—it has a fatal flaw; it requires a good-faith, multi-faceted, rational compromise from a business which is anything but. There are just too many competing interests, and too much nuance in the set of rights at stake.

In the absence of meaningful action to curb major labels' leverage over streaming prices, the major labels are now poised to grab so much market power in the streaming sphere that any future negotiations to implement a grand compromise like Richard Stumpf's will be torpedoed before they begin. Therefore, Congress and the DOJ should act now so the streaming industry may flourish for the benefit of consumers and creators alike.

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[45] *See id.*

[46] *Id.*

[47] *See* Letter from Gordon Smith, President & CEO, National Association of Broadcasters, to Makan Delrahim, Assistant Attorney General, Antitrust Division (Aug. 9, 2019), http://www.nab.org/documents/newsRoom/pdfs/080919_consent_decrees_comments.pdf (noting that unilateral action to terminate the consent decrees would "unmoor an entire industry").

[48] Dani Deahl, *The Music Modernization Act Has Been Signed Into Law*, VERGE (Oct. 11, 2018), https://www.theverge.com/2018/10/11/17963804/music-modernization-act-mma-copyright-law-bill-labels-congress.

[49] Richard Stumpf, *Atlas Music Publishing CEO: Solutions to Streaming Rate Debate 'Staring Right at Us' (Guest Op-Ed)*, BILLBOARD (Jun. 18, 2019), https://www.billboard.com/articles/ business/8516468/streaming-rate-debate-richard-stumpf-atlas-ceo-op-ed.