

FLIPPING PUBLISHING MICRO-PENNIES INTO A BUCKET

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ON-DEMAND STREAMING RIGHTS AND RATES: *HOW THEY WORK AND WHAT THEY ARE WORTH*

PERFORMING RIGHTS ORGANIZATIONS (“PROs”) – ASCAP / BMI / SESAC

The American Society of Composers, Authors and Publishers (“ASCAP”), Broadcast Musicians Inc. (“BMI”), and the Society of European Stage Authors & Composers (“SESAC”) are the three major Performing Rights Organizations (“PROs”) in the US. These PROs collect over \$2 billion in license fees from music users like television and radio stations, restaurants, performing venues, and digital services for



performing music. Songwriters and publishing companies whose works are performed in the US typically affiliate with one of these societies to collect license fees for the use of their **public performance right in a musical composition**. In the digital space, PROs usually provide music service providers a blanket license, which allows the music service provider to use all of the works in the PRO’s repertory for one fee. PROs are generally an efficient and effective way to administer performance rights in musical compositions.

Because PROs collect license fees for their entire catalogs, and not for specific performances of each writer or publisher’s works, the amount received as a license fee needs to be translated into a royalty rate payable to the writers and publishers. PROs rely on the performance information provided by its licensees in order to divide the blanket fees. For example, because ASCAP pays writers and publishers for domestic (i.e. US) performances on a quarterly basis, ASCAP apportions the license fee received by a digital music user according to the performance data received by that music user for that quarter (after the deduction of operating expenses). This “follow the dollar” method ensures that ASCAP members receive royalties in similar proportion to the amount received by the music user as a license fee.

PROs do not pay out for every digital performance. Because the per-stream rate is so small (often in hundredths of a penny) it would not be practical to issue a payment to every songwriter or publisher who has just a few performances in a given quarter. In order to pay efficiently, PROs typically use minimum performance thresholds for titles before that title is credited with royalties. Once the credit threshold is reached, the total royalties are divided between all writers and publishers on the work (50% to writers and 50% to publishers, per industry standards) and are issued by ASCAP accordingly.

HYPOTHETICAL #1 – Payment from a PRO for performances on a digital music service

Assume Live365 pays ASCAP \$80,000 in license fees in 4Q2013 and also provides ASCAP with data showing 150,000,000 performances of ASCAP works for that same quarter. This would mean that every performance would be equivalent to about \$.000533 (\$80,000

[distributable royalties] / 150,000,000 [performances]). Accordingly, it will take approximately 14,440 performances to reach one credit (14,440 [performances] x .0533 [rate] = \$7.70).

SCENARIO (a) – Bob Donnelly is an ASCAP writer member and ASCAP publisher member who writes and publishes his own works—therefore he is entitled to receive 100% of all royalties attributed to his works in equal distributions as a writer and a publisher. In 4Q2013, Bob’s music is streamed on Live365 **28,880 times**. In Bob’s corresponding ASCAP writer and publisher distributions for that quarter, he will receive a total of \$14.40 for performances on Live365.

SCENARIO (b) – Alternatively, if Bob was published by Sony/ATV, and his work was streamed **14,440 times**, Bob would receive \$3.35 (while Sony/ATV receives the other \$3.35).

ON-DEMAND (“INTERACTIVE”) MUSIC STREAMING – RIGHTS AND SERVICES

On-demand streaming is a term used to describe a type of music service that contains a catalog of recordings that a listener is able to browse and select to play any part of that catalog at their discretion. The key element of an on-demand service is that the listener can select any song “on-demand” and immediately hear the selected recording. On-demand streaming is also often referred to as “interactive” because the recordings will only play if the listener “interacts” with the service to select the recordings. Examples of this type of service can be found with Spotify, Rhapsody, and Rdio.

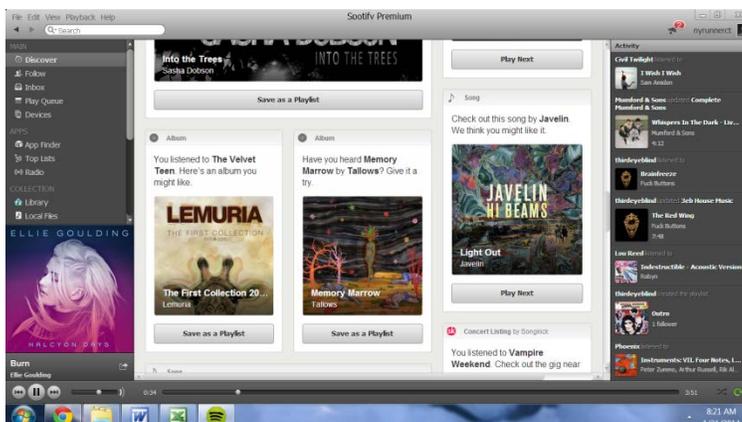
Rights Implicated

All on-demand services implicate three distinct rights: (1) public performance right in the musical composition (i.e. words and music), which is traditionally licensed by PROs (2) the digital reproduction, or “mechanical,” right in the musical composition, which is traditionally licensed by the Harry Fox Agency (“HFA”), and (3) the public performance right in the sound recording (i.e. the actual recording of a song) by means of a digital audio transmission, which is licensed by the individual copyright holders (most often record labels).

Most on-demand services, including Rdio, Rhapsody, and Spotify, have similar “interactive” services that implicate the same basic rights. Accordingly, rates across all three platforms should—theoretically—be very similar. At the very least, the agreed upon rates are likely to be similar across the three major music rights holders (Universal, Sony, and Warner).

Spotify

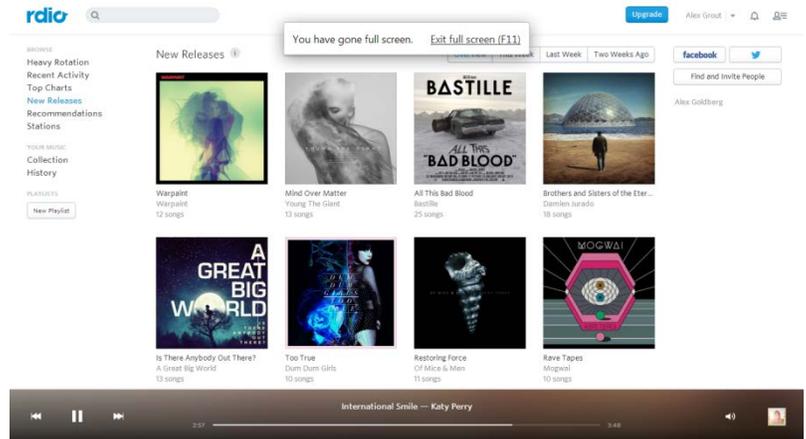
- 20,000,000 songs (although 4 million have never been played!)
- Rapidly expanding domestically and abroad;
- Currently available in 55 countries;



- In addition to the on-demand service, Spotify software can also play “local files” from your device.

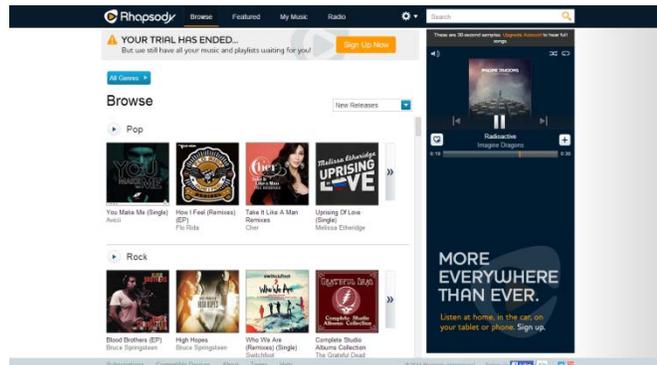
Rdio

- Created in August 2010 by founders of Skype;
- Self-described as “a social jukebox with over 20,000,000 songs to play on your phone, the web, even offline;”
- Available in 35 countries;
- Rdio offers fully interactive streaming, where you can build your own playlist and additionally has a “stations” that can be created and curated based on taste.



Rhapsody

- Launched December 2001 as first streaming service and re-launched in April 2010;
- Available in 17 countries;
- Rhapsody has a catalog of 11,000,000 songs;
- Offers music software that is free to non-subscribers (similar to iTunes software);
- Service can be used on mobile devices



HYPOTHETICAL #2 – Payments from Rdio for performances on a digital music service under different record and publishing deals

Hypothetical #2 Facts for Rdio:

- Total “Service Revenue” – **\$28,500,000**
- “All-In” Royalty Rate (10.5% statutory rate of “Service Revenue”) – **\$3,000,000** (appx.)
- Total Paid for Public Performance of Composition – **\$1,000,000** (appx.)
 - Total paid to ASCAP – **\$500,000**
- Total streams on service – **10,000,000,000**
 - Streams of ASCAP works – **5,000,000,000**

Rdio Royalty Rate for Performance Right for the Musical Composition

If Rdio reported to ASCAP that it had 5 billion streams of ASCAP member’s works, then the ASCAP performing royalty rate would be **\$.0001 per stream**. Because ASCAP distributes an equal amount of royalties to the songwriter and publisher of a work, the payable royalties would be divided into 50% payable to the writer and 50% to the publisher of the work.

$$\text{Calculation: } (500,000 \text{ [ASCAP performance license fee received]} / 5,000,000,000 \text{ [number of ASCAP streams]}) \times \text{[Songwriter or Publisher Share]}$$

Rdio Royalty Rate for Mechanical Right in Musical Composition

The mechanical fees Rdio owes to HFA are calculated by reducing the amount paid for the public performance of the composition—or \$1,000,000—from the “all-in” rate 10.5% rate of \$3,000,000. Here, the \$2,000,000 for the mechanical right in the musical composition will be paid to HFA. Rdio reports to HFA that it had 10 billion streams in the same quarter that it paid \$2M to it. Assuming minimal operating expenses, the HFA mechanical rate would then be **\$.0002 per stream**. This amount would be paid to solely to the publisher of the work, which would then issue royalties to songwriters in accordance with its agreement rate.

$$\text{Calculation: } (2,000,000 \text{ [HFA mechanical license fee received]} / 10,000,000,000 \text{ [total number of streams]}) \times \text{[Publishing Agreement Rate]}$$

Rdio Royalty Rate for Performance Right for the Sound Recording

In addition to the rights afforded to the musical composition, because the right to use a sound recording in an “interactive” service is permissive, Rdio would have had to agree upon a rate with the copyright owner (typically the record label) for the right to perform its sound recording of Bob’s music digitally. Although these agreements are made at market rates with confidential terms, let’s assume that the typical copyright owner receives **\$.0023 per stream**. By law, the amount attributed to the sound recording is thereafter divided: 50% to the owner of the sound recording, 45% to the featured artist in the sound recording, and 5% to non-featured artists.

$$\text{Calculation: } \$.0023 \text{ [Rate]} \times \text{[Number of Streams]} \times \text{[Share Payable]}$$

SCENARIO (a) – Bob and his deal with Sony – Assume that Bob Donnelly is an up and coming ASCAP singer songwriter and enters into a full record and publishing deal with Sony Music Entertainment (“SME”) and Sony/ATV. He records as a featured performer, but SME owns the sound recordings. In addition to receiving royalties directly from ASCAP as a writer, Bob is fully published Sony/ATV, where he receives 50% of the mechanical royalties HFA issues to Sony/ATV for his music.

Under Scenario (a) how many plays will it take for Bob to receive \$100 in Rdio royalties?

- **About 84,390**

- \$4.22 from ASCAP
 - $\$.0001 \text{ [Rate]} \times 84,390 \text{ [Number of Streams]} \times 50\% \text{ [Songwriter Share]}$
- \$8.44 from Sony/ATV o/b/o HFA
 - $\$.0002 \text{ [Rate]} \times 84,390 \text{ [Number of Streams]} \times 50\% \text{ [Publishing Agreement Rate]}$
- \$87.34 in Sound Recording Royalties
 - $\$.0023 \text{ [Rate]} \times 84,390 \text{ [Number of Streams]} \times 45\% \text{ [Featured Artist Share]}$

Under Scenario (a), total per stream rate?

- **\$.00118** (appx.)

SCENARIO (b) – Bob and his deal with Universal/Capitol – Bob is now an accomplished industry-veteran who has entered into co-publishing deal with Universal Music Group and an artist-friendly record deal with Capitol Records (“Capitol”). He records as a featured performer, but Capitol owns the sound recordings. In addition to receiving royalties directly from ASCAP as a writer, Bob receives 50% of all of his publishing royalties directly from ASCAP and additionally, Bob receives 75% of the mechanical royalties HFA issues to Universal for his music.

Under Scenario (b) how many plays will it take for Bob to receive \$100 in Radio royalties?

- **About 79,365**
 - \$5.95 from ASCAP
 - $\$.0001 \text{ [Rate]} \times 79,365 \text{ [Number of Streams]} \times 75\% \text{ [Songwriter Share plus Co-Publisher Share]}$
 - \$11.90 from Universal o/b/o HFA
 - $\$.0002 \text{ [Rate]} \times 79,365 \text{ [Number of Streams]} \times 75\% \text{ [Publishing Agreement Rate]}$
 - \$82.14 in Sound Recording Royalties
 - $\$.0023 \text{ [Rate]} \times 79,365 \text{ [Number of Streams]} \times 45\% \text{ [Featured Artist Share]}$

Under Scenario (b), total per stream rate?

- **\$.00126** (appx.)

SCENARIO (c) – Bob is an independent – Bob is wildly successful and now writes, records, performs, and publishes all of his own music. He also owns all of his own sound recordings and was the sole performer. Bob is affiliated with ASCAP as a writer and as a publisher, receives distributions as a publisher directly from HFA.

Under Scenario (b) how many plays will it take for Bob to receive \$100 in Radio royalties?

- **About 38,460**
 - \$5.95 from ASCAP
 - $\$.0001 \text{ [Rate]} \times 79,365 \text{ [Number of Streams]} \times 100\% \text{ [Songwriter Share and Publisher Share]}$
 - \$7.69 from HFA directly

- \$.0002 [Rate] X 79,365 [Number of Streams] X 100% [Self-Published]
- \$88.46 in Sound Recording Royalties
 - \$.0023 [Rate] X 79,365 [Number of Streams] X 100% [Featured Artist, Non-Featured Artist, and Sound Recording Owner combined]

Under Scenario (c), total per stream rate?

- **\$.0026** (appx.)

A Note about International Royalties

The rates and royalties received by a songwriter, performer, or other copyright owner for the use of their music by a digital music user abroad will depend on a number of factors including the copyright law of that country, the ability of the licensing agent (often a publishing company, record label, or collecting society like PROs, HFA, or SoundExchange in the US) to extract a competitive licensing rate, and the amount that is determined by the collecting agent to be owed to the writer, performer, or copyright owner. Although these factors will undoubtedly cause differing rates in each country, it is safe to assume that the more prominent or used a music service is internationally, the more royalties the writer, performer, or copyright owner will receive for the use of their music abroad. For example, as Spotify is available in at least 55 countries, the use of your music on that service is more likely to result in international royalties than with Rdio or Rhapsody.

CLEAR CHANNEL: MULTIPLE RIGHTS DEALS

Over the past 20 months, Clear Channel, the nation’s largest owner of traditional broadcast radio stations and the owner of internet music service I <3 Radio, has entered into multi-faceted deals with certain writers and catalogs to share in a percentage of the radio giant’s revenue. The first deal was struck with Big Machine Records in June 2012, and many other labels have signed on since (Glassnote, eOne, DashGo and—most notably—Warner Music Group).

These deals appear to cover a number of topics tied to digital royalties, including both the digital performance right in sound recordings (i.e. bypassing SoundExchange’s statutory rate for any ClearChannel performances, like I <3 Radio [the rate in these deals is estimated at approximately \$.0012, or slightly more than half the statutory rate]) and the public performance right in a song on both digital and terrestrial radio (i.e. bypassing the licensing otherwise typically agreed upon by major PROs ASCAP, BMI, and SESAC). But perhaps the biggest splash from these deals is that the terms appear to cover the performance in a sound recording over terrestrial radio—a type of performance that the US has not yet recognized by statute.

It is estimated that the parties entering into an agreement with Clear Channel will receive some “all in” amount from Clear Channel as a portion of Clear Channel’s revenue. Additionally, the labels will receive the benefit of having a direct relationship with the largest owner of the most effective music marketing tool in history. The other potential impact is that the rights holders in these deals may elect to deal directly with other music users in the space, or elect to withhold from Clear Channel’s competitors in the digital space (e.g. Pandora or Spotify). However, the current legal issues impacting the public performance right in the digital space (per recent rate-

court decisions impacting the consent decrees under which ASCAP and BMI operate) makes projecting that area of performance royalties extraordinarily difficult.

ONLINE-ONLY COMMERCIAL ADVERTISEMENTS

Generally, there are two rights involved with putting a song to audio/video commercial advertisements. These rights remain consistent whether the work is performed on television or the Internet. The initial permissions to synchronize music with a video, including a commercial advertisement (i.e. the “Synch” or “Sync” rights), must include explicit agreement to use:

- (a) the musical composition (i.e. words and music); and
- (b) the sound recording (only if using an original recording).

If the commercial producer is “covering” a song for the advertisement, the musical composition needs only to be cleared, but the producer must also obtain rights in the newly-recorded recording. For clearing existing compositions or recordings, each right is ‘cleared’ by the producer paying a flat fee for the “synch”-ing (the fees go to the rights holders of each, typically the publishing company and record label for the composition and sound recording, respectively). The amount of the fees can vary widely depending on the song used and the intended use (e.g. commercial to be shown on early morning Hulu or primetime NBC television broadcast?). However, the fee rate is often the same fee for the publisher [composition owner] and the label [master owner] on a Most-Favored-Nations basis (i.e. the producer must give the same rate and terms to both rights holders).

VEVO AND MUSIC PUBLISHING ROYALTIES

Founded in 2009, Vevo is a music video platform co-owned by Universal Music Group, Sony Music Entertainment, Abu Dhabi Media and Google, who also hosts VEVO on YouTube. It has been publicly reported that VEVO is currently generating over \$150 million per year, primarily from advertising sales. For a long period, Universal and Sony did not directly pay music publishers or songwriters for the music works embodied in VEVO music videos. Royalty payments were instead made solely to the parent company record labels, who had in artist and producer contracts, through controlled composition clauses, defined music videos as merely promotional tools, not revenue-generating assets.

Royalties paid to music publishers and songwriters are based on ad revenue generated by the videos on VEVO. VEVO itself is not licensed, but publishers have licensed and are paid for some of the content on VEVO through either (i) direct licenses between music publishers and UMG and SME that cover one or more musical works or (ii) “blanket” digital music video licenses, called New Digital Media Agreements (“NDMAs”), including a model NDMPA negotiated between the NMPA and UMG for independent music publishers. Still, much of the content on VEVO, including videos from cover artists, original series, many indie label music videos and other videos not covered under the licensing avenues above, remains unlicensed and music publishers and songwriters are not receiving royalties from the ad revenue generated.

1. **Synch Rights:** The record labels must to secure synchronization rights to cover the synchronization of the musical work within the video.

a. *Direct Agreements:* Music Publishers may have direct licensing deals with either UMG or SME that cover a specific video or group of videos. These direct deals are usually based on royalty rates based on the revenue received by the record label generated by ads placed on the videos covered by the license. These royalties are paid by VEVO to the record label, which then pays music publishers a percentage of the revenue the label receives.

b. *UMG/NMPA Model License Agreement:* In 2012, UMG and NMPA negotiated a model New Digital Media Agreement that covered music videos. Under the agreement, music publishers provided to UMG non-exclusive rights necessary for the synchronization of their music in an audio-visual work. In exchange, each publisher receives royalties, on a pass through basis by UMG, which were reported June 19, 2012 Billboard article as fifteen percent (15%) of advertising revenue received by UMG from VEVO for the relevant videos. Billboard also reported that publishers who opted into the model license received retroactive compensation from UMG, based on a percentage of the past revenue received by UMG, for past use of publishers' works in UMG digital music videos.

Example of royalty payment to publisher: Let's say Universal Music makes Video X and uploads it onto VEVO, and the Video generates ad revenue → VEVO takes a percentage of revenue and a percentage of the revenue is paid to YouTube as the content host → Then VEVO pays the remainder of the ad revenue to Universal (we'll say \$100) → Under the NDMA, Universal then pays 15% or \$15 of the revenue it received to the Publisher who owns the musical work synched into Video X (assuming 100% ownership of copyright).

2. **Performance Royalties:** VEVO has performance rights licenses with ASCAP, SESAC and BMI. Under these licenses, music publishers and songwriters receive royalties directly from the performing rights organizations for the public performance of their musical works on VEVO.

YOUTUBE AND MUSIC PUBLISHING ROYALTIES

YouTube is a digital video service owned by Google that has been in existence since 2005. For purposes of this music publisher royalty breakdown, there are three types of relevant video categories on YouTube: User Generated Content ("UGC"), Partner Videos, and Official Label Music Videos ("Label Videos"). For each of these video categories, there are several exclusive rights of music publishers and songwriters under the Copyright Act that may be implicated and are licensed, to varying degrees, by YouTube.

- *Mechanical Reproduction and Distribution:* To the extent necessary to host and distribute the videos that contain music on YouTube, YouTube must secure mechanical rights.
- *Synchronization:* The creator of each YouTube video that contains music should, though rarely does, license the synchronization of the song and/or lyrics with the audiovisual work.
- *Performance:* YouTube must secure the right to perform any copyrighted music contained in a video uploaded onto its website. YouTube has licenses in place with each

of the three PROs and pays performance royalties to the PROs that are then distributed to music publishers and songwriters.

- *Lyric Right*: For any YouTube video that contains the lyrics to a song, a license to display those lyrics is required. Lyrics remain primarily unlicensed on YouTube.

How rights are (or are not) licensed in each relevant video category on YouTube:

1. UGC: YouTube has direct licenses with over 4,000 music publishers which convey the rights necessary for YouTube to host and distribute videos containing music on its website. Most of these licenses were the product of a model license negotiated between National Music Publishers' Assoc. and YouTube that was offered for opt-in to independent music publishers. Most users who upload UGC have not secured underlying rights to synchronize the musical work with their audio-visual content. Under YouTube's UGC licenses, publishers are paid directly by YouTube and royalties are a percentage of the total advertising revenue generated by each video containing a musical work.
 - a. The royalty rate is determined by whether the video (i) contains the master sound recording of a song (i.e. A lip synch video or video where song is playing in the background) or (ii) is a "cover" of the song with no master sound recording present. Music Publishers will generally make approximately 50% of the advertising revenue for cover videos and approximately 15% of ad revenue for videos containing the master sound recording.
 - b. A chart demonstrating how royalties are paid under UGC licenses is set forth as Exhibit A.
2. Label Videos: Label Videos are the official music videos that are created by record labels and are uploaded by the label onto YouTube. For example, Warner Music has a YouTube Channel onto which the label uploads its official Label Videos. YouTube has not directly licensed these Label Videos, but in many circumstances music publishers have conveyed the right to synchronize their musical works with the video directly to the record label under a New Digital Media Agreement (NDMA), including through a model NDMA negotiated between National Music Publishers' Assoc. with Warner Music. Prior to NDMA's, most record labels relied on controlled composition clauses or not licensing the synchronization at all.
 - a. Under these agreements, royalties are generally a percentage of the advertising revenue received by the record label, meaning a publisher's royalty percentage is based on the ad revenue received by the record label and not on the total revenue generated by the music video on YouTube. By example: Let's say Label Video X generates \$100 in ad revenue. YouTube would keep approximately 45% or \$45

of that revenue and pass 55% or \$55 to the record label. Under an NDMA, the record label would then pay approximately 15% of the \$55 it receives, or \$8.25 to the music publisher.

3. *Partner Videos*: Partner Videos are videos uploaded onto the channel of video creators who have entered into partnership agreements with YouTube. These partners can take advantage of a variety of resources, features, and programs that YouTube provides to help build their video channel(s) and their audience in order to maximize monetization of videos. Partner Videos fall outside of YouTube's UGC licenses, and partners represent to YouTube that they have licensed all underlying rights (including music rights) within the videos. Despite this representation, the vast majority of partner videos containing music remain unlicensed with no revenue flowing to music publishers for use of their works, although a few direct licenses have been reported in the press (see Billboard's February 14, 2013 article on UMPG's licenses with Maker Studios and Fullscreen, both YouTube multi-channel networks).

DIGITAL JUKEBOXES AND MUSIC PUBLISHING ROYALTIES

A Digital Jukebox is a digital audio or audiovisual music player that, similar to its traditional counterpart, allows users to play songs or music videos that have been downloaded and stored on the device. Music licensing for digital jukeboxes may require the licensing of a number of exclusive rights depending on the device's functionality. Digital jukeboxes require public performance, mechanical, and potentially synch and lyric display rights from music publishers. The licenses for digital jukeboxes are primarily negotiated (i) directly with publishers, (ii) through companies such as the Harry Fox Agency (HFA) or (iii) through the performance rights organization (ASCAP, BMI and SESAC).

1. **Public Performance Licenses:** The copyright owner of a song has the exclusive right to perform his or her song in public, so performances of the song through a digital jukebox require a performance license from the performing rights organizations (PROs) ASCAP, BMI and SESAC. The PRO's have fairly standardized deals for digital jukeboxes. Jukebox companies that license with the PROs pay and report based on the standardized license to each PRO in a timely fashion for each and every digital jukebox that they have operating in the marketplace. Each PRO then pays out those royalties to music publishers and songwriters.

2. **Mechanical Licenses:** To use a copyrighted work on a digital jukebox, one must usually obtain a mechanical license negotiated directly with the copyright owner. In the digital jukebox realm, mechanical copyrights apply to the digital copies of songs downloaded and stored in each jukebox.

- a) Digital jukebox companies often hire companies, like HFA, to license some mechanical rights, track publishing rights data, report usage and pay each publisher.

b) For each song downloaded onto a digital jukebox the jukebox company must pay 9.1 cents, which is the statutory mechanical royalty rate under 17 U.S.C. 115 (Section 115). Therefore, if 20,000 songs are downloaded onto a digital jukebox, the jukebox company would have to pay a total of \$1,820 in mechanical royalties to the music publishers and songwriters that own those songs.

3. **Sync Licenses:** For digital jukeboxes that can play either karaoke or music videos, a synch license is also needed to cover the use of music synced to the music videos and karaoke. Occasionally, in the case of music videos, a record label has the ability to license the synch rights and pass through royalties to the relevant music publisher. But most times, particularly in the case of karaoke, synch rights are licensed by the jukebox company directly with the publisher.

KARAOKE AND MUSIC PUBLISHING ROYALTIES

Today there are many different services and companies that offer karaoke, whether at live venues, on karaoke CDs or downloads, or through karaoke applications or websites. For this reason, many of a copyright owner's exclusive rights under the Copyright Act may be affected by karaoke uses. Because of the number of rights implicated by karaoke, karaoke companies generally reach out to publishers directly or through HFA's slingshot program (through which they can distribute a proposed license to HFA members) to negotiate licenses for the use of publisher musical works.

1. **Synchronization:** Lyrics displayed in conjunction with a sound recording constitute an "audiovisual work," so karaoke licenses must cover the right to synchronize.

a) For traditional karaoke, the synch departments within a music publisher usually work with karaoke companies and have form agreements with a specific fixed rate to start and then a royalty rate per karaoke CD distributed. These rates are generally range between \$100-250 per track plus a royalty of between 10 and 20 cents per copy sold.

b) For apps and websites, there isn't an established system in place yet for licensing, but publishers would generally ask for an advance and a percentage of revenues generated by the app or website.

2. **Lyric Display:** Karaoke requires licensing the separate right to display lyrics. A karaoke company can either license lyric display rights directly with each music publisher or potentially license rights with a lyrics aggregator, such as LyricFind or MusixMatch.

3. **Reproduction:** The creation of a copy of a musical work implicates the mechanical reproduction and distribution rights of a copyright owner. Mechanical rights are governed by a compulsory license under 17 U.S.C. 115 (Section 115).

a) Copy of musical work onto CD/server

b) Copy of musical work created by user uploading cover version

c) Under Section 115 a licensee must pay 9.1 cents to the copyright owner for each copy of a musical work. So, if a company looks to sell a karaoke CD containing 15 songs, the company would own the copyright owners of each song 9.1 cents per reproduction or \$1.36 in mechanical royalties per CD sold or downloaded.

4. **Public Performance:** when musical compositions are performed publicly, as they are for most karaoke uses, licensees must license the public performance right as well, unless the venue at which the karaoke is performed has a public performance license.

a) This right require a performance license from the performing rights organizations (PROs) ASCAP, BMI and SESAC. The PROs provide karaoke companies, or establishments that offer karaoke, with a performance license that permits the licensee to perform hundreds of thousands of songs. Royalties are then paid back to each PRO, which then pay out to music publishers and songwriters.

5. **Derivative works:** Some arrangements of works would qualify as the creation of derivative works, another exclusive right held by the copyright owner.

LYRIC DISPLAY LICENSING AND MUSIC PUBLISHING ROYALTIES

The digital age has provided a chance to re-evaluate the value of song lyrics. Where lyrics were once relegated to liner notes, song lyrics and lyric videos have become some of the most sought after content on the internet, including on major websites like YouTube, and thus a noticeable new source of income for music publishers and songwriters. But, licensing and collecting royalties for the lyrics from websites has not been easy. With respect to lyric sites, only with the creation of third party aggregators, such as LyricFind, have publishers been able to tap into significant revenue. And now, with the rise of lyric videos, record labels and audiovisual digital sites are beginning to license and pay royalties for the ability to display lyrics in music videos.

1. **Lyric Sites and Lyric Aggregators:** Some of the largest online lyric sites, such as MetroLyrics.com, AZLyrics.com and lyricsfreak.com use aggregators, such as LyricFind and MusixMatch to license with music publishers to display lyrics. These aggregators handle all lyrics licensing terms between lyrics sites and publishers including (but not limited to) Warner-Chappell, Sony/ATV, , Universal and numerous independent publishers and songwriters. The aggregators collect all royalties from lyric sites and then distribute to music publishers after taking a percentage of the royalty payment.

a. Generally speaking the agreements are based on one (or a combination) of two models:

i. A revenue share model under which a site pays to the aggregator a percentage of the advertising revenue generated.

By example: FunLyrics.com earns \$1,000 in ad revenue □ it pays 35% (or \$350) to LyricFind. LyricFind takes 25% of the royalty (or \$87.50) and distributes the remainder (\$262.50) to publishers and songwriters.

- ii. A royalty based on a per-display basis that pays out based on the number of views of each song lyrics at a specific rate.

By example: Users view lyric pages on FunLyrics.com 10,000 times → FunLyrics.com pays 1 penny per page view or \$100 total to LyricFind. LyricFind takes 25% of the royalty (or \$25) and distributes the remainder (\$75) to publishers and songwriters.

- iii. A minimum guarantee royalty payment is often included to ensure payment where there is not significant monetization.

b. Most aggregator agreements permit publishers to take down certain content on a site, or to opt out of a specific deal or require pre-approval for some licenses.

2. **Lyric Videos and Licensing:** Some of the most popular videos on YouTube, VEVO, VIMEO and other audiovisual sites are music videos that display lyrics, or “lyric videos.”

a. There are very few market lyric deals for music videos. However, agreements generally provide an “uplifted” royalty rate from the rate paid by the label or service for the music video based on a percentage of revenue.

By example: GoGo Label has a synch license with Bob Publishing. The license provides for a 15% royalty rate for digital music videos based on the percentage of revenue. If the music video is a lyric video, the royalty rate would be uplifted to 20% (a 5% uplift) to account for the display of lyrics. So, if GoGo Label receives \$100 in revenue for a lyric video, it would pay to the publisher \$20.

NON-INTERACTIVE MUSIC STREAMING (INTERNET AND SATELLITE RADIO)

As the music industry keeps evolving and tech innovators enter the marketplace by creating products and services that offer alternative ways to provide music to consumers, new revenue streams are being created. Musicians and music companies alike must learn to maximize these revenue streams and turn half pennies into real money.

Internet music streaming is divided into two different categories: 1) non-interactive streaming, (services such as Pandora, Sirius XM, iHeartradio, etc) and 2) on-demand streaming (services such as Spotify, Rhapsody, etc.). Generally, non-interactive streaming service providers stream music in the same manner as AM/FM radio plays music on our car radios. Listeners do not have the option to pick specific songs or albums to listen to, rather they are provided with a musical playlist chosen by the program or service that may or may not take into account the listener’s musical preferences. Unlike on-demand streaming, non-interactive streaming consists of temporary copies of songs typically in the form of temporary cache or buffer copies on a server or drive (also known as “ephemeral” copies) to allow listeners to stream music at the same time that the music is loading onto their computer, tablet, or smartphone.

RIGHTS AFFECTED BY NON-INTERACTIVE STREAMING

Songs, as we all know, are protected under copyright law. What many do not know is that every song heard is actually the embodiment of two separate copyright works: 1) a musical

composition, and 2) a sound recording. The musical composition is made up of the underlying lyrics and musical notes written by a songwriter. A sound recording (commonly referred to as the “master recording”) is the actual recording itself embodying the recording artist’s interpretation of the musical composition as well as the work of producers, sound engineers and musicians.

In order to transmit a digital audio version of a song two distinct rights must be obtained by non-interactive streaming service providers: 1) the right to publicly perform the musical compositions (this is licensed and royalties are collected and distributed by the performing rights organizations (“PRO’s”), and 2) the right to publicly digitally perform the sound recording (most labels and/or copyright owners have signed up with SoundExchange to license, collect, and distribute these royalties on their behalf). Whereas on-demand streaming requires service providers to also obtain the right to digitally reproduce the musical composition (referred to as a “mechanical” license) in addition to the other performance licenses, non-interactive streaming does not require a mechanical license because any copies made for streaming purposes are only temporary and fleeting. As such, non-interactive streaming service providers need only seek public performance licenses from performance rights organizations and SoundExchange in order to transmit digital audio.

Licensing

Public performance licenses generally always require the payment of royalties. The PRO’s collect and distribute royalties associated with the digital public performance of the musical composition and SoundExchange collects and distributes royalties associated with the digital public performance of the sound recording under Section 112 and 114.

Sections 112 and 114 of the Copyright Act provide statutory licenses for the digital audio transmission of sound recordings. Section 114 covers a public performance for sound recordings while section 112 covers “ephemeral” reproductions. Currently, the only entity authorized by Congress to administer licenses under these sections is SoundExchange.

Rates and terms for these statutory licenses are determined by the Copyright Royalty Board, a board of three judges created by the Copyright Royalty and Distribution Reform Act of 2004 that determine the royalty rates for the use of copyrighted works. Rates and terms are set through either voluntary negotiations or trial hearings before the Board. If a service elects to negotiate rates and terms, then it negotiates these rates and terms with either SoundExchange or the PROs. Once a deal is reached, this is then presented to the Board for approval. If, on the other hand, a service chooses not to opt-in or negotiate rates and terms, then it may present itself to the Board and the Board will conduct a rate setting arbitration to establish applicable rates and terms.

Non-interactive streaming licenses for musical compositions can be obtained directly from each PRO (ASCAP, BMI, or SESAC). Each PRO issues a separate license for their entire catalog of musical compositions. Fees for these licenses are largely based on a percentage of the service provider’s generated revenue. The PROs use a “follow the dollar” method to collect and distribute royalties similarly to SoundExchange.

SoundExchange

As previously discussed above, SoundExchange is the designated non-profit organization that collects and distributes digital public performance royalties earned from music streaming service providers to artists and master copyright owners. More than 2,000 services currently pay royalties to SoundExchange and that number continues to grow every quarter. These services

include satellite radio providers, webcasters and digital cable music providers. In 2013, SoundExchange paid \$590.4 million in royalties to registered artists and labels.

For purposes of this panel and article, however, we will only discuss digital public performance royalties payable and distributed to the publishers and songwriters of a musical composition. For more information on SoundExchange and how performance royalties for the sound recording are collected, processed, and distributed, please see SoundExchange's website:

www.soundexchange.com.

HOW DO NON-INTERACTIVE STREAMING SERVICE PROVIDERS PAY PUBLISHING ROYALTIES ON MUSICAL COMPOSITIONS TO THE PROS?

“Traditional” License Fee Structure

Though online streaming is relatively new and the music industry is still adapting to the changes, license fees for the use of sound recordings and musical compositions have generally adopted a percentage of gross revenue rate or less often, a per-performance or per-session rate. The following services are representative of typical non-interactive streaming service providers that are affected by these license fee structures.

Sirius XM

Sirius XM satellite radio is a commercial free radio service provided to the consumer for a monthly subscription fee. XM can be accessed with a digital receiver in the home or automobile, as well as online and has 72 commercial free music stations. The company derives revenue from activation fees; sale of advertising on select non-music channels; direct sale of satellite radios, accessories, and other ancillary services such as weather, traffic, data and backseat TV services. XM uses its subscription revenue to pay royalties for the music it uses.

At the end of 2013, Sirius XM had an estimated 25.6 million subscribers with an average of \$129 in revenue per subscriber. Subscription fees range from \$9.99-\$18.99 per month or \$129-\$227 per year.

Pandora

Pandora Internet Radio is an automated music recommendation and music streaming service that operates mainly in the United States with limited access in Australia and New Zealand. The service plays musical selections based on a user's selection of genre, artist, or song. Pandora derives its revenue mainly from advertising revenue and subscription services. In 2013, Pandora reported its total gross revenue for 2013 was \$427.1 million, total listening hours had grown to 4.05 billion, and had streamed music to more than 200 million users. During January 2014, Pandora's listener hours increased to 1.39 billion, a 13% increase during the same period last year. This increased its total market share to 8.75%. As of January 2014, active listeners totaled about 73.4 million.

A Note About Royalty Disputes Between Pandora and ASCAP:

Pandora is currently in the midst of a federal court trial to determine how much it should pay ASCAP for use of ASCAP's catalog. Currently, Pandora pays a total of 4.3% of its revenue to publishers and songwriters, with a portion of that percentage going towards ASCAP's catalog.

Pandora's approach to royalties has been a hot topic in the last year due to its highly publicized dispute with ASCAP and RIAA over the reduction of royalty rates. Pandora has argued that its

competitors, mostly terrestrial radio providers, do not pay as much for music as they do. Unlike terrestrial radio, Pandora has a wider library of music to stream and must pay public performance royalties for both sound recordings and the underlying musical composition.

Pandora has pushed for legislation in the last couple of years that would require the Copyright Royalty Board to lower the royalty rates for internet radio to stream music and make them equal to the rates paid by terrestrial radio. While the legislation has not been passed, Pandora has been seeking other methods to circumvent current rates including buying a terrestrial radio station in South Dakota to qualify for terrestrial radio rates per its settlement agreement with ASCAP.¹ On January 20, 2014, Pandora and ASCAP began formal arguments in front of the rate court federal judges.² As of February 18, 2014, the trial portion closed and the judges are in the process of making their decisions.

iHeartRadio

iHeartRadio, owned by Clear Channel Communications, is a multi-platform free digital radio service that essentially works as an aggregator allowing users to listen to live stations all over the country or create their own commercial-free stations. Currently, the iHeartRadio app for smartphones and tablets has approximately 260 million downloads (a large increase from the 144 million downloads Clear Channel reported the previous year) and has attracted more than 40 million registered users. Clear Channel has previously asserted that it had no plans to monetize iHeartRadio now or in the future. However, in order to make royalty rates more favorable for its digital services, Clear Channel has struck up a deal with Warner Music Group to allow the label to collect royalties from Clear Channel's 850 terrestrial radio stations in exchange for more favorable rates for online streaming. This currently only affects public performance royalties due for sound recordings while the rates paid for musical compositions remain unchanged.

HOW DO PROs PAY OUT PUBLISHING ROYALTIES TO PUBLISHERS AND SONGWRITERS?

As previously explained, publishers receive royalties for the public performance of musical composition through the PROs- ASCAP, BMI, or SESAC. Each society has different terms and fees for non-interactive service providers, but all currently issue blanket licenses for their entire catalog of musical compositions to non-interactive service providers. Licensing fees vary between the three organizations, but all three provide non-interactive streaming service providers with the ability to pay a percentage of gross revenue (between 1.85% to 1.87%). ASCAP also allows service providers to pay \$0.06 on a "per-session" basis (a "session" means a period of listening time up to an hour, i.e., one session is equal one hour of listening time).

"Follow the Dollar" Method

PROs collect fees for their entire catalog and not just for specific performances of individual musical compositions. They do not pay out for each digital performance because of how small the per-stream rate is. Instead, the amount of monies received from each service provider is processed and turned into a royalty rate to be paid to publishers and songwriters.

¹ See "The Pandora Problem: Royalty, Streamed or Short Changed" by *Stephanie Jones and Michael Swiebach*, *San Francisco Classical Voice*, October 2013.

² See "Showdown for Pandora" by *Hannah Karp*, *The Wall Street Journal*, January 2014.

The PROs use a variety of tools to determine what royalties and how much royalties should be paid to any one publisher or songwriter. In accordance with the applicable regulations, the PROs use performance data provided by service providers to allocate, on a pro-rata basis, royalties received from each service provider. Once allocated, the PROs takes their administration fee from the royalties collected and then distributes the remainder: 50% to the publisher(s) and 50% to the songwriter(s).

Sample Calculations for Non-Interactive Service Providers That Pay A Percentage of Revenue for Public Performance Licenses:

PLEASE NOTE: Because the majority of the major non-interactive service providers pay on a percentage of gross revenue basis, we will not concern ourselves with a per-performance or per-session calculation as the math would be very similar to the below, with less steps. **All sample calculations made herein are calculated based on fictitious licenses, fees, and dollar amounts.**

Hypothetical #1: Let's assume the following about Service A and PRO #1-

- Service A total gross revenue - \$950,000,000
- Total royalty rate for musical compositions- 1.85% of gross revenue for PRO #1
- Total streams reported by Service A- 20,000,000,000
 - Total streams for PRO #1 catalog- 10,000,000,000

Royalty Rate for Performance Right for the Musical Composition

To calculate how much royalty monies should be allocated to each musical composition (assuming all the money can be accounted to individual musical compositions and all streams are attributable to publishers and songwriters), the following calculations should be made:

1. $\$950,000,000$ (total gross revenue) / 1.85 (royalty "rate") = **\$17,575,000 (approx.)** (this is the amount paid in total to PRO #1 for distribution as royalties)
2. $\$17,575,000$ (total paid to PRO #1) / 10,000,000,000 streams (total number of streams) = **\$0.00176 per stream (approx.)**

If Service A reports to PRO#1 that it had 10 billion streams of PRO #1 catalog works and paid \$17,575,000 in performance royalties, PRO #1 performance royalty rate would be \$0.00176 per stream. Now because all PROs distribute equal royalties to the songwriter(s) and publisher(s) for the work, this per stream rate is then divided 50/50 between the songwriter and publisher so that each receives **\$0.00088 per stream**. This would then be split up between multiple songwriters and publishers, if any.

Now, how much would a publisher and songwriter receive for 10,000 streams of one of their songs?

3. $\$0.00088$ (50% of the per stream rate paid to songwriter/publisher) X 10,000 streams = **\$8.80**

\$8.80 would be paid to the songwriter and another \$8.80 would be paid to the publisher for a **total of \$17.60 in royalties** paid for one musical composition.

WHAT ARE SOME ALTERNATIVE LICENSE FEE STRUCTURES FOR NON-INTERACTIVE STREAMING SERVICE PROVIDERS?

Newer service providers like iTunes Radio are attempting to find alternative fee structures that are not only beneficial, but also provide a more realistic balance between profit margins and content acquisition expenses.

iTunes Radio

Accounting for 75% of the global digital music market, iTunes is the leading provider of digital music sales. Used across multiple platforms and affiliated with a wide variety of other non-Apple services and products, the service allows users to purchase digital albums, songs, apps, videos, software, and books.

Recently, Apple decided to follow the internet radio trend by launching iTunes Radio, a radio service functioning like Pandora that allows listeners to create custom stations based on specific artists or genres. Unlike its counterparts, iTunes Radio intends for such stations to be “hand-curated” instead of relying on algorithms that may not always be accurate to provide listeners with new music recommendations and a better listening experience.

So what makes iTunes Radio so different from its established competitors? One word. Royalties. While performance royalties for musical compositions will follow the percentage of gross revenue model outlined above, on the sound recording side, iTunes is leveraging Apple’s deep pockets (and established relationships) to make direct deals with the record labels instead of using the statutory license fee structure used by Pandora. Although iTunes Radio is a non-interactive service, the direct deals look a bit different than other internet radio arrangements. One look at the iTunes Radio licensing agreements with indie labels shows that labels will be paid a healthy royalty even before the service turns a profit. Keeping in mind the specifics of the majors’ deals with iTunes Radio could be very different, below is Glenn Peoples’s breakdown of how an indie label gets paid from iTunes Radio in his June 2013 article for Billboard’s Business Matters:

“Even if Apple generates no revenue, labels will be paid 0.142 cents per stream under the minimum royalty. The contract defines the minimum royalty as 45% of net advertising revenues or \$21.25 per 1,000 listener hours in the first year and \$22.25 in subsequent years. In this case, \$0.2125 per listener hour works out to 0.142 cents per stream, assuming iTunes Radio will stream 15 songs per hour with an average of four-minute songs.

The standard royalty kicks in once Apple becomes better at generating revenue. In the first year, the standard royalty is 0.13 cents plus 15% of net revenue. In subsequent years, the standard royalty is 0.14 cents plus 19% of net revenue.”³

This is all assuming that iTunes Radio will stream 15 four-minute songs per hour and not accounting for skipped songs or songs from the user’s collection. Once these are accounted for, the royalties per listening hours are sure to dip, but have still been proven to stay slightly above

³ For a more in-depth look at how royalties may be broken down see “Business Matters: What iTunes Radio Will Actually Pay” by Glenn Peoples, *Billboard.biz*, June 2013.

Pandora's rate.

Another distinct difference from Pandora, besides the way that iTunes Radio pays out royalties (i.e. by not relying on the statutory license), is that it is actually three services in one package. The iTunes Store and the scan-and-match cloud are all part of the contract package, so when an indie label delivers an "eMaster" to iTunes, that track will then become available on all three platforms. As a result, this also means that revenue generation is not necessarily limited to a per stream basis.⁴

iTunes Radio was expected to hit a high note when royalties from all of its services were taken into account, particularly the digital sales via the iTunes Store. In 4Q12 alone, digital music sales accounted for roughly \$1.9 billion of iTunes' gross revenue. Because a single download generates much more revenue than a single stream, after doing the math, it was possible to predict that the royalty rate would rise significantly over that of any other internet radio provider. However, empirical evidence is showing that even though iTunes Radio provides a "buy now" button to incentive users to buy music directly from iTunes Radio, users are not actively using the button as much as Apple had hoped. There has been no sales boost as a result of the Sept. 18 launch of iTunes Radio. In fact, track sales dipped 12.9% during 4Q13 and the first 3 weeks of 2014.⁵

Still, while the initial optimism and hope that iTunes Radio would generate higher revenue for the industry has dwindled in the last couple of months, it may be too early to call it a failed attempt. An increase in rates paid by internet radio providers now will likely have a higher repercussion than anticipated. The Copyright Royalty Board is set to determine the statutory rates paid for 2016 to 2020 in the coming months and will be looking at the rates internet radio providers currently pay to base their ultimate decisions. In the end, the music industry may have Apple to thank for pushing royalty rates in the right direction instead of waiting for the legislative process to take its course.

Mobile Apps

Payment structures for mobile apps on the publishing side, regardless of platform, vary significantly based on a multitude of factors ranging from term, use, company, and type of application. Unfortunately, because this type of media and its market are relatively new, there is no set "standard" in place unlike in other forms of media.

Basic terms for music-based apps (such as SMULE and JAMMIT) typically provide a nominal advance, anywhere from \$250 to \$2,000/side, in addition to a periodic royalty payment. The rate of such royalty will vary (normally between 20- 25% of revenue with either a \$0.005 or \$0.008 floor) and largely depends on the company seeking a license and their ability (or lack thereof) to deliver quarterly reports. There are even some apps that provide no advance and are purely royalty-based.

On the other hand, the terms for non-music based apps may include a buyout provisions depending on the nature of the use. These fees are primarily dependent on the stature of the song requested and the company requesting. Fees can range anywhere from \$500/side to as much as

⁴ For more information see "How Does iTunes Radio Pay Artists?" by Michelle Davis, *Future of Music Coalition*, October 2013.

⁵ For more information see "Business Matters: The Butterfly Effect and Why iTunes Radio Hasn't Increased Track Sales" by Glenn Peoples, *Billboard.biz*, February 2014.

\$15,000/side.

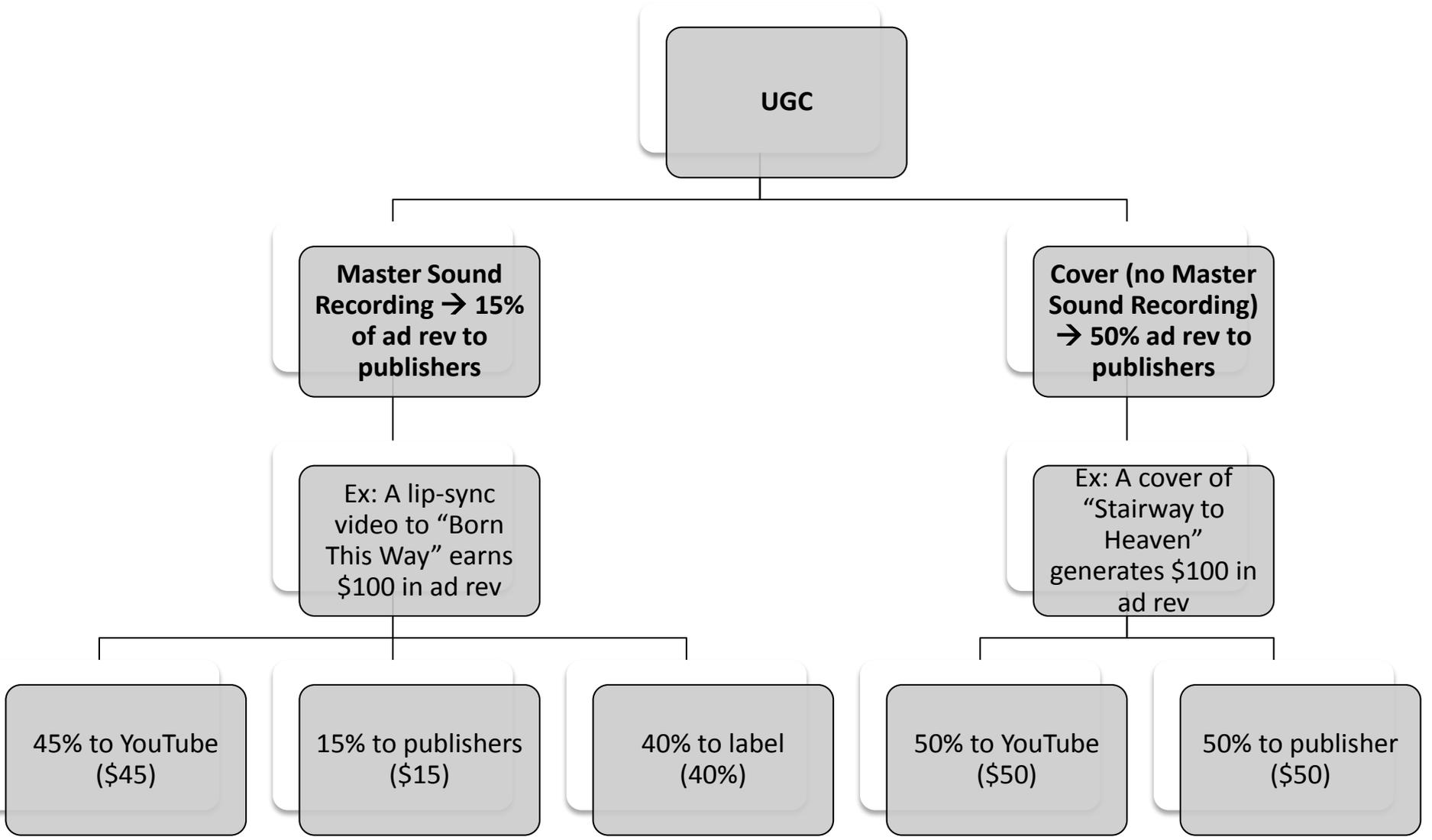
Even still, in-game fees also vary greatly and depend on how the music is used (i.e. background, menu, end credit, etc.); how much of the song is used; whether the song is available for streaming or download; content use; etc.

In general, most companies creating these apps are start-ups and will have little to no capital to invest in music licensing. As a result publishing companies need flexibility when negotiating terms and fees. All requests must be addressed and dealt with on an individual and independent basis.

RINGTONES AND MUSIC PUBLISHING ROYALTIES

Since 2009, ringtones have been subject to a compulsory license under Section 115 of the Copyright Act. By extending the compulsory license to ringtones, the U.S. Copyright Office allows businesses to use copyrighted works for ringtones without obtaining permission from publishers. However, any company looking to sell ringtones is required to pay mechanical royalties for using the song. The current statutory mechanical rate for ringtones is \$.24 per unit.

Example: If iTunes sold 50,000 ringtones of a particular song at \$1.99, it would be responsible making a \$.24 payment for each ringtone sold, or \$12,000 in total royalty payments for that song.



YouTube royalties are paid directly to publishers and do not pass through a music label.

billboardbiz

By Glenn Peoples | February 14, 2014 2:19 PM EST

A 1972 research paper by Edward Lorenz titled "Predictability: Does the Flap of a Butterfly's Wings in Brazil Set Off a Tornado in Texas?" introduced the term "the butterfly effect" into popular lexicon. It's generally understood to mean small events (a butterfly flapping its wings in Brazil) can have larger, unintended consequences (a tornado in Texas). Another way to say it is, "One thing leads to another."

Business Matters: Study Shows Why iTunes Radio Lacks Big Impact on Download Sales

A new report by Music Forecasting shows why iTunes Radio isn't the boon to track sales people thought it could be. Listeners of Internet radio aren't opposed to buying music. They simply don't want to interrupt the listening experience to hit the buy button. And it could end up having unintended consequences.

Music Forecasting believes it knows the problem. A new Music Forecasting report claims that iTunes Radio listeners use the service for a "lean-back" listening experience. Like other forms of radio, iTunes Radio provides listeners a variety of music for very little effort. Such an experience is not conducive to building a music collection.

This finding should deflate the some of the optimism that originally surrounded iTunes Radio. Launched Sept. 18, Apple's answer to Pandora was thought by many in the music business to have potential for incremental track purchases. The service tightly integrates a buy button that allows the listener to buy a track from the iTunes Music Store. It got off to a quick start, attracting 20 million listeners in about a month.

But no sales boost ever materialized. As I noted in November, a dip in track sales coincided with the launch of the service. Track sales were down 12.9% in the fourth quarter and fell an equal amount in the first three weeks of 2014.

Buying music on iTunes Radio clashes with the nature of radio. Users simply don't want to lean forward to buy music when they're enjoying iTunes Radio's lean-back listening experience. The availability of free music doesn't prevent people from buying tracks, explains Sam Milkman, executive VP at Music Forecasting. The interviews revealed

that most people still buy music -- both digital and physical -- and want to own a music collection.

- Pandora Hangs Tough in Face of Competition -- Including iTunes Radio
- Morning Fix: The State of Streaming; Beats Music's Positives and Negatives, So Far; UMPG and Pandora Make Deal on BMI Repertoire
- Business Matters: iTunes Radio Starting Strong But Not Yet a Pandora Killer

iTunes Radio will result in some level of purchases. The 40 to 50 people interviewed in Philadelphia and Raleigh, North Carolina are "very aware" of the button and think it's a good idea. Other Internet radio services such as Pandora have long had buy buttons that take the listener to either iTunes or Amazon MP3. But Milkman doesn't believe iTunes Radio's buy button will result in a large increase in incremental purchases. Instead, purchases will be casual and sporadic. "It seems more like a trickle than a flood."

iTunes Radio's inability to sell tracks isn't the main problem. The butterfly that causes a storm could be the difference between actual sales and expected sales. Recall that Apple negotiated directly with record labels for iTunes Radio rather than rely on the compulsory license used by Pandora. Apple's licensing terms works out to roughly 0.13 cents per stream in the first year, according to Billboard's estimates. (Pandora currently pays 0.12 cents for advertising supported stream and 0.22 for streams derived from paying subscribers.) Apple also got concessions that reduce its royalty burden: iTunes Radio can play up to two non-royalty-bearing tracks an hour that are promotional in nature.

Why didn't labels get more from Apple? One plausible explanation is they believed iTunes Radio's buy button would result in incremental sales. Without an expectation of incremental sales, labels would have demanded higher royalties. Like the butterfly in Brazil, these licensing terms could have unintended consequences.

In years past, the Copyright Royalty Board would look to royalties paid by on-demand services when setting statutory rates, not exactly an apples-to-apples comparison. This time the CRB will use iTunes Radio licenses -- set using optimistic sales expectations -- as a point of reference when setting rates for 2016 to 2020. Anything that changes future statutory rates will have very real financial consequences. If you assume statutory royalty payouts will rise 20% a year until 2015 and then 10% until 2020, a 0.1-cent increase in the statutory rate would pay an additional \$183 million to labels and artists from 2016 to 2020. What started as a flutter ends up a multi-million tornado.

billboardbiz

By Glenn Peoples, Nashville | June 28, 2013 7:24 PM EDT

A close look at the iTunes licensing agreement for indie labels shows iTunes Radio royalties have limited downside and strong upside. The minimum royalty calculation ensures labels will be paid a decent royalty until iTunes Radio becomes effective at generating revenue. iTunes Radio could be very valuable to labels if Apple can convince listeners to buy downloads at a healthy clip.

Even if Apple generates no revenue, labels will be paid 0.142 cents per stream under the minimum royalty. The contract defines the minimum royalty as 45% of net advertising revenues or \$21.25 per 1,000 listener hours in the first year and \$22.25 in subsequent years. In this case, \$0.2125 per listener hour works out to 0.142 cents per stream, assuming iTunes Radio will stream 15 songs per hour with an average of four-minute songs.

Apple iTunes Radio's Licensing Agreements With Indie Labels Emerge

The standard royalty kicks in once Apple becomes better at generating revenue. In the first year, the standard royalty is 0.13 cents plus 15% of net revenue. In subsequent years, the standard royalty is 0.14 cents plus 19% of net revenue.

Once iTunes's revenue-generating ability is 39% as effective as Pandora, the standard royalty of 0.142 cents (barely) exceeds the minimum royalty. For these calculations, I use Pandora's revenue per listener hour of 0.3 cents. The company had 4.18 billion listener hours and revenue of \$125.51 million in its quarter ended April 30.

If iTunes Radio becomes extremely effective at generating revenue against its listener hours, it will share its success with labels. The minimum royalty will exceed the standard royalty when iTunes becomes 171% more effective at revenue generation than Pandora is right now. In other words, the event iTunes Radio revenues go through the roof, labels will not be stuck with a small share of the revenue. (Here I use terms applicable after the initial year because I assume iTunes Radio will not generate that much revenue in its first year.)

None of these calculations take into account skipped songs or songs that are in the user's collection. iTunes Radio can play up to two songs per listener hour royalty-free if

the song comes from the user's iCloud collection, is a Complete My Album track (a promoted track that has not yet been purchased) or a "heat-seeker play" (a track that received promotional consideration from Apple). I also ignore the fact that iTunes Radio will not pay any royalties during the initial 120-day beta period.

Adjusting for royalty-free streams reduces the effective per-stream royalty. Taking away two royalty-bearing tracks every hour would turn a minimum royalty of 0.142 cents into an effective royalty rate of 0.124 cents, or slightly above the 0.12 cents Pandora is paying this year for ad-supported streams. (Streams from its Pandora One subscription service have a royalty of 0.22 cents.)

iTunes Radio's impact really soars when download purchases are taken into account. The radio service will have a "buy now" button to allow the listener to purchase a song at iTunes while it's playing on iTunes Radio. Since a single download is worth far more than a single stream, purchases can have a huge impact. And because Apple will stream promotional tracks to encourage purchases, it makes sense to adjust the iTunes Royalty to account for these incremental revenues.

Purchases' impact on the effective royalty rate depend on how often people buy a track they hear. If listeners buy one track for every 100 songs heard on iTunes Radio (one track every six hours and 40 minutes) a 0.142-cent royalty turns into an effective royalty of 1 cent -- a 661% increase from the standard royalty rate. If listeners purchase only one out of every 1,000 tracks heard (one track every 66 hours and 40 minutes) the effective royalty would be 0.232 cents.

Labels will find iTunes Radio royalties falling within a comfortable range. The per-stream royalty won't be lower than the 0.12 statutory rate received from pureplay webcasters (as part of the Webcaster Settlement Act). If Apple can get just one download out of 1,000 streams, labels will get at least nearly twice that statutory rate.

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How Does iTunes Radio Pay Artists?



by Michelle Davis, FMC
Legal Intern

For consumers, **iTunes Radio** may feel a lot like another version of the popular "predictive" radio service **Pandora**. Plug in an artist or genre, and an algorithm spits out sonically related tracks. But while the experience for listeners may be similar up to a point, the revenue flow behind the scenes isn't an exact match.

In order to break down how money gets from iTunes Radio to the artists, it's first important to remember that every song has two copyrights: one for the underlying composition (think notes and lyrics on paper), and one for the sound recording (think music on CD, tape or hard drive).

Broadcast royalty payments for the songwriters and the publishing companies that own the rights to the composition are negotiated and distributed by the Performance Rights Organizations (PROs). In the United States, that's **ASCAP**, **SESAC** and **BMI**. Keep in mind that algorithmic "radio" is still considered a "broadcast"—but instead of a DJ there's an intelligent robot that knows you secretly love **Miley Cyrus**. So, for the most part, the mechanisms that get the *songwriters* paid on Pandora and iTunes Radio are governed by the same principles: the broadcaster secures a blanket license with the PRO in exchange for unlimited access to their repertoire at a negotiated rate (overseen and enforced by a court under a consent decree established in the middle of the last century).

But when it comes to sound recordings, things look a little different. In 1995, Congress passed the Digital Performance Right in Sound Recordings Act, which created a *compulsory* license for sound recordings. (AM/FM radio continues to enjoy [an unfair exemption](#).) The upshot is that all webcasters, iTunes and Pandora included, are required to pay the owners of master recordings. Typically, these royalties are collected from the broadcaster by **SoundExchange** and then distributed to the performers and record labels who own those rights. However, it's important to note that this statutory rate is only "compulsory" in that the rightsholders can't opt out; the digital broadcasters can still choose to negotiate directly with the record labels and pursue direct licenses.

And that's what iTunes Radio has decided to do.

While Pandora continues to utilize the statutory license, iTunes is leveraging Apple's deep pockets (and established relationships) to make direct deals with the labels. Although iTunes Radio is a non-interactive service (meaning, users can't select which songs to hear when and skipping tunes is limited), the direct deals look a bit different than other internet radio arrangements.

Interestingly, because iTunes is not relying on government-mandated compulsory rates, it can move more deftly into new markets. While Pandora only operates in the U.S., Australia and New Zealand, iTunes Radio already [has plans to expand](#) to the U.K., Canada and beyond next year.

Not surprisingly, the details of iTunes' deals with the major labels have not been disclosed. However, the form contract sent to the indie labels was leaked and provides some insight into how artists will be paid.

So what's the deal?

The first line of the contract may be the most telling: "By clicking to agree to this Digital Music Download Sales Agreement... COMPANY agrees with ITUNES to the terms and conditions set forth herein..." So, essentially this is a take-it-or-leave-it offer that doesn't leave room for negotiation by the indie labels or the aggregators that represent them. It's safe to assume that the major labels had more leverage than this and were able to actively negotiate their terms. So, the specifics of the majors' deals could very well be different.

As to the substantive part of the contract, Apple will pay the indie labels a royalty of \$0.0013 per song plus

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15% of net advertising revenue for the first year. The royalty rate will subsequently increase to \$0.0014 per song play plus 19% of net advertising revenues.

What makes iTunes so different than Pandora is that it is actually three services in one. The iTunes Store and the scan-and-match cloud are all part of the contract package, so when an indie label hands over an "eMaster" to iTunes, that track is going to be available on all three platforms.

This also means that revenue generation is not necessarily confined to a per stream basis. When you stream a song on iTunes Radio, you also get a link to download the song from the store. And the payout for that stream is variable depending on if it's a "complete-my-album play" or a "heat-seeker play."

Ostensibly, the main goal of iTunes Radio is to increase downloads from the iTunes store, which does offer a better payout for the artists than a single stream (and this is true whether the service is "radio-like" or on-demand listening like Spotify). Whether this will serve to preserve Apple's dominant download market in the face of competition from on-demand streaming remains to be seen. Perhaps users will just prefer the easy, all-in-one interface iTunes offers. Maybe global positioning will keep the Cupertino, CA company at the top of the music-tech pile.

We'll be keeping our eyes on developments; in the meantime you won't want to miss our breakout panel on radio licensing (including digital) at the [Future of Music Summit](#) on Oct. 28-29 at Georgetown University in Washington, DC.

Submitted by [kevin](#) on October 17, 2013 - 4:56pm

Tags: [Artist Compensation](#), [Mechanical Royalties](#), [Performance Royalties](#), [internet radio](#), [iTunes](#), [Pandora](#)



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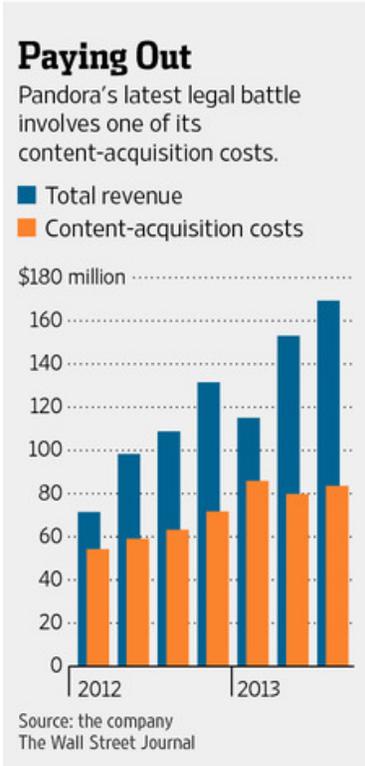
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By [HANNAH KARP](#) [CONNECT](#)
 Jan. 20, 2014 5:05 p.m. ET

[Pandora Media Inc.](#) P +1.98% and the American Society of Composers, Authors and Publishers are expected to square off Tuesday in a long-awaited federal-court trial to determine how much the Internet-radio giant should pay for the use of their compositions for the next two years.

The outcome could have a broad effect on the growing digital-music business, which now pays more to record labels and performers than to those who write and publish songs.

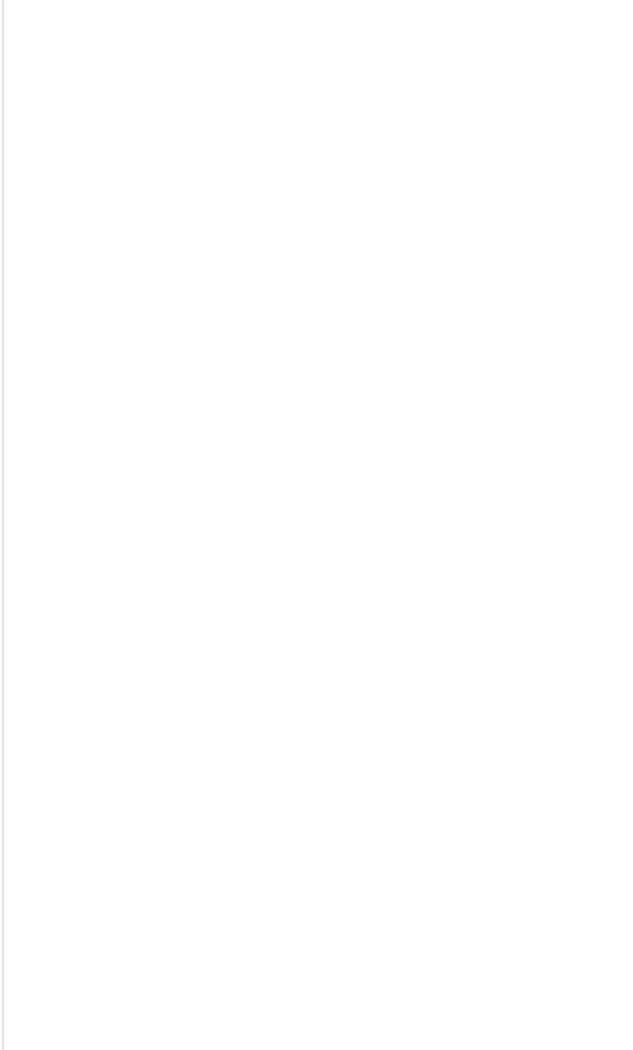
Pandora pays a total of 4.3% of its revenue to publishers and songwriters represented by Ascip and other organizations that collect royalties on their behalf. By contrast, the Oakland, Calif., company pays record labels and performers roughly half of its revenue.



Pandora sued Ascip more than a year ago seeking to pay writers and publishers less. The company argues that it shouldn't have to pay Ascip's songwriters and publishers any more than terrestrial radio broadcasters do—currently about 1.7% of their revenue—since Pandora, which generates the bulk of its revenue from advertising, considers local radio stations its closest competitors.

Until now, Ascip has charged Internet-radio services either 1.85% of their gross revenue or 0.06 cent each time a user tunes in for a listening session, whichever sum is greater. Pandora has been paying an interim rate along those lines since 2011, in the absence of a deal with Ascip over what it should pay through 2015.

Terrestrial radio stations in the U.S. have long paid royalties for airplay to songwriters and the publishers who represent them, but they have never paid record companies or performers, save for a few recent, isolated deals between Clear Channel Communications Inc. and a handful of smaller labels. The terms of those deals weren't



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disclosed.

Historically radio stations weren't required to pay record companies for the use of their recordings, on the theory that airplay promoted sales. As sales have declined in recent years, labels have sought to begin collecting royalties of their own for airplay, with limited success. Record labels started collecting royalties for digital-radio play in 1995; the rates they command are set by the Copyright Royalty Board in Washington.

Ascap, for its part, contends that it should earn an even bigger slice of Pandora's revenue than it does now. Its legal team is expected to argue that music is more valuable to Pandora than to terrestrial radio, since Pandora lacks sports and talk programs and plays far fewer audio ads.

Meanwhile, Pandora and new digital rivals, such as [Apple Inc.](#) AAPL -1.04%'s iTunes Radio, have agreed in recent years to license music directly from individual publishers at substantially higher rates than what Ascap has been charging Internet-radio companies for blanket licenses.

Apple, for example, has agreed to pay publishers about 10% of the revenue their catalogs generate on iTunes Radio, more than twice the share Pandora spends on publishing royalties.

Ascap cites that higher rate as an argument in favor of raising its rate.

U.S. District Judge Denise Cote, one of two U.S. judges who preside over song-licensing disputes, is tasked with determining the rate Pandora would hypothetically pay Ascap in a free market. It is a difficult job, given that the government has regulated the price of music-publishing licenses since 1941, originally in an effort to shield Ascap licensees from price discrimination.

A decision in Pandora's favor could lead to a growing challenge for Ascap, which celebrates its 100th anniversary this year. Some of the biggest music publishers are already considering pulling out of the organization altogether, after unsuccessfully attempting to partially withdraw their catalogs from Ascap so they could negotiate directly with new media services.

Judge Cote ruled in September that the law requires Ascap to provide Pandora with a license to play all of the works in its repertoire.

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