

Berklee College of Music

Reflection Paper

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A couple months after arriving in Valencia last summer The Orrin G. Hatch–Bob Goodlatte Music Modernization Act was signed into law on October 11, 2018 by United States President Donald Trump after years of lobbying from the rightsholder community including songwriters, publishers and performance rights organizations. The discussion around the fallout from this historical legislation continues to be widely debated in addition to the first rate increase for songwriters in many years. As important as this legislation is for rightsholders it stands to tighten the profit margin for streaming services who have largely been unprofitable in spite of their importance to the earning potential of the modern music industry. The pioneer of this streaming landscape is Spotify who in 2006, modernized music consumption with their creation of the streaming platform in Stockholm. After years of negotiations on the terms of the Music Modernization Act leading to an eventual compromise there seemed to be harmony in the music industry between the streaming services and publishing rightsholders until Spotify appealed the Copyright Royalty Board’s statutory royalty rate increase. The appeal of this rate increase that came before the passage of the landmark Music Modernization Act put the rightsholder community back at odds with Spotify and other streaming services that backed them such as Amazon, Pandora and Google. They contended that the appeal is not about the increase in statutory mechanical rates but about the rate-setting formula that was used to calculate those rates. Regardless of their assertion that they are siding with the songwriter community, it is highly unlikely that any change to the formula that they agree to would increase the amount of revenue paid to songwriters.

In the European Union a similar fight was brewing between YouTube and the rightsholder community. It has been thought that YouTube has been utilizing provisions set in set by the 1998 US Digital Millennium Copyright Act (DMCA) and subsequently in 2000, the EU eCommerce legal framework which created limitations to the liability of potential intermediaries in digital distribution platforms on the internet widely called safe harbors. As a result of these safe harbor provisions User Generated Content (UGC) internet platforms have been accused of extracting double value from the music industry. In the case of YouTube, music content only makes 5% of their content but drives 20% of their views and thus a large portion of their advertising revenue while paying approximately 800% less than Digital Service Providers (DSPs). Considering the fact that YouTube recently reached 1.9 billion logged in users without considering those users that visit without being logged in. With that analysis it is clear there is a value gap between YouTube and the music industry which drives the largest amount of users to their platform. In order to address this clear value gap The Directive of the European Parliament and of the Council on Copyright in the Digital Single Market (EU Directive on Copyright) proposed a plan consisting of 26 articles to modernize copyright in the digital age of streaming. During initial talks Articles 11 and 13 were the most contentiously debated of the articles. In response YouTube ran many advertisements targeting specific members of parliament as well as other users with the fear that this new legislation would remove popular UGC such as memes. The goal of these advertisements was to lobby against Article 13 to keep them from accepting additional liability for user content and to keep the safe harbor provisions that have allowed them to build their competitive advantage over the years since the initial copyright changes approximately 20 years ago. Their attempts were unsuccessful in the end

culminating with the European Commission passing the EU Directive on Copyright moving the fiercely debated Articles 11 and 13 officially to Articles 15 and 17 in the final text. The new provisions of article 17 will cause platforms such as YouTube to be liable for infringing content on the platform attempting to increase the use of services such as Content ID. YouTube has claimed that Content ID is already an effective method of policing copyright infringement but it is only utilizing cases that they deem necessary. As a result, I believe that these loopholes will disproportionately affect record labels and other smaller companies who do not have the financial bandwidth to make the changes proposed by the EU in light of these copyright changes in the United States and the European Union.

Coming from a finance and accounting background I am always interested in the financial implications of decisions which attracted me to the Music Modernization Act and EU Directive on Copyright in the first place. With this curiosity I decided to analyze the potential financial impact on Spotify's most recent financial statement Form 20-K to further understand why they may be appealing this ruling that seems to give more life to the creators who make their platform viable. Additionally, I wanted to see the effect in the European Union on indie record labels as well as the effects of piracy on the bottom lines just to analyze how impactful the changing legislation may be going forward. The results of my financial analysis showed me that over the five years subsequent to the CRB rate increases that Spotify stands to lose \$2.6 billion in profits due to increases in content costs. A large increase in operating costs from a historically low profitability company could spell trouble, especially as their status as a newly publicly traded company obligates them to shareholders. With that much on the line it is not

surprising to see Spotify appealing the CRB rate increases even if it appears to be cutting off their nose to spite their face. Financial analysis of Beggars Group 2017 statements retrieved from Companies House revealed that the large independent label loses an estimated 6.1% or \$475,000 of revenue through piracy which is mainly executed by stream ripping from internet platforms such as YouTube. I estimated these totals are using a number of industry sources including the European Intellectual Property Office's report on the Economic Cost of IPR infringement in the Recording Music Industry, WINTEL's 2017 report on the Independent Music Industry, the 2019 Global Music Report and 2018 Consumer Insight Report from the IFPI and British Phonographic Industry's All About Music: Recording Music in the UK Facts Figures report. These industry reports estimate many different impactful totals and percentages through analysis of the independent and recording music industry as a whole. Through a series of calculations gained from these reports I was able to figure out a total of the impact of each of the bills on Spotify and Beggars Group. It is clear that there is a financial burden that will be placed on these companies by the blockage of this new legislation blockage in Spotify's case or their passage in the case of Beggars. Going forward allowing rightsholders to negotiate at an arm-length basis common in the free market should increase revenue to individual rightsholders for years to come.

I undertook this extensive research because believe that this information is critical to the music industry and especially artists. At the heart of the industry is passion for music but it is also undeniable that when the product is worth billions that it is a commercial business at the end of the day. Although most artists begin creating for the passion of music there needs to be

a wider understanding of the implications of large-scale legislation such as the MMA and EU Directive on Copyright. This analysis benefits me and the industry at large because it helps me to further bridge the gap between the commercial side that tends to be at odds with creative. This understanding of both ends of the spectrum will allow me to be a more impactful professional in the future because I will not only operate out of passion for music but business awareness too. The results of this research aligned with my expectations because it gave me a quantitative perspective of actual figures even with the limitations present in analyzing an industry with many different variables and limited transparency. Going forward I will have a much more in-depth picture of what is actually at stake when these large platforms battle the factions of the industry over important subjects such as the copyright environment.

With my background I came to Berklee interested in primarily understanding the revenue flow in the industry. Throughout my coursework I learned much more of the business which interested me in understanding the entire legislative landscape around the ownership of assets which are the copyrights of the musical creations. Before this research paper I did not fully understand why this fight to modernize copyright has been ongoing for years. After this financial analysis I was able to gain a quantitative perspective on what was at stake for each of these individual stakeholders. This depth of knowledge will be valuable in my career even if I do not go on to specifically work in a faction of the industry that deals in copyrights such as licensing. Understanding the financial implications of the creative environment in which I will work stands to inform my future business decisions and help to understand the motives behind the decisions of others in the industry more clearly.