WORKING PAPER

UNSHACKLING THE FUTURE OF MUSIC

How outdated legal rules are holding back the music business

By Mark Schultz [1]

Summary

The music business is a digital industry which, through its innovative licensing practices, has moved from an ownership model, CDs and downloading, to an access model, streaming, with consumers now having greater choice than ever before. Nevertheless, radio remains the dominant way of consuming music despite the increasing popularity of music streaming services. In this part of the market, outdated regulation of licensing practices remains in place, distorting the market and holding back the music business.

Most countries do not let the owners of sound recordings decide who can broadcast their recordings, nor the price that users pay. Instead, copyright owners are merely entitled to receive remuneration for the use of their recordings in broadcasting and public performance. This restriction is a surprising exception to a fundamental rule of property rights, namely that the right owner is entitled to authorise or prohibit the use of her/his rights by third parties. This restriction also ties the hands of sound recording right holders in licensing negotiations. Ultimately, they have no choice but to accept below-market prices determined by law or by rate-setting bodies.

This arrangement discriminates against music rights holders, pushing down remuneration rates below their market value and reducing investments by the recording industry back into artists and repertoire, to the ultimate detriment of consumers.

This exceptional arrangement is even more surprising considering that music is the essential input to commercial radio. It occupies about 75% of commercial radio airtime, attracts listeners, and drives broadcasters' advertising revenues. However, licence fees for the use of sound recordings

Radio remains the dominant way of consuming music despite the increasing popularity of music streaming services

amount to only 1.65% of global commercial radio industry revenues. Few businesses selling a service that relies almost entirely on another's product would expect to pay such a miniscule price to their supplier.

This policy brief explains the current legal rules for broadcast and performance rights to recorded music applied throughout most of the world. We explain how these rules are distorting the marketplace, and what might be done about them.

Ultimately, we recommend giving artists and record companies the same rights that almost any other business has: To determine who can use their products and to negotiate with buyers for a fair price, without interference from regulators or courts. At the very least, courts and regulators should approach rate-setting with much greater care and in the knowledge that the current system makes it virtually impossible for sound recording right holders to negotiate a fair deal, therefore greatly undervaluing their music. Instead of following historical rates, which are unjustifiably low, rates should be set according to the market value of the use of the rights.

The music business is far more regulated than most other industries

Introduction

Although people have more entertainment choices than ever, outdated legal rules are still treating some right holders unfairly and denying choice to consumers. While the music industry's innovation has resulted in new and exciting ways for consumers to access music, the industry remains held back by extraordinary and restrictive regulations over the licensing of the most popular means of consuming music: radio.

In this respect, the music business is far more regulated than most other industries. For instance, most countries impose a "compulsory license" on the owners of rights to sound recordings, allowing broadcasters to publicly play protected recordings provided they pay a standard rate. Copyright owners cannot choose to whom they license these performance rights; they cannot do exclusive deals; and they cannot set their own prices. Instead, rates are set by courts, regulators or legislatures, rather than markets.

This degree of regulation is extraordinary. For most consumer goods and services in most countries, prices are freely set in the market and businesses can mostly choose with whom they transact.

As policymakers throughout the world contemplate the future of the creative industries and the digital services that distribute creative content, they should challenge the outdated regulatory status quo in the broadcast of recorded music. Setting prices this way is neither fair, efficient, nor good for consumers. And whatever policymakers do to develop future policy frameworks, they must recognise that the deeply flawed current system is outdated and harmful to record companies and artists. It is time to unshackle the music business.

This Policy Brief explains the existing rules for licensing recorded music, why they are unusual and lead to inequitable results, how they are holding the music industry back, and what might be done about them.

The current system for sound recording performance rights

Copyright gives creators control over most of the economically important uses of their work, but the regulation of the broadcast and public performance of sound recordings is an exception to this rule. Like other creators,

the owners of copyright in sound recordings control the making of physical and digital copies, the licensing of their recordings to digital music streaming services (Spotify or Apple Music for example), and the licensing of other uses of their recordings, such as their inclusion in soundtracks for commercials, movies, and tv shows. However, most countries do not permit copyright owners to control whether their music is broadcast or played publicly, nor what price they can charge for playing it.

These "performance rights", are typically governed by "remuneration-only" rules. In such a system, right holders cannot stop others from publicly playing or broadcasting their recordings but are entitled to receive remuneration for this use. (In legal terms, a copyright owner cannot get an "injunction" – a court order that a party stop using its property.) The level of remuneration is typically set by law, government decrees, or other third parties outside of the market. In instances where a countries allow a rights holders to attempt to negotiate rates in the marketplace, a court or other authority will set rates if the rights holders and users cannot agree. As we explain later, users have every reason to hold out for a court to set the price. Effectively, then, remuneration only-rules dictate that rights holders can determine neither who uses their music nor the price they pay.

	No rights at all	No performance rights	Remuneration only	Nominal exclusive rights
Scope of rights	No copyright in sound recordings, so no control over performance, copying or distribution.	Copyright owners have no control over playing or broadcasting of their recordings.	Copyright owners have no control over playing or broadcasting of their recordings. Performance rights are often mandatorily managed by CMOs, which typically must license the entire repertoire to all.	Copyright owners nominally have control over playing or broadcasting of their recordings, but performance rights are often mandatorily managed by CMOs, which typically must license the entire repertoire to all.
Determining compensation	No compensation	No compensation	CMO may be able to negotiate rates, but if unable to reach agreement, it is likely that an administrative body or court will ultimately determine the rate. In other cases rates are simply set without the possibility of negotiation.	Rightsholder (typically CMO) may be able to negotiate rates, but if unable to reach agreement, it is likely that an administrative body or court will ultimately determine the rate.
Legal means of stopping non-licensed users	No right to injunction	No right to injunction	No right to injunction	Injunctions may theoretically be available, but courts are often reluctant in practice to grant injunctions, thus leading to judicial or administrative determination of fees.
Examples of countries with this regime	Cuba Libya Somalia Yemen	Afghanistan Iran North Korea United States*	Canada France Germany Switzerland (This is the most common regime)	Brazil South Africa Taiwan United Kingdom

Figure 1: Summary of the regulation of performance rights

Source: Schultz 2018. This chart simplifies several nuances further detailed in the original.

**In the US, rightsholders have no right to payment for terrestrial broadcasting or general public performance but do have such rights for digital subscription radio services.*

Some countries provide more protection and freedom to copyright owners than others, but even in the best-case scenario, opportunities for copyright owners to negotiate licenses for sound recordings are limited.

To sum up differences among countries:

1. A handful of countries provide no rights at all in sound recordings, not for unauthorized copying, distribution, rental, or digital uses, nor for collecting license fees for performance.
2. Some countries provide sound recording right holders control over copying, distribution, rental and digital uses, but don't grant any right to control or get paid for performances or terrestrial broadcasts (notably China and the United States).
3. Most countries (including Canada, France, Germany, and Switzerland) don't grant any right to control performances or broadcasts but do grant a right to get paid, at a rate set by legislation, courts, or administrative bodies.
4. Some countries nominally grant exclusive rights, which theoretically means that copyright owners can control performance or broadcasting of their works and negotiate payment. In practice, these rights are often managed collectively. Furthermore, courts are often reluctant to grant injunctions to prohibit use, and if the parties cannot agree to a price, then prices are set by a court or administrative body. South Africa and Taiwan are two recent examples of nominal exclusive rights countries where courts or administrative bodies intervened to set prices.

Sound recording right holders almost universally do not or cannot manage their performance rights and cannot negotiate on their own behalf.

In addition, sound recording right holders almost universally do not or cannot manage their performance rights and cannot negotiate on their own behalf (even in nominal rights countries). Instead, they all must place their performance rights in a pool controlled by a local collective management organization (CMOs).

Moreover, CMOs often find their hands tied in negotiations with licensors as we discuss below.

The impact of the current rules for the value of performance rights

The inability to control performance rights makes a big difference to the music business as broadcasting and playing recordings in a public setting is an important way to economically exploit recordings. Yet, while radio remains the most popular means of consuming music, the revenues paid by radio stations for their use of music are substantially and disproportionately below the value they enjoy from the use of music.

Sound recording right holders suffer from the current system in three inter-related ways:

1. Bargaining power is inequitable, as the current system dramatically favours licensees, thereby distorting the market.
2. This leads to the under-pricing of performance rights.
3. Deflated compensation for performance rights stifles the ability of record companies to invest in artists and repertoire.

Inequitable Bargaining Power Distorts Markets

Mere remuneration rights skew bargaining power dramatically in favour of users. Sound recording right holders cannot choose whether to authorise others from broadcasting or otherwise publicly performing their works. To the extent that negotiations can occur, they occur in the shadow of ultimate resolution by a court or regulator, where the prospective user has no fear that they will be stopped from using the recordings in the meantime.

A broadcaster or other user therefore has every reason not to bargain fairly with copyright owners. The worst that can happen is that it may eventually pay an "equitable" rate determined by a third party. This will only happen after some delay, after the user pleads its case for a lower rate to a court or administrative body. Meanwhile it can continue to use the music, often without an obligation to pay anything to right holders while the dispute is pending (this is for instance the case in Germany), and avoiding any rate increases for the duration of the dispute.

This negotiation dynamic encourages rational users to always refuse to deal and to delay as they benefit economically from doing so. In fact, one might say that radio stations and others owe it to their shareholders, given the opportunity the system presents them.

The current regime undervalues performance rights

Since artists and record companies are neither free to negotiate on their own behalf nor able to stop others from using their recordings, there is no real market for music performance rights. Absent such a market, it is difficult to know the "correct" value of those rights. However, the fact that the majority of commercial radio airtime consists of music suggests at the very least that rates are not too high, and certainly not high enough to impede the use of music by commercial broadcasters.

In many countries, music constitutes around 75% of commercial radio airtime (Figure 2), yet performance fees for the use of sound recordings amount to only 1.65% of global commercial radio industry revenues (Figure 3). These figures show that music is an essential input into commercial radio and dominates the airwaves, yet the sums paid for use of that music are only a very small fraction of the overall revenues of radio stations. Few other businesses could expect to essentially act as a reseller of another's product, even a value-added reseller, and pay the mere 1.65% paid by the global radio industry for the use of sound recordings.

Economic models have estimated that commercial royalties likely would constitute between 25%-50% of revenue if licensors and licensees could bargain more freely[2].

Skewed bargaining power is one factor behind the existing depressed rates.

Just as important, however, is that having a court or administrative agency try to set the "right" price will always fail, as they would need to be all-knowing to do so. In the marketplace, people bargain every day over the price at which to buy and sell products at based on their own knowledge of their needs, desires, costs, and opportunities. Market prices are the aggregate result of the input and knowledge of vast numbers of people. By contrast, courts and administrative agencies only can ever see a sliver of this information, and it is biased by the arguments of the parties. Courts also tend to look to historic rates, which are often assumed to be a proper base-

Country	Average Percentage
Bulgaria	74%
Canada	76%
Denmark	40%
Finland	55%
France	68%
Germany	70%
Italy	65%
Latvia	70%
Netherlands	54%
New Zealand	82%
Norway	58%
Spain	76%
Sweden	75%
Switzerland	75%

Figure 2: Average percentage of airtime devoted to music on commercial radio

Source: Schultz 2018.

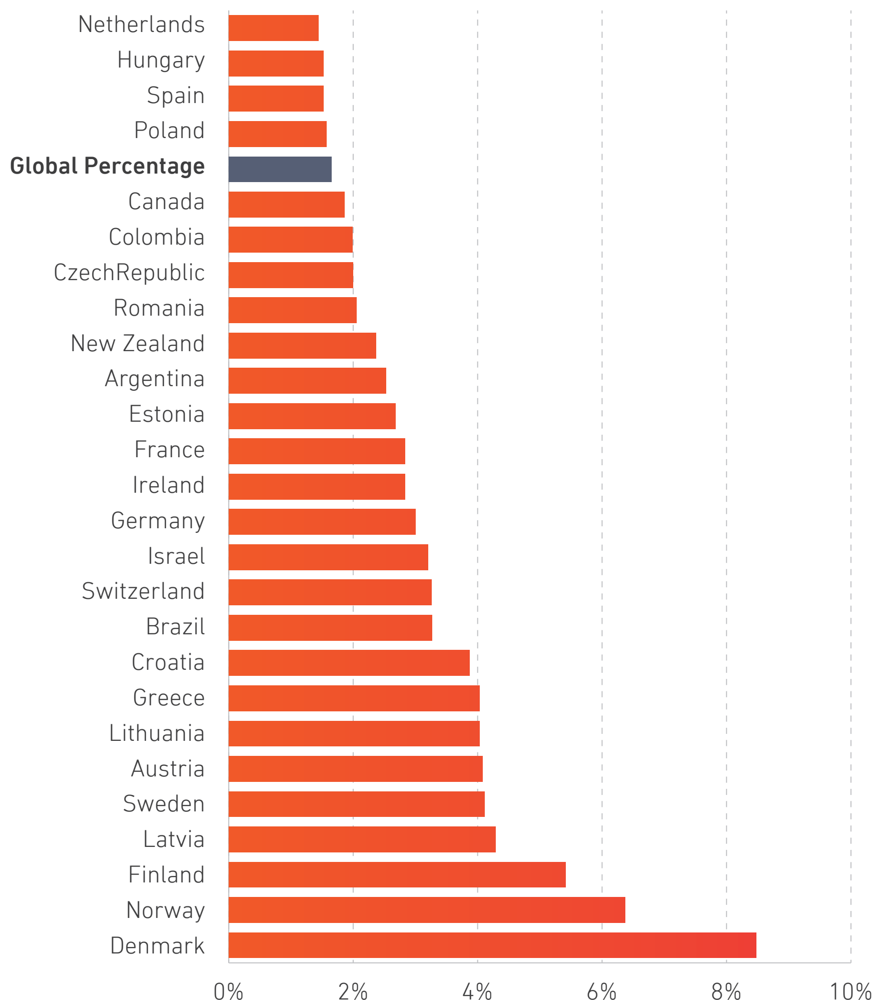

Figure 3: Percentage of revenue paid by commercial radio industry as performance fees for sound recordings in 2017

Source: Schultz 2018.

The current system limits the ability of the recording industry to invest in new artists and music

line without adequate scrutiny as to whether these rates represent current market value, or ever did so in the past. Since license rates all over the world are set this way, there is no market price for these particular rights to which to refer.

The current system limits the ability of the recording industry to invest in new artists and music

Outdated regulation of the licensing of sound recording right to radio stations has resulted in radio stations paying extremely low rates for their most valuable business input. With record companies investing an average of 27% of their revenues back into artists and repertoire and marketing of artists, the artificially low rates paid by radio have a direct and negative effect on the ability of record companies to invest in artists, their careers, and their artistic creations. Consumers are the ultimate losers, as choice is diminished by less revenue being available to invest in new artists and music.

Under the current system rights holders cannot choose who gets a performance license to music, when they get it, how much they pay, or often which part of the catalogue they can play. This also reduces opportunities to innovate in the marketplace, with licensees unable providing points of dif-

ferentiation through innovative music licensing practices, to the detriment of artists, record companies, and consumers.

This can be contrasted with the market for digital music services, where record companies' innovative licensing practices have resulted in dramatic developments in the emergence of music streaming services, giving consumers more choices in how they may access music than ever before in what music to listen to and how. In the radio context, the applicable legal regime is preventing full competition and business model experimentation.

This loss of innovation and suppression of investments in new artists and music, caused by the restrictive licensing regime, should therefore be a matter of concern to policymakers.

Policy recommendations

To make the market for musical performance rights more competitive and pro-consumer, the following steps should be taken.

- Mere remunerative performance rights should be replaced with exclusive rights, allowing sound recording copyright owners to enter into market-based negotiations for the use of their rights.
- In any event, injunctions should be available to enable the prevention of unauthorised uses of rights. At the very least, they should be available in the case of bad faith negotiations and delay.
- Where rate-setting bodies or authorities continue to have jurisdiction over rate-setting, they should set rates by reference to the standard of the economic value of the rights in trade – the true value of the use of the rights by the licensee.
- In applying that standard, rate-setting bodies should not use existing rates as the starting point for setting new rates, as they are unlikely to accurately reflect the true value of the rights. Instead, they should thoroughly assess current and changing economic conditions. To that end, licenses granted to streaming services could for instance be considered as a meaningful reference point, given that they are negotiated according to the realities of the marketplace.
- Courts and regulators should approach rate-setting with the understanding that the current system skews bargaining power in favour of the licensee.
- Delay should not be profitable for licensees. Measures to prevent putative licensees from strategically delaying a licence include:
  - Making new rates retroactive to the date of the first offer from licensor.
  - Requiring putative licensees to pay monies into escrow until such time as the rate is set.
  - Awarding a higher interest rate, accounting for the internal rate of return of the licensee.
  - Adding penalties or pre-established damages for bad faith delay.

These changes would rebalance a market long distorted by an extraordinary institutional arrangement that deprives right holders of control of their property and reduces investments in artists and repertoire.

About the author

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Mark is a Senior Fellow at the Geneva Network and a Professor of Law at Southern Illinois University. His research focuses on the law and economics of the global intellectual property system. He has testified before the U.S. Congress on copyright law, spoken at programs hosted by the World Intellectual Property Organization (WIPO), the U.S. Patent and Trademark Office, the U.S. Trade Representative, and the U.S. Copyright Office, as well as numerous universities, think tanks, and industry groups. He serves as an expert on the U.S.-India IP Dialogue and is Chair of the Academic Advisory Board of the Copyright Alliance.

Endnotes

1. Professor, Southern Illinois university School of Law; Senior Fellow, Geneva Network. A more detailed discussion of this topic can be found in Schultz, Mark F., The Market for Performance Rights in Sound Recordings: Bargaining in the Shadow of Compulsory Licensing (2018), https://ssrn.com/abstract=3292512.
2. See Boyer, M. 2018. "The Competitive Market Value of Copyright in Music: A Digital Gordian Knot (The Working Paper Version – v2)". CIRANO Working Papers 2018s-30, CIRANO; Watt, R. 2010. "Fair Copyright Remuneration: The Case of Music Radio". Review of Economic Research on Copyright Issues, 7(2); 21-37; Watt, R. 2011. "Revenue Sharing as Compensation for Copyright Holders". Review of Economic Research on Copyright Issues 8(1); 51-97.