MEDIA LAW
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Legal Practice Guide: Digital Music Distribution

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Industry Insight into Legal Issues in the Global Music Market

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Published as Part of
Media Law International's LPG Series

September 2018

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Legal Issues in Music Streaming: The Value Gaps

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Written before Amendment of the Copyright Directive
Passed by EU Parliament on 12 September 2018

LEGAL ISSUES IN MUSIC STREAMING: THE VALUE GAPS

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1. Music streaming as the new frontier of digital music distribution

Streaming is designed to enable web-based access to virtually infinite music libraries at user demand, unconstrained by time and place.

Users can listen to as much music as they wish, for as long as they wish, on devices that work as pure music players, with their storage function relegated to a relic of the past.

This basic description of how streaming works marks the main difference between the streaming service and its immediate predecessor in the realm of digital distribution of music, such as music download.

Music streaming can yet be seen as an evolution of downloading, in that both require the availability of a hardware infrastructure upstream for the hosting of digital copies of musical works. The two diverge downstream, as streaming requires no permanent memorisation of the file on the user's device.

Instead, packets of compressed digital data are received and temporarily stored (copied) in "buffers" (i.e. small portions of DRAM memory) of the recipient's device, so that they are almost in real time, decompressed, decoded and sent to a sound card, which emits sounds audible as music to the ear.

Therefore, differently from download, the playing of the file happens contextually, with no significant latency between the point in time the user clicks on a track and when the playing starts. Streaming is technically differentiated between live (or webcasting) and on-demand streaming. For the purpose of this paper, only the latter is considered.

The advent of streaming, made possible by the emergence of more effective storing and transmitting technologies, coupled with the increase of bandwidth, has dramatised the phenomenon of music dematerialisation.

For example, the complete separation between the ownership of a physical support and the enjoyment of music.

The streaming-led dematerialisation can also be viewed as a paradigm change, whereby users no longer buy music as a product but rather have access to a service.

With streaming, the service component may be said to be as important as the product component, if not prevail over it.

From a remuneration stand-point, the concept of streaming encompasses two main different models.

The differentiation in this respect runs between the "premium" offering, whereby users subscribe for a periodic fee and have access to the full version of the service, and the "freemium" proposition, which is entirely supported by advertising.

This means users accept to exposing themselves to advertising messages that interrupte the flow of music, coupled with a usually impoverished version of the service.

Another taxonomical clarification is necessary with respect to the concept of "musing streaming service providers".

Namely such a category should be taken to embrace not only pure musical content providers, such as Spotify, Deezer and Tidal, who control whatever is uploaded and streamed (henceforth referred to as "pure players"), but also music streaming services, such as first and foremost YouTube, that are intended as platforms for users to upload the content they wish, the so-called User Uploaded Content (UUC).

UUC may consist firstly of entirely original content, in the form of the users' own creations. However, a second form of UUC consists of either unauthorised wholesale reproductions of third parties' content, such as songs, albums and music videos, or of derivative works.

These include user generated content using parts of a third party's protected work such as, for example, musical soundtrack for an otherwise original footage.

It is this second category of UUC that is relevant for the purposes of this paper, because for users it represents an alternative to accessing music via pure players' platforms.

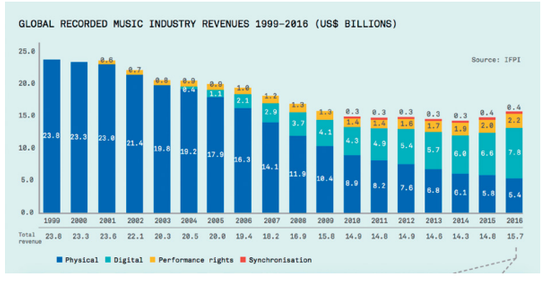
Although YouTube has launched a paid monthly subscription service in a few countries, named YouTube Red, currently the YouTube business model is essentially advertisement-based and does not even require users to register to it in order to access content.

2. The economic importance of streaming

The 2017 Global Music Report of the International Federation of the Phonographic Industry (IFPI) shows that, over the past 15 years, the music industry's revenue, generated in the aggregate from performance rights, synchronisation, physical and digital sales, have decreased by almost 40%, with a steady declining curve since 2000.

However, the downward spiral has come to an end and the trend eventually returned to growth from 2015.

Eventually, in 2016 the global recorded music market eventually experienced a revenue increase of 5.9 compared to 2015 (see Figure 1 below), which the IFPI defines as "the fastest rate of growth since IFPI began tracking the market in 1997".



The recorded growth is entirely attributable to digital revenues and, within that ambit, to streaming revenue in particular. When looking into the composition of global music revenue by segment, the IFPI figures show that digital revenue (from download plus streaming) in 2016 accounted for 50% of the total market, with a growth of 17.7% during 2015.

This was significantly driven by a 60.4% growth in streaming revenue.

Streaming of late has therefore taken the lion's share of growth in the global recorded music industry.

This is signified by the observation that in the same period download revenue has indeed declined by 20.5% and therefore streaming now represents the largest portion at 59% of digital revenue.

Streaming revenue, according to the report, may be attributed for the largest part to more than 100 million users of paid subscriptions. This number has more than doubled, hitting 212 million, when considering the entire audience of paid and ad-supported subscriptions.

These numbers provide the economic context to this paper and attest the centrality within the industry that streaming services have gained.

They also show that the music industry's economic crisis is far from being solved. As yet over a third of its pre-crisis value is missing.

It is, however, all the more uncertain that streaming services are the remedy to the problem. Perhaps instead, taking into account the music streaming providers' prevailing business models, streaming services would work as the sanctioning of an irreversible impoverishment of the industry at large or,

to put it differently, of a stable different wealth allocation, to the detriment of artists and music labels.

In Section 3 below, I will cover on the problems caused by the pivotal role now assumed by streaming services within the music distribution industry and I will focus, in particular, on the so-called Value Gap issue.

In Section 4, I will map out the legal solutions at EU level that are being envisaged to tackle the Value Gap issue. In Section 5 some conclusions will be outlined.

3. Setting the problem: The Value Gap(s)

The growing popularity attained by music streaming services has attracted the scrutiny of the industry community, which has been increasingly vocal in manifesting discontent for the mismatch between the skyrocketing consumption of music worldwide through streaming platforms and the yet proportionally small revenue that streaming service providers return to right holders.

This is what is recognised as the Value Gap issue. This term is exclusively used within the music industry to stigmatise UUC streaming service providers, whose business models, according to critics, result in the most unbalanced distribution of resources for record labels and artists.

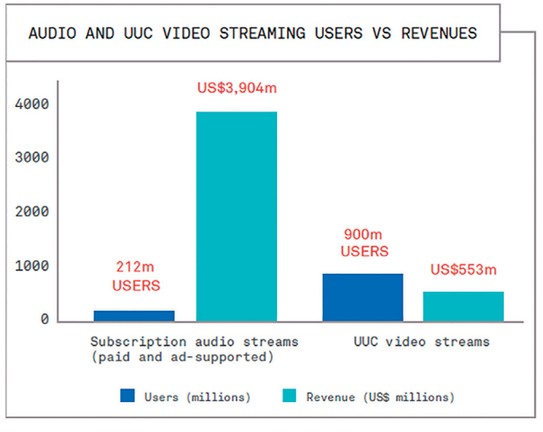
The IFPI 2017 Global Music Market report dedicates a specific chapter to the qualified Value Gap.

In the report, the issue is reported as one pertaining solely to UUC services. YouTube is expressly mentioned as the organisation that extracts high revenue rates by selling advertising space in association with streams of music related UUC, while returning very little to right-holders.

The IFPI report does not shy away from pointing the finger at this Value Gap as the "biggest threat to the future sustainability of the music industry".

This stance rests on a comparison between the revenue generated by subscription services and the revenue derivied from UUC streams. In both cases this is in proportion to the number of users.

As is shown in Figure 2 below, numbers appear staggering. The total revenue that UUC streaming service providers reverse to the music community with almost 1 billion users is only 1/6 of the sum paid by subscription services with a user base as small as 1/4 of the former.



The music community holds that the unfair distribution of revenue generated by UUC streaming services is due to a flaw in the legal framework, both at EU and US level.

This flaw allows UUC streaming service providers, differently from pure players, to keep operating their businesses, without any need to negotiate and enter into license terms with right-holders.

In Europe, the legal gap in question has been identified in the Safe Harbour (SH) that the E-Commerce Directive 2000/31/EC (ECD) has erected for, *inter alia*, ISSPs (Information Society Service Providers) engaged solely in the hosting of information stored at the recipient request, pursuant to Article 14 of the ECD.

These ISSPs shall be shielded from liability in the event that illegal content is uploaded, when certain conditions are met and notably that the ISSP does not have reasons to believe that illegal content is stored on its service and further that the provider, when notified that such an activity is being conducted, expeditiously removes or disables access to the relevant content.

The second condition is ordinarily referred to as "the notice and take-down procedure", by analogy with the procedure under Section 512 of the US Copyright Act (although much more detailed and specific).

Under the EU regime, the case-law has further added that for ISSPs to benefit from the SH under Article 14 ECD, it is necessary that they are neutral *vis-à-vis* the illegal content they store, i.e. that the host should not play "an active role allowing it to have knowledge or control of the data stored" (EUCJ ruling in the L'Orèal v. eBaycase C-324/09).

In this connection, it has been observed that YouTube's neutral role is questionable, to the extent that, *inter alia*, 80% of watch time on the service is on content that the platform itself suggests.

Along with this, the lose terms in which the EU notice and take-down procedure is framed have been accused of not helping define with certainty the scope for the host service providers' exclusion of liability.

The music world has hence complained that the SH mechanism was fit in an era within which information society services were in their infancy.

However, the mature digital market has come of age and lends itself to being abused by technology giants that leverage the same SH to make money at the expense of the music community.

On this basis, the community has openly pressed the EU and US authorities for legislative reforms aimed at closing the gap.

The factual picture must be completed with a description of the ContentID tool that YouTube has put in place, as it helps identify the nature of the Value Gap problem denounced by the music industry.

ContentID is presented by YouTube as a system that copyright owners can use to easily identify and manage their content on the

platform. It is based on a database of files fed by content owners themselves, against which UUC is scanned by YouTube each time new content is uploaded.

When content in a video matches a work listed in the database, rights owners are informed and can decide whether to have the illegal content removed or otherwise monetize it, by having the advertising revenues directed to them.

ContentID represents the larger source of revenue for right-holders on YouTube. In fact, according to some sources (https://thetrichordist.com), YouTube ContentID generates approximately 60% of all revenue paid out by YouTube.

However, YouTube's figures look even more like insignificant when the average per stream amount derived from ContentID (USD 0.00030) is compared with the average per stream amount paid by pure players (USD 0.005). It pays out only a fraction (7% to 10%) of the pure players' bill.

Content ID requires no license royalty bearing agreements with the rights owners and it is a benign concession made by YouTube, which otherwise could pay nothing at all and simply stick with the SH contemplated by law.

According to the aggrieved music community, the relationship with YouTube is therefore utterly unbalanced and unfair.

The Value Gap review that is outlined so far does not, however, provide the full context of the debate on the fairness of the distribution method of revenue generated from streaming services.

It is also necessary to account for yet another manifestation of the Value Gap. This time, denoting a fracture between artists (authors and performers), on the one side and record labels on the other side.

This different characterisation of the gap stems from the meagre sum of total revenue paid out by streaming service providers that endup in the pockets of artists.

The news abounds with artists' complaints about the inconceivably low sum they receive compared to the number of streams.

The root cause for the inequality in the revenue distribution perceived by artists has been identified by artists' representative organisations, through the lack of transparency in the tripartite relationship to which artists are the weak party.

The making available of music through streaming platforms is, in fact, ordinarily governed by dealings, whereby record labels license-in the rights from artists. They then license-out the rights to distribute music to digital music services, which in turn pay the agreed upon per-stream revenue to the labels. The labels finally pay a share of their profit to the artists.

Artists have no visibility of the actual terms of the financial relationship, which is intermediated by record labels, and also have difficult or no access to reliable data.

Artists' associations have highlighted the opaqueness of the upstream relationship between labels and digital music services, as ensuing from the record labels' negotiation strategy, which is based on package deals, whereby they are thought to exact substantial down-payments from providers, in the form of attributable minimum advances for the service to secure the availability of the labels' entire catalogue.

These advances are most likely not shared with artists and in any event there are no means why which they can access the information. This is because the agreements are said by streaming services to be sealed by NDAs. Likewise NDAs also prevent authors from knowing the rates achieved for their own works.

EU authorities have been prompted to resolve the two manifestations of the Value Gap by way of normative intervention.

These calls have found their way in the proposal for a directive on copyright in the September 2016 Digital Single Market (the Draft Directive or DD), outlined below.

4. The DD's solutions to the Value Gaps

4.1 The provisions concerning UUC streaming services

The DD tackles the UUC streaming services related Value Gap under Article 13. As it can be inferred from the policy considerations set out in the DD's preparatory and supporting documents, the Commission holds that the evolution of digital technologies, with the advent of Web 2.0, has turned the internet into the absolutely dominant outlet for access to copyrightable content.

However, as shown in paragraph three, to date the number of users accessing content through UUC streaming players platforms pales in comparison with those accessing content on paid pure players' platforms.

The Commission has found that this imbalance may create distortions, by producing a sort of negative umbrella effect.

In fact, UUC platforms detract from the value of music that users perceive, by giving access to plenty of music at no cost. Consequently, pure players are compelled to keep service fees low, while the potential audience of willing and paying subscribers remains comparatively limited.

The DD's proposal is, therefore, based on a follow-the-money approach, as its goal is to divert part of the revenue of UUC platforms to the benefit of the music world.

To this end, the proposed Article 13 seeks to strengthen the SH's conditions that are provided for hosts under Article 14 of the ECD. It is also intended to clarify the right of communication to the public under the InfoSoc Directive (Directive 2001/29/EC).

The aim of Article 13 is to deprive UCC service providers of the option of not concluding license agreements with right-holders.

While referring to the DD's full text available on https://ec.europa.eu/digital-single-market/en/news/proposal-directive-european-parliament-and-council-copyright-digital-single-market. An overview of the new provisions is summarised below.

The first innovation of Article 13 is that it creates a fourth category of ISSPs out of the three contemplated under the ECD. Notably, that of hosts that "store and provide to the public access to large amounts of works… uploaded by their users" (henceforth these ISSPs will be referred to as Large UUC ISSPs).

The DD provides no hint as to how the quantitative condition (large amounts of works) should be deemed fulfilled.

This means that it will be an issue of fact, to be established on a case-by-case basis, and might indeed be the source of uncertainty on the actual scope of the rule.

The second important innovation of Article 13 is that Large UUC ISSPs will be required to act proactively and adopt "appropriate and proportionate measures".

This includes "effective content recognition technologies" aimed at ensuring "the functioning of agreements concluded with right-holders for the use of their works".

In any event, even in the absence such an agreement "to prevent the availability on their services of works identified by right-holders through the cooperation with the service providers".

Recital 38 to the DD is crucial for providing clarity on Article 13. Notably, the provision should be interpreted as redefining the conditions under which, under Article 14 of the ECD, hosts will be responsible for playing an active role *vis-à-vis* the UUC, thereby losing the benefit of the SH.

This will be the case when ISSPs engage in "optimising the presentation of the uploaded works…or promoting them, irrespective of the nature of the means used therefor".

If the new SH conditions are not met then ISSPs qualifying as Large UUC ISSPs, "thereby going beyond the mere provisions of physical facilities", shall be obliged to conclude licensing agreements with right-holders.

In any event, neutral hosts for the purposes of the SH, redefined as Large UUC ISSPs, shall still be subject to the obligation to take appropriate measures required under Article 13.

The newly created category of Large UUC ISSPs therefore shalla lways be obliged to put in place measures to prevent protected works from being illegally made available to the public.

The proposal also seems to drastically imply that the provision, by the ISSP of access to "large amounts" of UUC, will *per se* qualify as an act of communication to the public, relevant under Article 3 of the InfoSoc Directive.

This includes the ensuing obligation for ISSPs to enter into license terms with the right-holders, unless they genuinely qualify for the redefined SH under Article 14 ECD.

The proposal is prone to scepticism as to its compatibility with the existing liability regime for ISSPs under the ECD and the InfoSocDirective. The DD has chosen to intervene, through Recital 38, in the notion of "neutrality" of hosts which, under Article 14 ECD, would exempt them from liability.

The importance of the Recital has been reduced by supporters of the proposal as amounting to nothing more than codification of the existing CJEU's case law on the notion of host "neutrality".

However, this stance does not seem accurate. In particular, the Recital's sentence "irrespective of the means used therefor" may turn out to rule out UUC providers' exemption of liability whenever they adopt any means of content organisation, leaving the application of the SH to residual instances.

This, however, does not seem aligned with case law, particularly in the case of L'Oréalv eBay (C-324/09), where the EUCJ did not seperate the notion of hosts' responsibility from that of "knowledge and control" in Recital 42 ECD.

The EUCJ did mention "the presentation of the content or its promotion" as examples of ISSPs' non-neutral activity.

However, what seems to be the more law-compliant reading of the judgment is that only support tailored to individual users would qualify as a non-neutral.

Meanwhile, generic automated assistance made available to the generality of users would not. This is because the latter would not imply – in accordance with Recital 42 - any knowledge on the ISSP's part of the illegality of the content stored.

Therefore, under the ECD and contrary to the statement made in Recital 38 of the DD, it is precisely "the nature of the means used" by the host that makes a difference to decide whether a service is neutral or not.

According to the DD, once neutrality is ruled out *vis-à-vis* the deployment of "any means" capable of optimising the content presentation. Following this, the Large UUC ISSPs concerned will be exposed to direct liability under the existing copyright framework.

In fact, as per Recital 38, Large UUC ISSPs might, by definition, be required to go beyond the mere provision of physical facilities (which is as such considered neutral under the InfoSoc Directive) and therefore to perform an act of communication to the public under Article 3 of the InfoSoc Directive.

The above reported readings of Article 13 show that the DD might lead to a *de facto* surreptitious change of EU copyright law and of the ECD, hidden in a Recital, short of any consideration of the possible systemic repercussions and of any supporting case law's interpretation legitimising such a view.

Criticism has also been voiced about the Large UUC ISSPs' obligation to implement, in any event, preventive measures.

This is viewed as inconsistent with the provisions of Article 15 of the ECD (no general

monitoring obligations) and even in contrast with the Charter of EU Fundamental Rights.

This is because it imposes a disproportionate burden on the freedom to conduct one's business (Article 16 of the Charter), as well as end-users' right to the protection of their personal data (Article 9 of the Charter) and to their freedom of expression (Article 11 of the Charter).

4.2 The provisions concerning the artists' Value Gap

The DD in articles 14 to 16, supported by Recitals 40 to 43, addresses what in this paper has been defined as the second facet of the Value Gap, concerned with the fairness of the remuneration that trickles down to artists from streaming services.

As outlined, this Value Gap essentially stems from two intertwined causes: the weak bargaining positions of artists, compared with the negotiating power of record labels and streaming service providers, as well as the information asymmetry for want of adequate information for artists on the exploitation of their works.

The tripartite configuration of the relationship has artists relegated to the role of a nuisance to take care of only after the main agreement between record labels and service providers has been sealed.

The DD remedial proposal provides, in the first instance (Art. 14), a transparency enhancing tool, under which artists should have access to "timely, adequate and sufficient information on the exploitation of their works and performances…notably as regards modes of exploitation, revenues generated and remuneration due".

Recital 41 clarifies that the implementation of this transparency obligation by Member States must take into account the specificities of each sector, and to this end, shareholders should be consulted, in order to identify sector-specific requirements.

Therefore, the Recital encourages recourse to collective bargaining.

The second paragraph of Article 14 mandates the adoption of measures to secure effectiveness and proportionality of the transparency obligation.

At the same time, it contemplates, as a *de-minimis*, the case in which "the administrative burden resulting from the obligation would be disproportionate in view of the revenues generated…".

In this latter case Member States may adjust the transparency obligation.

The adjustment here can arguably be taken to allow for a substantial relaxation of the burden, probably to the benefit of smaller market participants.

Similarly, Article 14 states, as an exception, that the transparency obligation shall not apply when the contribution made by the relevant artists is not significant, having regard for the overall work or performance.

The scope for application of this exception is not clear. One could argue that it is intended to cater for situations in which a copyrightable asset qualifies as a work of joint authorship.

For such work, however, some of the contributions do not pass the materiality threshold for the relevant contributors to be considered as "authors" or "performers" for the purposes of the applicable copyright law.

If so, the specification would seem redundant, as existing principles of copyright law would suffice to bar those immaterial contributors from any right to remuneration for the exploitation of their works and, as a logical consequence, from the right to transparency.

Article 15 of the DD establishes a contract adjustment mechanism, which may be invoked when the remuneration originally agreed is disproportionately low compared with the revenue, and benefits subsequently derived from the exploitation of the work.

This mechanism should enable artists to request additional appropriate remuneration.

Recital 42 of the DD clarifies the provision, explaining that contracts for the exploitation of authors' rights are normally of long duration, offering few possibilities for authors and performers to renegotiate them.

The same Recital implies that the contract adjustment mechanism in question, in the absence of an agreement between the parties, should consist in the recourse to a court of law or other competent authority that the Member State may identify.

Finally, Article 16 of the DD tackles the "fear factor", i.e. the artists' reluctance to enforce their rights in court against their contractual partners. The provision calls on Member States to provide for an alternative dispute resolution procedure to adjudicate disputes around the transparency or the contract adjustment mechanisms.

The DD does not provide any hints as to the type of ADR that should work to make artists' light-heartedly take action against their strong counterparties.

The effectiveness of Article 16 is doubtful, as experience from other sectors shows that the weak party in a contractual relationship will simply not be willing to confront the opponent in any venue, unless and until mechanisms effectively shielding them are put in place, in the form of, for example, collective litigation mechanisms or delegation of representation to associations.

The provisions of the DD relating to the artists' Value Gap have not attracted much debate or controversy, unlike those concerning UUC streaming services

This should *per se* raise concern because if the strong parties in the contractual relationship had felt their privileges at risk of actually being dented they would certainly voice their concern.

The transparency obligations, if properly implemented, are a step in the right direction.

This is because they should provide artists with means to, at least, make better informed decisions and indirectly stimulate horizontal competition between record labels for the offering of better conditions to artists.

Likewise, the contract adjustment mechanism is, in theory, a good solution that resembles well known instruments of copyright law purporting to secure for artists their fair share of any increase in value of any subsequent sale of their works (the so-called droit de suit-eor the resale right of Directive 2001/84/EC).

Yet, as mentioned, the prospects for effective enforcement of these rights remain uncertain.

From a systematic perspective, the norms of Articles 14 to 16 of the DD do not interfere with any other corpus of EU law.

Instead, they qualify as a limited harmonisation of contract law for a very specific sector, in the absence of any otherwise general harmonisation of this area of the law.

5. Conclusion

As I write these conclusive remarks, I am on Spotify listening to a Bach's cantata of astounding beauty and once again I tell myself that streaming services are a blessing for music lovers.

Yet, I am part of a minority of paying subscribers and, therefore, one of the goodfellows in the eyes of the music community. The bad guys for the community are UUC platforms and their users.

The causal link between the success of UUC platforms and the impoverishment of the music industry is, however, at best uncertain.

This is because the radical transformation that the copyrighted content industries are undergoing appears to be unnoticed, bearing in mind the crucial role of UUC platforms for the promotion and discovery of music.

This is most notably the case for independent labels, with monetisation coming from live performances, merchandising and other less traditional channels.

The EU Commission has nevertheless sympathised with the music industry's view and veered towards the radical solution of Article 13 of the DD.

The purely quantitative element of "storing and providing to the public access to large amounts of works" that the solution is based on does not appear sophisticated enough to justify the unravelling of established tenets of the ECD and of the InfoSoc Directive.

It could also ironically entrench the position of the incumbent (YouTube) to the detriment of smaller market participants.

In this regard, criticism has been voiced against the obligation in Article 13 DD for all Large UUC ISSPs to provide for content recognition technologies, regardless of whether or not they qualify for the ECD's SH, as this obligation raises costs for small streaming providers.

Conversely, despite the doubtful efficacy of the envisaged enforcement mechanisms, the DD's Articles 14 to 16 appear to be spot-on as they seek to adjust the bargaining power imbalances under contract law.

Therefore, Articles 14 to 16 are beyond the straits of the doctrine of dominance under competition law, and in line with an established tendency in Europe.

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