Neighbouring rights in the digital era: how the music industry can cash in

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Why sound recording producers, sound recording artists and performers as well as digital service providers have everything to win in finding a consensus on neighbouring rights in the digital era

As we detailed in our previous article on our take on Midem 2015, the music industry's digital revenues grew by 6.9% to USD6.9 billion in 2014 and are now on a par with the physical sector.

Indeed, globally, like physical format sales, digital revenues – which comprise incomes from both digital downloads and streaming – now account for 46% of total music industry revenues. In 4 of the world's top 10 markets, digital channels (streaming and downloads) account for the majority of revenues (i.e. 71% of total 2014 industry revenue in the US; 58% of total 2014 industry revenue in South Korea; 56% of total 2014 industry revenue in Australia and 45% of total 2014 industry revenue in the UK).

In particular, streaming is going from strength to strength, with music digital subscription services – including free-to-consumer and paid-for tiers – growing by 39% in 2014, while downloading sales declined by 8% but remained nonetheless a key revenue stream as they still account for more than half of digital revenues (52%).

Global brands providing music streaming subscription services, referred to here as "digital service

providers" or "DSPs", such as Deezer and Spotify, continued to reap the benefits of geographical expansion. There were some notable new entrants into the streaming area: YouTube launched its subscription service Music Key in late 2014, while Apple launched its own streaming service roll out in July 2015 further to its USD3 billion acquisition of Beats, and Jay Z and other top artists re-launched talent-managed streaming service Tidal earlier this year.

Streaming subscription revenues predictably offset declining downloading sales to drive overall digital revenues, pushing subscription at the heart of the music industry's portfolio of businesses, representing 23% of the digital market and generating USD1.6 billion in trade revenues.

Music industry analyst Mark Mulligan predicts that streaming and subscriptions will grow by 238% from the 2013 levels, to reach USD8 billion in 2019, with download revenue declining by 39%. He concludes that streaming and subscriptions will represent 70% of all digital revenue by 2019.

While this evolution towards more music streaming is very customer-friendly (who does not want to have the option to select and potentially hear millions of tracks, anywhere in the world, on a device no bigger than the size of a jean's pocket?), new legal and business issues have arisen as a result.

In particular, right owners of musical content (i.e. right owners in the musical composition – typically, songwriters, composers and music publishers or collective licensing organisations – on the one hand, and right owners in the recorded performance of that composition – typically, the record label, the recording artist-performer and non-featured musicians and vocalists – on the other hand) repeatedly ask themselves how they are financially benefiting from this surge in streaming consumption and income. How do they get paid?

Also, more and more digital service providers want to know how they can access high-quality musical content and obtain the right to stream the widest musical catalogues on their platforms, at a reasonable price. Since scaling up is the key to success for any technology company, DSPs also want to have the right to stream such musical content all over the world.

Finally, as the surge in musical digital consumption and income is becoming a factual evidence, certain categories of income streams are developing and taking more of a preponderant role. For example, sound recording performance rights, or "neighbouring rights", are a growing source of global revenue for recording artists and record labels. While recorded music sales of physical products have declined 66% since their high in 1999, revenues from overall neighbouring rights have increased dramatically, reaching Euros2.034 billion globally in 2013.

Musical rights represent around 90% of the royalties collected in relation to neighbouring rights. Audio-visual rights are worth around Euros200 million, benefiting mainly to performers, while the rest of these royalties (around Euros1.834 billion) relate to musical neighbouring rights. Where are these musical neighbouring rights going? How are they collected then distributed?

This article focuses on how deals are done with digital service providers, in the musical streaming arena, in relation to sound recording performance rights. We will, in a future article, look at the licensing aspects of mechanical rights and performance rights for right owners in the musical composition, in the digital era. Here, we focus only on neighbouring rights and the situation of right owners in the recorded

performance of a musical composition – typically, the record label, the recording artist-performer and non-featured musicians and vocalists.

1. Getting to grips with neighbouring rights in the digital era

Neighbouring rights, also called “related rights”, were consecrated by law, step by step, in order to ensure that people who are “auxiliaries” to the creation and/or production of content (artists, performers, music producers, film producers, non-featured musicians and vocalists, etc) can have more control over their creative endeavours.

There is no single definition of neighbouring rights, which vary much more widely in scope between different countries than authors’ rights or copyright.

However, the rights of performers, phonogram producers and broadcasting organisations are certainly covered by related rights, and are internationally protected by the Rome Convention for the protection of performers, producers of phonograms and broadcasting organisations, signed in 1961.

Aside from the Rome Convention, another international treaty addresses the protection of neighbouring rights in the musical sector: the WIPO performances and phonograms treaty (WPPT) signed in 1996.

At the European Union level, three directives have been instrumental in developing a harmonised legal framework relating to neighbouring rights: the directive of 27 September 1993, relating to the coordination of certain rules on author’s rights and neighbouring rights applicable to satellite broadcasting; the directive of 29 October 1993 – replaced by the directive n. 2006/116/EC of 12 December 2006 – on the term of protection of copyright and certain related rights; the directive n. 2001/29/EC of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society.

As mentioned above, sound recording performance rights represent the bulk of all neighbouring rights collected worldwide, and they are a growing source of global revenue for recording artists and record labels.

For example, in the US, SoundExchange, the organisation responsible for collecting and distributing sound recording performance royalties, distributed USD590 million in 2013, a dramatic increase from the USD3 million the organisation distributed in 2003. In the decade since SoundExchange’s inception, the organisation has generated USD2 billion in royalties to artists and record companies.

Out of a total of Euros2.034 billion of neighbouring rights collected in 2013, 48.9% originate from Europe (Euros1.101 billion), 30% from North America (Euros681 million), 11.9% from South America (Euros268 million) and 8.6% from Australasia (Euros192 million).

With a 28% share of worldwide royalties, the US is the main market for neighbouring rights, even though the collection of such rights is limited to the public performance of sound recordings on digital medium

only (such as online radio like Pandora, satellite broadcasting like Sirius/XM and also online streaming of terrestrial radio transmission like iHeartRadio). Unlike most of the world, the US does not apply sound recordings performance rights to broadcast radio, terrestrial radio and performance of sound recordings in bars, restaurants or other public places.

The market of neighbouring rights is mainly concentrated in 10 countries, which control 82% of worldwide royalties, with a strong concentration in Europe. Apart from the US, the United Kingdom (12%), France (11%), Japan (7%), Brazil (7%), Germany (7%), Argentina (3%), the Netherlands (3%), Canada (2%) and Norway (2%), are the top 10 worldwide markets. Outside the US, sound recordings enjoy broader performance rights for broadcast (including terrestrial radio), public performance and so-called communication to the public.

Globally, sound recording performance rights are administered by music licensing companies or collecting societies. These organisations are responsible for negotiating rates and terms with users of sound recordings (e.g. broadcasters, public establishments, digital service providers) collecting royalties and distributing those royalties to performers and sound recording copyright owners.

There are around 60 collecting societies around the world focused on sound recording performance royalties.

2. Collecting societies and neighbouring rights: the future is bright for right owners

2.1. How are neighbouring rights protected and collected on a territorial-basis?

While it could appear that neighbouring rights are protected and remunerated in a very homogenous way around the world, thanks to the structured international and European legal framework described above, in fact these related rights and the business practices of collecting societies are very different and vary from territory to territory.

Each of the 60 collecting societies operates in a territory which recognises performances in slightly different ways and has a specific business practice.

For example, the US Copyright act grants owners of sound recordings an exclusive right to "*perform the copyrighted work publicly by means of a digital audio transmission*". This right is limited by a statutory license for so-called "*non-interactive digital audio transmissions*". Therefore, services which comply with the statutory license may stream sound recordings without permission of the copyright owner, subject only to remitting data and payment to SoundExchange. The US Copyright act specifies how SoundExchange divides and distributes the royalties: 50% go to the sound recording copyright owner; 45% is distributed to the featured recording artist; and 5% is sent to an independent administrator which further distributes those royalties to non-featured musicians and vocalists.

In the United Kingdom, the UK copyright, designs and patents act grants sound recording copyright

owners exclusive performance rights in their sound recordings. In addition, the UK act gives performers on those sound recordings a right of "equitable remuneration" for a share of the licensing proceeds for uses of the sound recordings. Therefore, when a sound recording is broadcasted in the UK, the performers on those sound recordings have a right against the producer (i.e. the record company) of the recording as to a share of the producer's revenue from that usage. From a legal standpoint, it is very different from the US statutory license regime where the featured artist's share is as against the user of the sound recording, not the record company. As mentioned above, the UK is the second largest market for neighbouring rights globally. According to the 2014 financial results of UK collecting society PPL, it collected a total of £187.1 million total licence fee income (from broadcast, online, public performance and international revenue sources).

In Germany, the Law on copyright and neighbouring rights similarly grants performers and producers rights to remuneration for the performance of their sound recordings. While this German law grants performers rights of equitable remuneration for the broadcast of communication to the public of their fixed performances (i.e. sound recordings), it grants producers a share of the performer's proceeds from the licensing of broadcast and communication to the public rights. Therefore, the producers' revenue from such activity is as against the performer, not the user of the sound recording. This is the exact opposite to the UK regime, and nothing like the US system.

In France, the Intellectual property code also grants sound recording copyright owners exclusive performance rights in their sound recordings, through a statutory license. Like in the US, digital service providers which comply with the statutory license may stream sound recordings without permission of the copyright owners, subject only to remitting data and payment to SCPP (when the record producer is a major), SPPF (when the record producer is an independent label), ADAMI (for performers) and SPEDIDAM (for non-featured musicians and vocalists). The Intellectual property code provides that 50% of the royalties go to the sound recording copyright owner, while the other 50% go to the performers and non-featured musicians and vocalists.

2.2. How are neighbouring rights protected and collected on a cross-border basis?

One of the recurring questions that artists and labels ask themselves is how they are protected from one territory to the other. Indeed, music is a global business, especially in the digital era: artists successful in one territory often are successful in others.

Worldwide success implies that the sound recordings of artists are going to be performed publicly in other territories than where they reside. How, then, can performers and producers collect sound recording performance royalties in territories where they are not nationals and may not have direct agreements with the relevant societies?

The answers are complex and derive from the application of the provisions set out in the Rome Convention and the WPPT above-mentioned.

Article 2 of the Rome Convention details the level of protection that it grants nationals of contracting states in each others' territories. In short, contracting states owe nationals of other territories the same level of protection they recognise for their own nationals. This concept of "National Treatment" is key to international copyright treaties and works to ensure that members do not unfairly discriminate against

nationals of other contracting states.

Articles 4 and 5 of the Rome Convention specify that sound recordings made by nationals of contracting states, first recorded in contracting states, or first published in contracting states, are eligible for National Treatment. Similarly, a performer's performance will be granted National Treatment if it was rendered in a contracting state, incorporated in a protected sound recording, or if not recorded, broadcast from a contracting state.

Article 12 of the Rome Convention sets out the equitable remuneration for performers, producers (or both) for secondary uses of their sound recordings (e.g. broadcasting, communication to the public). The US is not a signatory to the Rome Convention because, in 1961, this country did not recognise sound recordings as copyrightable subject matter (only in 1995 were sound recordings granted a limited digital public performance right in the US).

Article 4 of the WPPT sets out the treaty's national treatment requirements. Contracting parties must grant nationals of other contracting parties the same level of protection they grant to their own nationals. Article 3 of the WPPT imports the qualification criteria for performers and producers from the Rome Convention (articles 4 and 5). Thus, performers and producers who would be entitled to National Treatment under articles 4 and 5 of the Rome Convention are entitled to National Treatment under article 3 of the WPPT, as if all members of the WPPT were Rome Convention members. This ensures that US performers and producers eligibility is analysed in the same way, even though the US is not a Rome Convention signatory.

Article 15 of the WPPT details the equitable remuneration right of performers and producers and largely follows the provisions of article 12 of the Rome convention. A contracting party may recognise an equitable remuneration right for secondary uses of sound recordings (e.g. broadcast, communication to the public) for performers, producers or both, or may choose not to recognise such a right at all. Contracting parties may choose to limit their application of article 15 by depositing a notification detailing the scope of its limitation. Such notifications may have implications for the level of national treatment member states owe each other's nationals under article 4.

Article 4 of the WPPT requires contracting parties to provide full national treatment to each others' nationals. However, article 4(2) states that contracting parties may limit the scope of national treatment to the extent another contracting party has availed itself of a reservation under article 15. For example, because the US does not recognise a terrestrial broadcast right for its own nationals or those of any other country, most WPPT members choose not to grant terrestrial broadcast rights to US nationals, even though they are recognised for their own nationals. This concept of "like-for-like" treatment is often referred to as "reciprocity" and is distinct from "national treatment".

When seeking to maximise the amount of royalties one collects for artists and record companies abroad, these concepts of "national treatment" and "reciprocity" are critical to keep in mind. Understanding what qualifies for full national treatment and what qualifies for limited reciprocity can have an impact on the amount of neighbouring rights revenue an artist or label realises.

For example, a US performer recording in Europe would be qualified for performer royalties (or a European performer recording in the US).

Eligibility for royalties is often a fact-based, case-by-case analysis focused on the nationality of performers and producers, where recordings took place, and where they were first published. Knowing these important facts is crucial to ensuring that artists and labels receive what they are owed.

Collecting societies play an important role here: not only do they collect fees from users in their own territories and distribute those to their domestic royalty recipients, but they often act on behalf of their member artists and labels to collect undistributed royalties abroad.

In particular, PPL in the UK, and SAMI, in Sweden, have a share of international royalties above 20% in their respective total amount of royalties collected. This is explained by the fact that both UK and Swedish music are great exports around the world. Consequently, PPL has identified international income as a growing source of revenue and has set up a very dynamic policy of royalties collection abroad, signing dozens of reciprocity agreements with sister collecting societies.

3. Sound recording owners and digital service providers: how to get the streaming deal done?

In its latest report on neighbouring rights in the digital era, French collecting society ADAMI highlighted that the worldwide market of neighbouring rights in collective management should grow exponentially in the next few years.

However, the report noted that the share of sound recording public performance royalties attributed to digital is still quite low, apart in the US where related rights in collective management only come from digital sources (i.e. streaming). As more and more consumers use streaming – as opposed to music downloadings and physical formats -, ADAMI forecasts that the share of sound recording public performance royalties deriving from streaming will become an essential part of the income paid to performers and record producers.

For now, most of the sound recording public performance royalties collected by collective management societies originates from equitable remuneration, which is in part linked to advertising revenues of commercial radio and TV.

Digital service providers regularly get a lot of flak from performers and independent record producers, for the low share of sound recording public performance royalties attributable to streaming, that these right owners get back.

In particular, top talent such as Taylor Swift and Radiohead left Spotify with fracas, in 2014 and 2013 respectively, complaining that end-consumers don’t pay enough to access their catalogues on Spotify. It is true that as artists earn on average less than one cent per play, between USD0.006 and USD0.0084 according to Spotify Artists, it may seem that DSPs are not pulling their weight here.

Having said that, what digital service providers are interested in is to have access to top-quality musical content, worldwide, that they can offer on their streaming platforms to end-consumers at a reasonable

price.

To achieve that, they must define a commercial strategy in relation to the type of musical content they want to offer and in which territories. Such commercial strategy, which explains the service description and consumer offering as well as the economic model backing that up – should be set out in the DSP's business plan and then in its term sheet of a licensing agreement.

Depending on such business strategy, the size and gravitas of the DSP, as well as its budget to secure the rights to the public performance of sound recordings, the digital service provider may decide to obtain either "statutory licenses" from collecting societies, as described above, and/or negotiate bespoke licenses.

Indeed, it is important to note that the statutory license does not apply where there is a direct deal between the digital service provider and the phonogram producer. This has happened with the deals struck between Clear Channel and phonogram producers such as Glassnote (the label for Mumford and Sons) and Big Machine (the label for Taylor Swift).

For example, Merlin is a global digital rights agency for the independent label sector, which offers the attractive option of globally licensing, via a single deal, the world's most important and commercially successful independent music labels. Among the DSPs that Merlin license, feature Soundcloud, Vevo, Google play, Deezer, YouTube and Spotify. Recently, Merlin has entered into a direct deal with Pandora, giving that digital service provider its first arrangement outside the statutory system.

In Europe too, many customised streaming services are licensed directly (rather than collectively). Some phonogram producers tend to keep their "making available" rights, rather than mandating collecting societies to license them on their behalf.

Snowite is another recorded music rights licensing organisation that negotiates bespoke licensing deals, on behalf of DSPs such as Fnac Jukebox and Reglo Musique, with majors, indie labels and collecting societies.

Another important contributor to the success of getting a deal done between DSPs and owners of sound recordings, is the music lawyer: it is essential to reach out to a lawyer who understands how to translate the vision of the digital service provider into a deal that can get done. Such lawyer should also guide the DSP in implementing its licensing strategy with sound recording owners, in particular by favouring introductions and referrals to key decision-makers within major and independent record labels.

To make the most of the financial opportunities offered by neighbouring rights in the digital era, and by streaming in particular, performers, recording artists and their record labels should actively seek attractive opportunities to license their sound recordings to top digital service providers, while ensuring that consistent and accurate reporting of their licensing partnerships are in place, notably through the exercise of royalty audit rights. Digital service providers will get access to all the music catalogues they want for their streaming platforms, as long as they understand and accept the (financial) needs of sound recording owners.

Annabelle Gauberti, founding partner of music law firm Crefovi, which specialises in advising the creative industries, out of Paris and London. Having worked with creative clients for more than thirteen years, Annabelle is an avid believer in the importance and value of looking forward, and planning ahead, to thrive in the current music industry and its new paradigm. The work undertaken by her regularly includes advising songwriters and composers on publishing deals; producers and performers on record deals and all of the latter on streaming deals and sync transactions; as well as intellectual property registration and protection, intellectual property and commercial litigation, negotiating merchandise deals and partnerships between brands and bands.

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