

"Licensing music works and transaction costs in Europe"

Final study

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EXECUTIVE SUMMARY

Establishing and running online music services is a complex task, raising both technical and legal difficulties. This is particularly the case in Europe, where complex rights licensing structures hinder the development of the market and the launch of new innovative online services. Compared to the US, Europe is lagging behind in terms of digital music revenue. Furthermore, the development of the market is fairly disparate among different countries in the European Union.

This study aims to identify and analyse transaction costs in music licensing. It examines the online music markets and outlines the licensing processes faced by online services. It offers a qualitative and quantitative analysis of transaction costs in the acquisition of the relevant rights by online music services. The study also suggests different ways of decreasing transaction costs.

The research focuses on three countries (the UK, Spain and the Czech Republic) and builds on data collected through a survey with online music service providers available in the three countries as well as interviews with relevant stakeholders in the field of music licensing.

THE EUROPEAN ONLINE MUSIC MARKET

The music industry has steadily expanded over the past few years, away from selling CDs towards selling music online or through concerts and live music. (Masnick, Ho, 2012). Among the 500 licensed online music services in the world (according to IFPI), many emulate the physical record store, by offering 'download to own' tracks at a similar price point. The music market is now increasingly moving beyond the replication of 'brick and mortar' stores and towards innovative models that offer consumers a new digital experience. Within the EU, however, overall digital music revenue still lags behind the US, and the more established services are still moving into new European markets. While there are 14 pan-European services, most online music platforms still launch in specific countries, reproducing physical borders online.

The analysis of three European markets – the UK, Spain and Czech Republic – shows that:

- the more developed an online market is, the bigger the variety of business models: while in all three markets the 'download to own' model still prevails, innovative services are growing, attracting new consumers and generating more revenues (Spotify, Deezer, We7...), without cannibalising the 'download to own' market. This trend, however, is mostly apparent in the UK.
- the more developed the online music market, the bigger the diversity of potential investors from different fields: these range from record labels, record stores and pure players, to hardware manufacturers, internet service providers, offline and online retailers, and mobile operators
- the bigger the market (UK or France), the bigger the incentive for major (potential pan-European) services to enter at the early stages. Internationally operating services are usually initially made available in the most important markets – UK or France – before trying to expand towards new markets.
- Innovation in business models and online music distribution, while driving growth, also leads to power and control adjustments between the traditional players and new market entrants.
- there is still some uncertainty about which business models will prove most successful. Online service providers who experiment with inventive online services often fail to break even, even when they prove highly popular and provide income to right holders. Right holders are cautious

and often reluctant to license new and innovative services, such as free streaming, as they fear these will prevent sales.

LICENSING FOR MUSIC SERVICES ONLINE: A COMPLEX PROCESS

Licensing music for online music platforms entails dealing with the copyright granted to a spectrum of people involved in composing, performing, recording and exploiting musical works. While the copyright framework has been, to some extent, harmonised in the EU, licensing processes depend on a multiplicity of layers of protection of right holders. Licensing processes also depend on varying rights management practices and on the involvement of different management entities. A music service seeking licences will have to acquire the making available right and the reproduction right in the musical works, as well as rights to use the recording (performers and producers' rights). Depending on the size of their catalogue, their geographical scope and their position in the market (large or small player), music services will have to deal with more or less licensing partners.

Negotiations for pan-European services are very costly and time-intensive, as they involve a considerable number of licensing entities. The 2005 Recommendation of the European Commission aimed to facilitate cross-border licensing. It triggered multi-territorial licensing of the major publishers' catalogues by new licensing entities, and the multi-territorial licensing of their repertoire by some CMOs. However, obtaining licensing through the new entities remains complex and time intensive. In addition, online music services need to negotiate with other CMOs for authors' rights that are not licensed on a multi-territorial basis, adding even more complexity and costs to the licensing processes.

The system for acquiring record producers' rights seems to be less complex as a more manageable number of entities exist, such as aggregators or the joint licensing initiative MERLIN for independent record producers, which provide licences on a multi-territorial basis.

Several alternative licensing models have emerged for music or for other sectors, which facilitate transactions between music service providers and right holders. This study reviews some examples – the Youtube Content ID system, the creative commons licences, the US statutory rates and compulsory licences for certain uses as well as the model adopted in the EU for satellite broadcasting – which could provide inspiration for those working to establish a more efficient environment for online licensing.

THE COSTS OF LICENSING

Transaction costs (TC) include all the costs incurred when a transaction takes place – akin to friction in physics. In the cultural industries, the level of transaction costs has increased with the development of digital technologies due to the rapidly increasing amount of content made available and features of copyright law (e.g. copyright's length and the absence of mandatory registration, in particular when compared to patents). The study focuses on *ex ante* transaction costs, including

- Identification costs, which correspond to all the costs incurred to identify and find the rights owners.
- Negotiation costs, which correspond to all the costs incurred between identification and the actual agreement.

The analysis shows that online music services face significant transaction costs when it comes to identifying and negotiating with right holders – costs which are additional to the costs of licences themselves: services available in several countries and which offer more than one million titles can face transaction costs of up to €260,000 and require 6 employees (FTE)¹. The identification of rightholders can take up to six months, and negotiations up to two years.

¹ Online music service providers were asked how many people they employ, which are translated in full-time equivalent (FTE)

In context, this is significant: most online music services still do not break even and launch in a highly competitive and innovative environment where launching fast is critical to success. They must also support other key investments, notably technological infrastructure and royalty and advance payments to rightholders. The study identifies the key factors that impact on transaction costs are:

- Fragmentation of rights among various right holders: multiple authorisations from multiple rightholders lead to high number of transactions.
- Uncertainty on rights ownership reinforces the uncertainty of the environment in which the service providers operate. The service providers are dependent on the information on rights ownership, and this information is controlled by right holders. Service providers are asked to pay several times for the same track or repertoire. This is in large part due to the fact that right holders are often unable to provide information on the rights they hold. Although this problem is particularly relevant as regards CMOs, the survey has confirmed that it also relates to the major publisher's repertoires.
- Geographical scope: Services accessible across Europe participating in the survey use twice as much manpower for licensing rights than services available in one country. Lacking easy means to acquire multi-territory licences, TC constitutes a huge barrier for online music services which aim to have a presence in all EU countries
- The type of right holders: The analysis shows that the greatest costs are faced in negotiations with major record producers and publishers (or their new licensing entities). Major entities use their stronger negotiation power based on the size of their catalogue and the fact that they are unavoidable partners for most online music services. For most services in the sample, negotiations are as lengthy with CMOs as with independent publishers or record producers.
- Innovative nature of the service: The more innovative, non-traditional the business model, the higher the transaction costs for the service: streaming services that do not replicate the traditional pay-per-download model face higher TC than downloading services, in particular in their negotiations with right holders.
- Service providers' main activity: Services run by record producers face lower transaction costs than services run by market entrants. The analysis showed that TC in terms of identification costs are the lowest for record labels (almost immediate) compared to pure players (ten weeks) and technology company (six months).
- Size of catalogue: TC are higher for services which provide access to a larger number of titles. There is however no proportionality in the cost gap.

Hence, transaction costs are particularly high for

- services operating at a pan-European level offering a generalist repertoire, as they have to identify, and negotiate with, an high number of right holders.
- Innovative or new business models, due to uncertain revenue streams and consumer acceptance of their business models, which decreases their bargaining position, as well as their capacity to undertake lengthy negotiations with right holders.
- services launched by new market entrants, such as internet service providers, pure players or mobile device operators and manufacturers, who have no long-standing links with the traditional music industry (record labels or publishers), as these might lack important knowledge about the functioning of the music industry when setting up services.

IS THERE A WAY TO DECREASE TRANSACTION COSTS?

In order to decrease transaction costs and the impact of the above mentioned barriers to multi-territorial licensing different options worthy of consideration in the discussion to streamline the licensing process are listed below. These options are intended to make the licensing process more efficient, create a level playing field between different players and foster innovative services by

combining minimum regulation with certain competition among licensing entities. They concern both collective and direct licensing.

- Bundling the mechanical and performing rights for digital uses in a single right. This would help to facilitate negotiations with regards to the rights of authors and publishers, in particular of Anglo-American repertoire for which today, licences have to be cleared in separate transactions.
- Promoting (contractual) mechanisms to concentrate the relevant rights on a single right holder (as is already the case in relation to record producer's and performers' rights in the hands of the record producers).
- Developing a system of multi-territorial extended collective licences run by authors' CMOs which have the capacity to manage large repertoires. CMOs complying with certain requirements would compete to issue multi-territorial licensing. This option is not very far from the European passport for multi-territorial licensing for CMOs, included in the European Commission's Proposal for a Directive on the collective management of copyright in the single market.
- Requiring holders of essential facilities for online service providers (notably the major players), to license on fair and reasonable terms.
- Setting up dispute resolution systems appropriate for multi-territorial licensing and applicable to both collective and directive licensing.

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INTRODUCTION

The digital music market is taking off. There are numerous music startups aiming to provide digital services around music (Masnick and Ho, 2012 p. 28) and services started to experiment with business models – moving away from the simple ‘download to own’ online music shop. Online music services such as iTunes, Spotify, Deezer, or 7Digital are expanding their offers into new markets and increasing the number of titles available to consumers. At the beginning of 2012, the largest international online music services were available in 58 countries, while one year before they were present in only 23 (IFPI, 2012, p.8). Purchases of music online (downloads) increased in the US from \$1 billion to \$1.5 billion from 2006 to 2009 (Price, 2010) and the number of subscribers to online streaming services such as Spotify and Deezer is steadily increasing (in total more than 13 million in 2012 (IFPI, 2012 p.10)). Selling music online has become a new source of revenue for the music industry (IFPI, 2012, p.6) and forecasts predict that digital music stores will soon bypass the physical.

Nevertheless, online music service providers still face serious obstacles in establishing their businesses. Notwithstanding the fierce competition from unlicensed music services, setting up and running online music services can reveal itself to be a complex task: difficulties can be technical and legal. On the one hand, establishing the technical infrastructure to make an online music platform work requires considerable financial and human investment. On the other, online music services face particular difficulties in acquiring the necessary licences to use musical works online. Legal uncertainties, difficulties in identifying and locating the relevant right holders as well as securing cross-border licences, lack of transparency in rights management, lack of ownership data are some of the problems that hinder the development of a competitive market for online services. They oblige service providers to invest considerable, even disproportionate resources (financial, human and time resources), in rights clearance.

Especially in Europe, complex rights licensing structures seem to hinder rapid development of the market. Compared to the US, Europe is lagging behind in terms of the revenue generated by digital music and sales. Furthermore, the development is disparate among the different countries of the European Union, and rather than speaking of one European market the 27 markets have to be looked at separately. A European single market for digital rights that could drive the development of the European online music market and close the development gap with other large countries and namely the US is still far from being achieved. The European Commission has identified complex rights licensing processes in relation to the delivery of multi-territorial licences as a major impediment to the development of a thriving European online music offer². Over the past decade it has attempted to enhance the development of pan-European online music services by easing licensing and rights management processes in order to stimulate the creation of an attractive online offer for Europe’s citizens. In order to allow for streamlined licensing processes in Europe in July 2012 it issued a proposal for a directive on collective rights management in Europe.

THE AIM OF THE STUDY

This study aims to identify and analyse the different factors impeding efficient licensing processes for the use of musical works online in Europe, in order to propose solutions to decrease transaction costs, and thereby create a favorable environment for innovative online music services.

It is based on the assumption that an environment conducive to the reduction of transaction costs, will favour the establishment of a diversity of innovative online music services in Europe, allowing European

² Other reasons identified by the European Commission include technological barriers (limited access to high-speed networks), lack of legal certainty for service providers (differences in legislation in areas such as consumer protection or content rating), payment methods (access to credit cards), consumer trust in online transactions, illegal downloading of files (piracy) and cultural and linguistic differences (EC 2012, p.7). The EC also acknowledges that service providers sometimes do segment online music platforms territorially and/or launch only in the more mature markets (e.g. with higher consumer online spend) due to purely commercial reasons.

consumers to legally access music content online (even anytime, anywhere, from any device). This will help to create a European single market for creative content, and help creators to make the most of online distribution.

The study provides an overview on recent developments of the online music market (both globally, and in particular in Europe) and the established licensing practices in the sector, and to identify the sources of the high costs of licensing for online music services.

In particular the study identifies and quantifies transaction costs related to the acquisition by online music services of intellectual property rights in order to run licensed music services.

SCOPE OF THE STUDY

Transaction costs usually refer to all costs incurred to make a transaction occur and can be compared to friction in physics (Williamson, 1989): without them, transactions would be much easier, it is worth trying to reduce them, but it is never possible to suppress them entirely. In the cultural industries, the level of transaction costs has increased with the development of digital technologies due to the rapidly increasing amount of content made available and the features of copyright law, such as copyright's length and the absence of mandatory registration, in particular when compared to patents (Varian, 2010). A typology of different transaction costs can be made in relation to the online distribution of music content:

- Identification costs, which correspond to all the costs incurred to search for, and identify the rights owners
- Negotiation costs, which correspond to all the costs incurred between the identification and the actual agreement
- Monitoring costs, which correspond to all the costs incurred to make sure the agreement is enforced.

Identification and negotiation costs can be qualified as *ex ante* costs, i.e. costs incurred before the transaction. Monitoring costs are *ex post* costs, i.e. costs incurred after the transaction. This study will focus on *ex ante* costs, as these influence the conditions and costs of setting up an online music service. Nevertheless, it is important to keep in mind that while it is analytically possible to distinguish between all these costs, in reality they can be strongly intertwined. For example, the contracting parties may spend more on negotiation costs to prevent problems once a transaction takes place.

The study analyses transaction costs of online music services, and therefore does not take into account transaction costs of right holders. The following types of services are looked at in this study:

- **online** services, meaning that local media players which read music files stored on a computer are outside the scope
- services that give access to sound content, and more specifically **music content** (sites that give access to video clips or to audio episodes with a narrative rather than music or to poems, etc. are outside the scope)
- **delinearised** or non-linear services, i.e. on-demand services, where viewers "pull" content from a network (e.g. webradios are outside the scope)
- services that give access to **dematerialised** content (e.g. websites selling Compact Discs to be shipped are outside the scope)
- services that **select** the content they give access to (as opposed to e.g. user generated content platforms such as Youtube or Dailymotion)
- **"legal"** services: since it is difficult to isolate the legal cases we take as a basis the list of services provided by the IFPI in its Digital Music Report (see also pro-music.org (IFPI, 2011))

Some providers offer services that are in the scope as well as services that are outside (e.g. Amazon sells CDs but also files to download). For such providers, only services within the scope have been considered, provided they are sufficiently independent from the rest of the activity. Thus the activity of Amazon MP3 is within the scope of the study but not of Amazon in general.

Although the report has a clear European dimension, a sample of European countries – the UK, Spain and the Czech Republic – is studied more closely. These three markets have been chosen because of their different size and stage of development.

METHODOLOGY

The research builds on data collected through extensive bibliographical research, a survey among online music service providers in the three chosen territories (UK, Spain, Czech Republic) and interviews with relevant stakeholders in the field of music licensing.

Existing scientific literature on transaction costs in the music sector is scarce. To gather relevant information on the business and licensing practices in the digital music sector, and to make the quantification of transaction costs possible, a survey targeting music services providers was conducted. The questionnaire was disseminated to 41 services providers operating in the UK, Spain, Czech Republic and on a pan-European/global level.

The global response rates were quite high (global response rate of 22%) and provided a sufficient amount of information on market developments and licensing practices, although most responses came from smaller services. There were, however, important differences in response rates per country. With only two services responding in the UK and in Spain, it was not possible to come up with a global analysis concerning the quantification of transaction costs in the national markets. However the database resulting from the survey allowed information in relation to diverse profiles of service providers to be gathered:

- Independent services vs. services owned by other players (e.g. record label);
- Different revenue model (most services combine various revenue models);
- Specialised vs. general content;
- Size of the catalogue made available to consumers (from a few hundred to millions of titles);
- The number of territories where the service is available (national vs. global).

The small size of the database does not prevent quantification of findings. However it makes any attempt to generalise, or even extrapolate results tenuous. Hence the quantification of TC resulting from the ongoing survey provides insights and puts forward illustrative examples rather than a complete and accurate picture of the online music market in the three markets.

Interviews were conducted with 25 online music service providers, representatives of collective management organisations, trade organisations, record producers, aggregators and independent experts (please see list in annex 3). Interviews proved to be an excellent means of collecting information especially on market developments, the legal framework and commercial practices.

CONTENT

The study is structured around three major questions, relevant for a start-up service provider wishing to enter the market:

- How does the market look at present and how is it likely to evolve? This first part of the study describes the development of the online music market, analyses the recent trends in business models, market players and strategies and provides a description of three different European markets: the UK, Spain and the Czech Republic.
- What licences are needed and from whom? The second part of the study considers the existing copyright rules in relation to licensing for online music services in the EU, shows how these have been harmonised in the EU and describes right holders and existing systems of right management in the EU. It provides an overview on rights acquisition processes and looks into alternative licensing models.
- How much does it cost? The third part of the study describes the transaction costs faced by different types of service providers in relation to the licensing process and analyses the factors which are likely to increase these transaction costs.

Finally, the conclusion summarises major findings and provides policy recommendations on how to decrease transaction costs in relation to licensing for online music services.

1. THE ONLINE MUSIC MARKET

The licensed online music offer has been slowly but steadily developing and generates increasing income for right holders. Purchases of music online (downloads) increased in the US from 1 billion to 1.5 billion from 2006 to 2009 and royalties collected by CMOs from online distribution, are steadily increasing, while still far from capturing the entire potential value of this new market (Ghafele and Gibert, 2011). The next section shows that the increase in growth of the licensed music offer online (section 1.1) and digital music sales (section 1.2) is still unequally distributed between the US and Europe and within Europe itself (section 1.3). Digital distribution has nevertheless substantially changed the music industry's functioning, structure and business models (section 1.4).

1.1 FROM ONLINE MUSIC STORES TO MUSIC IN THE CLOUD: THE GROWTH OF THE LICENSED OFFER

A few milestones highlight recent evolutions of the music industry. The first is the advent of Napster in 1999.³ The site provided the first popular peer-to-peer service that allowed internet users to exchange content (essentially music), but this was done without asking for the right holders' authorisation. Although Napster was shut down in 2001⁴ other, more technologically advanced, unlicensed services have emerged and been adopted by internet users. These services compete to some extent with licensed online music services and more generally with music sales. Among the 500 licensed online music services in the world counted by the IFPI (IFPI, 2012, p.10 see also www.pro-music.org), many services replicate the physical recording store, by essentially offering download to own services. Nevertheless, there are increasingly innovative services that make use of opportunities offered by digital technologies to attract audiences in other ways, such as Spotify, Deezer, Rhapsody.

The launch in 2003 of Apple's iTunes Music Store initiated the development of legal online music stores⁵ allowing downloads on a pay-per-act basis. It also marked the entrance of technology companies into online music distribution and other creative content. There had been previous attempts to launch online music stores from Cductive in 1996 to MusicNet in 1999 and Pressplay in 2002. Although the latter were launched by major music companies, they did not succeed in getting music catalogues that were extensive enough to attract a substantial mass of consumers, contrarily to the iTunes Music Store.⁶ Today iTunes dominates the market for music download with 70 % of all music downloads at the global level (Beazley 2011).

With the development of the online music market a variety of more innovative business models have emerged experimenting with the different possibilities that digital technologies offer for online music services. Currently, there are numerous startups investing in the digital music business (Masnick and Ho, 2012, p.28). These new business models include advertising-based, free streaming services and various combinations of download on a pay-as-you-go or subscription basis, free-advertising-based streaming services and subscription-based streaming services.

Subscription services which allow their subscribers access through download (e.g. Emusic)⁷ or streaming (e.g. Spotify)⁸ to their catalogue for a given time period are a rapidly developing category of services.

³ Napster's success is partly based on the existence of the MP3 format that allows music files to be much lighter, and hence to be up- and downloaded faster and more easily.

⁴ Napster was reopened as a service offering licensed content later on.

⁵ E.g. from the launch of the iTunes Music Store on April 28, 2003 to December 2003, Apple has reported having sold more than 25 million songs on the Store. In the end of 2011, Apple had sold more than 275 million iPods and the iTunes Music Store more than 10 billion songs (Laung Aoaeh, 2011).

⁶ Although it is only on November 16, 2010 that the entire Beatles catalogue was officially made available on iTunes.

⁷ www.emusic.com last accessed on 26 April 2012.

Emusic

Launched in 1998 in the United States, Emusic is a pioneer in the field of digital music retail, and it has remained its main activity. Specialising in independent labels, Emusic has a catalogue of over 13 million downloadable tracks. The Emusic revenue model has undergone relatively few over the years: it offers a download-to-own service on different subscriptions plans:

- A basic subscription plan (£9.99 in the UK, €11.99 in Spain and Czech Republic), allows up to 23 downloads a month. Average price for a track is £0.43 or €0.52.
- A premium subscription plan (£24.99 in the UK, €31.99 in Spain and Czech Republic), allows up to 66 downloads a month. Average price for a track is £0.38 or €0.48.

In 2006, Emusic UK and Emusic Europe were established. In 2012, the service is available in 30 countries (the EU, USA, Canada, Norway and Switzerland), to an estimated 400.000 customers and 75 employees. Emusic accounts for revenue of around €80 million (unofficial figures). In 2010, the service announced a move towards major labels, which has caused its pricing offers to rise significantly. Since then, Emusic offers tracks from both major and independent labels, but it has struggled to widen its customer base (around 400.000 since 2010). Some independent labels have also left Emusic due to this shift⁹ (Masnick 2010).

Subscription services often offer a "Freemium" model which allows users on the one hand free access to music content, limited in time, choice and on demand possibilities (e.g. it is closer to an online radio service than on demand streaming), and/or contains advertising, and on the other hand unlimited (or less limited) access to paying subscribers. The most notable examples in Europe include Spotify and Deezer that are increasingly popular and constantly gaining subscribers, while concluding deals with all major and many independent record labels and launching partnerships with social networks (such as Facebook (Houghton 2012)) and telecoms operators (such as the partnership between Orange and Deezer in France (Abboud 2011)).

Spotify

Based in London, Spotify Ltd was founded in 2006. With a fast-growing catalogue of over 15 million songs available from 13 countries (including Spain and the UK), this digital music provider focuses on the social aspects provided by its applications (possibilities to create personal profiles, add friends and share music or playlists). Spotify is the typical example of a Freemium model. It supplies the following services:

- A free, ad-funded service allows to stream a limited amount of music (subscription required)
- Spotify Unlimited for €4.99 (or £4.99 in the UK) per month allows access to unlimited streaming, with no advertisement. A radio mode is also available with this plan.
- Spotify Premium for €9.99 for (£9.99 in the UK) per month adds an access to mobile music streaming to the advantages of Spotify Unlimited. This subscription plan also provides an 'offline mode', which synchronises selected playlists with a computer or mobile phone (up to 3333 tracks on mobile phones) to listen to music when no internet connection is available.

Spotify grew in 2011 by 160 to €190 million, but registered losses from €28 to €45 million (Anderson

⁸ www.rhapsody.com last accessed on 26 April 2012.

⁹ These labels include Domino, Merge, and the Beggars Group of labels.

2012). Nevertheless, users subscribing to Spotify's paid service totaled around 3 million across 13 countries in 2012 (compared to 1 million in 2010 (IFPI, 2011b)), and around 7 million used to service's free streaming service. Similarly to other freemium services, Spotify tends to offer less free content than it used to in its initial stages (limiting accounts to 10 hours of free music, for example).

Spotify is often perceived as the main rival to Apple's I-Tunes store (Arctic Start-up, 2012). Spotify has also strived to expand its business model through partnerships with mobile operators like 3UK. The use of cloud technologies also enables Spotify to be used on a range of devices (wireless music amplifiers, digital TV, Hi-fi) and to develop multiple partnerships (Boxee, Phillips, Logitech).

Another important category of online service that rely partly on music content are **video sharing platforms** such as YouTube or Dailymotion. Today, almost 60 % of the world's population watch music video on the computer (IFPI, 2010) – and it can be assumed that this takes place online.

Music can also be consumed using **mobile** connected devices. The development of smart phones (and more recently tablets) has made more services available, which are increasingly used by consumers.

Vodafone Music

The handset manufacturer Vodafone launched its music service in 2007 in the UK. With a catalogue of more than 6 million tracks, Vodafone provides a hybrid service with a download-to-own service available through subscription services on mobile phones, as well as a bundled offer of data services (internet, music, messaging). Once purchased, tracks can be downloaded on mobile phones as well as on computers. Bundling music with other data services is a deliberate strategy for Vodafone.

Different pricing plans are available:

- download of 4 tracks for €2.50 a month
- download of 10 tracks a month for €5 a month
- download of 25 tracks a month for €10 a month

These music packages are proposed as options in monthly mobile plans.

Since 2007, an unlimited download-to-own service has been available, through a partnership with Musicstation (now Omnifone) for €3 a month, if bundled with other services (such as web access). Availability and pricing of this option vary heavily depending on countries.

Vodafone Music is now available in 25 countries around the world. In 2011, Vodafone Music announced 650.000 subscribers to its service.

One of the latest innovations is the **music in the cloud** offer (e.g. Apple's iCloud). While some see cloud computing as a mere marketing tool, promoting new models for the organisation of content, without any significant technology change, others consider it to be a technological revolution that offers users access to content (email, personal or work documents, creative content, etc.) on any device at any time (Civic Consulting, 2012, p. 12). With such services, users no longer rely on the ownership of a digital copy, but instead access music anywhere, anytime, using a variety of devices (provided one has an access to the internet). In such a configuration consumers use a service rather than own a product.

7Digital

Created in 2004 in the UK, 7Digital offers a catalogue of over 18 million tracks, available on a pay-as-you-go basis. A subscription plan also grants access to unlimited streaming of songs. Prices for a single track usually range from £0.79 to £0.99 in the UK and from €0.99 to €1.29 in Spain.

The services proposed by this website include:

- A download to own service. Tracks can be downloaded multiple times and stored on a personal device (computer or mobile phone) or on a cloud server, which is accessible and streamed from any connected device.
- A free radio service, 30 seconds previews of songs are also available.

7Digital develops partnerships with other organisations to provide digital music services. These partners range from smartphone, game consoles and computer manufacturers to ISPs and in-car entertainment businesses. 7Digital also provides tools to program mobile phone or web applications.

7Digital has more than 3 million customers over the world (USA, Europe, New Zealand and some Asian markets). Online stores are available from 37 countries, although only 19 countries benefit from a dedicated platform.

The following table shows the most common business models¹⁰:

Business model	Description	Examples
Download-to-own songs or albums on a pay-as-you-go basis	Allows users to buy and download songs or albums	iTunes Amazon Nokia Music Beatport
Freemium	Free, but limited access to music content, coupled with unlimited premium access to paying subscribers	Spotify, Deezer
Video sharing (user-generated content platforms)	Allows free (advertising -based) access to music videos	Youtube, Dailymotion
Subscription services	Allows users to subscribe for a fixed period (month, several weeks) To a limited or unlimited number of downloads/streams	emusic (download), Rhapsody (streaming)
Cloud services	Allows users to download music and store it in personal online boxes, accessible from any device at any time	lcloud, 7digital, Rhapsody

¹⁰ It has to be noted that this table relies on a research done in April 2012. There are many fluctuations in the sector regarding business models, therefore examples provided reflect the situation in April 2012 and can have changed in the meantime.

1.2 DIGITAL MUSIC SALES

The online offer of titles is steadily increasing. Record companies licensed 13 million tracks at the global level in 2010 (IFPI, 2011a). Digital channels account for 29 % of record companies' revenues, which is more than any other content industry except for the video games industry (IFPI, 2011a)¹¹. According to PWC estimates, digital sales will surpass physical sales in 2012 (PWC and Wilkofsky Gruen Associates, 2010). The digital market is particularly developed in the US, Japan and the UK (IFPI, 2011b).

Users subscribing to innovative services such as Spotify's paid service total around 4 million in July 2012 (SpotiDJ, 2012) across 13 countries in 2012 (compared to 1 million in 2010 (IFPI, 2011b)), and around 7 million used the free streaming service. Deezer has 20 million users and 1.3 million paying subscribers (Deezer, 2012). These developments may predict the uptake of legal subscription services, even though figures on the profitability of stand-alone online music services are difficult to obtain, and it seems that even Apple, with the market leader iTunes gains more revenue with the sales of iPods than through its online music store (Laung Aoaeh, 2011)¹², Deezer recently announced that it has been profitable in France since 2011 (CMU, 2012). Spotify is growing rapidly, but has also seen losses: Spotify grew in 2011 by 160% to €190 million, but registered losses from €28 to €45 million (Anderson 2012). Despite the fluctuating developments of music service providers, right holders increasingly benefit from online distribution of their works, as royalty collections of major European authors' CMOs for public performance rights and reproduction rights collected through the Internet and new media have been continuously rising in Europe (for instance for public performance rights from €20 million in 2007 to €33.3 million in 2009 and for reproduction rights from €31.7 million in 2007 to €48.5 million in 2009) (EC 2012, p. 83).

1.3 THE EUROPEAN DIGITAL MUSIC MARKET: A MULTI-SPEED MARKET

Taken as a whole, the European market still lags behind the US, which at a glance, is particularly surprising as the EU accounts for more internet users (368 million in the EU, compared to 245 million in the US in 2012 (World Fact Book and Eurostat, 2012)) and therefore more potential consumers for digital music. In 2010 digital music revenue amounted to \$2 billion in the USA in 2010 and \$996 million in Europe (IFPI, 2011b). In addition, digital music sales have surpassed physical music sales in the US, but Europe is still far from achieving this. Almost half of all music revenues came from the digital sector in the US in 2010 (52 % in 2011), while physical sales still account for 73 % of all music revenues in Europe. 19 % of the potential royalty market is captured by collecting societies in Europe, compared with 23 % in the US (Ghafele and Gibert, 2011). Furthermore, the national markets in Europe have not developed similarly: in 2010, the digital share of recorded music sales varied from 2 % in Hungary to 29% in Denmark.

While there are a few pan-European services and players, most services still only launch for specific countries, replicating physical borders online. Therefore it is difficult to consider the European market as a single market.

These imbalances are reflected in the expansion of international service providers. They are typically made available first in the most important markets - UK and France before expanding towards new markets. The USA, as the world leader in digital sales (IFPI, 2012), is clearly seen as a strategic market and is most often favoured over smaller European markets. For example, Rara or Spotify, after a first wave of expansion in key European countries, chose to launch in the USA rather than smaller European markets. Deezer might be quoted as an exception, having deliberately chosen not to launch in the US (nor in Japan) while being made available in many countries all around the world (TNW 2011). On the

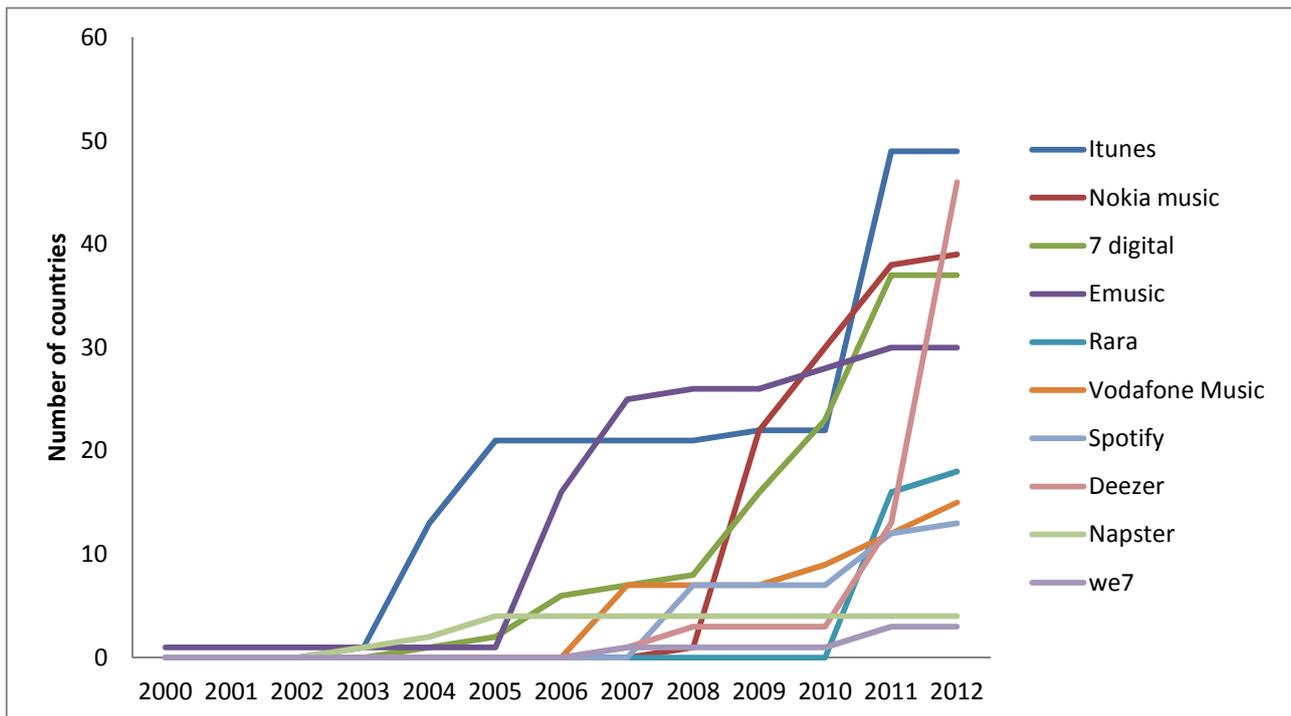
¹¹ There is a huge difference between the US and Europe here: almost half of all music revenues come from digital in the US while physical sales account for 73% of all music revenues in Europe (IFPI, 2011b).

¹² It can also be argued that the success of iPods has favoured the adoption of the Mac ecosystem by consumers.

other hand, music radio company Pandora is thriving in US, but has not entered the EU market because of the complexities of licensing (Paidcontent, 2011).

As a result there are fewer pan-European services than there could be. In the US there are 21 music service providers (IFPI 2011 b), while in Europe there are only 14 services that are specifically targeting several European markets. Apart from the two global services Traxsource and Classics Online, which have been available worldwide since their creation, most EU-wide services were first launched in specific countries or groups of countries, before expanding to new territories. This has been the case for iTunes, Spotify, 7 Digital, Napster, Rara or Emusic. Some service providers, such as Nokia or Vodafone, have integrated their music offer with other activities and have thus benefitted from pre-established networks. Nokia music was launched in 2008, and it is available in 39 countries (Virki, 2011).

Availability of service providers



Only 10 out of the 14 services available in different EU countries were considered for this chart, since Last.fm, Classics online and Traxsource have been available globally since their launch and relevant data was not available for Beatport.

In order to illustrate the differences in the development of digital markets in Europe, a sample of three markets at a different stage of development has been analysed more in detail: the UK being the most developed market having reached certain maturity, Spain being at an intermediate phase and the Czech Republic being in the early stage of development. While their different stages of development make it difficult to compare the three markets, several general conclusions can be drawn on the development of online music markets.

First, it can be said that the more developed a market, the bigger the variety of business models used by services. Thus, in the UK, where many services are available (51), online music is presented in many different ways. Customers can choose from a wide range of services, from the traditional download-to-own on a pay-as-you-go basis to innovative 'all-included' services which cover streaming, download-to-own and even mobile services. This is also true for Spain, but to a lesser extent, for the Czech Republic with the traditional download-to-own on a pay-as-you-go model prevails.

Second, online music markets are interesting for potential investors from different fields, as these increasingly entered the market with its development. Hence, in the UK and Spain there are a variety of service providers, ranging from a few record labels, to hardware producers, Internet service providers, mobile operators, and retailers. In that sense, the Czech market is less developed being essentially borne by record labels and iTunes.

Thirdly, it clearly seems that the more developed the market, the bigger the incentive for international (potential pan-European) services to enter first. As above, international service providers often enter the most developed markets in Europe first, before expanding towards smaller territories.

1.3.1 The UK: the biggest market in Europe

The UK is one of the major digital markets in the world, ranked third after the US and Japan in 2011 (IFPI, 2011b). In 2011, revenue from UK digital albums sales broke the 2010 record with £117.8 million, compared with £82.2 million in 2010 (Music&Copyright 2012b, p.3). This means that during this period 19.6% of album revenue came from the digital market, up from 14.5% in 2010 (Music&Copyright 2012b, p.3). Single track download sales increased by 8 % in the UK in 2011 (10 % in the US and 23 % in France) and digital album sales increased by 27 % in 2011 (19 % in the US and 23 % in France, 23 % on a global level) digital album sales in the UK account for 24 % of total volume of album sales (IFPI 2012b).

Online music services

In 2011, there were 65 online music service providers present in the UK¹³ (14 in 2006), 51 of which are in the scope of this study (the remaining services provide UGC, videos only, ringtones).

Most service providers are run by pure players (30 services), but there are also online retailers (11 services), mobile operators and ISPs (3 and 4 services), hardware manufacturers (7 services), online and off-line retailers (3 services), 2 record labels and 5 other online services (such as YouTube, MySpace, MSN music, etc). Data from the IFPI reports on digital music show that most services were set up between 2009 and 2010.

Business models in the UK online music market¹⁴

Access/method of payment	Pay-as-you-go Usual prices: £0.60/£0.80 per track, and £3-£8 per album	Subscription Usual prices: from £4.95 to £9 per month.	Subscription and pay-as-you-go
Download-to-own	17 services ¹⁵	3V Music Store, eMusic, Napster, Naxos Music Library, Nectar Music Store, PlayNow.	Boomkat
Streaming		Spotify*, We7*, Karoo*, Deezer*	

¹³ This figure is based on the IFPI 2012 digital music report, but includes only services that could be found in early 2012 and that provide digital music online.

¹⁴ This table gives an approximative picture of a market which is in continuous evolution. Cut-off date was April 2012.

¹⁵ Amazon MP3, ArtistXite, Beatport, Bleep, djdownload.com, Drum & Bass Arena, Fairshare Music, Historic Recordings, Juno, Partymob, Passionato, Play.com, Tesco Downloads, The Classical Shop, Track It Down, Traxsource, TuneTribe.

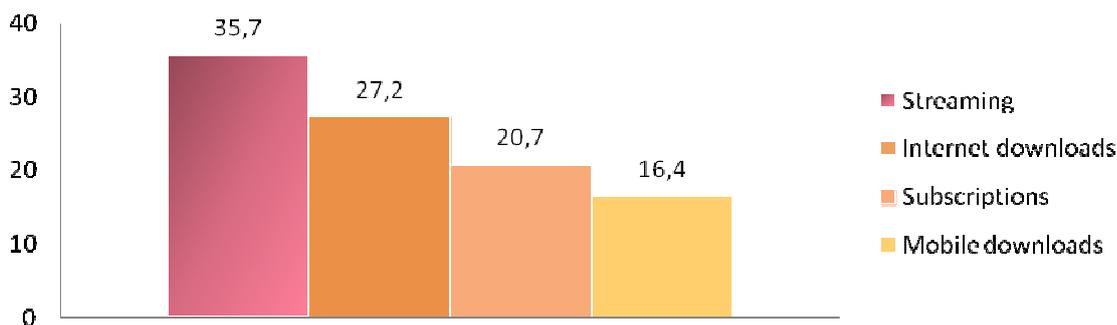
Download-to-own and streaming		Classical.com, Classical Archives, Musicstation, Rara	Classics Online
Download-to-own and free radio	iTunes (cloud), Last fm, Oozit, 7 Digital (cloud) and Amazing Tunes,	Music Anywhere (cloud service)	
Mobile download-to-own	Jamster, T-Mobile, Vodafone Music, Mobile Chilli and Textatrack		Nokia, Orange Music, Orange Monkey and O2
Mobile streaming		PureMusic, Sony, BBMMusic	

*Freemium-model, offering free streaming and streaming on subscription basis with better conditions

Significant developments are expected in the most recently developed cloud services, offered at the moment, for instance by iTunes, 7Digital, and Music Anywhere, and in particular from BlackBerry, Apple and Google (BPI 2011: 26).

1.3.2 Spain: a medium-sized market

Despite high levels of piracy in Spain¹⁶, digital music sales keep increasing: from \$18 million (2006) to \$37 million (2011). In 2011, Spain was at the 14th place for digital in the global ranking established by IFPI. In total, digital makes up for 20 % of the music sales in 2010 (IFPI, 2011). In 2011, the rise of streaming services made this revenue model the largest source of digital music sales with a 35.7 % share, followed by download to own with 27.2 % of digital music sales.



Digital sales by source share in Spain, 2011 (Music & Copyright 2012a, p.18)

Online music services

At the beginning of 2012, the IFPI counted 31 online services among which 21 qualified for this study as on demand music services. There were 14 pure players, 3 mobile operators, 2 hardware manufacturers, 1 online/offline retailer (Mediamarkt) and YouTube. The 8 various other online video/social media services

¹⁶ The number of copyright infringements per year was estimated at 1,9 billion, compared to 1,3 billion in Italy, and 1,1 billion in the UK (Tera Consultants, 2010, p.52-55).

are out of the scope of the study. Several services such as Play (Sony Ericsson) and Dada no longer exist.

Business models in the Spanish online music market ¹⁷

Access/Method of payment	Pay-as-you-go	Subscription	Subscription and pay-as-you-go	Free (ad-based services)
	Usual prices: €0.69/€0.99 per track, and €9.99 per album	Usual prices: from €4.99 to €9.99 per month.		
Download-to-own	Beatport, IbizaDanceClub, Media Market-Download	eMusic, Magnatune		
Streaming		Deezer*, Spotify*		Musicuo, Rockola.fm
Download-to-own and streaming		Rara		
Download-to-own and free radio	iTunes (cloud), 7 Digital (cloud), Last.fm, Los40.com			
Mobile download-to-own	Jamba, Olemovil, Orange		Nokia music, Vodafone music	
Mobile streaming and download-to-own			Movistar emocion	

*Freemium-model, offering free streaming and streaming on subscription basis with better conditions

1. 3.3 Czech Republic: a small European market

The Czech music market is characterised by a long absence in legal online music services, which has led to the rise of unlicensed online music platforms. In the world ranking established by IFPI the Czech Republic is in 42nd place for digital. Digital music sales made up \$1 million of total recorded music sales

¹⁷ This table gives an approximative picture of a market which is in continuous evolution. Cut-off date was April 2012.

in 2010, but they had been almost \$2 million in 2007 and 2008. In 2010 digital record sales made up 5% of the total while physical sales accounted for 70%, and performance rights for 25% (IFPI, 2012b). The small independent platforms of various publishers or record labels particularly struggle in finding customers (interviews). Yet, few international global repertoire services have been accessible from the Czech Republic and with the arrival of iTunes at the end of 2011, experts expect the market to take off.

Online music services in the Czech Republic

Independent Czech music publishers already established online music stores in 2002 (indies-records, today split in three different websites selling independent Czech music online), and YouTube entered the market in 2008 and was, until 2010, the only international music service accessible from the Czech Republic. In 2010, the first international and national music services offering a more general (including Anglo-American) repertoire entered the market, including i-legalne, e-music, Telefonica O2-Active. Since the autumn 2011, the Czech digital market has considerably evolved: iTunes has opened its store for the Czech Republic and the first truly general Czech platform i-legalne.cz closed down in early 2011 – seemingly due to a difficult relationship with major publishers and record labels, refusing to provide licences for a service that would not use DRMs (interview).

In 2012 there are 15 music services accessible from the Czech Republic¹⁸, most of them established in 2010 and offering download-to-own services. Innovative services such as Deezer or Spotify are not yet accessible from the Czech Republic, but since September 2011 there has been the Czech freemium service Musicjet. Services offering global repertoire include eMusic, iTunes and Musicjet. The mobile operators Telefónica and T-Mobile also offer online music services – O2 active of Telefonica offers a music download service for mobile phones and PC for its clients. There are also a variety of smaller Czech services offering specialised or niche repertoires, such as Supraphonline for classical music of the Czech record label Supraphon, Arta for jazz and Czech music, Indies Mg , indies.eu, indiesrec.eu for independent Czech alternative music, Gimel for religious music, and several platforms offering background music for karaoke and dance (Xgmidi, Pokrok, Midistage).

Business models in the Czech online music market¹⁹

Access/method of payment	Pay-as-you-go	Subscription
Download-to-own	10 services: IndiesMG, Czmusic, indiesrec, Arta, Supraphonline, Gimel, xgmidi, pokrok, midistage	eMusic
Download-to-own and radio	iTunes, 7Digital (accessible, but no specific platform for Czech Republic)	
Streaming		Musicjet*
Mobile download-to-own	O2 Active, T-Mobile	

*Freemium-model, offering free streaming and streaming on subscription basis with better conditions.

¹⁸ Most of the services started operating in the Czech Republic in 2010 but many services have stopped their activity in the Czech Republic (such as 7digital, Vodafone Music, i-legalne.cz) and there is a lot of fluctuation. The listed services exist in April 2012 and were identified according to a list provided by the Czech collecting society for authors, OSA.

¹⁹ This table gives an approximative picture of a market which is in continuous evolution. Cut-off date was April 2012.

1.4 STRUCTURAL CHANGES IN THE MUSIC INDUSTRY

The impact of digital technologies on the music industry has resulted in more complex business models and structure of the music market. There is still a great deal of experimentation with business models and many companies are struggling to survive in the highly competitive market (Caldas, 2012). In addition, new actors have burst into the music industry, undermining the control that traditional players had on the value chain. This relative instability of the market results in a highly uncertain environment for licensing deals, contributing to increasing transaction costs.

1.4.1 Online music services in search for profitable business models

Digital distribution has affected existing business models of the music industry – the way money is earned in relation to the consumption of music. It has also altered consumer behaviour, as consumers today increasingly want to access music at any time on any device, rather than owning music physically in forms of CDs or even mp3 (Wikström, 2012 p.9). Traditional business models mainly relied on the sale of physical products, in particular CDs. This type of revenue model (pay-as-you-go) was first transferred to the online environment through download-to-own services but increasingly coexists with innovative services that use the possibilities and the internet to offer new models to listen to music. They experiment with combinations of various business models, such as free streaming and subscription-based streaming or download in order to respond to new consumer behaviours. Yet, there is still some uncertainty about which business models will allow service providers to attract large audiences and extract revenues. Right holders are cautious about licensing for online services and often reluctant to license for new, innovative services, such as free streaming, as they fear these will prevent sales.

One of the business models that seems promising is the so-called freemium model. Right holders and in particular the major publishers/record labels and CMOs were, for a long time, reluctant to license more innovative services, such as (free) streaming services (DangNguyen et al. 2012), considering that users listening through free streaming are less willing to buy music (see also section 3). Nevertheless, the initial free streaming services, such as Deezer or Spotify have developed a business model in which they combine a free, but (increasingly) limited streaming service with a paying premium subscription service. They are increasingly generating revenues for right holders and attracting audiences. Today some record labels are seeing their largest revenues from Spotify (Van Buskirk, 2012).

With the growing success of freemium services like Spotify and Deezer, it is increasingly acknowledged that streaming services can be an important source of revenue for the music industry (Ryan, 2011). DangNguyen et al. 2012 note that streaming subscription services, rather than cannibalising on music sales, are complementary to online sales and can even increase attendance to live performances. In general it seems that the larger the offer on streaming services, including all major and independent labels, the greater their success and hence their turnover (Caldas, 2012).

In relation to subscription, services offering unlimited access to music, be they available in streaming or in a download-to-own formats, it is still uncertain whether enough users are ready to engage. Research has shown that subscription is particularly interesting for high consumers of music content due to its higher purchase barrier (Amberg and Schröder, 2007) and several interviewed experts confirm this view: subscribing to unlimited streaming services, costs approximately €10–€12 a month, and an annual spend of €120 to €140 for music, which might be a lot for many consumers. A recent survey has shown that the majority of UK consumers are not willing to pay for a subscription for music services, 44% out of 2500 respondents (both subscribers and non-subscribers) indicating that subscription was too expensive and 65% of nonsubscribers indicating that they were "very unlikely" to subscribe to unlimited-access music service in the next 12 months (Music&Copyright, 2012c, p.13). This consumer behaviour can also be observed at Spotify's premium subscription service, which has attracted 4 million

subscribers so far, while over 10 million subscribers use the free service. Nevertheless, there are increasing numbers of subscribers paying subscription services, and the success also depends on developments of both the licensed and unlicensed offer.

With the emergence of music services in the cloud, (allowing users to access content anytime, anywhere, from any device, provided they have Internet access), consumption behaviours of music listeners may also change. This type of service might be very attractive to users, and increase their willingness to subscribe to unlimited services.

The market is still in the development phase, which is indicated by the large number of services which fail (Caldas 2012). The high fluctuation of the number of services operating in each country, as well as the high number of services changing their revenue models, indicates that the market has not yet stabilised. Lists of service providers in each country provided by the IFPI (IFPI, 2012a; IFPI 2011, IFPI, 2010) confirm that every year there are new market entrants in the different countries, as well as services exiting the market, for instance Sony Ericsson's play.com in Spain or the Czech streaming service i-legalne.cz.

Similarly, many services are still searching for the right business models and have changed their terms of use several times. For instance in 2011/12 We7 and Deezer decided to change their model from a free streaming service to a free radiostation service (in addition to the premium on-demand streaming service) (Andrews, 2012). This might also be linked to right holders' unwillingness to license interactive streaming services for free (as it has been indicated on We7 website)²⁰.

The search for the right business models implies that there is still a good deal of fluctuation in the market and service providers are testing various possibilities to attract users. Although subscription-based services seem to attract large audiences and work well at the present, technology is evolving so fast that it is possible to foresee how the market will develop in several months.

As the following sections show, the length of negotiations for licences also depends on the type of business model of the service. The more the business model resembles a proven model, which at present would be a download-to-own on a pay-as-you-go basis, subscription-based streaming or download, the higher licensors trust in the capacity of the service to make revenue and hence the quicker the process of acquiring licences. Moreover certain right holders have shown their reluctance to license for innovative uses.

1.4.2 High concentration among traditional music companies and new market entrants

There has been a high concentration in the market among traditional music companies and in terms of music consumption, and the existing structure of the value chain has been disturbed by the entrance of new players in the market. First, the market is now dominated by three major music companies (down from six in 1998), which have a worldwide share of 70 percent of the market for distribution.²¹ After EMI Group was sold to Universal Music and Sony in November 2011,²² the three major companies are Universal Music Group, Sony Music Entertainment and Warner Music Group. EMI was the only company with headquarters located in Europe. Next to the major music companies, the market consists of a large number of SMEs, the so-called independent or indie labels.

Second, the major music companies used to dominate the whole industry from production to distribution (with around 70% of distribution turnover at the global level) but their control over the

²⁰ <http://www.examples.we7.com/change/> retrieved 18 April 12.

²¹ A distinction should be made between major recording companies and major publishing companies. All major music companies are active in both activities (music recording and publishing) but there can exist some independence between both activities. Publishing rights and recording rights for one title do not necessarily need to belong to the same company.

²² On 11 November, EMI's recorded music business was sold for £1.2bn to Universal Music while EMI's publishing division was sold for £1.3bn to a consortium led by Sony (Sweney and Sabbagh, 2011). The buy-outs might however be rejected by competition authorities, notably at the European level.

value chain is being undermined by the entrance of new actors in the industry (Hracs, 2011) with which artists and independent labels can directly make deals (TNO, 2011). New market entrants include hardware companies such as Apple (iTunes) or Nokia (Nokia Music), mobile and Internet service providers, such as Telefonica or Vodafone, off-line and online retailers such as HMV, Mediamarkt or Amazon and a variety of pure players operating online services, as their major activity, such as Spotify, Deezer or We7. The same is true for marketing with social networks and other recommendation tools which to some extent substitute traditional ways of marketing records. More generally, the value chains are becoming more complex and less linear (Media Consulting Group, 2011).

As a response, the majors try to be more proactive at the level of online services, for instance by launching online music services themselves, entering joint ventures, taking over services or concluding preferential deals with some services. Traditional players do still have important bargaining power, as they own the rights to repertoire. However, the new market entrants act as important gatekeepers for making music accessible online, as they can also decide to keep some types of repertoires out of their catalogue. While it is in their interest to have as large catalogues as possible, it is also in the interest of right holders to access as many online music platforms as possible. The market and its major players are therefore confronted with important changes in business models and modes of distribution of music, reflected in power and control adjustments between the traditional players and new market entrants.

1.4.3 Increasing importance of the management of intellectual property rights

In addition to the rapid development of online music services, there has been another shift in the way revenue is generated in the music sector: with decreasing revenues from physical sales, more emphasis has been given to revenues from live performances. Record labels are increasingly responding by trying to maximise their share of income by offering artists so-called 360 degree deals covering all the important aspects of an artist's career and rights (public performance, record sales, videos, merchandising etc.) (Harrison, 2011, p. 89). Revenues from live performance rights have been increasing in the past years and at present constitute, together with rights for online distribution (EC 2012, p. 82 et seq.), the music companies' main asset. Therefore most players in the music industry have an interest in the development of online uses, and in particular in having more consumers buying music in online music stores or using streaming services to listen to music. In this context, a streamlined licensing process for the online uses of rights is crucial in order to develop legal offers. However, especially in Europe, the existing framework, which has worked well for the physical distribution of music, seems to be too complex and inefficient for online licensing processes. The music industry and policy makers are therefore looking for solutions to make licensing for online use, especially multi-territory licensing, less complex and costly (in terms of money and time). The next chapter will highlight the major problems.

2. THE WHAT, WHY AND HOW OF LICENSING OF MUSIC FOR ONLINE USES

In order to acquire the necessary permission to offer musical works on an online service, the music service provider must negotiate with several different right holders or entities managing their rights. In practice, a complex system has been set up in which authors and performers entrust third parties, such as publishers, collecting societies and record labels, to manage their rights.

The following section aims to describe the existing copyright provisions applicable to licensing for online music services, and how they operate in practice. It shows that while the copyright framework has, to some extent, been harmonised in the EU, licensing processes depend on a multiplicity of layers of protection to right holders, (section 2.1), as well as rights management practices of the various right holders and management entities involved (section 2.2-2.4). It illustrates the complexities of licensing processes through different scenarios which may be faced by a music service provider (section 2.5) and finally describes existing alternative licensing models (section 2.6).

2.1 RIGHTS AND RIGHT HOLDERS IN MUSICAL WORKS

Licensing music for online music platforms entails dealing with copyrights granted to a spectrum of people involved in the process of composing, performing, recording and exploiting musical works. In order to understand licensing processes, it is necessary to clearly identify the different right holders implicated in the process and the rights they are granted by international treaties, European and national law.

2.1.1 One track –multiple right holders

Every music track has several right holders. These include:

- Composer(s) and lyricist(s) – “the authors” – who respectively write the music and the lyrics.
- Singer(s) and musician(s), – “the performers” – who interpret the music and the lyrics created by the authors.
- The record producer who makes the financial investment to record the performance.
- The music publisher, who acts as manager of the author and is in charge of issuing licences to users of the music, marketing and promotion of the music and collecting income from licences (Harrison, 2011).

Authors, performers and record producers have a set of legally recognised rights to control the exploitation of their works. As for music publishers, they are not considered copyright owners by law, but usually become copyright holders by virtue of the transfer of rights from the author (Dehin, 2011, p.222). As mentioned above, the music industry is dominated by three large corporations – the “majors” (Universal, Sony, Warner Chappell) that concentrate publishers’ and record producers’ own and derivative rights²³. In relation to online licensing for multi-territorial uses of musical works other players can also be involved in the rights management process described in section 2.2.

²³ On Friday 11 November, EMI’s recorded music business was sold for £1.2bn to Universal Music while EMI’s publishing division was sold for £1.3bn to a consortium led by Sony (Sweeney and Sabbagh, 2011). The buy-outs might however be rejected by competition authorities, notably at the European level.

2.1.2 One track- two sets of rights

One track usually does not only have multiple right holders, there are also several different rights granted to these persons by copyright law. Composers and lyricists have a recognised set of economic rights on their compositions and lyrics. Performers and record producers are also entitled to some economic rights (the so called related or neighbouring rights) respectively on the fixations of their performances and on the first fixation of the sound (recording). Economic rights can be transferred from the author to a third party..

In relation to licensing for online music services, economic rights that need to be cleared for authors, performers and record producers include the making available right²⁴ and the reproduction right (as it is considered that copies of the work are made when downloading)²⁵.

In the EU, these rights are granted to authors and holders of neighbouring rights in the 2001 Directive on the harmonisation of certain aspects of copyright and neighbouring rights in the information society (Directive 2001/29/EC). This Directive transposes the WIPO Internet Treaties and harmonises national copyright and neighbouring rights legislations to adapt to technological and commercial developments relating to the rise of digital technology (Directive 2001/29/EC, recital 15). Accordingly, authors enjoy the exclusive rights to authorise or prohibit reproduction of the work (Article 2) and to communicate it to the public (Article 3), by wire or wireless means, including making their works available to the public in an 'on demand' way (making available right). Performers and phonogram producers²⁶ also benefit from the exclusive right to authorise or prohibit the reproduction (Article 2) and the making available (Article 3.2) of the fixation of their performance or the phonograms.

More recent legislative developments in the European arena such as the Directive modifying the Term of Protection Directive of 2006 (Directive 2011/77/EU), may influence the contractual relationship between performers and record producers with regards to the remuneration scheme in place for performers. Such impact will however largely depend on the national implementation made by the Member States, which is still in process. According to the Directive (Article 1.2c), the performer would be granted the right to put an end to the contract of transfer of rights with the record producers after a period of 50 years following the publication of the record and/or its communication to the public or if the record producer fails to commercialise a sufficient number of copies of the record or does not make it available to the public. The performer would also, after a period of 50 years from the first publication, have an unwaivable right to receive annual supplementary remuneration from the record producer.

These new provisions may have an impact on licensing practices between rights holders and online music providers, in case performers effectively put an end to transfer contracts (creating the need of an additional transaction). Moreover, the additional remuneration to be paid annually by the record producer to the performer could increase the price of the licence, which would have to be paid by the online music provider.

2.1.3 The European copyright framework

As a consequence of EU's attempts to harmonise copyright legislation across the Union, few differences continue to exist between Member States, at least as far as the most substantive provisions

²⁴ This right was introduced by the 1996 WIPO treaties, in order to enable right holders to exploit their content digitally. The making available right is part of the communication to the public right and has been recognised in 1996 to authors by the Copyright Treaty (WCT, Article 8) and to performers and record producers by the Performances and Phonograms Treaty (WPPT, Articles 10 and 14).

²⁵ In addition to legal definitions, collecting societies have established their own "categories" of rights, generally referred to as "GEMA-categories". In the context of licensing for online distribution they therefore refer to "performing rights" implying "making-available" rights and to "mechanical rights" when speaking of reproduction rights.

²⁶ Film producers and broadcasters as well.

concerning the online distribution of music. The examination and comparison of the copyright legislation in the UK, Spain and the Czech Republic has shown that the existing difficulties in terms of licensing rights for the online distribution of musical works are linked to complex licensing practices.

The main differences in the most relevant copyright provisions and in the three Member States can be summarised in the following points:

- In the UK the record producer enjoys copyright in the sound recording while in both other countries, the record producer is granted related rights.
- While in the UK authors are allowed to assign their rights to a third party (in practice, this is usually the publisher), meaning that they give away their copyright and the control thereof, in Spain publishing contracts are subject to restrictions in the details and in the Czech Republic the assignment of rights is explicitly prohibited by law –although authors can grant licenses to publishers according to the specifications provided in the law.
- taking into account that the exclusive right of making available is usually transferred to the record producer, Spanish law has recognised an additional right for performers of remuneration for making available mandatorily managed by a CMO.

In the context of the present study, only the last difference seems to potentially have a clear impact on the licensing environment. The Spanish right to remuneration for performers, increases *ex post* transaction costs for online music service providers that have to pay separately to (and negotiate the price with) the performers' CMO. The strict limitations on Spanish publishing contracts as well as the Czech prohibition on the assignment of rights do also have an impact, since this limits on the scope of publishing contracts. Particularly in *droit d'auteur* countries the publisher is not in a position to centralise all rights (KEA 2006, p. 14).

The UK recognition of a copyright instead of neighbouring rights is not of relevance as in both cases, the music service provider will have to deal with record producers and find licensing agreements with them.

The multiplicity of right holders – authors, performers, record producers– and rights – making-available and reproduction right – makes licensing processes complex, as all of these rights have to be cleared for all right holders. This "fragmentation of rights" generates multiple transactions which increase identification and negotiation costs. As the following sections indicate, rights management practices make these processes even more complex and potentially costly. The management of rights and licensing practices work in the three countries and for multi-territorial uses will be described in detail. Section 2.2 deals with the management of authors' and publishers' rights, section 2.3 describes the management of performers' and record producers' rights, while section 2.4 provides a detailed description of whom to deal with for the appropriate rights when licensing for online music services.

2.2 THE MANAGEMENT OF AUTHORS' AND PUBLISHERS' RIGHTS

In order to ensure better management of their rights authors and performers usually assign, license or entrust all, or parts, of their rights to a third party, which will take care of exploiting or managing those rights. Such third parties are the publisher for authors and the record label for performers.

Both, authors and publishers have traditionally chosen to let collective management organisations (CMOs) administer their rights for most uses (2.2.1), although this trend has been challenged by recent movements in relation to the licensing of publishers' rights for multi-territorial uses (2.2.2).

2.2.1 Collective management organisations administering authors' and publishers' rights

Right holders are free to choose whether they want to administer their rights for online uses (making available right and the reproduction right) themselves or through a collective management organisation (CMO). Usually, authors choose to administer their rights through such an organisation and CMOs administer a large catalogue of rights of musical works (the repertoire) (Dehin, 2011, p.222).

CMOs are in practice natural monopolies that have become powerful institutions in several Member States (KEA, 2006, p.16). Their main role is to negotiate licence fees with users, collect the fees from the user, monitor the usage and distribute fees collected to individual right holders. They often have legal obligations of a social and cultural nature, such as supporting the arts or social activities for their members and, to a different extent according to the country, their governance and functioning mechanisms are defined by copyright legislations (Dehin, 2011, p. 224). National legislation may contain obligations concerning their accountability *vis a vis* right holders (obligations concerning the assignment and administration of rights, redistribution of collected revenues and transparency) and users (obligation to license rights and on tariffs transparency) (KEA, 2006, p.67). The operations of CMOs have been highly criticised because of opacity and their inability to respond to the needs of the online environment. In order to harmonise the rules governing the activities of CMOs the European Commission has introduced a legislative proposal for a Directive on collective rights management and the multi-territorial licensing of rights in musical works for online uses (Proposal Directive, 2012). The objective is twofold; first, to improve the way all collecting societies are managed, by establishing common governance, transparency and financial management standards, and second, to set minimum standards for authors' rights societies in the music sector which deal with the multi-territorial licensing of online services.

There are CMOs for authors and publishers (usually one entity) and for performers and record labels (one or two entities) in each country. In relation to licensing rights for online uses, a music service provider will have to deal with CMOs for authors and publishers, as in most cases record labels, administering online rights of performers together with their own rights, manage those rights directly or through aggregators.

In the three countries examined in this report, the following CMOs for authors and publishers operate:

- In the UK there is the PRS for music, regrouping the Mechanical-Copyright Protection Society (MCPS) in charge of collecting and managing mechanical rights (reproduction rights) for publishers (the MCPS is owned by the Music Publishers Association), and the Performing Rights Society (PRS) in charge of managing performing rights (communication to the public/making available rights) for authors and publishers²⁷. In relation to online licences, the PRS for music collects royalties for both societies, and redistributes them accordingly (25% to the PRS, 75% to MCPS for online download and streaming).
- In Spain, the Sociedad General de Autores y Editores (SGAE) administers the rights of authors and publishers. AGEDI manages the rights of record labels and AIE of performers. Music service providers operating in Spain will usually only have to deal with the SGAE, as far as download and streaming services are concerned since record labels directly negotiate their own rights and the rights that usually have been assigned by the performers by contracts. However, service providers need to deal with the AIE in relation to the remuneration to be paid to performers (see above).
- In the Czech Republic the Ochranný svaz autorský pro práva k dílům hudebním, o. s. (OSA) deals with authors' and publishers' rights. In the process of licensing for download or streaming services, music service providers will only have to deal with OSA, as record producers negotiate their licences directly, usually including performers' rights.

²⁷They have been merged to a common label "PRS for music" in 2009, yet remain formally two separate societies.

In terms of rights management a distinction must be made between the so-called Anglo-American repertoire, which is generally understood as the musical works registered with the CMOs of the United States and United Kingdom (Mazzioti, 2011, p.3) and musical works managed by the continental European CMOs.

- In continental Europe authors generally conclude contracts with publishers, granting them a part of the royalties collected by CMOs. Authors assign or entrust their copyright on an exclusive basis to a CMO, which distributes the collected royalties between the publisher and the author (Dehin, 2011, p.226).
- In the UK, authors have traditionally assigned their reproduction rights (mechanical rights) to publishers and let the CMO PRS administer their making available right (performing rights). Royalties collected by the MCPS are paid to the publishers, who transfer parts of it to the author, according to their publishing agreement. The MCPS operates as an agency of publishers, rather than as a collecting society, and could in theory enact their rights for each use outside the United Kingdom, according to the agreement between the MCPS and publishers. In practice however, when UK publishers do not have a local branch in foreign countries, they appoint local sub-publishers that are members of the local CMOs through which they manage the publishers' rights (Mazzioti, 2011, p.17).

2.2.2 New entities for multi-territorial licences

There have been important changes in licensing processes in the past years regarding licences for the multi-territorial use of musical works. These changes are linked to the European Commission's activity in the field of music licensing aimed at facilitating cross-border licensing.

EC monitoring of licensing practices

Traditionally, CMOs were able to license for their own territory (country), their national repertoires as well as the repertoires of CMOs of other countries due to a system of reciprocal agreements between these societies (Bently, 2009, p.277). The system of reciprocal agreements allows copyright users to obtain territorial "blanket licences" for the world repertoire through the CMOs of their country of establishment. If CMOs wished to offer services in a number of territories, they had to negotiate with each CMO in each territory, as a local CMO had no mandate to provide licences for another society's territory.

Santiago and Barcelona Agreements

In response to technological developments and with the aim of providing commercial users with multi-territorial licensing solutions for online distribution of musical works, CMOs adapted these reciprocal agreements so as to include the management of the rights involved in online distribution (Mazzioti, 2011, p.5).²⁸ Both the Santiago and Barcelona agreements included the so-called clauses of economic residence whereby users were obliged to resort to the collecting society of their country of residence. In 2004, the European Commission started anti-trust proceedings against the Santiago agreement, and expressed its objections mainly concerning the clauses of economic residence, as they made it impossible for users to obtain a licence from the CMO of their choice (European Commission, 2005, COMP/C2/38126). As a consequence the agreements were abandoned.

The 2005 Recommendation

Relying upon the fact that both agreements were not renewed, in 2005 the European Commission's DG Internal Market published a Recommendation on collective cross-border management of copyright and related rights for legitimate online music services (European Commission, 2005), advocating multi-territorial licensing for the online environment. It asked Member States to enable rights holders to assign the management of their online rights to any CMO on a territorial scope of their choice and to give

²⁸ Santiago Agreement for online public performance rights and Barcelona agreements for digital reproduction.

them the right to withdraw any of the online rights and transfer the multi-territorial management of such rights to another collecting society, regardless of the Member State of residence or the nationality of the CMO or of the rights holder.

CISAC Decision

Practices concerning reciprocal agreements for online uses were once again challenged by the so-called CISAC Decision (European Commission, 2008) in which the Commission considered that membership restrictions and territorial exclusivity clauses contained within the agreements were against competition rules. The decision has been appealed by almost all the affected CMOs before the European Court of Justice (Case T-442/08, 3 October 2008).

The direct consequence of the actions undertaken by the Commission, in particular the 2005 Recommendation, was the withdrawal of the major publishers' Anglo-American repertoire from traditional CMOs and the creation of new entities to manage their rights (mechanical rights) in relation to multi-territorial uses. These new licensing entities are managed and owned by several traditional CMOs such as PRS for Music, GEMA, SGAE and SACEM. Many independent publishers, following the example of major publishers, have also entrusted the PRS to manage their rights through a new licensing entity to facilitate multi-territorial rights management of Anglo-American repertoires. Some CMOs now issue multi-territorial licenses on their own repertoire and also on the repertoire of other collecting societies (EC 2012, p. 104).

This implies that today music repertoires are even more fragmented than they were before 2005. Rights to the entire music repertoire are managed by an increasing number of different management entities that cannot always accurately identify the rights they manage, due to the dispersed and fragmentary nature of both the rights and right holders. In practice, as confirmed by our survey, music service providers wishing to acquire authors' and publishers' rights for multi-territorial use have to deal with all CMOs, as well as with new licensing entities for mechanical rights of major, and possibly independent, Anglo-American repertoire (four or five new entities). In addition, they will have to deal with record producers (see section 2.3).

The following new entities have been set up to manage the mechanical rights for the majors' Anglo-American repertoires (for details see ELIAMEP, 2009 pp.26-29):

- CELAS for EMI²⁹, managed and owned jointly by GEMA and PRS launched 2006
- DEAL for UNIVERSAL Music Publishing Group (UMPG) owned by SACEM, launched in 2007, also including the French repertoire of UMPG
- PEDL for Warner entrusts its rights to PRS for Music (UK), STIM (Sweden), SACEM (France), SGAE (Spain) and BUMA-STEMRA (Netherlands) and launched in 2007
- PAECOL for SONY/ATV owned by GEMA launched in 2008

The PEL-initiative has been launched for the Latin repertoire of Sony Music Publishing, Peer Music and Central and South American CMOs, and is managed by the Spanish collecting society SGAE.

In order to give independent publishers the option to license their mechanical rights on a multi-territory basis through one rights manager, PRS for music has launched the IMPEL initiative. IMPEL had 16 members in January 2012, including some of the largest independent publishers (PRS for music, 2012). PRS for music also includes the corresponding performing rights for works of IMPEL members in such licences. In 2012 it had concluded licensing deals with 7digital, Spotify, Amazon, Apple I-tunes, Apple icloud and Research in Motion and had collected royalties exceeding £1 million (PRS for music, 2012). The

²⁹ As indicated, EMI publishing has been sold to Sony/ATV in 2011, but no information about the existence of CELAS and the management of multi-territorial rights could be obtained.

independent publisher Chrysalis Music also entrusted the PRS to administer its rights for multi-territorial uses.

All these initiatives can grant licences for the mechanical rights for all types of online and mobile exploitation of Anglo-American music works, including downloads, streaming, webcasting and ring tones for their respective repertoires. They all apply tariffs based on those in place in the country of exploitation of the service. Some of them, such as CELAS and IMPEL can also deliver the associated licences in relation to the making available right (performing rights) (Mazzioti, 2011, p.11-14).

In comparison to the above-mentioned mono-repertoire initiatives, a different pan-European licensing model has also emerged, which is based on the regional consolidation of music repertoires. In 2007, the Spanish, French and Italian CMOs for authors composers and music publishers (SGAE, SACEM, SIAE) launched the initiative ARMONIA aimed at licensing these societies' national repertoires, as well as Anglo-American works of Universal Music Publishing and Latin works of Sony/ATV, EMI music publishing and Peer Music, as a single bundle of distinct repertoires, for online and mobile exploitation. This licensing model is still in a very early phase of development. In 2011 Armonia closed a deal (the only one the authors of this study are aware of) with the pan-European service Beatport, issuing three different licences for each collecting society, instead of a single licence (Interview).

Similarly, the Baltic and Nordic CMOs - KODA (Denmark), STEF(Iceland), STIM (Sweden), TEOSTO (Finland), TONO (Norway), LATGA-A (Lithuania), AKKA-LAA (Latvia) and EAU (Estonia) have set up in 2009 the Nordisk Copyright Bureau (NCB) to administer their mechanical rights. The NCB delivers a joint Nordic/Baltic online license (JOL), combining mechanical rights managed by the NCB with performance rights managed by local member societies. Thus, online music service have the option to acquire a single licence that covers all eight countries (Dyson, 2012 p.7). Tariffs are also based on the principle of 'country of destination.' Since 2010 the NCB has had an agreement with PRS for music on royalty processing and the cooperation on the development of NCB as a regional hub for rights management in Europe (PRS for music, 2010). No information on the actual number of agreements concluded for online music services could be obtained.

2.3 RIGHTS LICENSING OF PERFORMERS' AND RECORD PRODUCERS' RIGHTS

While management of authors' and publishers' online rights is usually entrusted to CMOs, generally speaking the management of performers' and record producers' exclusive rights (related rights), is done either directly or through commercial third parties, such as aggregators³⁰.

Usually, the performer transfers all, or substantial parts, of their online rights to the producer and receives a percentage of the revenues on the recording (royalties). The record producer, hence, administers the performers' rights, as well as its own rights on the sound recording. While major and large independent record labels often handle the management of their own (and the performers') rights, smaller independent record labels often pass through aggregators to deliver their music works to online platforms.

Aggregators convert and encode music formats and deliver technical copies of the music, and act as distributors of music over the internet, negotiating directly or through an intermediary the deals with online music services.

They usually have exclusive contracts with the record labels they represent; although in some cases record producers may negotiate deals directly with the music service provider, for instance with large providers such as iTunes (Interview).

³⁰ Aggregators are for instance: The Orchard, PIAS UK, Consolidated Independent (CI), Artists without a label (AWAL), KUDOS Distribution, Zebraluions (that belongs to Warner Music), Altafonte.

At the national level, they negotiate deals directly with the online music service providers. Frequently, established music services use standard agreements. As a result, negotiations are quite rapid – as there is (almost) no negotiation – and transaction costs are reduced for service providers, in comparison with a situation where they would have to negotiate with every record producer³¹.

For negotiations with large, multi-territorial music service providers, such as Spotify, Deezer etc, the aggregators usually resort to MERLIN as this collective initiative allows them to access more interesting deals (see below).

MERLIN (www.merlinnetwork.org) is a joint licensing entity for independent record producers which was created in 2008 in response to the evolution of the licensing field. It represents record producers on a non-exclusive basis and provides blanket licences for independent repertoire for multi-territorial use to online music service providers. It operates on a not-for-profit basis and negotiates licensing agreements with online services for independent record labels' music content online and in the new media environments worldwide. It is specialised in negotiating licences relating to new and emerging technologies and thus concentrates on licensing streaming and mobile services, and any other innovative service. Accordingly, they do not have agreements with important traditional download services such as iTunes, as all of their members are involved with them on their own through their aggregators/distributors.

This initiative offers, on the one hand, a one-stop shop for a large number of rights to online music services and on the other hand a better position in negotiations for right holders. MERLIN gathers together the majority of independent music companies, and is therefore often referred to as the fifth major (interview).

2.4 DIGITAL WAREHOUSES

Another way for music service providers to access licences for music content is to acquire them through digital warehouses which offer music service providers a catalogue of all music rights needed (including those from publishers and authors, record producers and performers on a national or multi-territorial basis). These entities take care of negotiating licences with all right holders and delivering them together with the content in the right format, including all meta-data, to the platform.

2.5 LICENSING FOR ONLINE MUSIC SERVICES STEP-BY-STEP

Rights clearance practices depend on the geographical scope (multi-territorial or local), the type of repertoire (Anglo-American or European/local) and the type of licensor (major or independent record label, or CMOs). With regards to transactions, in general, there is not one transaction per right, per right holder or per music track, but several rights can be acquired in one transaction. The different scenarios described below distinguish, on the one hand, the geographical scope of the service, and on the other the type of repertoire.

2.5.1 Case 1: Licensing for a small-scale service accessible in only one territory

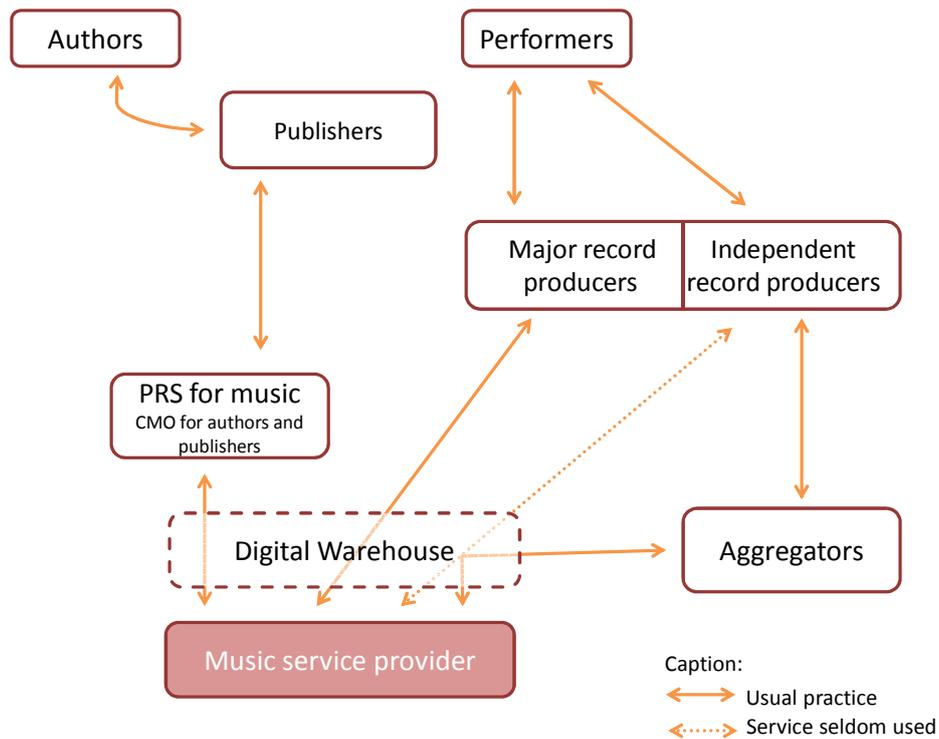
Services accessible in only one territory will usually have to acquire rights from the local CMOs for authors and publishers and from record labels. In general, this scenario applies to smaller services operating only in the local territory. Larger services operating in the local territory will mostly have to

³¹ Aggregators themselves face additional transaction costs derived from the negotiation with the record producer they represent.

negotiate the major publishers' repertoire directly and big European local repertoires with the national CMOs.

UK

The following diagram shows rights licensing processes for small services in the UK:



In the UK online service providers will have to deal with:

- the collecting society PRS for music, which offers joint licences for the online use of musical works, for both mechanical and performing rights for authors and publishers for its local repertoire as well as for the major Anglo-American repertoire. PRS for music, offers several types of standard agreements according to the size of the service, which, however, have to be adapted on a case-by-case basis, as most services are original and their model is therefore not taken into account in the standard agreements. Reciprocal representation agreements between CMOs are still in place for download and streaming licences for smaller services. However, it depends on the willingness of the PRS and major publishers, whether major publishers' repertoire can be licensed through the PRS or directly with the publishers.
- the record producers (directly or through aggregators) for producers and performers rights. Independent record producers generally license their online rights through aggregators. Only large independent record producers as well as major record producers license their rights directly.

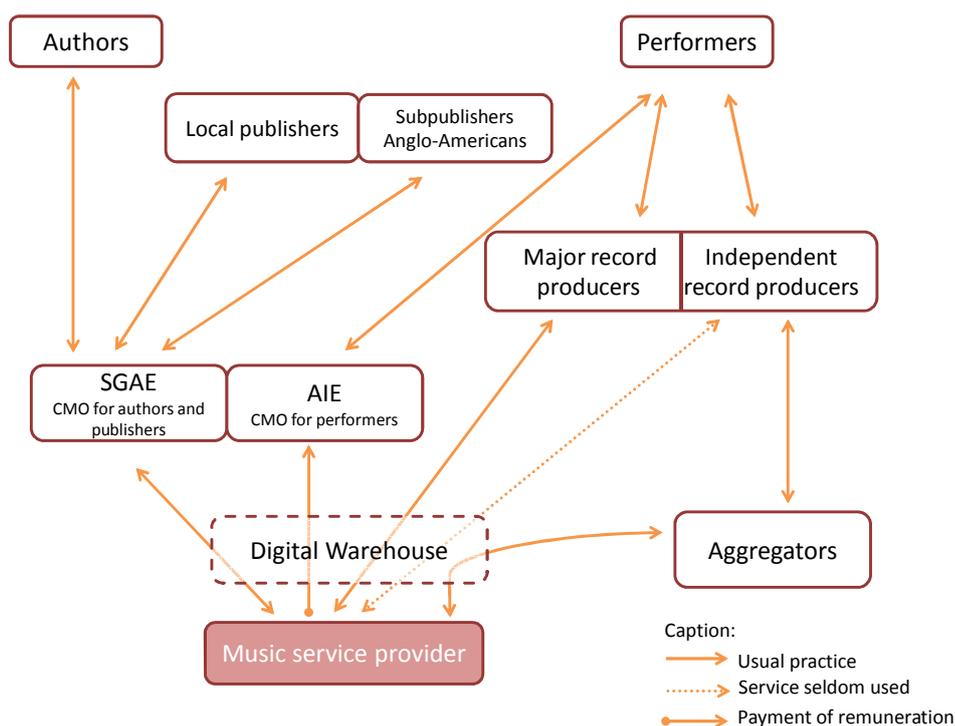
In relation to rights administered by the collecting society PRS for music (brand name for PRS and MCPS), it has to be noted that in 2006 PRS and MCPS put in place a joint system, the so-called joint online licence, which covers performing (making-available) and mechanical rights (reproduction) in

musical works for most types of online and mobile music services offering music to the public. Thereby, they offer a one-stop shop regarding authors and publishers rights to be acquired for online music services. The licence covers use of music in terms of permanent downloads, on demand streaming unlimited downloads, premium and interactive webcasting and pure webcasting. There has been a settlement agreement by the Copyright Tribunal between MCPS-PRS and stakeholders from the music industry and the online and mobile industries, which has endorsed royalty rates (Stokes 2009, p.199).

According to the PRS, lengths of negotiations with service providers depend on the type and history of the service. Licences will be accorded more quickly for established services, operating for a certain time, than for start-ups. Treatment of demands will also be longer for services with an original business model, as more adaptation of the standard agreements will be needed. There are seven PRS board meetings a year in which agreements are accepted. Ideally the board tries to respond to a demand from one meeting to another but in more complex cases this is not possible. This means that ideally, it should take 6-8 weeks for a service to get the appropriate licence from the PRS for music for authors' and 'publishers' rights, and licences for record labels will be needed in addition.

Spain

The following diagram shows rights licensing processes in Spain:



In Spain the online music provider will have to:

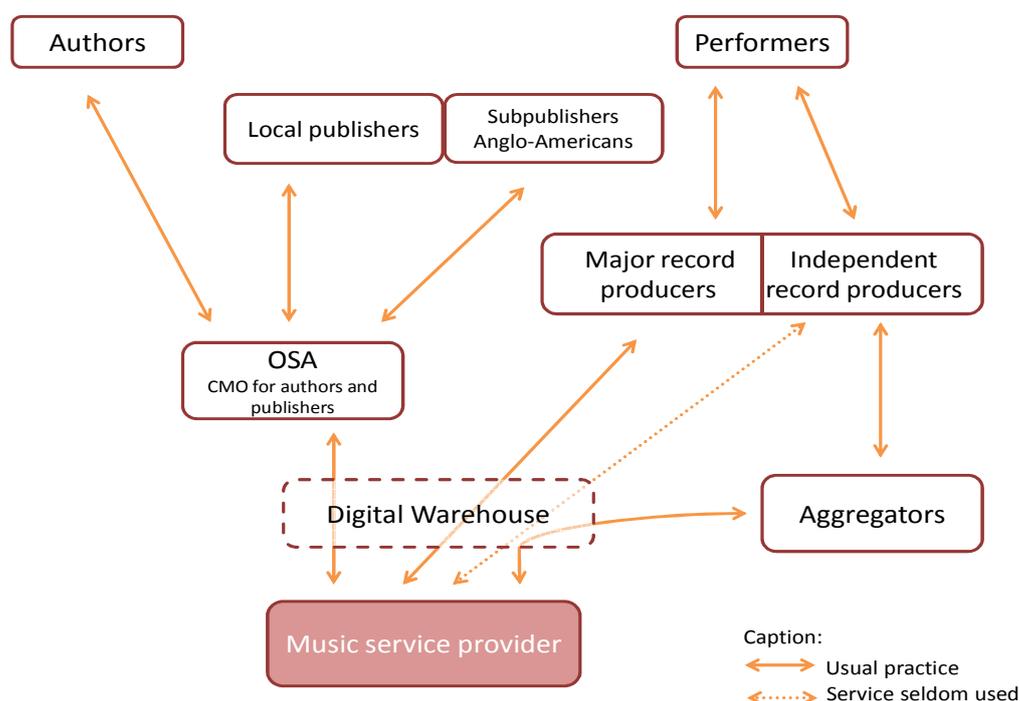
- negotiate the making available and reproduction rights for authors and publishers with the SGAE. Although major publishers have withdrawn their repertoire from SGAE's, in practice this withdrawal only relates to multi-territorial licences, and possibly large service providers. At the national level, SGAE manages both authors and publishers rights for local and Anglo-American repertoire, and collects the royalties that are further distributed among authors and publishers according to their corresponding participation. SGAE grants several types of licenses for on demand services in the Spanish territory: for music download on demand, for music streaming on demand, for webcasting

and for ringtones. Model contracts are available at SGAE's website. The minimum fees are revised each year in line with the evolution of the rate of inflation in the previous year at a national level.

- negotiate with the record producer or their aggregator to obtain both performers' and record producers' rights for the online use of the work.
- pay AIE, the CMO of performers, the remuneration due to performers for the making available.

Czech Republic

The following diagram shows rights licensing processes in the Czech Republic:



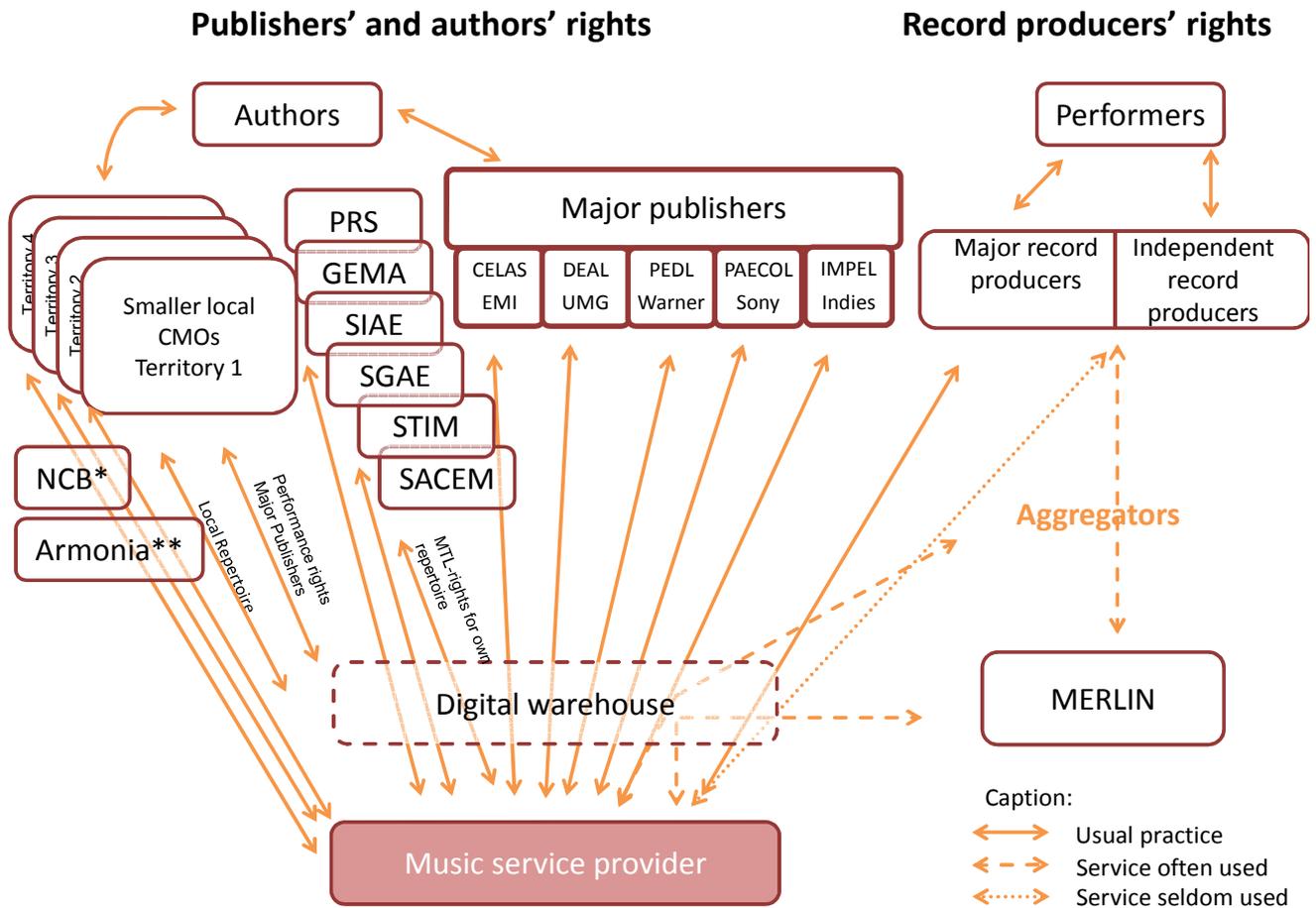
In Czech Republic the online music service provider will have to deal with

- the collecting society for authors and publishers OSA, for the making available right and the reproduction for authors and publishers of the work
- with the record producer (directly or through aggregators) for the rights on the recording as well as for the rights of performers who usually license their rights to record producers

OSA operates with a standard agreement, which, in common with the other countries, is adapted on a case-by-case basis to each service. Negotiations can take anything from several days to several months, depending on the service's model; a classic streaming or downloading model does not need long time to be licensed, while innovative, hybrid models, where no pre-existing standard agreements are in place can take several months. Licences cover the making available and the reproduction rights for authors and publishers. A small, locally operating service can usually acquire a blanket license for the global repertoire from OSA, as reciprocal agreements still apply.

2.5.2 Case 2: Licensing for a service accessible in several territories

Service providers have to negotiate, depending on the repertoire they wish to offer, with several different entities. Usually, online service providers operating at a pan-European or multi-territorial level wish to offer a catalogue as large as possible. This would include the Anglo-American repertoire as well as local repertoires (from both, majors and independents) from the various countries, in which the service is accessible. Consequently, service providers will have to negotiate with all the right holders and other entities involved. The following table shows the processes:



* For Baltic and Nordic repertoires (making available and reproduction rights).

** For French, Italian and Spanish repertoires (making available and reproduction rights).

For Anglo-American repertoire owned by majors, music service providers will have to acquire licences from:

- rights management organisations that manage multi-territorial reproduction rights (mechanical rights) for Europe. CELAS for EMI, PAECOL for SONY, DEAL for Universal, PEDL for Warner;
- local CMOs for the performing rights, unless it is possible to get the licence for these rights through the mandated management entity (which is possible in the cases of CELAS and IMPEL);
- major record producers for the mechanical and performing rights.

For independent Anglo-American repertoire:

- either from local CMOs for authors and publishers or from a new entity, such as IMPEL by PRS for music for the two rights for authors and publishers;
- from independent record producers in each territory, or through a collective rights management entity/aggregator, usually through MERLIN for the two rights for record producers and performers.

For local repertoires, they will have to acquire licences from:

- CMOs issuing multi-territorial licenses for the making available and reproduction rights on their own repertoire – several, mostly large CMOs, such as PRS for music, GEMA, SGAE, SACEM and SIAE, or STIM grant multi-territory licences for their own repertoire and for other repertoires directly managed by them – ex. Irish IMRO's rights are licensed by PRS and the Portuguese PTA's rights are licensed by the Spanish CMO SGAE.
- small CMOs issuing licences for their own territory, offering only their multi-repertoire based on existing reciprocal agreements;
- the new entities offering a consolidated repertoire: ARMONIA, NORDISK COPYRIGHT BUREAU, .
- independent record producers in each territory, or through an aggregator, usually through MERLIN for the two rights for record producers and performers.

2.6 ALTERNATIVE LICENSING MODELS

In order to facilitate licensing processes alternative licensing models and practices have emerged for music or for other sectors, to enable more efficient transactions between music service providers and right holders. The following section looks at the major alternative licensing models that could potentially be used as substitutes for, or alongside, traditional licensing practices.

2.6.1 The Youtube Content ID model

The way the user-generated platform YouTube operates may be seen as an alternative licensing practice, in particular in the way ex-ante transaction costs e.g. identification costs are handled. On such a platform, users (professionals and amateurs) post videos which are hosted on the platform. Under the e-commerce Directive right holders may notify YouTube if they believe content posted by a user is infringing their rights³².

In order to allow right holders to provide such notifications, YouTube has implemented an online tool, the Content ID, to allow requests for videos to be taken down. The Content ID system allows right holders to identify when their content is being uploaded by a user and when content is recognised, to decide whether to block access, monitor the use or monetise the content through advertising. It is based on a database containing ID files for copyrighted audio and video works.

The cost of developing the Content ID system is borne up-front by YouTube, but the system allows the service provider to develop the technologies and databases best suited to each platform. However, YouTube still relies on right holders to identify their content and has to negotiate with the major right holders (CMOs, new licensing entities, record producers) in each territory where these right

³² Internet intermediaries (such as access providers, hosting providers, search engines) are protected from being held liable for copyright infringements by users of their services in a situation where they have no knowledge of the existence of an infringement of copyright-protected content on their infrastructure. They are not obliged to monitor the site for infringing content, but, if material is infringing, must take it down expeditiously in order to benefit from the liability rules. Internet intermediaries are not protected under the liability rules if they have "actual knowledge" of an infringement on the site. Articles 12-14 of the E-Commerce Directive (Directive 2000/31/EC).

holders are interested in monetising their content. These negotiations can be time and cost consuming when dealing with the majors and big collecting societies.

2.6.2 Dual Licensing policies: Copyright and Creative Commons

With the emergence of the Internet and the possibility for authors and performers to make their works accessible online, without passing through intermediaries, the idea of individual rights management has attracted increasing attention. In the beginning of the 2000s "Creative Commons" licences were established (<http://creativecommons.org>), operating under the rationale "some rights reserved" and offering a set of six licences to creators to choose from (Kreutzer, 2011). Under these licences authors keep their copyright, but can choose the degree to which they wish to share and distribute the work to the public: licences allowing sharing, mixing, distributing the work without restrictions but require mention of the the name of the initial creator (Attribution CC BY–licence), allowing only non–commercial distribution and sharing, with mentioning the name of the initial creator (Attribution–NonCommercial–NoDeriv CC BY–NC–ND); or allowing commercial and non–commercial sharing and distribution with or without modification of the work (Licences: CC BY–NC–SA; CC BY–ND, CC BY–NC).

Today, individual rights holders increasingly wish to experiment with different ways of managing their rights and therefore license, in parallel to traditional licensing modes, through Creative Commons licences (Mazzioti 2010, p. 32). On the basis of the European Commission's 2005 Recommendation, as well as the *Daft Punk* decision (European Commission, Case 37.219), in which the European Commission ordered the French collecting society SACEM to make it possible to the group *Daft Punk* to administer their rights for exploitations on the Internet and through physical formats individually, several collecting societies now increasingly offer limited "dual licensing" policies. These combine traditional collective rights management for commercial uses with individual management of authors' rights for non–commercial uses: for instance the French SACEM (SACEM, 2012), the Dutch BUMA/STEMRA³³, the Danish KODA³⁴ and the Italian SIAE have set up such systems.

Several online music service providers, such as US–based Magnatune³⁵ and the digital warehouse Beatpick³⁶ also set up licensing models that allow some use of Creative Commons licences, in particular for free, non–commercial uses. Jamendo is an online platform entirely based on CC licences. Artists select the licence of their choice (including for commercial uses) and upload their music. They are also given the opportunity to adhere to commercial programmes to monetise further exploitations. Nevertheless, creators belonging to a CMO cannot participate in this service since, since most contracts established by collective rights societies are exclusive and therefore do not allow artists to give away their music for free on the internet" (Jamendo, 2012). Even in the case where dual licensing initiatives apply, their scope is usually narrower than those of the licenses used by Jamendo. Artists received a share of the advertising revenues and, if they adhere to the commercial programmes, are paid in addition for the commercial exploitation of the work.

The effective use of this licensing model in online platforms is largely dependent on the flexibility of the CMOs agreements, their compatibility with Creative Commons licences and the capacity of authors and platforms to effectively enforce their rights (Russi 2011, p. 130–131) as well as on the adaptation and flexibility of existing legal frameworks in each territory in relation to collective management of copyright (Mazzioti, 2010, p. 35). Efforts of the European Commission to harmonise the legal framework, as well as to enable right holders to choose freely the CMO they wish to administer their rights (see section 2.2.3), might contribute to making the use of Creative Commons licences easier.

Creative Commons licences introduce flexibility in licensing processes by anticipating the terms and uses permitted by copyright holders. Moreover, licensing terms are immediately recognisable thanks to the human–readable (the Commons Deed), lawyer–readable (the Legal Code), machine–readable

³³ <http://www.bumastemra.nl/leden/creativecommons-pilot/> Retrieved on 14 May 2012.

³⁴ <http://creativecommons.org/weblog/entry/8012> . Retrieved on 14 May 2012.

³⁵ <http://magnatune.com/info/licensing> for non–commercial uses. Retrieved on 14 May 2012.

³⁶ http://www.beatpick.com/intro/fag#creative_commons retrieved on 14 May 2012.

(metadata) language attached to the work. *Ex ante* transaction costs are therefore eliminated for non-commercial uses. Commercial uses made from non-commercial Creative Commons licences could nevertheless require additional negotiations to take place. However, bearing in mind the way in which the above mentioned platforms operate, negotiation costs seem to be quite low due to the standardisation and automatization of the entire process (online services providers impose their terms and conditions which are accepted by artists; if the artists does not accept the terms he/she simply does not have to adhere to the commercial programme).

2.6.3 Statutory rates and compulsory licences

Other licensing models where transaction costs seem to be considerably reduced are those governed by statutory or compulsory licences. Such systems are in place in the United States for some online uses.

First, the statutory licence governed by Section 114 of the US Copyright Act allows service providers to automatically acquire a licence from a government-appointed body – Soundexchange – to use a sound recording in exchange for a royalty. This applies to performance rights in sound recordings for non-interactive music services. Hence, service providers do not need to ask for multiple authorisations and negotiate separate rates with each right holder, but benefit from a one-stop shop with a fixed royalty rate established by law or regulation for all copyright owners (authors, publishers record producers) and performers (Soundexchange.com). Music service providers have almost no identification costs, dealing with one central point of contact for every transaction, and do not need to negotiate on rates, as these are fixed. The same rate applies to all types of right holders, be they independent or major, large or small (AIM,9 August 2011), which puts a limit on the bargaining power of certain players and ensures certainty to music providers in relation to length and success of licensing processes.

Second, with regards to 'on demand' streaming and downloads³⁷, section 115 of the US Copyright act, provides for a compulsory mechanical licence with terms and rates agreed by industry participants and adopted by the Copyright Royalty Judges (paragraph 801 (b) (7) (A) USC). Online music service providers therefore can obtain such licences to reproduce and distribute "nondramatic musical works". Agreements between the major industry groups have been endorsed by the Copyright Royalty Judges in 2008 setting statutory royalty rates and standards for digital services, including on demand streaming, downloading and limited downloading for rights of authors and publishers³⁸. Stakeholders have reached a new agreement 2012 (Barker, 2012) that has been submitted to comments and to the approval of the Copyright Royalty Board (US Copyright Royalty Board 2012). Yet, there is no compulsory licence with regard to record producers' rights and music service providers must negotiate these licences individually (Wagman, 2009, p. 102).

Online service providers know in advance the conditions, and in particular the prices, agreed by the industry and approved by the Copyright Board, although they still need to provide notice of intent and acquire permission for each individual title. While this makes licensing processes more efficient in one way, it does not completely eliminate significant transaction costs. Although many publishers are registered in the Harry Fox Agency, there is no possibility, such as that which exists under the system for performing rights for non-interactive streaming, to acquire blanket licences in a one-stop-shop (Cordi, 2007,p. 881). Music online services need to fill out lengthy administrative documents for each song in order to obtain compulsory licences and copyright holders rarely use this mechanism as they prefer to directly license the work (Wagman, 2009, p.104). All in all, compulsory rates put pressure on the right holders and their representatives to accelerate the licensing process. There have been many debates between those wishing to see the system expanded in order to limit market power of the

³⁷ As stated in recent case law, in US download only amounts to reproduction rights and not to the right of public performance, *U.S. v ASCAP (in re Realnetworks)*, 485 F. Supp. 2d 438, 443 (S.D.N.Y. 2007), partially confirmed by *U.S. v ASCAP et al.*, No. 09-0539, 2010 WL 3749292 (2nd Cir. 2010),

³⁸ Rates can be found at <http://www.harryfox.com/public/DigitalLicensesLicensee.jsp> (last accessed 14 May 2012).

major players and those in favour of abolishing it completely³⁹. Nevertheless no reform has yet been implemented (Gervais, 2011, p. 434).

2.5.4 The provisions governing European satellite broadcasting and cable retransmission

In 1993, the Council of the European Union passed the Directive 93/83/EEC on the coordination of certain rules concerning copyright, and rights relating to copyright applicable to satellite broadcasting and cable retransmission. This piece of legislation contains certain provisions that are worthy of observation when considering the options to overcome transaction costs and to facilitate licensing for multi-territorial services.

Under the Directive, satellite broadcasting is governed in the European Union by the "country of origin principle". Article 1(2)(b) of the Directive stipulates that a satellite broadcast amounts to a communication to the public only in the country of origin of the signal. This means that satellite broadcasting services only need to acquire licences in the Member State where the signal originates (IVIR, 2006, p.272). Nevertheless, the Directive neither prohibits licensing on a territorial basis (KEA 2010, p.145, IVIR 2006, p.25) nor prevents certain technical practices (ex. encryption) to avoid the receipt of programmes in countries for which the broadcasted was not intended (IVIR, 2006, p.272). As regards royalties, the parties should take into account all aspects of the broadcast, including the actual audience, the potential audience and the language version (Directive 93/83 Recital 17).

This system significantly contributes to lowering the frequency of transactions that have to take place when licensing for multi-territorial services.

In addition, the Directive foresees the possibility of applying collective management, in particular "extended collective licences"⁴⁰, to satellite broadcasting (art. 3.2) – collective management is mandatory in the case of cable services (art. 9.2).).

An application of the country of origin principle coupled with collective rights management to online delivery of audiovisual content could greatly reduce transaction cost since service providers would need to clear licences only in one country. The option has already been discussed as a possible legislative way forward with the view of creating a single European market for video on demand (European Commission's Reflection Document from 2008, KEA 2010)⁴¹. The EC has also considered this option in the Impact Assessment of the proposal for a directive on collective management but finally disregarded it (EC 2012 p. 45 et seq., p. 170 et seq.). It could potentially also be seen as a solution for online music rights.

On the other hand, a system based on mandatory collective management could be favourable for traditional online services providers since they would be given the possibility to clear multi-territorial blanket licences of re-aggregated repertoires and to thus save money on transaction costs. Extended collective licences would combine collective management with direct licensing by those right holders that do not wish to have their works managed by collecting societies.

³⁹ The US Congress debated in 2006 the §115 Reform Act and the Copyright Modernization Act of 2006 H.R. 6052 109th Cong.§102 (2006) , which did not pass. The reform proposed to abolish the compulsory mechanical licence and creating instead a collective licensing system (see Cardi, 2007, p.882 for details).

⁴⁰ As a modality of collective management, the system of "extended collective licences allows for one-stop shop except for those right holders that have expressed their intention to be excluded from the collective agreements. These extended collective licences are generally used for certain specific uses, notably online uses (KEA 2011).

⁴¹ Different from the audiovisual sector where the rights are usually concentrated on the producers, the application of the country of origin principle to music would still require the users to deal with several licensing entities (at least CMOs, record producers). The main risk of applying the country of origin principle in Europe concerns a race-to-the bottom among music services to establish themselves in the territory with the lowest levels of remuneration or the weakest negotiating party. Here it is worth to recall the system used in the IFPI simulcasting agreement scrutinised by the European Competition authorities in the Case Comp/C2/38014. The simulcasting agreement allowed broadcasters to obtain record producers' rights through multiterritorial licenses issued by collecting societies of their choice to transmit terrestrial programming simultaneously over the internet. While as regards the clearance of rights, the agreement was based on the principle of the country of origin (emission state), in order to prevent a race to the bottom as regards the royalties to be paid to right holders, the agreement established that remuneration would take into consideration the royalty rates applied in the territories into which the user simulcasts its services. The agreement was considered in accordance with competition law.

Negotiations for pan-European services are very costly and time-intensive, as they involve a considerable number of licensing entities. The 2005 Recommendation of the European Commission, has to some extent facilitated licensing, since it triggered multi-territorial licensing either through new licensing entities on the major publishers' repertoires or by some CMOs on their own repertoire and, in some cases, on the repertoire of partner CMOs. However, as demonstrated in the next section, obtaining licences through the new entities is still a lengthy process. In addition, online music services need to negotiate with other CMOs for the authors' rights that are usually not in the hands of the new entities and with local CMOs for the repertoires that are still not licensed on multi-territorial basis, adding even more complexity and costs in licensing processes. The system for acquiring record producers' rights seems to be less complex today, as a more manageable number of entities exist, such as aggregators or the joint licensing initiative MERLIN for independent record producers that license on multi-territorial basis.

3. THE COSTS OF LICENSING FOR MUSIC SERVICES

The previous section demonstrates the extent to which online music service providers operate in a complex licensing environment, in particular when they want their service to be available at the pan-European level. This section analyses the impact of transaction costs on online music service providers. It does so first by using a conceptual framework based on Transaction Cost Theory, to build a set of assumptions regarding the main sources of costs in the online music licensing process (section 3.1). It then illustrates, based on a sample of online music services, the impact of these different costs (section 3.2.).

3.1. TRANSACTION COSTS IN THE ONLINE MUSIC LICENSING PROCESS

Analysis of the costs faced by online music service providers in the licensing process relies on Transaction Costs Theory. Furthermore, the analysis focuses on *ex ante* costs and distinguishes between identification and negotiation costs (section 3.1.1.). A crucial contribution of the study is the application of this theory to the analysis of the licensing process, which has led to the development of six assumptions (section 3.1.2.).

3.1.1. Definition and identification of Transaction Costs

The section identifies, quantifies and analyses transaction costs in online music licensing within Europe. To do so, it begins by describing the conceptual framework (Transaction Cost Economics) and how it can be used to analyse online music licensing. Transaction Cost Economics (TCE) was developed by Oliver Williamson (Williamson, 1989), notably based on the works of Coase (Coase, 1937) – and is also known as neo-institutional economics.

The analysis is built on insights developed by the law and economics of copyright (e.g. see Landes and Posner, 1989). The use of TCE in this branch of law and economics is now relatively commonplace (Gordon and Bone, 2000). TCE is focused on transactions, which can be defined as the transfer of property rights, whereas property rights relate to the rights of the individuals to use, alter, generate income from and transfer resources (Anding and Hess, 2002). TCE aims to analyse the conditions in which the transactions take place and has been applied to various social situations – from the functioning of an industry to the relationships within a family (Williamson, 1989). In this section, the property rights are intellectual property rights (IPR), and transactions concern the licensing of these rights to online music services.

Transaction costs (TC) include all the costs incurred when a transaction takes place. Williamson compares them to friction in physics (Williamson, 1989): without them transactions would be much easier, it is worth trying to reduce them but it is never possible to suppress them entirely. In the cultural industries, the level of transaction costs has increased with the development of digital technologies due to the rapidly increasing amount of content made available and features of copyright law (e.g. copyright's length and the absence of mandatory registration, in particular when compared to patents) (Varian, 2010).

This study focuses on *ex ante* TC. It is common to distinguish between *ex ante* and *ex post* TC. *Ex ante* costs are all the costs incurred before a transaction and *ex post* costs are all the costs incurred after a transaction. The online music market is still young, with many emerging services, therefore it is more relevant to focus on *ex ante* costs, which arise during the establishment of a service. However while it is analytically possible to distinguish between these costs, in reality there can be strong links between them. For example, many right holders in the music industry are not eager to license their

rights to services because on the one hand they do not expect the services to give them money and on the other hand they fear consumer use of these services will replace the purchase of CDs (which may remain the most profitable activity). At the other end, online music service providers may face significant *ex post* TC in identifying repertoire and uses for reporting and invoicing purposes.

From a theoretical point of view, these issues stem from the fact that contracts are incomplete and no contracting party can simply rely on the other party (Williamson, 1989). Therefore, *ex ante* actions are useful in preventing *ex post* abuses but they will never be enough to prevent them entirely. In addition every agent tries to assess *ex ante* the reliability of the other party in order to determine the conditions/circumstances under which there could be a transaction.

Based on Hansen and Schmidt-Bischoffshausen (2007) and Picot et al (2001), the following typology of *ex ante* TC for transactions around rights for online distribution of music content can be set out:

- Identification costs, which correspond to all the costs incurred to identify and find the rights owners.
- Negotiation costs, which correspond to all the costs incurred between identification and the actual agreement.

The study focuses on the TC supported by the online music services. This approach is rarely considered in research on TC in online content markets. Previous studies consider TC at a general level, without necessarily entering into the details of the TC faced by every partner (e.g. Varian, 2010). When they focus on one partner, they often consider the role played by CMOs in reducing (or increasing) TC (e.g. Hansen and Schmidt-Bischoffshausen, 2007, Ghafele and Gibert, 2011).

3.1.2. What causes higher transaction costs? An overview of the literature

Certain characteristics of transactions impact on their cost. This section develops assumptions concerning the characteristics which have an impact in online music licensing. To do so, it covers two kinds of literature: general literature on TC theory and literature on online music licensing. According to Williamson (1975), transactions differ along three dimensions (or determinants), which have an impact on their related costs: asset specificity, uncertainty and the frequency of transactions. Before analysing each dimension, the impact of the number of transactions is considered.

a) The number of transactions

Every transaction incurs costs, hence the total TC faced by a firm increases with the number of transactions. Thus, from a general perspective digital technologies increase TC because they make an increasing amount of content available (Varian, 2010). Online music service providers must identify and negotiate for every additional country where they will be present. Therefore, it is anticipated that **online music services which are available in several countries face higher TC than those which are available in only one country**. In other words, multi-territorial accessibility increases TC (Leurdijk and Nieuwenhuis, 2011b) unless, of course, an efficient and operative system of multi-territorial licensing or one-stop shops are in place, so that service providers do not need to clear licences in each territory.

Online music service providers must also identify and negotiate with a variety of right holders for the different repertoires they want to add to their catalogue, with each repertoire comprising anything from one to millions of titles. Hence it is expected that **online music services with bigger catalogues face higher TC than online music services with smaller catalogues**. However, TC are not necessarily proportional to size, a transaction will in general cover more than one title, e.g. one major's catalogue. Conversely cases arise where one or a few titles require several transactions.

b) Dimension 1: Asset specificity

Assets include all economic resources owned or controlled by firms to produce value. Assets are said to be specific when their owner cannot redeploy them to alternative uses without a (significant) cost (Williamson, 1989). Business partners investing in specific assets face delicate negotiating positions because they need a transaction to take place, otherwise they will have lost money by investing in an asset that cannot be redeployed without a cost. However the higher the specificity, the harder it is to find partners willing to invest in such assets.

From the service providers' point of view, the assets comprise all the resources acquired to set up the music services.⁴² Most online music services (at least the more generalist ones) cannot avoid making deals with the right holders that own or manage rights for the most important parts of the repertoire. This is one reason why major publishers and major record producers are in a better position in negotiations and it is therefore expected that **online music services face higher negotiation costs when dealing with major publishers and major record producers.**

To a lesser extent, this could also apply to other categories of right holders:⁴³ CMOs are generally unavoidable business partners for online music service providers – for providing both local blanket licences as well as multi-territory licences. However their bargaining power might be lower because in general they must have uniform conditions for all users (Ghafele and Gibert, 2011). In addition, CMOs are often obliged by law to provide licenses to users.

For these reasons, researchers tend to conclude that CMOs help to reduce TC (SABIP, 2010), in particular because they represent a central contact point (Hansen and Schmidt-Bischoffshausen, 2007). In other words, instead every service provider negotiating with every right holder, service providers have to negotiate only with one, or a few, CMOs. However, licensing through CMOs can have an opposite impact on TC because CMOs work on the basis of exclusive mandates enjoying a *de facto* monopoly, which can give them more bargaining power (in particular if part of their repertoire is crucial for the success of the service). In addition, while CMOs in some cases offer service providers uniform conditions for similar uses, music service providers proposing innovative services may not benefit from these conditions, as their services do not correspond to the same criteria. Lastly, although law often obliges CMOs to license users, licensing processes can be long and CMOs can still decide on rates, which are sometimes claimed to be too expensive for innovative services (ELIAMEP, 2009, p.93; Andrews, 2011).

In addition, in some territories, access to the local repertoire can be crucial and this local repertoire may be owned or managed by independent record producers. Therefore, some independent record producers may have higher bargaining power. They can also use this power to get better conditions, which may slow down negotiations.

c) Dimension 2: Frequency of transactions

Frequency corresponds to the number of transactions, over a given period, that take place between business partners. The impact of frequency on TC is dual, i.e. when partners have more frequent transactions, this can either decrease or increase the costs relating to each transaction. The duration of licences and the conditions for their renewal play a role in this dimension.⁴⁴

On the one hand, when the frequency of transactions is high, partners are more likely to trust each other because they think that their counterpart is encouraged to behave well in order to continue

⁴² The other assets are the musical works, which belong to the right holders. However, musical works are not assets that are produced specifically for being provided (e.g. through downloads, streaming) by online music services. In other words, the recording companies do not necessarily need to be present on these services.

⁴³ An interesting question would be to know to what extent a service could be launched with only 'major' repertoire, i.e. repertoire managed by major publishers (or the new licensing entities) or major record producers. This is however impossible to assess with the current data. To our knowledge, no service currently runs with only such a repertoire, notably since a huge part of it is interdependent with CMO repertoire.

⁴⁴ No result could however be derived related to the impact of either the duration of licences or the conditions for their renewal.

making transactions. Hence, higher frequency can lead to easier and less costly transactions, in particular as far as negotiation costs are concerned.

On the other hand, when frequency is high, partners may be more wary of possible misconduct on the part of their counterpart and the negative consequences of such misconduct on the (numerous) transactions. Hence, in contrast to the previous explanation, higher frequency can lead to more complicated and more costly transactions. To prevent the increase of TC, partners may try to build stronger links from the start, e.g. through financial links.⁴⁵

d) Dimension 3: Uncertainty and the behavioural assumptions

Uncertainty refers to both unpredictable external events (e.g. a new technology allowing new uses) and behavioural uncertainty, the latter relating either to lack of communication, strategic opportunism or misconduct (Williamson, 1989). The greater the uncertainty, the higher the TC (SABIP, 2010), sometimes to the extent that uncertainty prevents transactions from taking place at all. The impact of uncertainty on costs is connected with, and primarily results from, opportunism and bounded rationality (Anding and Hess, 2002).

Bounded rationality corresponds to the fact that human decisions are limited by the information available, their ability to analyse that information, and the time they have to make a decision (Simon, 1997). More generally, decisions become less "rational" (and hence uncertainty is increased) due to (Anding and Hess, 2002, based on Shapiro and Varian, 1998):

- a wider availability of transaction opportunities (with more content being available and technology enabling Internet users to have access to services and content from all around the world)
- the fact that information goods (i.e. musical works) are difficult to value

Opportunism corresponds to the fact that no business partner can completely trust the other. This mainly has an impact on negotiations, since each contractor tries to assess the risks and put in place written clauses to protect them from opportunistic behaviour. Thus, right holders can be more reluctant to reach an agreement because, among others,⁴⁶ they suspect online music service providers do not respect copyright (Anding and Hess, 2002).⁴⁷ This can also have an impact on identification costs because right holders have the incentive to allow online music service providers to meet all the identification costs (Varian, 2010).⁴⁸

The uncertainty is reinforced by the lack of transparency around repertoire ownership, i.e. the lack of information available on which work belongs to which right holder(s). The service providers are dependent on the information about rights ownership, and this information is controlled by right holders. In addition, the music services providers which were interviewed complain that right holders, and in particular CMOs and some of the new licensing entities, are unable to properly identify their own catalogue of works and rights.

Because the use of music content by online services is relatively new, transactions take place in an uncertain environment, which may make partners more reluctant to reach an agreement. In particular, the advent of online music services constitutes a disruptive innovation (Christensen, 1997) for the recording industry with the entrance of new players which experiment with new business models.

⁴⁵ This may explain why Spotify's shareholders include all the music major companies and MERLIN.

⁴⁶ Another reason that is less connected to TC is the possible cannibalisation from pay-as-you-go through streaming services (see section 1).

⁴⁷ Here again we see the links between ex ante and ex post costs: if a partner foresees that ex post costs will be too high (e.g. for a right holder to prevent the service to give unlimited access to consumers in order to gain popularity, cf. Universal vs. Deezer), it may spend more time ex ante negotiating. Also if agreements are too costly to monitor (to make sure that the service does not exceed the rights it as granted) then the right holder may not accept any transaction at all.

⁴⁸ The opposite is true in theory (online music service providers are incited to let right holders search for the service providers' identity and enter into contact with them) but in reality the music service providers are dependent on the right holders' agreement for their services to be available, rather than the other way around .

- Therefore, it is expected that some online music services will face higher TC than others because they are new players, i.e. **online music services owned by traditional music industry players face lower TC**. These services have the most experience in the music industry and as a result should be able to identify the right holders more easily, they may also have more credibility when negotiating (especially compared to newcomers such as most online music services). In addition, they may already own or manage rights.
- The online music services that are the most innovative in terms of business models will face higher TC, i.e. **online music services that propose streaming or subscription services face higher TC than services which operate on a download-to-own model**. In addition, the agreements the service providers obtain may not allow them to easily modify their business model (e.g. their commercial offer).

3.2. WHERE THE TRANSACTION COSTS ARE: AN ANALYSIS BASED ON A SAMPLE OF SERVICES

3.2.1. General considerations: total transaction costs and their impact on the roll out of new services

Online music rights licensing is a costly process for online music services. However, until now, no study has attempted to quantify the Transaction Costs within the licensing process, in particular from the point of view of the service providers. The questionnaires, undertaken for the study, provide the basis for estimates on TC and their links to the willingness of online music services to be available in either one or several European markets.

According to the estimates (see the Annex 1 for the whole methodology), services available in several countries, and with an offer of more than 1 million titles, could face transaction costs of up to €260,000 and employ six full-time equivalents staff (FTE, see Annex 1 for the definition). Whereas services available in only one country and with a very small (less than 2,000 titles) and specialised catalogue (e.g. in local indie rock) could face yearly spending of €6,000 and employ 0.5 FTE.

The difficulties faced in the licensing process also impact the dynamics of the market, specifically the time needed to launch a service. Thus, they can slow down innovations, such as the release of new services (in particular services relying on an innovative business model). The approach used in this study does not allow the impact of TC on the time taken to launch a service to be quantified. This is because TC theory is more relevant to static analysis (Nooteboom, 1992). It is also possible that the time taken to identify, and negotiate with, right holders, does not cause a delay in the launch of the service because other processes take place at the same moment (e.g. technical development of the platform).

Taking into account all these limitations, according to the estimations, the identification of the right holders can take up to six months. The negotiations can take as long as two years. Although the estimations should be treated cautiously, they show that these limitations can slow down the rolling out of new (and in particularly innovative) online music services.

The following subsections detail the key factors which impact on transaction costs. The size of the sample of services does not allow for a complete analysis of the impact of every factor. Therefore, for every factor identified and analysed here, the figures do not necessarily isolate the impact of a given factor.

3.2.2. Fragmentation of rights increases the transaction costs for the music service provider

The fragmentation of rights relates to the fact that every music track will have several right holders or right managers, which may differ according to the country (see Chapter 2). When rights are fragmented every use of a track requires multiple authorisations, from several right holders, thus a higher number of transactions takes place. Fragmentation of rights is one of many factors to influence TC. In particular, it increases TC for online music services available in several countries and/or with a bigger catalogue.

The fragmentation of rights adds to the uncertainty of the environment in which the service providers operate, and service providers frequently claim that they are rarely sure that for any track or repertoire they have acquired all the relevant rights. Rights ownership depends partly on recording contracts, which are often difficult to trace. In many cases, contracts have been drafted years before online music platforms appeared and therefore do not refer to uses that could be particularly relevant to online distribution, e.g. the making available of individual tracks. Thus in 2010, Pink Floyd won a court claim against EMI which prevented the record company from selling single downloads of the band's concept albums on the internet (Croft, 2010). In the end, Pink Floyd and EMI reached an agreement, which allowed Pink Floyd's music to be available as individual tracks and as albums (Castillo, 2011). However, this shows that online music service providers may be dependent on litigations of which they are not part.

Uncertainty is further reinforced by the lack of identification systems and databases, in particular in CMOs and some new licensing entities (see Chapter 2). In addition, the fragmentation of repertoires that has recently taken place in Europe may add yet more uncertainty (cf. the lack of transparency of the repertoire ownership, see 3.1.2.). The internet exacerbates the problem by enabling more uses and because the technology makes it easier to go beyond national borders.

For all these reasons, the fragmentation of rights increases identification and negotiation costs (Working Group on Copyright, 2011).

3.2.3. Multi-territory services face higher transaction costs

Online music services were distinguished according to whether they are available in several (EU) countries or in one country. As expected, TC are higher for services available in several countries than for those available in only one country.

Services in the sample which were available in several countries use twice the manpower for licensing rights than services available in only one country (respectively 3.1 and 1.7 FTE). Expressed in financial terms, (thus taking into account wages, see the Annex), total costs are four times higher for services available in several countries (€118,000) than in one country (€29,000).⁴⁹ The main reason is that online music service providers need to duplicate their costs when they make their service available in another country. With the absence of easy means to acquire multi-territory licences, TC constitutes a huge barrier for online music services which aim to operate in all EU countries (see also chapter 2).

In particular negotiations are more costly for services available in several countries. Thus it takes them on average, one year and three months to negotiate with major publishers, compared with nine months for services available in one country. It also takes them on average three months to negotiate with CMOs for authors, in comparison to one week for services available in one country.

This important finding confirms the conclusions in the literature (e.g. Leurdijk and Nieuwenhuis, 2011a) and those drawn from interviews. It should however be qualified in a number of ways. First, our argument is that licensing with one local right holder (e.g. CMO) results in lower TC than acquiring a multi-territory licence, but this does not necessarily mean that licensing with many (e.g. 27) local right holders to get the equivalent of one multi-territory licence results in lower transaction costs than multi-

⁴⁹ Due to the lack of respondents, it is not possible in the figures provided here to completely isolate the impact of the number of countries from other factors (e.g. the size of the catalogue).

territorial licences. Thus, a situation in which every right must be acquired on a strictly territorial basis is inadvisable, even though it is moderately easy to acquire a licence in every territory.

The Service E case illustrates the fact that services available in several countries face higher TC, notably in terms of negotiation (see also the Annex 1).

Description of the service (Service E)

An established online music service that provides permanent download and streaming services (pay-as-you-go and subscription). The catalogue is large (the largest in our sample) with 17 million titles but the number of available titles varies according to the country. The service is available globally.

Specificities of TC

The online music service faces important TC around €220,000 every year, according to their own estimation and confirmed by our calculations based on the number of people employed to identify and negotiate contracts. Negotiation costs appear particularly high, since it takes the service between one and two years to negotiate with right holders.

Lessons learnt

The large TC faced by the online music service are due to the fact that the service has a large catalogue and is available in many countries. The service provider identifies the fragmentation of the rights and the geographical scope as the main sources of TC. Accordingly, the length of negotiation on tariffs is identified as one of the main bottlenecks to establishing the service. For these reasons, the catalogue varies according to the country.

This case is a typical example of how TC (in particular negotiation costs) vary with the categories of right holders. All right holders with whom the service provider negotiates are considered to be difficult ("unreasonably costly or time-consuming") but it takes twice as long to negotiate with major record producers, compared to indie record producers.

This case exemplifies the problems faced by services that would like to present a large offer available at the European level.

3.2.4. The type of right holders has an impact on negotiation costs

The analysis shows consistent differences in terms of negotiation costs according to the type of right holders the online music service provider is dealing with. Five categories of right holders were identified (see Chapter 2):

- CMOs granting territorial licences
- New licensing entities and CMOS granting multi-territorial licences
- Major record producers
- Independent record producers
- Aggregators

The analysis confirms that the greatest negotiation costs are faced in negotiations with major record producers and new licensing entities. This confirms that majors wield their higher negotiation power based on the size of their catalogue and the fact that they are unavoidable partners for most online

music services.⁵⁰ Accordingly, all respondents rated the negotiations with majors as “unreasonably costly or time-consuming”. The distinction between CMO and indies is less straightforward. For most services in the sample, negotiations are as long with CMO as with indies.⁵¹

Finally, it is worth noting that transaction costs concerning the negotiation with the new entities created by the major publishers for multi-territorial licensing are still very high (as indicated by one respondent, negotiations can take up to 2 years).

3.2.5. Services that propose a bigger catalogue incur greater transaction costs

Online music services were distinguished according to the number of titles in total in their catalogue (irrespective of the size of the catalogue for every territory). A distinction was drawn between services with a catalogue of around 1,000 or 2,000 titles⁵² and those with more than 1 million titles.

As expected, TC are higher for services providing access to a higher number of titles. There is however no proportionality in the cost gap.⁵³ This is illustrated when comparing the cases of Service E and the Service A. The main difference between both services is the size of the catalogue. Service E offers 17 million titles and incurs costs equivalent to around €220,000 every year to identify and negotiate with right holders (see box). Whereas, Service A offers around 100 albums and incurs costs equivalent to around €6,500 (see box).⁵⁴

Description of the service (Service A)

An online music service that provides a small and highly specialised catalogue for download (pay-as-you-go). The service belongs to independent publisher and record label that owns the catalogue, around 100 albums related to indie Czech music. The service is available globally.

Specificities of TC

The online music service incurs TC among the lowest of all the services in our sample (around €6,500). TC are however high when compared to the size of the catalogue available. Identification costs are very low with the almost immediate identification of right holders, due to the fact that the service is related to a record label and hence there are already agreements (on other rights) between right holders and the service provider. Negotiation costs are reported only for CMOs for authors and it takes on average one month to negotiate, which is considered to be reasonably costly.

Lessons learnt

The online music service incurs lower TC than the other online music services, although it is available at the EU level and beyond. This is due to the specificities of its offer, which is small and aimed at a niche market. This is combined with its reliance on a more established business model (permanent download with pay-as-you-go). However, the market is potentially so small that it is very unlikely that the service recoups its TC. In fact, the service still incurs substantial costs compared to the size of its catalogue, even though it already owns a substantial portion of the rights.

⁵⁰ For example, it takes one year for Service A to negotiate with major record producers while it takes only one week with indie record producers or with indie publishers. Similarly for Service E, it takes one year and a half to negotiate with new licensing entities, two years with major record producers and ‘only’ one year with indie record producers (see also box...).

⁵¹ E.g. one month for Service A.

⁵² Some services only gave information on the number of albums in their catalogue. We assumed that 1 album = 10 tracks.

⁵³ Thus, it takes two months for the services with a catalogue of less than 2,000 titles to identify right holders against four months for those with a catalogue of more than 1 million titles. Services with a catalogue of more than 1 million titles employ in average 4.7 FTE to deal with the licensing of rights, which costs them in average €163,000. On the other side, services with a catalogue of less than 2,000 titles employ in average 0.7 FTE to deal with the licensing of rights, which costs them in average €9,000.

⁵⁴ Part of the difference is due to the fact that both services negotiate with different right holders. Actually service A already owns the rights for most of its catalogue and hence does not have to deal with majors. On the other hand, both services need to negotiate with CMOs for authors, and these are much faster for service A (one month) than for service E (9 months).

3.2.6. The level of transaction costs depends on the service providers' main activity

Online music services were distinguished depending on the main activity of their provider: pure online music services (services that are independent or belong to online content providers); companies that are technology-driven (e.g. producing mobile devices or ISP); and record labels.

TC are expected to be lower for services whose providers' main activity is a record label. The result is clearly demonstrated for identification costs, which are the lowest for record labels (almost immediate) compared to online music services (ten weeks) and technology companies (six months).

3.2.7. Services based on more established business models face lower transaction costs

Online music services were distinguished according to their business model.⁵⁵ As discussed in Section 1, services providing permanent downloads generally function on a pay-as-you-go basis (or sometimes by subscriptions); streaming services rely on subscriptions.⁵⁶

Streaming services are more recent than downloading services. In addition, downloading services' revenue model is more alike to the traditional revenue model in the recording industry based on the sales of recordings. Therefore, streaming services are expected to face higher TC than downloading services, in particular in their negotiations with right holders.⁵⁷

⁵⁵ In particular according to their revenue model (pay as you go; subscription; advertising-based) or their type of content service (permanent download; streaming).

⁵⁶ Other business models include freemium and cloud services (see section 1). They were however not included in the sample.

⁵⁷ Actually, streaming services in the sample employ 3.9 FTE to deal with online music rights licensing against 2.6 FTE for downloading services, i.e. respectively €133,200 and €95,400. Thus Service A faces lower TC also because it relies on a traditional business model (see also box...).

CONCLUSIONS

According to the estimations based on the survey, an online music platform aiming to provide multi-territorial services in Europe would have to invest at least €230,000 in transaction costs alone to get a licence for a catalogue of more than one million titles. This is a large amount given that most online music services still do not break even and that this figure only refers to transaction costs and must be considered by the service providers in addition to other key investments, notably technological infrastructure and licence fees.

The **fragmentation of rights, right holders and repertoires** is the cornerstone of the problem. Online music service providers willing to set up multi-territorial services need to enter into negotiations with a multiplicity of right holders and managing entities: record producers, aggregators, CMOs for publishers and authors, new entities for publishers' rights, etc. They need to acquire two rights (the making available and the reproduction right), which can be split between different right holders for the same title. While for record producers' (and performers) rights licensing seems to be less time-consuming and costly, mainly because all the relevant rights are usually concentrated on a single kind of right holder (the record producer), rights licensing for authors' and publishers' rights seems to be much more complex. Although the major publishers' withdrawal of rights from CMOs in relation to the Anglo-American repertoire has provided a one stop shops for some rights, it has also caused a further fragmentation of repertoires. It does however seem that major publishers increasingly re-aggregate their rights to CMO's repertoires for certain licensing activities, (mostly local online services) in order to streamline licensing processes (interviews; EC 2012 p.162).

This multiple fragmentation together with territorial licensing practices make it extremely costly to license **multi-territorial services**. The existing initiatives of multi-territorial licences issued either by new entities created by the major publishers or by CMOs on their own repertoire (and sometimes on the repertoire of neighbouring CMOs⁵⁸) have only partially contributed to the facilitation of the process. Clearance of multi-territorial licenses is still a very costly process and does not prevent legal uncertainties – it is not clear if the new entities, usually hosted in CMOs, are governed by national rules on collective management (EC 2012, p. 26 and footnote 121). At present, service providers aiming to deliver music in several territories need to obtain multi-repertoire mono-territorial licences from local CMOs in addition to the existing multiterritorial licences for authors and publishers rights. As regards record producers' and performers' rights, clearance usually goes through direct licensing. Record labels commonly provide licenses themselves or go through intermediaries on multi-territorial basis so that the process is more straight forward – without prejudice of the factors mentioned below. All this amounts to a considerable number of lengthy transactions.

The **bargaining power** of certain right holders puts service providers (particularly medium to small service providers) in a difficult negotiating position. Within the music industry, major publishers and record producers, account for almost 75 % of the market and have an important bargaining power in terms of negotiating rates and conditions, as they hold the assets that online music services with a generalist catalogue need to acquire. They seem to make extensive use of this bargaining power, according to interviews with service providers. The transaction costs analysis indicates that negotiation with major publishers and record producers usually takes much longer than with independents and CMOs. In addition, major right holders ask for advances to be paid by online music service providers when acquiring licences. While the largest online music services may either have enough bargaining power to refuse such payment or be able to pay, this might be a major impediment for small businesses and start-ups in launching an innovative service offering a general music repertoire.

⁵⁸ As reported in the EC's Impact Assessment: "Some CS already entrust their rights to other CS for the purpose of MT licensing of online services: e.g. the Irish society's (IMRO) rights are licensed by the UK society (PRS) and the Portuguese society's (PTA) rights are licensed by the Spanish society (SGAE)." (EC 2012, p. 44 note 154)

Negotiations with majors for start-ups with uncertain revenue streams, is therefore even longer and more cost-intensive. Advances may represent a substantial amount of money for a start-up, which will not necessarily be quickly recouped through revenues. The Czech start-up i-legalne, the first licensed Czech online music service operating from 2008 to 2011, failed to succeed in the market partly due to the high advances and minimum guarantees requested by major publishers (Interview and Kovalik 2011). In certain cases, they may conclude other agreements for instance including majors as part of share holders, as is the case for Spotify or the Czech service Musicjet.

On the other side, it seems that the largest music service providers enjoy a stronger bargaining situation in the market, as they are leaders in terms of revenues and popularity. When negotiating with less powerful right holders (small independent producers and collecting societies) they are in a position to impose their conditions on rates and thereby often set the conditions for tariffs and conditions for the all the music service providers (interviews with collecting societies, service providers and aggregators).

For newcomers the situation may be even more complicated. Services providers that have had a traditional role in the music industry will incur lower transaction costs than other actors. This may be due not only to the fact that these actors often own the relevant rights, but also to the fact that they have much more information and knowledge about the music industry, its functioning and the key players. Such service providers may face less asymmetry of information towards right holders: knowing the music industry, they are less likely to make costly mistakes to be 'duped'. Every actor in the online music industry faces the uncertainty related to the emergence of a new market with new technologies and business models that have to be explored. However, online service providers from outside the traditional music industry, face the additional uncertainty of having to understand the functioning of such an industry.

This together with the finding that the more innovative the business model, the bigger the transaction costs makes **things particularly difficult for online music start-ups**. Collecting societies and major right holders usually make use of standard agreements to set out the conditions under which licences will be granted or acquired and eventually leave a very small margin for negotiation for the contracting party to which the agreements are imposed. At the theoretical level, standard agreements can accelerate negotiations and encourage incomers (here: potential online music services) to enter the market as prices are "posted" in advance (Williamson, 1989). This is certainly true for traditional music services offering simply download or streaming services where the use of standard agreements accelerates negotiation processes substantially (especially in relation to negotiations with CMOs). However, unusual services offering hybrid services or innovative revenue models always take longer to negotiate licences as standard agreements need to be adapted. The same may be true for start-up services for which right holders will take longer to examine the viability of the business model and the ability of the service to pay royalties⁵⁹.

It can thus be assumed that if start-ups are newcomers with no previous links to the music industry the situation is even more complicated and transaction costs may be even higher.

Finally it is worth noting that an additional factor multiplying transaction costs is the **right holders' inability to properly identify their own catalogue of works and rights and the lack of uniform standards for the monitoring, reporting and invoicing of related uses**. Licensing processes are further complicated by the fact that it is often difficult for online music service providers to obtain information on what rights they are acquiring. Various standards and reporting systems are in place at present and while the record producers seem to have found one standard system, (the International Standard Recording Code) CMOs, who are used to operating in an environment in which they deliver blanket licenses for their whole repertoire, are (still) not able to deliver lists of rights granted in a license (Mazzioti, 2010, p. 30 and EC 2012, p.25). As a consequence, in order to be certain that they have acquired all necessary permissions, music service providers claim that they have to accept paying for some rights several

⁵⁹ Nevertheless, as one respondent has indicated, due to the limited bargaining power of start-ups, negotiations can potentially also be quicker.

times (EC, 2012, p.25), as collecting societies, and even publishers (interviews), are often technically not able to provide exact information on the rights they administer. This uncertainty has been identified as an impediment to the easy and quick licensing negotiations with the CMOs and new licensing entities and online music service providers often ask for guarantees in this respect to CMOs. While this problem is difficult to isolate from identification and negotiation (*ex ante*) transaction costs, it is mainly a problem of *ex post* transaction costs, which are outside the scope of the study. However, a detailed analysis of this problem can be found in the European Commission's impact assessment on collective rights management (EC, 2012, p. 25).

Efforts to establish reporting and database management standards for authors' and publishers' rights are ongoing, but there seems to be no satisfactory system in use at the moment. First the European Commission established the Global Repertoire Database Working Group in 2009 to investigate how a global repertoire database could be established and function. This cross-sector initiative includes EMI Music Publishing, Universal Music Publishing, iTunes, PRS for Music, STIM and SACEM, ECSA (the European Composer and Songwriter Alliance), ICMP (the International Confederation of Music Publishers), CISAC (the International Confederation of Societies of Composers and Authors), Google and Omnifone. The working group has appointed the International Copyright Enterprise (ICE) as the technology solution provider and Deloitte as project manager to support the delivery (PRS, 2011).

Also, the entities CELAS, GEMA, SACEM, SACEM/DEAL, PRS for Music, PAECOL and ARMONIA have developed a common standard - the CCID-standard (Claim Confirmation & Invoice Details) to standardise files accompanying invoices and to improve communication between licensors and licensees (SACEM, 2009).

Finally, the CISAC has begun to develop a common information system (CIS) for identifying and exchanging information about music works and metadata and to provide a common gateway, called CISNet, which would link CMOs' databases around the world (Butler, 2010). Yet, it seems that the implementation of such a system for identification and management of data is not followed by all CMOs, as these often still prefer to use the systems they have been using for a long time (Butler, 2010).

All these factors contribute to slow the licensing process and therefore the setting up of cross-border European services. In this context, transaction costs are particularly high for:

- services operating at multi-territorial level offering a generalist repertoire, as they have to identify, and negotiate with, a significant number of right holders.
- services experimenting with hybrid and/or innovative business models, due to uncertain revenue streams and consumer acceptance of their business models, which decreases their bargaining position, as well as their capacity to lead lengthy negotiations with right holders.
- services launched by new market entrants, such as internet service providers, pure players or mobile device operators and manufacturers, who have no long-lasting link with the traditional music industry (record labels or publishers), as these might lack important knowledge about the functioning of the music industry when setting up those services.

IS THERE A WAY TO DECREASE TRANSACTION COSTS?

In order to decrease the transaction costs and the impact of the above mentioned factors for multi-territorial licensing different options can be considered. The options presented below are intended to streamline the licensing process, create a level playing field for the different players and foster innovative services by combining minimum regulation with certain competition among licensing entities.

Against the fragmentation of rights, the most efficient solution seems to be to **bundle the mechanical and performing rights for digital uses** in a single right. This would help to facilitate negotiations with regard to authors' and publishers rights, in particular of Anglo-American repertoire for which today, licences have to be cleared in separate transactions. In addition, the **promotion of (contractual) mechanisms to concentrate the relevant rights on a single right holder** (as it is already the case in relation to record producer's and performers' rights in the hands of the record producers) would help to neutralise the effects of the fragmentation of rights and lower identification costs.

Defining the way to promote repertoire aggregation for multi-territorial uses is more challenging. Mandatory collective management or the creation of a central body (a kind of Europe-wide one-stop shop) issuing multi-territorial licenses would in principle facilitate the licensing process but would negatively affect the establishment of innovative business models since monopolist entities are by nature adverse to taking risks. Moreover, a system allowing every European CMO to issue multi-territorial licences would not necessarily guarantee that all European CMOs have the infrastructure in place necessary to manage these licences.

For these reasons, it seems that a system of **multi-territorial extended⁶⁰ collective licences run by those CMOs capable of managing big repertoires** would be much more efficient. This would force a selection of (in theory) the most responsible and efficient entities to comply with certain requirements and to compete to issue multi-territorial licensing. Because of the extended effect of these societies they could aggregate the repertoire of all the (national) right holders that do not opt out of the system to their own repertoire⁶¹. They should be required (although under certain conditions) to accept the request of other CMOs or foreign right holders to aggregate their repertoire to local ones and could even be required, under certain conditions, to have "(almost)-all included" repertoires licensed in order to guarantee cultural diversity (a kind of "must-carry" rule). This option is not very far from the European passport for multi-territorial licensing for CMOs put forward by the recently published proposal for a Directive on collective rights management (Proposal for a Directive Title III). CMOs that comply with certain requirements notably in terms of identification, data handling, invoicing capabilities, etc. would be able to issue multi-territorial licences (Proposal for a Directive, article 21 et seq.). By including such mandatory requirements, the proposal addresses one of the main obstacles for multi-territorial licensing: to ensure the identification of rights and right holders –at least of those managed by CMOs– and to guarantee that (some) entities issue multi-territorial licences which are really capable of dealing with the requests of service providers and of invoicing services and remunerating right holders in reasonable terms. However, it is not clear if the proposal applies to the new entities created by the publishers nor how important provisions of the proposal (e.g. rules on repertoire identification and data processing) could be enforced in a meaningful manner.

Furthermore this last measure would guarantee the compatibility of collective management with direct licensing by individual right holders, including under creative commons and other kinds of open licences. However, in order to ensure a level playing field and a competitive market, licensing activities of those with a dominant position in the market should be also under surveillance. In particular, holders of essential facilities for online service providers (notably the majors –either publishers or record labels– or

⁶⁰ The extended effect of these licences would affect only the right holders that would belong "naturally" belong to the Society repertoire (i.e. Spanish composers or publishers as regards SGAE local repertoire). Although one may argue that it would be extremely difficult to identify and report uses concerning those right holders that are not members of the society but that would naturally belong to the society. However, the extended effect would serve as a kind of insurance for service providers that they have cleared all the relevant rights.

⁶¹ The extended effect could be activated at the request of the service provider in relation to specific rights that cannot be identified.

any other entity managing a big repertoire) should be under the scrutiny of the competent authorities to ensure that they **license on fair and reasonable terms**.

An alternative measure that could substantially contribute to diminishing the transaction costs and put pressure on CMOs and right holders is to set up a compulsory license with **common rates**, similar to the one already in place in the US for interactive uses. However, taking into account its limited use in the US, the likely reluctance of *droit d'auteur* countries (where these kind of licences hardly exist) towards such rates, the difficulties in reaching agreements of European scope, the administrative burden that this would entail as well as the level of intrusiveness in the contractual freedom of stakeholders, it seems that this model is not the most appropriate to foster multi-territorial licensing in Europe.

In addition to common rates and in order to break the deadlock in negotiation process, the establishment of a **dispute resolution system** appropriate to multi-territorial licensing should be considered. The uncertainties concerning the legal nature of the new licensing entities as well as the application of existing dispute resolution systems to conflicts concerning CMOs multi-territorial licensing activities, make it necessary to introduce a clear system to solve conflicts concerning these new licences. The system should not only be mandatory to CMOs but also open to other right holders that should be at least encouraged to adhere. Although this is something already considered by the recent EU proposal on collective management (art. 36), the text fails to announce an extended application to other copyright agents or right holders.

Throughout this study, it has been argued that although transaction costs faced during the negotiations with CMOs are very high, transaction costs concerning the negotiation with the majors (both publishers and record producers, and therefore the new entities set up by major publishers with the support of collecting societies) are also considerable. In order to foster a European Single Market allowing for innovative online music services to emerge and develop, the ongoing discussion should take this in consideration and go beyond the provisions on collective management to also consider direct licensing exercised by right holders with a dominant position in the market.

ANNEX 1: METHODOLOGY

INDICATORS

Four indicators were used to quantify and analyse *ex ante* TC for licensing online music rights (see details for the formulas afterwards).

T the **time** spent to identify or negotiate with right holders. In particular online music service providers were asked:

- how long it takes them to identify right holders
- how long it takes them to negotiate with every category of right holders
-

WF the **workforce**, i.e. the number of people employed every year to identify or negotiate with right holders. Online music service providers were asked how many people they employ, which are translated in full-time equivalent (FTE). As respondents had to indicate the number of full-time and of part time employees, an additional assumption was made: part time were considered to be working half time.

R the **rating** given by the respondents. Respondents had to qualify, hence to give their opinion, on various aspects of rights licensing, with possible answers varying from "unreasonably costly or time-consuming" to not very costly or time-consuming". Rating allows the differences in terms of TC between different types of right holders to be expressed and compared. It can also express differences in terms of the impact of x on TC, for example, if one feature of services increases more TC than another.

C the **cost** expressed in financial terms. Respondents very rarely provided indications on the actual monetary costs they face. Therefore, data relative to time and workforce were used to assess monetary costs. Hence the values in weeks were multiplied by weekly wages to obtain the total monetary cost. In the same way, the FTE were multiplied by annual wages (depending on the country where the online music service is based) to obtain the total monetary cost. OECD data were used as sources for annual or weekly wages (OECD, 2011).

FORMULAS USED TO QUANTIFY TRANSACTION COSTS

Quantification of identification costs

- WF_i the average number of people employed to identify right holders:

$$WF_i = \frac{1}{n_i} \sum_{j=1}^{n_i} (Ft_j^i + Pt_j^i)$$

- o where Ft_j^i stands for the number of people employed full-time by service i to identify right holders;
 - o where Pt_j^i stands for the number of people employed part-time by service i to identify right holders;
 - o where n_i stands for the number of services that have provided information on the number of people employed to identify right holders.
- R_j the average rating of costs (i.e. "on a scale from 1 to 5, 1 being the strongest, how would you rate the costs and time spent...?") related to identifying right holders:

$$R_j = \frac{1}{n_j} \sum_{i=1}^{n_j} R_i^j$$

- o where R_i^j stands for the rating of costs given by service i , related to the identification of right holders;

- o where n_I stands for the number of services that have provided information on the rating of identification costs.
- C_I the average financial costs spent to identify right holders:

$$C_I = \frac{1}{n_I} \sum_{i=1}^{n_I} C_i^i$$

- o where C_i^i stands for the financial costs spent by service i to identify right holders:
 - $C_i^i = T_i^i \cdot W_{\text{week, country}(i)}$
 - where T_i^i stands for the time needed by service i to identify right holders (in weeks);
 - where $W_{\text{week, country}(i)}$ stands for the weekly wage in the country where the service i is settled;
- o where n_I stands for the number of services that have provided information on the time needed to identify right holders.

Quantification of negotiation costs

- $T_{N,RH}$ the average time needed to negotiate with a type RH of right holders:

$$T_{N,RH} = \frac{1}{n_{N,RH}} \sum_{i=1}^{n_{N,RH}} T_{N,RH}^i$$

- o where $T_{N,RH}^i$ stands for the time needed by service i to negotiate with a type RH of right holders;
- o where $n_{N,RH}$ stands for the number of services that have provided information on the time needed to negotiate with a type RH of right holders;

- WF_N the average number of people employed to negotiate with right holders:

$$WF_N = \frac{1}{n_N} \sum_{i=1}^{n_N} (Ft_N^i + Pt_N^i)$$

- o where Ft_N^i stands for the number of people employed full-time by service i to negotiate with right holders;
- o where Pt_N^i stands for the number of people employed part-time by service i to negotiate with right holders;
- o where n_N stands for the number of services that have provided information on the number of people employed to negotiate with right holders;

- $R_{N,RH}$ the average rating of costs (i.e. "on a scale from 1 to 5, 1 being the strongest, how would you rate the costs and time spent...?") related to negotiating with a type RH of right holders:

$$R_{N,RH} = \frac{1}{n_{N,RH}} \sum_{i=1}^{n_{N,RH}} R_{N,RH}^i$$

- o where $R_{N,RH}^i$ stands for the rating of costs given by service i , related to the negotiation with a type RH of right holders;
- o where $n_{N,RH}$ stands for the number of services that have provided information on the rating of negotiation costs with a type RH of right holders.

- $C_{N,RH}$ the average financial costs spent to negotiate with a type RH of right holders:

$$C_{N,RH} = \frac{1}{n_{N,RH}} \sum_{i=1}^{n_{N,RH}} C_{N,RH}^i$$

- o where $C_{N,RH}^i$ stands for the financial costs spent by service i to negotiate with a type RH of right holders;

$$C_{N,RH}^i = T_{N,RH}^i \cdot W_{week, country(i)}$$

- where $T_{N,RH}^i$ stands for the time needed by service i to negotiate with a type RH of right holders (in weeks);
- where $W_{week, country(i)}$ stands for the weekly wage in the country where the service i is settled;
- where $n_{N,RH}$ stands for the number of services that have provided information on the time needed to identify right holders.

Quantification of total ex ante transaction costs

- WF the average number of people employed to identify, and negotiate with, right holders:

$$WF = WF_I + WF_N$$

- C the average financial costs spent to identify, and negotiate with, right holders:

$$C = \frac{1}{n} \sum_{i=1}^n C^i$$

- where C^i stands for the financial costs spent by service i to identify, and negotiate with, right holders:

$$C^i = WF \cdot W_{year, country(i)}$$

- where WF the average number of people employed to identify, and negotiate with, right holders;
- where $W_{year, country(i)}$ stands for the yearly wage in the country where the service i is settled;
- where n stands for the number of services that have provided information on the workforce needed to identify, and negotiate with, right holders.

Assessment of the impact of factors on transaction costs

The study identifies several factors which are likely to have an impact on TC (see section 3). To assess the impact of such factors, the previous formulas were applied to sub-samples of services. For example, the analysis confirms that: **$WF(\text{several}) > WF(\text{one})$** , meaning the services that are available in several countries employ more people to identify, and negotiate with, right holders, than the services that are available in one country.

The assessed factors are (see section 3):

- The number of countries where the service is available
- The type of right holder
- The number of titles in the catalogue
- The service provider's main activity
- The type of business model

QUANTIFICATION OF EX ANTE TRANSACTION COSTS - FIGURES

1. Quantification of total ex ante TC⁶²

Every year, online music services employ on average 2.5 FTE to identify, and negotiate with, right holders. In financial terms, *ex ante* TC amount on average to €79,900 per year for every service.

⁶² This does not correspond to the sum of identification and negotiation costs because the databases (questionnaires) are not complete.

These figures conceal a huge disparity among online music services. Actually online music services employ between 0.5 and 6 FTE. The disparity is even higher in financial terms with costs between €6,500 and €257,100. It is important to bear in mind here that this only relates to the TC *ex ante* to license rights. Hence it does not include *ex post* TC (i.e. all costs to make sure that the agreement is rightly enforced), neither does it include the actual license fees paid to the right holders.

There are also important differences between online music services in terms of the most costly activity. For some services, identification is very quick and negotiation takes much longer. Thus, for service E, it takes 3.39 weeks to identify right holders but between six months and two years to negotiate. For Service C, identification takes anything between one week and one year, but so does negotiation with indie publishers or record producers. For this service, negotiations with CMO for authors however only take one week.

2. Quantification of identification costs

It costs on average €2,600 for the services to identify all the right holders in relation to their catalogue. Expressed in time, it took them two months.

Again, this average hides a great disparity between services. For some services, the identification of right holders was almost immediate, in particular those which have a very small catalogue and work with right holders that they already know. In the worst cases it was reported that it took six months to identify right holders, which corresponds to a cost of €6,500. Therefore, some services rated the time spent to identify right holders as "not very costly or time-consuming" and others found it to be "unreasonably costly or time-consuming".

3. Quantification of negotiation costs

No average was calculated for negotiation costs since the type of right holder appears to play a crucial role here.

In fact, it takes more than one year on average to negotiate with majors (publishers or record producers) for an average cost of more than €40,000. Negotiations with indies are on average less costly. It takes a bit less than four months to negotiate with indie publishers and a bit less than seven months to negotiate with indie record producers. Negotiations with CMOs are the easiest, taking on average two months or less and costing less than €7,000.

UNITED KINGDOM

Authors

The UK Copyright, Designs and Patents Act (CDPA)⁶³ from 1988 protects musical works (CDPA s. 3(1)) as well as sound recordings (CDPA s. 5B (1)). Authors of musical works, considered as authorial works together with literary, dramatic and artistic works, are those persons who create the work (CDPA section 9 (1)).

An author of sound recordings, considered as entrepreneurial works, together with films, broadcasts and the graphical arrangements, is the "producer" (section 9 (2)(aa)), who is defined as the "person by whom the arrangements necessary for the making of the sound recording are undertaken" (CDPA section 12 (3)). This should be understood as the entity which paid for the sound recording (Harrison, 2011 p.76), usually the record company (Bently&Sherman, 2009 p.123). Usually, recording contracts deal explicitly with the allocation of ownership of copyright and while in many cases a range of different people may have been involved in the sound recording, UK courts have made it clear that the "producer" implies organisational involvement and control over the process of production, rather than technical involvement in the recording. However, in cases where sound recording is produced through the collaboration of different people, using non-traditional modes of distribution, such as the internet, might be difficult to determine the producer (Bently&Sherman, 2009 p.123).

The Copyright act views authorial works as products of creativity which have to comply with the criteria of originality, while entrepreneurial works are seen as products of investment and do not have to comply with the criteria of originality (Bently and Sherman, 2009, p.93).

The two relevant rights for online licensing of music, that is the reproduction right and the making available right, are granted to the copyright owner. These two rights are part of the so-called "restricted acts" (section 16), and are explicitly seen as the exclusive right to copy the work (reproduction right) (section 17) and the exclusive right to communicate the work to the public (section 20). In relation to the reproduction right, it should be noted that the CDPA considers that the right is infringed whether the copy is permanent, transient, temporary or incidental to some other use of the work (CDPA section 17 (6)).

In the CDPA the communication to the public right, includes the making available of the work to the public by electronic transmission in such a way that members of the public may access it from a place and at a time individually chosen by them (Section 20 (2) (b)).

The CDPA also grants the copyright owners the right to transmit by assignment, by testamentary disposition or by operation of law their copyright (section 90(1)). The transmission may also be partial (section 90 (2)). Hence, the author of a musical work (composer, lyricist) can assign or license their rights to someone else, which would be generally the publisher or the CMO. If an author assigns his or her rights to somebody, the assignee becomes the copyright owner. An exclusive licence on the contrary, does not confer the status of copyright owner to the licensee, and thereby provides limited rights and remedies.

⁶³ <http://www.ipo.gov.uk/cdpact1988.pdf>

In the UK, authors generally assign their reproduction rights to publishers (so-called mechanical rights) and transfer their communication to the public rights (so-called performing rights) to the collecting society PRS (Mazzioti, 2011, p.17).

In relation to the assignment of reproduction rights to publishers, authors may receive a royalty or a lump sum payment; however this is not determined by the CDPA. Everything depends on the agreement between assignee and assignor (Bently&Sherman, 2009 p.262). Publishers in the UK used to charge the collecting society MCPS to administer their rights for them, not as assignee, but as an exclusive agent (Mazzioti, 2011, p.17).

Performers

Performers and people with recording rights in their performances benefit from protection under the Copyright law, although this has only been the case since the CDPA came into force on 1 August 1989 (Stokes, 2009, p.31). The Act protects live performances (section 180 (2)), including recordings, as well as sound recordings made directly from the live performance or from a broadcast of the performance or made directly or indirectly from another recording of the performance (section 180 (2)).

Performers and record producers

Performers have the right to authorise any recording of live broadcasts of their performances (section 182). In addition, they have the right to consent to the exploitation of these recordings, which includes the right to authorise the reproduction of recordings (section 182 A) and the right to authorise the making available to the public of recordings (section 182CA). They have also the right to authorise the exploitation of recordings made without their consent (sections 183 and 184). Performers can license or assign these rights in whole or partly (section 191B), but any assignment and exclusive licences must be done in writing and signed by the assignor (section 191B(3) and section 191D). Performers are not granted equitable remuneration for the exploitation of sound recordings when the sound recording is made available online through on demand services (section 182D(1) (Bently&Sherman,2009,307).

Record producers are considered as authors under section 9(2)(aa) of the CDPA, which designates the author of the sound recording is the "producer". They are granted the right to reproduction of the sound recording (section 17), as well as the right to communicate it to the public, including the making available right under section 20 of the CDPA.

SPAIN

Authors and publishers

The Spanish law on intellectual property grants authors the exclusive rights to authorise or prohibit the reproduction and the communication to the public (and the making available of their work to the public) (article 17). Indeed in Spain the right of communication to the public encompasses the making available right (article 20.2i)).

Under the Spanish system, by virtue of the contract of music publishing, the author transfers the rights of reproduction and distribution (article 58), as well as the right of communication to the public, to the music publisher (article 71) (Bercovitz &Cano,2003, p.183; Teocalda, 2004)) on exclusive or non-exclusive basis, so that the publishers exploit the work in exchange for participation part of the economic benefits generated by this exploitation (art. 6)(AIE, 2009). As commonly specified in publishing

contracts, these rights are to be managed by the authors' and publishers' collecting society SGAE (as far as the withdrawal of publishers rights is concerned see infra section 2.2.3). Division of economic benefits is usually fifty-fifty.

Performers

Performers are given the exclusive right to authorise or prohibit the reproduction of the fixations of their performances (article 107). The performer also enjoys the exclusive right to authorise or prohibit the making available of fixations of his/her performances (article 108.1.b)).

Spain is the only country that has gone further in the implementation of the international and European texts and has added another level of protection for performers' rights. Inspired by the right to equitable remuneration that commonly applies to certain communications to the public, Spain recognised in the law implementing the Copyright Directive a remuneration right for making available which can only be fully understood if read in parallel with another innovation in the Spanish law: the *iuris tantum* presumption under which the exclusive right of making available is transferred to the record producers. The remuneration right cannot be waived and must be paid by the person who makes available the phonogram -i.e. the online music provider (section 108 of Spanish Copyright). In order to make it effective, it is mandatorily managed through CMOs - in this case through AIE: the performers' collecting management organisation. Although because of its novelty, this right was difficult to enforce initially (AIE,2009), AIE has already concluded several agreements with online operators. Most recently with Spotify.

In light of this, online music providers willing to provide music performed by Spanish artists must enter negotiations with AIE around the fees to be paid for the performers' remuneration right concerning making available - notwithstanding the negotiations with the record producers to acquire the record producers *and performers* exclusive making available rights.

Producers

Record producers are also granted the exclusive rights to authorise or prohibit the reproduction and the making available to the public of their phonograms (articles 115 and 116.1).

CZECH REPUBLIC

Authors

The Czech Copyright Act⁶⁴ protects in article 2(1) musical works, along with literary, dramatic, musico-dramatical, choreographic etc. works. It considers the person who created the work to be the author (Article 5(1))(Diblík&Veit, 2012 p.138ff). Authors are granted the right to reproduce a work under article 13 and the right to "communication to the public" under article 18. The reproduction right includes temporary or permanent, direct or indirect copies of the work, or parts of it, in whatever for and through whatever means. The right to communication to the public includes also the right to make the work available in such a way that members of the public may access at a place and time they choose, especially by using a computer network or similar network (article 18 (2)).

⁶⁴ Czech Copyright and Neighbouring Rights Act n°121/2000 Sb. last amended by law n°153/2010 Sb. and law n° 424/2010 Sb. in 2010 English version of the law, last amended in 2006 is accessible at <http://www.mkcr.cz/cz/autorske-pravo/zakon/predpisy-v-anglickem-prekladu-7613/>

Under Czech law, authors cannot transfer their rights (and article 26 (1)) (Tuma, 2007, p.11). However, the author may grant another person, through a licence agreement, the authorisation to exercise some or all rights of use for the work (article 46). Licences have to respect three conditions: the author cannot grant licences for the exercise of rights in a way unknown at the moment of signature (article 46 (2)), the licensee is obliged to exercise the rights granted effectively, unless agreed otherwise (article 46 (3)), and each licence agreement has to be concluded in writing (article 46 (4)). The licensee may also grant a sub-licence to a certain person or grant a licence to a third person (article 48). Any contract must foresee remuneration (article 46 (1)) to the author or at least the way such remuneration is calculated (article 49 (1)). For any licence to a phonogram producer, for the reproduction of the fixed musical work, the author has the right to equitable remuneration (article 49 (3)).

Publishers

Article 56 specifically deals with publisher's licensing agreements stating that any licensing agreement by which the author grants a licence to reproduce and distribute a literary work, a musico-dramatical or musical work shall be a publisher's licence agreement. In this case, unless otherwise agreed between author and the publisher, the licence is deemed to have been granted exclusively (article 56 (2)).

Performers

Performers, are given the exclusive right to authorise or prohibit the reproduction of the fixations of their performances (article 71 (2)c). The performer also enjoys the exclusive right to authorise or prohibit the communication to the public of his/her fixed performance (article 71 (2)g).

Performers are also granted the right to remuneration for any use of the performance fixed on a phonogram published for commercial purposes (article 72 (1)). This right can only be exercised through the CMO. However, it only includes radio and television broadcasting or re-transmission, the article does not mention making available to the public.

Record producers

Phonogram producers are granted by article 76, the exclusive right to use their phonograms and in particular the right to reproduce to phonogram (article 76 (2) a) and the right to communicate to the public (article 76 (2) e). They have to pay equitable remuneration to the authors for the reproduction of any phonogram (see above and article 49 (3)).

ANNEX 3: LIST OF CONSULTED INSTITUTIONS

All interviews were conducted on a confidential basis, therefore no names of interviewees are provided in the list below.

- Eight music service providers (four in the Czech Republic, two in Spain, two international)
- British collecting societies, PRS for Music authors and publishers
- British collecting society for performers and record producers, PPL
- Spanish collecting society for authors and publishers, SGAE
- Spanish collecting society for phonographic producers' rights, Agedi
- Spanish Collecting society for phonographic producers' rights, AIE
- UFI, the Spanish Independent phonographic union
- Czech collecting society for authors and publishers, OSA
- Czech journalist specialising in online content markets
- Promusicae, Spanish organisation representing record labels
- Two independent record labels (UK and Spain)
- Two aggregators (UK and Spain)
- One international legal expert on licensing for online services
- PIAS
- MERLIN
- IMPALA

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