

# Music Collecting Societies and Webcasting

*Mr. Ville OKSANEN, Mr. Mikko VÄLIMÄKI*

*Helsinki Institute for Information Technology (HIIT)*

*P.O.Box 9800, FIN-02015 HUT, Finland*

Tel: +358 50 598 0498; Fax: +358 9 6949768

[ville.oksanen, mikko.valimaki,]@hiit.fi

Most academic work on copyright collecting societies has focused on the relation between the society and the collecting societies or on the external efficiency of collecting societies. In this paper we are more concerned about the internal efficiency of collecting societies in the field of music. We explore the issue in the context of webcasting licensing arrangements and discuss the effects of the collecting societies to the competition between individual musicians. The authors of this paper believe that a typical agreement between collectives and right holders favour certain groups of artist with the expense of others. There is an inherited conflict of interest on what kind of pricing model collecting societies should choose between the established artists and artists in their early careers. The same can be also applied to the artists who perform mainstream music versus the artist who are more in the niche genres of music. Finally, we propose a more refined model for webcasting licensing arrangements with price discrimination.

## 1. Introduction

The role of collecting societies has been in a steady rise. The progress has been accelerated by strong support from the governments, especially inside European Union, which started from the directive “Television without frontiers” in 1989.<sup>1</sup> The idea itself is not new, the oldest known society of authors (Societe des Auters et Compositeurs Dramatiques) dates back over 200 years. Still, the current situation

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<sup>1</sup> Council Directive of 3 October 1989 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities (89/552/EEC)

seems to favor using this mechanism to curb the rising transaction costs of the digital world by clearing the rights for online publishing in centralized manner.

The development is not without problems. Collecting societies are very often de facto monopolies (e.g. Germany, France, Netherlands) or even de jure (e.g. Italy, Finland). This means that there has to be some kind of control in place to minimize the otherwise inevitable negative economic effects of imperfect competition. Typically the application of competition laws has resulted in numerous court cases in the both sides of the Atlantic.<sup>2</sup>

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## **2. Economic rationale of collecting societies**

Why do copyright collectives exist? Besen at al (1992) stress that collectives tend to reduce transaction costs. According to Merges (1996) copyright collectives help to identify and locate rights holders as well as reduce the costs of continuous licensing. For a radio station, it is much easier to make one agreement with a collecting society than to make separate agreements for every song played in the station. Also, it is often very hard to identify the right negotiation party in the first place. This means that even if the radio station might be able to get better agreement from artists directly, the negotiation and search costs would be prohibitive high. (Besen at al, 1992)

Another source of savings, this time for the right holders, is the joint enforcement of intellectual property. A single license fee has typically so little value that it does not

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<sup>2</sup> A good review of the US-cases can be found from Besen & Kirby (1989) and the EU-perspective is presented, for example, in Stamatoudi (1997).

justify any kind of enforcement costs alone. Understandably, the situation changes fundamentally when there are thousands or hundred thousands of fees to collect. As Watt (2000) mentions, international collecting is even clearer example of an area, in which a single artist cannot effectively enforce his or her rights. Instead, collecting societies make bi- or multilateral agreements to represent each other in their countries.

Finally, and most importantly from the perspective of this paper, collectives set the license prices. Different pricing strategies include tying the price to revenues, number of listeners, quantity of use, purpose of use, etc. Johnson (1992) points out the almost inevitability of under utilization if the collective has the power to use “all-or-nothing” pricing strategy. Assuming that the collective does not know the reservation price of each licensee some potential buyers choose not to buy the license resulting in social costs (because for consumers using already created intellectual works creates benefits with little or no costs).

### **3. Competition with the Collective**

Most collecting societies use blanket licenses for many purposes. We can think of three kinds of reasons:

- Administrative costs are considerably lower than in a model where all licensed works are priced individually.
- Bundled songs are a good deal also for the buyer, which pays typically a lower price, compared to individual licensing.<sup>3</sup>
- The collecting societies are often in monopolistic situation and having many different prices might cause problems with the competition law.

Unfortunately, blanket licenses are also a source of inefficiencies. We believe the identification and precise modelling of these inefficiencies to be troublesome if

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<sup>3</sup> There's a relatively large literature on bundled information products. The bigger the bundle is and the more heterogeneous the target group, the more efficient the outcome is.

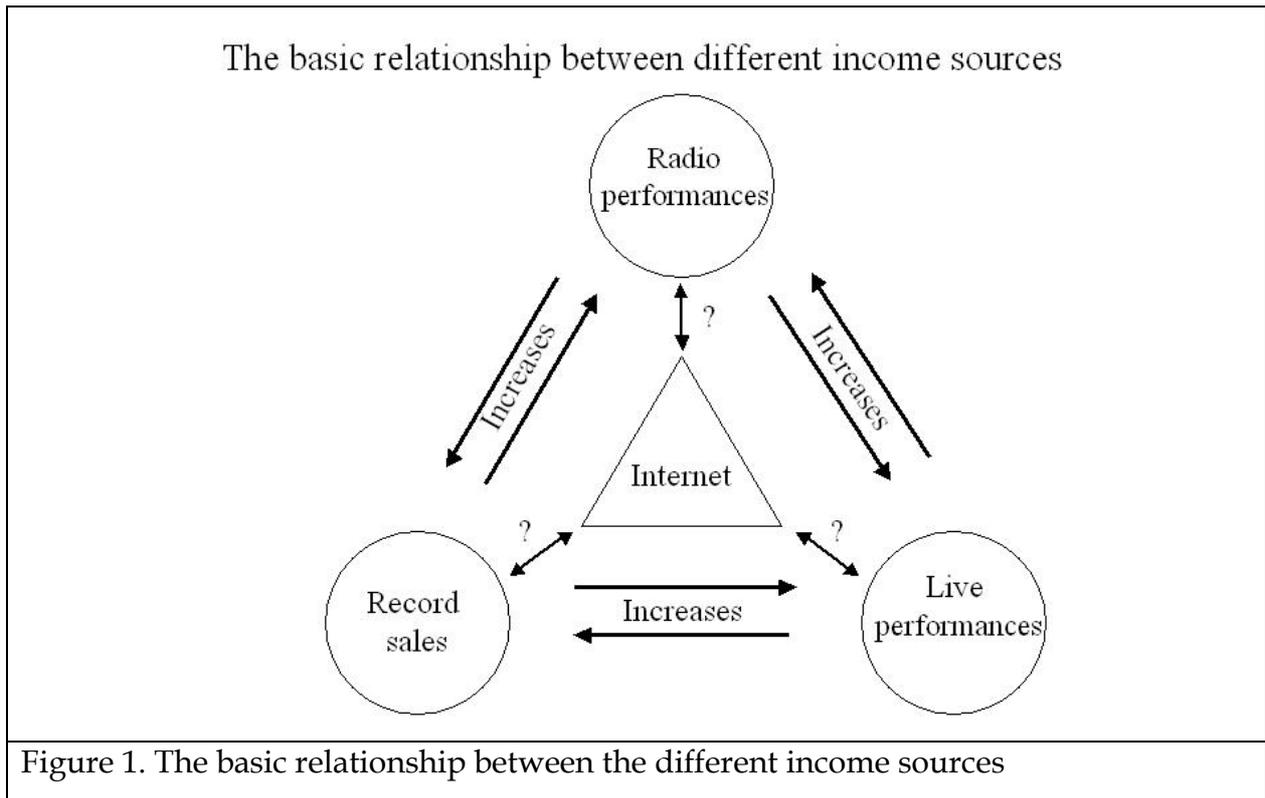
accuracy and realism is desired. As Watt (2000, p 191.) notes, the mathematical complexities may alter the paper unreadable the more realistic the model gets. Therefore, instead of creating a formal model to describe the sources of inefficiencies, we merely give outlines of the problem origins.

The first and perhaps the most important factor is, that licensed music is typically only one of the sources of income for the artist and record company. Figure 1 illustrates the basic relationship with radio performances, live performances (concerts) and record sales. In reality, the situation is of course murkier. For example, radio performances are at the same time advertisements for CDs but also a rivalling product. Moreover, the proportion of income divided between the artist and the record company is typically different regarding different income sources. All income from CD sales may be directed to the record company until all production costs have been covered while the income from live performances may directly to the artist (Vogel 2001 pp. 160-165). In traditional radio performances “the split” varies depending on what kind of contract the artist has with the record company. Finally, the factors named above might be country or region dependent.

An unsolved question in the big picture is the role of the Internet. Currently very few artist get substantial direct income from Internet. Rampant file sharing in peer-to-peer networks may be seen as the ultimate form of piracy from the rights owner’s perspective. Still, at least some of the artists have managed to use Internet as a tool to advertise their work and thus get (in)direct additional income.<sup>4</sup> Also recent experiences from Apple’s online music store clearly demonstrate that it is indeed possible to compete with the “free”.

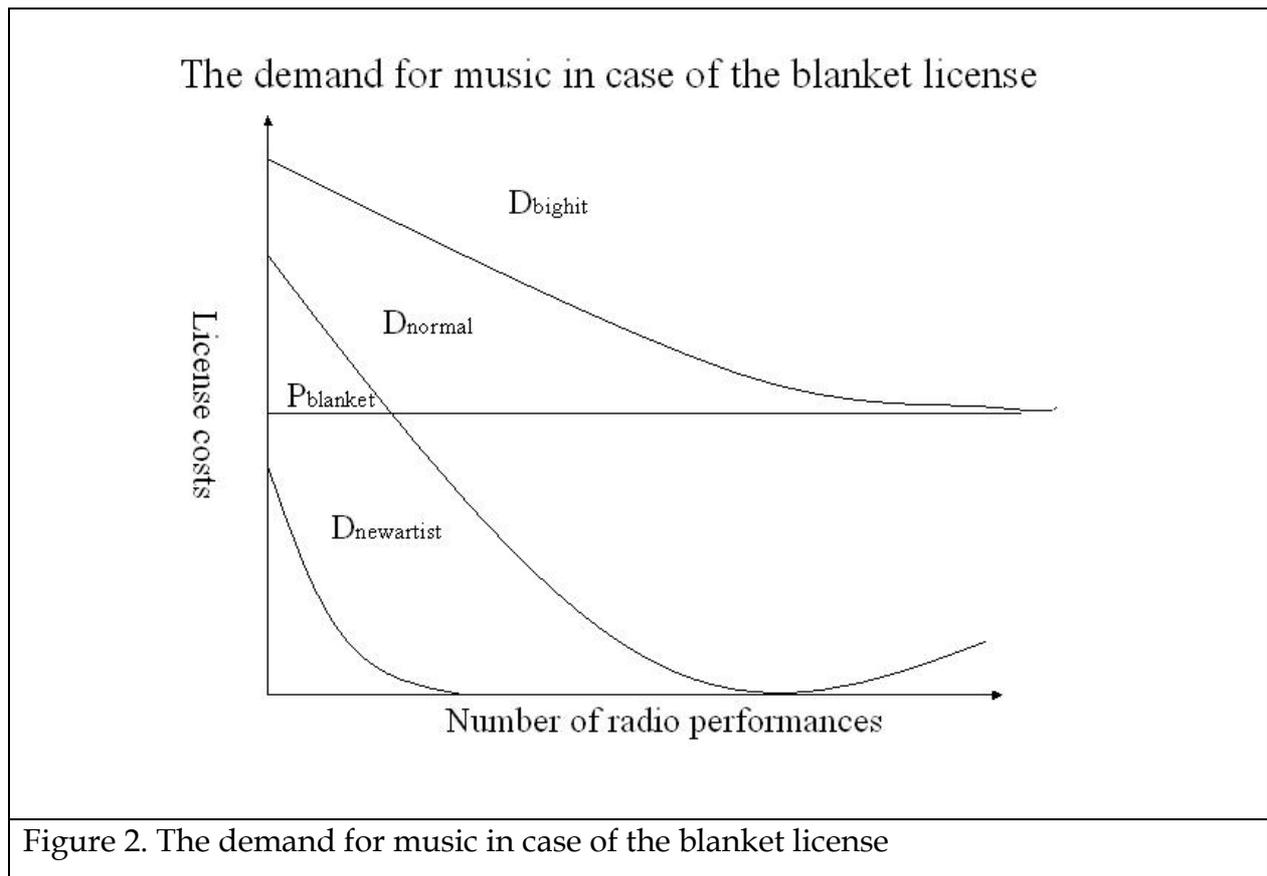
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<sup>4</sup> The best-documented case is perhaps Janis Ian’s story: <http://www.janisian.com/articles.html>



Another factor, which is relatively easy to describe but hard to formalize is the different value of songs for licensees. Figure 2 tries to present the demand curves for three different songs.<sup>5</sup> Unfortunately, without extensive empirical research the exact shape of the curves remains unknown. For example, it is possible that the value and thus the demand for songs actually increase at the beginning because the early exposure makes the songs more familiar to the audience. Also, the demand may also go in different cycles.

<sup>5</sup> We don't discuss in this paper, how the value of songs forms in broadcast. Ting, and Wildman (2002) offers some insights to this question related to Internet radio.



In any case, one thing may be declared certain. Without price competition some songs are under priced and similarly some songs are prices too high. This is not a problem for the collecting society as long as the general price level is sustainable, which means that it makes sense to radio stations to pay the license fee. Instead, it is a problem for the artist (and record company), which does not get the needed exposure from the radio because his or her music is overpriced. This kind of situation in other areas (for example, rent control) causes typically side payments or black market, which seeks to balance the market disorientations. Correspondingly, payola payments are well documented in the radio business before they were prohibited in the sixties (Vogel 2001, p. 163). The discussion has heated up lately again and this time the (accused) methods are subtler than direct payments to DJs or program managers. For example, one radio chain is claimed to demand the record companies to use station's concert services in exchange for airtime. Another way has been independent promoters, which pay for to receive first notice of the station's playlist "adds." (Martin 2002) Even if the payola-prohibition may have been justifiable based on cultural plurality, the

payments still increased the efficiency of overall system and thus should have lead to increased production of songs.

The situation with big hits is also sub-optimal from the artists' and recording companies' perspective. The radio stations overuse these songs because they have no incentive to limit the playtime as long as the audience still likes to hear the particular song. This may be a problem if we take into consideration the link to CD-sales. In practice, there is some empirical evidence that the excessive radio (and TV) use of music is replacing the demand for CDs.<sup>6</sup> Figure 3 presents one possible demand curve for CDs related to the radio performance but again here the true shape remain to be confirmed by more empirical studies. Interestingly, there is no evidence that neither the recording companies nor artists would have tried to prevent this by making similar deals with radio stations as in case of under exposure has happened. This would be still only way to correct the market disorientation caused by the blanket license.

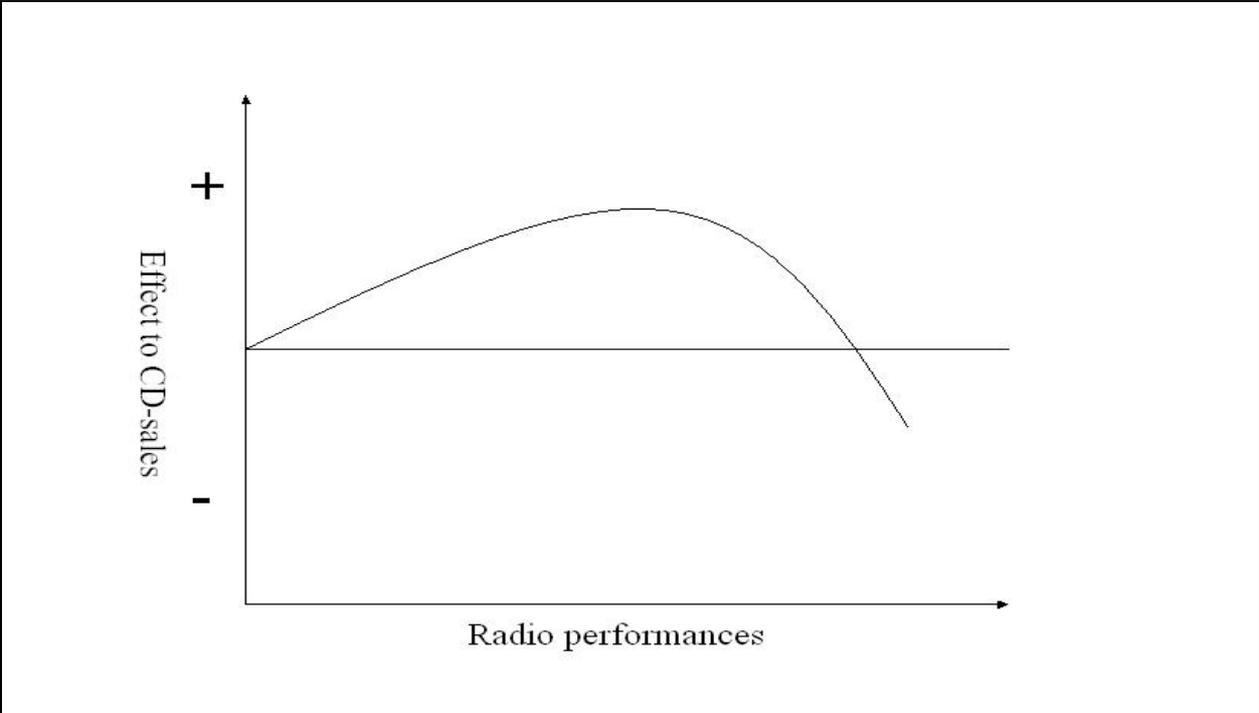


Figure 3. The effect of radio performance to CD-sales

<sup>6</sup> In a recent study, Gramex has found that at the moment 45% of Finns claim that radio replaces the need to buy CDs. This information received from Ms. Taina Kämäräinen, who works as a lawyer in Gramex.

#### 4. Licensing Fees in Webcasting

Webcasting can be defined as one-to-many streaming of digital music and video on the Internet. Today there are numerous different technical implementations of webcasting for different purposes. For radios, some of the most used technologies include MP3, Windows Media Audio, Real Media and Ogg Vorbis streams. Webcasting software allows radio stations to control e.g. the playing and archiving of songs in detail. As of today, it is already possible to webcast better quality audio than with FM with relatively cheap hardware investments.

There are currently thousands of active web radios. They could be categorized roughly in three groups:

- State-subsidized FM stations who also webcast (simulcast) their program. In Europe e.g. BBC in the UK or Finnish Broadcasting Company in Finland belong to this category;
- Commercial FM stations who also webcast (simulcast) their program;
- Internet-only radio stations. Most successful new radios such as DI.fm with over 10 000 concurrent listeners on an average day seem to focus on niche listeners and still depend on voluntary work.

Internet radio should have a great potential, because the audience is global. Unfortunately, the current music licensing schemes do not support the development of truly global services. One might imagine that this would be also in the interest of artists and record companies, because online radio services offer a relatively easy way to fight against unlicensed and unpaid peer to peer-distribution – typically a well functioning radio broadcast should be favoured by the users against cumbersome search from peer to peer -networks.

## 4.1. United States

In 1998, the US Congress amended the Copyright Act with Digital Millennium Copyright Act to provide that non-subscription services may publicly perform copyrighted sound recordings on Internet if they comply with the terms of a new statutory license. To apply, the service should not contain interactive features and the primary purpose of the service must be to provide audio or other entertainment programming to the public.

Right holders, including for the first time major record companies and independent labels alike, founded SoundExchange to administer collective licensing. The organization tries to negotiate the rates with the users but if no agreement is found, the Librarian of Congress sets the rate based on the report from Copyright Arbitration Royalty Panel. The arbitration process is expensive and time-consuming so the both sides have a strong incentive to reach an agreement without it. Consequently, the current rates are based on negotiated solutions. The normal rate is 0.0762 cents per performance, 1.17 cents per aggregate tuning hour or 10.9 percent of gross revenues and the fee for small webcasters<sup>7</sup> is:

*..the royalty rate shall be 10 percent of the eligible small webcaster's first \$250,000 in gross revenues and 12 percent of any gross revenues in excess of \$250,000 during the applicable year, or 7 percent of the webcaster's expenses during the applicable year, whichever is greater. (Copyright register, 2002)*

## 4.2. Europe

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<sup>7</sup> A small webcaster is defined as: "For 2003, together with its affiliates, has gross revenues during 2003 of not more than \$500,000; and for 2004, together with its affiliates, has gross revenues plus third party participation revenues and revenues from the operation of new subscription services during 2004 of not more than \$1,250,000". (Copyright register, 2002) There is also a special rate for non-commercial webcasters (0.02¢ per performance)

Unlike in the United States, it has not been possible to obtain European-wide licenses from one source because of traditional national and regional borders. Instead, the negotiations have taken place in the national level and have made the EU-wide transmissions more or less infeasible. In an attempt to address this problem, The EU-Commission approved IFPI's reciprocal agreement for simulcasting, which should make it possible to get a multi-territory/multi-repertoire license from "one-stop shop". As a part of the deal the Commission required that in the future the administration fees have to be separated from the actual license fees. The Commission also considered possibility that the actual license fees would have been opened for competition, but concluded that this would have caused the agreement to fail, because the national collecting societies would have lost their economic incentive to join the system:

*In the absence of a minimum degree of control over the licensing terms, a society, which contributed with its members repertoire to the "one-stop" package of repertoires would incur the risk that another participating society - in order to attract users - lowered the global royalty fee below the level considered to be acceptable by the former society and/or its members. In this situation, such society (and its members) would lose revenues when compared with the scenario where it did not participate in the Reciprocal Agreement arrangement. (European Commission 2002 p. 20)*

The question about the exact basis for the license payments is left open in the agreement, but the most likely options are:

- an aggregate fee based on a percentage of the revenue generated from the simulcast in the territory of each collecting society;
- an aggregate tariff corresponding to a rate per track per stream (i.e. linked to repertoire use and number of hits on a site). (European Commission 2002 p. 8)

#### **4.3 Case study: Webcasting in Finland**

Finland has been one of the leading countries in the information and telecommunication technology. Accordingly, one might make an assumption that Finland would have been one of the forerunners in webcasting and streaming media. That assumption is however far from the truth. In reality, there is currently only one very little commercial channel, which simulcasts its program to Internet.<sup>8</sup> The (fully government owned) Finnish Broadcast Company simulcasts also its channels after long negotiations with Finnish copyright collectives.

Just a few years ago many Finnish radio stations were experimenting with simulcasting. The results were not that inspiring, because the bandwidth was expensive and there was only few customers using the services. The Finnish collecting societies Gramex (which represent performing artists and producers) and Teosto (composers, lyric writers, arrangers and music publishers) asked at that time only marginal license fees.<sup>9</sup>

The change came in around 2001. At that time Gramex decided to raise its licensing fees and as the result the radio stations stopped their simulcasting services. Because no compromise was found after the negotiations, the Association of Finnish Broadcasters decided to ask the court to set the price. The Association also made a formal complaint of unfair use of dominant market power to the Market Court. Neither of these processes has yielded so far any results.<sup>10</sup>

The current licensing scheme is presented in the table 1 below.

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<sup>8</sup> Radio Helsinki, which is more or less a community based channel. Radio Dei also simulcasts its program but the service is only available for the members of certain Christian association (Kristityt Yhdessä ry).

<sup>9</sup> Information received in private conversation with mr. Eero Mörä, who's the corporate lawyer of Alma Media, the second largest private media company in Finland

<sup>10</sup> Information received from Mrs. Leena Rynänen, the chairman of the Association of Finnish Broadcasters and Erkka Jaakkola, Vice President of SBS Finland Oy

Type of broadcast	Gramex	Teosto <sup>11</sup>
<b>Simulcast</b>	0,0007€ per performance * max users during the month	50€
<b>Webcast</b>	0,001€ per performance * max users during the month	50€

As we can see, the model is relatively simple compared to the US system. There is only marginal price discrimination based on the number of maximum listeners during each month. Compared to US, Finland has no special fees for small webcasters or any other station category. Consider the most extreme situation with a webcaster, which has 120000\$ gross revenue and the program is mostly music. Assume the audience of that service to peak at 2500. In the US, the license fee for this kind of station would be 10% of its yearly gross revenue, which means that it should pay 1000\$ per month. In Finland, the monthly licensing fee would be  $0,001 \text{ €} * 2500 * 300 * 30 + 50\text{€} = 22550\text{€}$ .<sup>12</sup> The difference here is over twenty-fold even if we do not consider currency conversions. In the case of simulcast, the license fee would be 15800€, which is still 15-fold difference. This difference matters also in practice. Out of approximately 70 Finnish commercial radio stations only 10 would be larger than the definition of the small webcaster in the US.<sup>13</sup>

If the US small webcaster exception does not apply the difference between US and Finland becomes smaller. The difference comes from mainly different method of calculating the usage of the songs. Still, differences might be substantial if the variance between the peak users and actual users is large. There are no obvious reasons why Finland should be so much more expensive place to license music. After all, most music played in the Finnish radios is owned by the same multinational recording

<sup>11</sup> Teosto uses still experimental fee because the demand for licenses has been minimal so far. Information received from mr. Jari Muikku, Director, Customer Services, Teosto.

<sup>12</sup> The fee is based on 300 songs per day.

<sup>13</sup> Information received from Mrs. Leena Rynnänen, the chairman of the Association of Finnish Broadcasters

companies or their local affiliates as in the US. The authors of this paper believe that the biggest reason for the current outcome is inadequate legal backing for forced agreements like CARP in the US. The traditional court system used in Finland is all too inefficient and random price-adjusting mechanism to be used in a dynamic environment like the Internet.

## **5. Concluding Remarks**

A traditional wisdom says that artists cannot succeed without radio exposure. Unfortunately this gate is nowadays quite narrow and the current licensing practices make it only narrower. Artists should be able to make direct investments to get their music to radio channels, but this is considered to be illegal, which is hard to understand from an economic point of view.

We believe the system could be more efficient if more creative licensing models were allowed. Both big hits and new artists are currently losing. Also, all news songs created which do not get played result in more social costs. In monopolistic markets price discrimination increases typically efficiency and thus having different pricing categories inside the collecting societies should not be restricted by the competition regulation but instead be actually required. As has been shown in earlier studies, the benefits of collecting societies may be lost if every works has to be priced individually.

Instead, having a few larger groups of songs, which share a common price, might offer an intermediate solution. To address the payola-problem, one group could be consisting of songs, which have a negative fee so that radio stations are actually paid to broadcast the works in this group.

Finally, the Internet should be the ultimate solution for removing the narrow gates of current system. As the price for bandwidth goes down, the biggest remaining expenditure will be the licensing fees. We can conclude with Merges (1996) that voluntary institutional arrangements for price setting as has happened in the US are

preferred. Based on the Finnish example, a credible threat of immediate state intervention is required for an efficient solution in webcasting.

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