

## Live Nation & Ticketmaster: The Case For and Against the Merger

By Jack Goodall

Live Nation and Ticketmaster announced their intent to merge early in February 2009. Many questions have been raised about the legality and the effects of the merger. Public hearings and professional panel discussions have followed. A Senate Judiciary Subcommittee led by Honorables Herb Kohl and Charles Schumer first investigated the proposed union. More recently, at Berklee, the Envisioning Touring panel brought together leading executives of the live music industry to weigh in on the topic, while in a separate event students of the Music Law Group debated the issue. Everyone has questions, but are there any clear answers?

I begin with everyone's favorite part: the cons of the proposed merger. Live Nation Entertainment (LNE), which would be the name of the new conglomerate, would undoubtedly be a near monopoly, if not an actual one. The combined organization would have control over "everything before, during and after a concert [that] takes place over the course of an entire tour"-- a "pretty sizable" influence according to Billboard's Ray Waddell. It would include much of the show promotion, the ticketing, and the ownership of venues around the country and abroad. I would ask anyone to try and book a major music tour without playing a venue that currently is under contract with either Live Nation or Ticketmaster or both.

Ticketmaster sold over 141 million tickets in 2007, valued at over \$8.3 billion, and controls the ticket sales for over 80% of the venues in the country. Live Nation, the world's biggest concert promotion company, produced 28,000 events in 2007 that were attended by 64 million fans. They were spun off from Clear Channel

Entertainment, the same company that rolled up radio stations and concert promoters with SFX Entertainment. According to Live Nation CEO, Michael Rapino, the company's market share in major cities is only around 14%. This number seems shockingly low, most likely because the counting total includes shows at the very-small club level.

LNE would sell the majority of tickets in the country through contracts with 11,000 venues across 20 countries. They would also manage a large number of major acts through Live Nation's 360 deals and Frontline management, own most of the country's amphitheatres and a large number of clubs, own two major ticket resellers (TicketExchange and TicketsNow), and have access to various sources of



competitive data through the sale of competing promoters tickets. Jerry Mickelson, Chairman and Executive VP of promoter Jam Productions, called this "vertical integration on steroids" during his witness testimony at the Senate hearing.

A conflict of interest seems to arise when noticing the number of artists that are managed directly under this new company. Will these artists be required to deal with LNE if they are under Frontline management? Will they get better deals than artists who are not under the LNE name? Irving Azoff, after all, is renowned for getting his artists the best deals.

A focal point of the discussions of this merger revolves around how it will affect the consumers. LNE claims to become a more efficient organization that will bring about bet-

### MISSION STATEMENT

*The Music Business Journal (of the Berklee College of Music) is a student publication that serves as a forum for intellectual discussion and research into the various aspects of the music business. The goal is to inform and educate aspiring music professionals, connect them with the industry, and raise the academic level and interest inside and outside the Berklee Community.*

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# EDITOR'S NOTE

We begin this edition of the Music Business Journal with the issue that's on everybody's mind: the looming merger of Live Nation and Ticketmaster. The possibility of the two giants consolidating has brought a considerable amount of controversy. Consumer advocates, politicians, and rock stars like Bruce Springsteen have come out against the merger, calling the proposed company a monopoly. Read Jack Goodall's cover piece to find out more about the possible pros and cons of the merger.

The other big news in the music industry comes from Sweden. Just recently, as Jamie Anderson reports, a Swedish court found the four founders of the Pirate Bay, the world's most popular file-sharing website, guilty. Sweden has long been known as a safe haven for torrent sites like the Pirate Bay, and the country has a deeply entrenched culture of file-sharing.

The verdict is a major victory in the entertainment industry's fight against piracy, but the fight is not over. Pirates will be determined to continue sharing files, though perhaps in a more clandestine way. Piracy will likely be driven further underground, which may or may not be good for content owners. On one hand, illegal file-sharing may be slowly driven out of the mainstream. But on the other, the more fragmented and underground file sharing gets, the harder it will be to combat.

Last issue, we reported on the agreement between the major record labels and Apple to bring variable pricing to the iTunes music store. This time, Adrian Trujillo explains the real importance of the change and the newfound power it gives labels by allowing them to control the sale price of their music. Also check out Peter Alhadeff's Buzzword discussing price elasticity of demand, an economics concept that relates the price of a product to consumer demand for the product (with obvious implications for Apple's variable pricing scheme).

Spring is about change and new beginnings. The articles above highlight the kind of changes going on around us, while the rest of the issue features the new and novel things that are revitalizing the music industry. Ventures like Topspin, Pandora, Lala, and Spotify are reinventing the way people obtain and experience music, while the iPhone and other smart phones are finally fulfilling the potential of mobile music.

Sincerely,  
Mark Schafer

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### Live Nation & Ticketmaster (contd.)

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ter ticket prices and innovation in ticketing. This speculative statement seems highly unlikely. Every time Ticketmaster has acquired a new company since buying out Ticketron in the early '90s, ticket prices have continued to rise much faster than the rate of inflation. A dominant market share and reduced competition rarely leads to lower prices and innovation in any market. While artists can set prices for their tickets, the offers come from the promoters who should know their region and demographics. Let us not forget that when oil companies complained about being in trouble in the 1990s, the Exxon/Mobil merger was allowed to go through. Since then oil prices skyrocketed and the company has raked high profits.

Even those in the secondary ticketing market have something to say about the merger. LiveStub CEO, Michael Hershfield, will lose a lot of business against LNE. He, along with others, claims that the new company could possibly bypass the primary ticketing market altogether and release tickets immediately to its secondary ticketing sites. Fans would be forced to bid off of each other for tickets. The secondary market has certainly revealed that there is a large market to pay enormous premiums for concert tickets. This would also benefit LNE because ticketing companies make their money off of the fees and service charges, not the face value of a ticket.

Ticketmaster has already alarmed many with the Bruce Springsteen incident of directing consumers to its TicketsNow site with ticket prices that were marked up, even when there were still tickets available on the primary site. The company has also become involved in lawsuits from plaintiffs claiming similar incidents in the NCAA and in Canada.

During his testimony, Michael Rapino also mentioned that competition in the live music industry is healthy. All of the pent-up talk during 2008 about Live Nation pioneering its own ticketing system once it broke away from Ticketmaster was banished when the merger was announced. If a firm with an industry clout like Live Nation decides to forgo its plans to run a ticketing site only a couple months into business, who else would want to enter that market? It is not the technology that prevents companies from competing in this market, but the exclusive contracts that Ticketmaster has with the majority of venues in the country.

Because of this, competing independent concert promoters will most likely have to use the company as a ticketing system for their shows. By using the LNE system, they are giving up valuable information to their main competitor. LNE would have access to the release dates, prices, demographics, contacts, and other private information of its competitors. These independent promoters would be putting money directly in the pocket of their biggest opponent.

There are also antitrust issues per se. The merger certainly goes against promoting competition, and vertical integration, which occurs when a supplier buys a reseller or vice versa, is a bone of contention. Ticketmaster supplied the tickets for the shows that Live Nation was promoting and both were recently direct competitors in the ticketing market.

However, there have generally been a number of points made in support of the merger.

First, it is said that both the ticket seller and the promoter have no

motivation to keep ticket prices high because their main interest is to fill the venue, as profits are rarely made on the ticket price itself.

Second, as an industry leader, LNE might help pool resources and could help innovate ticketing technology as well. Live Nation, for instance, was a tour producer as well as promoter, and needed more funding to pay for shows, which became harder for them as tours got bigger.

Third, both companies reported major losses in the 4th quarter of 2008. This could mean trouble for each one, and the possibility of cut-backs. Other organizations like Apple and AT&T have become involved in the music industry through digital music. If they made any move into the live music industry, who would be able to compete with their financial leverage? An industry leader such as LNE would be the only viable competitor. For example, Live Nation representatives present at the Envisioning Touring Panel at Berklee discussed how the consolidation of the live music trade helped major level artists. Tours and artists had never played bigger shows or been as successful before.

In summary: Will the merger create a monopolistic giant, or is this perhaps a new model of efficiency that can lead the industry into a hopeful future where live music earnings are better monetized?

To me, the freshest ideas have historically come from the ground up, not the top down, and personally I do not feel as if LNE has the system in place to foster the young talent of tomorrow, even though they claim that is a mission of theirs. This reservation, in addition to any unethical and anti-competitive biases inherent in the merger, gives me pause for thought.

I refer the reader as well to the most public forum for this discussion so far, at <http://judiciary.senate.gov/hearings/hearing.cfm?id=3674>.



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## CURRENT EVENTS

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### Google Using Free Music to Make Inroads in China

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By David Widaman

On March 30th, Google announced the launch of a long-rumored, legal music downloading service available exclusively to mainland China. The service, called Google Music Search, will allow internet users the freedom to search within and legally download files from an online catalogue of over 1.1 million copyright-protected songs. Files located within the expansive database will be proffered through a downloading portal administered by Top100.cn, a Chinese company headquartered in Beijing. Google will not charge users for the service, instead agreeing to split advertising revenue generated by the site with 140 participating music companies, including industry behemoths Universal Music, Sony BMG Music Entertainment, EMI Group, and Warner Music Group. Top100.cn says it plans to pay for its own hand in distributing the copyrighted material by selling ad space on its site, as well.

Google, which has struggled mightily thus far in its effort to expand market share in China, acknowledged the move to be an aggressive power play. China's dominant search engine, Baidu, continues to attract a significant majority of all search queries within the country, reportedly around 62%, while its biggest competitor, Google, still attracts a mere 28% of traffic. Google hopes its new role as China's first fully legal music downloading hub will give it a boost in its efforts to catch Baidu, which owes much of its current popularity to illegal downloading. With approximately 300 million of its 1.3 billion citizens already online, China is by far the world's largest individual internet market, and by many accounts, its most larcenous.

The International Federation of the Phonographic Industry (IFPI) estimates that nearly 99 percent of all music downloads in China are of an illegal nature. Baidu has been widely accused of abetting this behavior by providing the use of unlicensed music files to its users, and by offering links to illegal downloading portals. The Chinese search engine, which has so far declined comment on Google's recent moves, is already facing multiple lawsuits, among them those filed by IFPI, Music Copyright Society of China (MCSC), Universal Music, Sony BMG's Hong Kong division, and Warner Music Hong Kong. There exists little optimism, however, that any punitive ruling against Baidu would actually alter China's entrenched culture of illegal file sharing.

Resigned to the sheer magnitude of online theft in China, record labels and publishers had grown skeptical of the profit potential offered by the immense market. It appeared unlikely that the world's most populous nation would ever provide an opportunity to boost, even partially, the record industry's woefully sagging revenues. Thus, when over a year ago Google approached major music companies in the United States with the idea for a new, advertising-derived earnings model, the industry was eager to bite. The ad-based business model, which at one time would have been considered to be an embarrassing concession, has proven more attractive to music companies than continuing to earn no money at all.

Finer points of the deal remain ambiguous. Google and its participating partners have not commented on the exact breakdown of the revenue sharing plan, nor have music companies made clear what royalties artists and songwriters expect to gain through the new model. Yet on the whole, morale seems high among the industry's major players. Chief Executive Officer of IFPI John Kennedy recently spoke enthusiastically of the deal, saying, "The launch of Google Music Search is fantastic news for artists, composers and producers as well as consumers across China." The move ushers in a brave new age for music companies and has, for better or for worse, contributed significant precedent to the necessary evolution of the record industry.

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### Choruss Testing Collective Licensing on College Campuses

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By Kyle Shoemaker

Over the past year, Jim Griffin has been working on a collective licensing plan that would allow college students across the country to download an unlimited amount of music, in exchange for a small fee built into the cost of their tuition. The initiative, known as Choruss, is currently being funded by Warner Music Group and has also gained support from Sony, EMI, and Universal, as well as, the National Music Publishers Association and the Electronic Frontier Foundation. Choruss is expected to begin its pilot phase this coming fall, and there are currently five schools said to be on board.

In a nutshell, students would log-on to their campus' network, using software similar to that of Kazaa or Limewire, and be allowed to trade music with their peers or download directly from a central server. The fees collected by Choruss would then be distributed to artists, songwriters, record labels and music publishers. If successful, Choruss would likely look to extend its program to Internet Service Providers.

Choruss represents an enormous step forward for the music industry, as it has previously resisted collective licensing online since the early days of Napster. Griffin has repeatedly called the plan an "experiment," and continues to reassure interested parties that Choruss does not seek a "one size fits all" approach. Once established, Choruss will roll out as an independent non-profit organization similar to the likes of ASCAP and BMI.

Jim recently spoke on a panel entitled "Marketing and Distribution in a Digital World" at the National MEIEA Conference, which was held at Berklee on March 28th and 29th. Though he did not directly reference Choruss, elements of the plan surfaced regularly throughout his remarks, and much of the audience was fully aware of his proposal. Following the panel, Jim was greeted by a mob of excited music business students from across the country interested in working with Choruss at their respective schools.

## BUSINESS ARTICLES

### Labels Control Prices at Last: A Perspective on Apple's New Variable Pricing

By Adrian Trujillo

Bringing an end to the age of 'one-price-fits-all' songs on the iTunes Store, Apple launched its long-anticipated three-tiered pricing system earlier this month. As the Internet's foremost retailer of digital music, iTunes initiated the new model alongside the conclusion of digital rights management (DRM) copy protection on sales from the iTunes Store.

It is not generally understood, however, that the labels, not Apple, will in future be in a position to encourage demand by manipulating prices. As the article will explain, the labels will now be able to suggest tiered prices to a retailer (in this case Apple) and expect compliance. This is a first ever in the history of the record business.

The three-tier system—also known as variable pricing—is a model the four major record labels had been pushing for since the launch of the Store in 2003. This new scheme provides songs to be purchased at three different price points—69¢, 99¢, and \$1.29—with the majority of chart-toppers and new releases priced at the highest tier. Older, less well-known songs may be priced at the traditional 99 cents or they may be pushed down to the new low price of 69 cents.

The hope for this new pricing scheme is that it will allow the labels to generate more revenue from popular songs (with the higher price) as well as provide incentive for customers to search for lower-priced songs they might have previously overlooked when they did not boast the appealing 69-cent price tag. A song that might have previously gotten very few or no downloads may now be in the running to become a top download.

#### Background

The move to variable pricing didn't come at zero cost to the majors, however. The three major labels that still had DRM protection on the iTunes Store—Universal Music Group, Sony Music and Warner Music Group—agreed to eliminate the copy protection from iTunes sales as well as allow for the purchasing and downloading of music over the iPhone 3G networks. In exchange for these provisions, the labels were granted variable pricing—an unprecedented retail model that could prove to be a little heavier than most people may believe.

Before the digital revolution, labels provided retailers with suggested retail list prices (SRLP), but such a price was only suggested. As noted by Dr. Peter Alhadeff in his essay "The Value of Music and the Trappings of the Marketplace, 1990-2005", the labels were unable to push minimum retail prices to retailers for various legal and economic reasons. First, the availability of countless retailers across the country meant that all of them were carrying the newer, popular material. The music the public loved the most was ubiquitous in retail and no retailer could raise the price without losing sales. Perfect competition in the market for hits, in fact, was driving prices downward and preventing the labels from maximizing returns. Second, when the labels attempted to fix minimum prices in the late 1990s, they were met with various anti-trust lawsuits. Finally, big department stores and hypermarkets were using lower-than-average music prices to drive customers in and buy other, more expensive goods. The combination was, and has been, detrimental to the value of recorded music.

Now, and for the first time, the majors are dictating the prices of their entire catalog—from the chart-toppers to the lesser-known (and perhaps lesser quality) songs on older albums. This concept is further exemplified when it is noted that iTunes has approximately an 87 percent market share of all digital music downloads, with Amazon (the Internet's second largest music store) at only approximately 16 percent of the market share. In the digital world, the towering importance of the Apple store, essentially a solo retailer, can at last help the labels place product and take advantage of the concept of elasticity of demand, well known in marketing and economics.

Early critics declared that this new pricing scheme would open the door to stores such as Amazon and Lala, where customers could still find songs priced at 99 cents or cheaper. However, it was affirmed within the first 24 hours of iTunes' new model that Amazon, Lala, Rhapsody and Wal-Mart would be adopting the new variable pricing scheme, acknowledging iTunes' change (as well as their own) as an "industry shift". As of now, there are still songs that are priced cheaper on other online music retailers than on the iTunes Store, but it is expected that these will change in the near future.

Many industry professionals and consumers were worried, however, that the 30¢ price increase could drive customers away from buying music altogether. The manager of Nine Inch Nails asked:

"Wouldn't it make sense to try to price it cheaper instead of squeezing the handful of people who are still willing to pay for music?"

And a lot of those critics were partially correct. A quick glance at the Billboard charts for the week of April 7th revealed that sales of songs that were priced at the higher tier indeed did go down by approximately 12.5 percent from the previous week. On the other hand, sales of songs that remained at the original iTunes price of 99 cents went up at a margin of approximately 10 percent. Overall track sales of the iTunes store, however, were higher than the previous week by approximately 3 percent. Despite the negative affect, though, total revenue was actually up from the previous week. The extra 30¢ received per top-tier song offset any sales decrease of those same songs.

It is also important to note that merely making more money off of individual track sales is not the primary goal of the record labels. With the new price structure, record labels hope that they might be able to package various singles, bonus tracks and extras into bundles that will sell at a lower price than buying each item separately, or that may be otherwise unavailable. Furthermore, there is hope that rather than spend the extra money to buy a few tracks off of an album, customers will now see the \$9.99 album price (which will remain the same for the most part) as a better deal than it had been before variable pricing. These changes will provide for a model that conceptually resembles the old retail model the labels were used to before the late 1990s, based on albums as opposed to singles.

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And as the onset of variable pricing settles into the minds of professionals and consumers alike, many people question whether iTunes should introduce a subscription-based service as well, effectively locking iTunes' place as the number one online music retailer and licensor. However, many contestants of iTunes adopting a subscription service reveal that if iTunes were to do such a thing, it would merely be reintroducing DRM protection when it had worked so hard to get rid of it in the first place. Such a move would be counterproductive. Furthermore, it is understood that subscription services account for much less of the overall market than online music store sales do.

As for the elimination of DRM, customers can now purchase songs from the iTunes Store and play them back on any portable media player that supports AAC file-encoding, as well as burn unlimited copies onto CDs and various other digital data storage media. This encourages owners of other media players to purchase songs on iTunes now that there is no protection preventing them from putting the songs on non-Apple media players.

It will be interesting to see what happens the rest of the year in terms of the trend of tier-priced songs. Will customers accept the new prices? How will the labels' new "bundles" fare in a market driven by singles and individual downloads? Will the top-tier singles continue to decline, or will the initial shock of higher prices fade away to reveal ever-growing numbers? Could iTunes have introduced the model that could effectively end all other online music retailers, or will these price changes even out the market share amongst the retailers? One thing, however, is for certain—the new variable pricing model is a watershed event in the history of the recorded music industry.

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### Can Topspin Simplify the Artist to Fan Relationship?

By Mark Schafer

Topspin Media is a music company co-founded by Peter Gotcher (who also co-founded DigiDesign, the company behind ProTools) and Shamal Ranasinghe. The company is in the process of fine-tuning its proprietary software platform that allows artists and their teams to build fanbases and careers more efficiently and effectively than ever before. Though currently working with artists on an invitation-only basis, the company is set to officially release its software platform sometime in the coming months. Anticipation of the software's official debut has been building, but the company still has not set any specific release date.

There is always quite a bit of hype surrounding new music ventures, with a lot of chatter about "new models", "emerging trends", and bold predictions about the music industry that never seem to quite pan out. Topspin has been getting a lot of hype lately, but most people don't really know what the company actually does. In a nutshell, the company's software allows an artist to harvest, organize, analyze, and capitalize upon marketing information. The company has so far mostly used their platform for high-profile direct-to-fan releases with artists like Nine Inch Nails, David Byrne and Brian Eno, and Paul McCartney. They have also worked with lesser-known artists like Joe Purdy and Spinnerette.

But before we get too in depth about what Topspin does, we should back up a bit and take a look at the traditional record industry approach to marketing to see what makes the company different. Conversation about the decline of the traditional record industry is often framed in the context of new and old media formats - the increasingly anachronistic CD sinking into oblivion as digital music files like the mp3 become the basic unit of the 21st century music experience.

Apple is one company that has led the way toward a new model based on digital downloads replacing physical distribution networks and the CD (and of course, cutting out the brick-and-mortar record store). By seamlessly integrating their iTunes music store with their iTunes music management software, Macintosh computers, iPod music players, and iPhone smart phones, the company has established itself as the leader of the digital music market.

And while Apple has been immensely successful with this approach, it has not played out as well for the larger music industry. To begin with, the volume of digital music sales has not nearly matched the decline in physical album sales. Record labels not only sell fewer copies of their releases, but also have to deal with the sizeable cut that Apple takes off the top of their digital music sales.

Recording artists have likewise struggled with this decline in sales volume. If they are signed to a label, they have deal with recording contracts designed for an era when gold and platinum records were somewhat commonplace. When artists choose to forego labels entirely, they often flounder in a crowded marketplace because they lack the marketing and promotional support to make a big splash.

The current problem for artists, then, has very little to do with the format or distribution of music and much more to do with marketing. In the old days, record labels had complete control on the marketing and distribution of music. That allowed them to sell a low-margin product at high volumes, which provided a bloated budget for "carpet-bomb" marketing. That approach entails spending massive amounts on things like advertising campaigns, which seek to reach as many people as possible in the hopes of reaching a few possible customers. This strategy worked for a long time, but as album sales plummeted, marketing budgets have been slashed, creating a vacuum that other players in the music industry are now striving to fill.

This is where Topspin comes in, approaching the problems the struggling mu-

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sic industry from the perspective of marketing. The company is based on a software platform that puts a number of tools at the instant disposal of a band and its management team. These include customizable music players that fans can easily embed in their own personal pages. The players not only allow purchase directly from the embedded widget, but also collect a wealth of information, including what songs are being listened to, where they are being listening to, how much of a track is being listened to, and more.

That's just the beginning. A major feature of Topspin's software involves intelligent, customizable electronic mailing list that allows bands to easily collect and capitalize upon a wealth of information about their fans. This is an example of permission marketing, wherein the consumer voluntarily agrees to be marketed to. It not only satisfies the fans' desire for information and messages directly from the band, but also allows the band to collect valuable information from the people most likely to buy their music, merchandise, and concert tickets.

Topspin's platform is intended to use that information in brand new ways. For example, it is easy to see a map laying out where people are joining the mailing list, steaming songs, or purchasing music. It is easy to see where people are buying music and how much they are spending. If an artist has a show coming up in Kansas City, for example, the software allows the artist to send an e-mail only to fans located within a hundred miles of that city. You can even plot customers, listeners, and mailing list subscribers on a map to see where fans are, how much they are listening, the money fans are spending, and more.

There are many other benefits to that kind of flexibility. Among them is the ability to contact fans only when there is information relevant to them. While fans love to hear from their favorite bands, they will tend to unsubscribe from the mailing list if they are receiving 3 messages a day full of information irrelevant to them. It is important to send messages enough to keep fans connected, but not so many that people become alienated and annoyed. The ability to customize messages is a huge help in achieving that goal.

The idea is to connect artists to their fans in the most direct way possible, building a personal connection that strengthens over time. Brian Klein, manager of Joe Purdy, was recently quoted on Topspin's online blog speaking about the company. He was able to release Joe's

new album "2 hours after Joe finished his cover art and approved the mastered audio. His fans knew that from the email that we sent to them and they felt special! They knew that they had it immediately and felt empowered. AWESOME! Word of mouth, instant back end info on who is buying and where, direct email thank you to the fan, viral player that spreads our store across the web, super distribution, more fans. I love it!"

Of course, it is well and good to talk about great marketing and building a connection with fans, but for an artist to make any money, people still need to buy music. The Topspin approach here is to allow as many people as people hear the music, target those most likely to make a purchase, and offer those people a range of purchase options.

For example, Topspin released an album from Paul McCartney's Fireman project. Fans had the choice to stream the album for free, buy the album on mp3 for \$8.99, a CD for \$12.99, \$29.99 for the album on vinyl, and \$79.99 for a package containing 24-bit 96khz tracks on one DVD and multi-track sessions for selected songs on another. Even more, one could choose to substitute high-quality FLAC or Apple Lossless files for mp3s at the \$8.99 price.

On a basic level, giving people choices involves the fan in the process, allowing them to customize their purchase based on their own needs. By enriching the purchasing experience, the artist is strengthening that ever-important bond with their fans and increasing the likelihood of future purchases.

But there is more going on here. Remember that the old recorded music business model relies on selling large numbers of low-margin products. Selling high-priced packages directly to fans allows the band to increase both the profit margin and actual amount of the purchases. In fact, Topspin's current average revenue-per-sale is an impressive \$22.

Also remember that legal music sales are always in competition with free illegal downloads. Though there will always be a group of people that almost always pay for their music (and another that refuses to pay for any music), there is a large group of people on the fence that purchase only some of their music. The challenge is always to give those people enough incentive to shell out their hard-earned cash instead of simply downloading it for free.

There have been a number of direct-to-fan album releases that have done a great job of doing just that. For example, the website for David Byrne and Brian Eno's album Everything

That Happens Will Happen Today offers fans a choice between mp3s and higher quality FLAC files. The deluxe edition, meanwhile, features bonus songs, a short film, a hardbound book, a special screensaver, and more. All of that enhances the music experience far beyond what an illegal download can offer.

There is also a more abstract incentive to fans to purchase music that comes with direct-to-fan releases. By cutting out record labels and retailers, fans know their purchase money is going directly into the band's coffers, rather than into the hands of retailers, distributors, and labels. The major record labels often have a rather negative image among the public at large, so many people feel much better about purchasing music directly from the band they love.

But remember, Topspin is a flexible software platform designed to help give artists control of their own destinies. And while direct-to-fan album releases have been a major part of Topspin's focus so far, it is certainly not the only use for the company's technology. On the company's website, for example, there is a post that highlights a band called BASECAMP that used Topspin to get word out about one of their first gigs at a 400-capacity rock club.

That's good, considering that concert tickets and merchandise have started to seem more important to a band than record sales, a reversal from the past. Topspin is absolutely not a record label, but a marketing tool that helps artists and their teams manage their relationship with their customers (the fans).

But after a few years in development, Topspin's software and services are not yet available to the "public" (to be more specific, Topspin only works with artists, not the public at large). Currently, the company is working with a select number of artists in an effort to perfect their software. The Topspin website says it will be launching within months, but there has yet to be a specific timetable for release. Meanwhile, the company is spending a lot of money to continue developing its software. That money will not last forever, and in this economic climate it may be difficult for the company to convince investors to support the company as it struggles to get off the ground.

So while Topspin is doing some wonderful things and in many ways deserves the hype it has been receiving, it is important to remember that hype is rarely a reliable predictor of long-term success. Only time will tell how things will turn out. In the meantime, the entire music industry will be keeping its eyes on this innovative new company.

## BUSINESS ARTICLES

### Haven No More: Sweden Deals Blow to File Sharing

By Jamie Anderson

The morning of February 16th, 2009 marked the beginning of a trial in Sweden the likes of which the world had never seen before. The Pirate Bay has been accused of “assisting copyright infringement” and “assisting in making copyrighted content available” by major entertainment enterprises Warner Bros., Columbia Pictures, Sony BMG, 20th Century Fox, EMI, MGM, and Universal. Founders Peter Sunde (AKA Brokep), Gottfrid Svartholm (AKA Anakata) and Fredrik Neij (AKA TiAMO), along with major financial supporter Carl Lundstrom, all pleaded not guilty to the claims. With numerous large entertainment companies asking for 117 million Kronor (\$13 million) from four individuals, the outcome definitely seemed stacked against the Pirate Bay from the beginning. But TPB is no stranger to the law, having already won a similar lawsuit back in February of 2008, so neither side took anything for granted going in.

On April 17th, the verdict was released and The Pirate Bay was found guilty for “assisting in making copyrighted content available”. Damages were set at 30 million Swedish Kroners (\$3,620,000), with each individual sentenced to pay \$905,000 and serve one year in jail. The Pirate Bay has promised an appeal, which must be filed with Sweden’s higher court by May 9th

The Pirate Bay was initially founded in November of 2003 in Sweden by Gottfrid Svartholm and Fredrik Neij, both members of the Swedish anti-copyright group Piratbyran (The Piracy Bureau). In 2004, lifelong friend of the pair Peter Sunde joined the team, and in late October the three left Piratbyran to run the site on their own servers. Today, TPB is the world’s largest and most frequently used .torrent sharing website on the web.

The way the site works is quite simple. Anyone with a torrent client on his or her computer (such as uTorrent and Transmission) can take a file or group of files and compress them into much smaller .torrent files. The file can then be uploaded to a server, such as the one owned by the Pirate Bay. Other people (known as “leechers”) can then download the file onto their computer.

The small size of these files and the convenience provided by sites like the Pirate Bay makes it very easy to download a huge

amount of content with a few clicks of the mouse. The .torrent files often contain an artist’s entire discography, rather than a single song, album, or movie. Thousands of dollars worth of music, movies, and software can be obtained in a matter of minutes.

As in the United States, Swedish law indicates that it is illegal to share copyrighted material without permission. That means the act of downloading a .torrent file of copyrighted material is a clear violation of the law on the part of both the leecher and the seeder (the person downloading the file and the one hosting it). TPB acts as an index or a search engine for .torrent files. In fact, their website is strikingly reminiscent of Google’s home page. Although TPB does own and operate on its own servers, the actual .torrent files are hosted on different servers. This is intentional, as the Pirate Bay believes that this shields it from legal responsibility.

The big difference between the two popular search engines is that with Google, if you type in “Pink Floyd” you’ll get thousands of webpages with links to news articles, online music stores, blogs, etc. On TPB if you searched the same thing, every link displayed would bring you to another website on which the copyrighted material was actually hosted and available for download. Despite the fact that TPB doesn’t actually host any of said copyrighted material, its searches are much more refined than those of Google and Yahoo, and all links lead to easily obtainable content.

On the first day of court it was clear that the prosecutors had a strong case, but they suffered some missteps caused by insufficient knowledge of BitTorrent technology in the early part of the trial. This led to half of the charges against the defendants being quickly dropped. When interviewed by a blogger, Peter Sunde said (in typical internet parlance), “how the hell did they think this was going to be something else than an EPIC FAIL for the prosecution? We’re winning so hard.” Throughout the trial, all four defendants showed this kind of confidence and seemed sure they would prevail.

Despite their setback, the prosecution still had very strong evidence to present to the court. Monique Wadsted, representative of the movie industry, pointed out that the Pirate Bay is one of the main distribution channels for illicit pre-release leaks of albums, movies, TV shows, and more. John Kennedy of the IFPI,

for his part, testified on behalf of the music industry during the trial, pointing to the decline in CD sales from \$27 billion to \$18 billion over the last ten years. He placed the blame for this decline squarely on the shoulders of digital piracy. He also made the point that TPB has 22 million users and a million daily visitors. With over 1.6 million .torrent files and growing, TPB makes up for 55% of all BitTorrent traffic.

Other industry witnesses took a more hands-on approach to building a case. Magnus Martensson, another IFPI lawyer, built his presentation by downloading an album using the Azureus BitTorrent client and taking screenshots of each individual step. The defense, naturally experts in the realm of BitTorrent, countered this presentation by pointing out a number of errors. For example, they cast doubt on the witness’s testimony by showing the lawyer did not properly document a connection between the Pirate Bay and the transfer of copyrighted material.

Per E. Samuelsson, a lawyer and copyright expert, took the stand and claimed that under Swedish law, TPB owners had done nothing wrong. “EU directive 2000/31/EG says that he who provides an information service is not responsible for the information that is being transferred. In order to be responsible, the service provider must initiate the transfer. But the admins of The Pirate Bay don’t initiate the transfers. It’s the users that do and they are physically identifiable people. They call themselves names like King Kong.”

This defense became known to TPB supporters as the “King Kong Defense” and was brought up multiple times during the trial. Gothenburg University professor Kristoffer Schollin also showed his support for TPB by testifying in their defense. An expert on BitTorrent technology, he added to the fact that TPB is more of an open, unmonitored database, which can be thought of as an extremely advanced hyperlink.

The last day of trial was on March 3, 2009, where both sides presented their closing statements. Fredrik’s lawyer Jonas Nilsson summed up the defense’s stance by restating the fact that the “website is open in nature and it is the site’s users that decide what content TPB tracks.” Closing statements from the prosecution was followed by a request for 117 million Kronor

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## BUSINESS ARTICLES *(contd.)*

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(\$13 million) in damages and one year in prison for each defendant. The court then adjourned to make their decision, finally coming back with a guilty verdict. The defendants received the one-year prison sentences, but the damages come to just over \$3.5 million dollars, a fraction of the requested damages.

After an epic battle in the courtroom, the Pirate Bay founders and fans still seem optimistic. There has been an outpouring of support for the Pirate Bay from its users. On top of hacking into the IFPI's website during the February court sessions, supporters threw large, rowdy parties in the streets of Sweden throughout the trial. Currently in Sweden, a Pirate Bay support group calling themselves "the Pirate Party" is gathering in numbers and getting ready to run for a spot in Parliament in the upcoming 2009 European elections. The main goal of this group is to reform current copyright laws, or as Pirate Party leader Rick Falkvinge puts it, to "shake the political copyright world at its core." Since the verdict of the trial, over 6,000 new members have joined the Pirate Party, bringing the claimed number of members upwards of 20,000.

Currently TPB servers are fully functional, and the webpage looks almost the same. After the verdict on the 17th, Brokep added a link to a video of himself conducting a press conference after the trial. He called the ruling "crazy" and "bizarre" and vowed to keep the site running. Despite his continued confidence, the defendants have an uphill battle ahead of them fighting against the weight of this ruling.

As if to confirm this, a number of other Swedish torrent trackers have decided to shut down, including Swebits, Nordicbits, Swepiracy, ZyneBytes, MP3Nerds, Seedit, and others. These trackers, which operate the same way the Pirate Bay does, voluntarily shut down because the Pirate Bay guilty verdict leaves them exposed to similar prosecution.

All of this is great news for the international entertainment industry, as the world's most prominent source of pirated content has been convicted and will most likely have to shut down. But just as it would have been wrong to declare piracy over after the collapse of the original Napster service, it would be imprudent to see the apparent defeat of the Pirate Bay as the beginning of the end for illicit P2P file sharing. This is a battle that is bound to continue for some time to come.

### iPhone Applications Open Doors for Mobile Music

By Tiffany Peon

It's been in your pocket since the mid-90s. It's been more of an essential than your home phone since the early millennium. And now it stands to replace your laptop, your library, your mp3 player, and so much more. Gone are the days of tearing apart your home in search of a calculator, calendar or flashlight, cellphones have long replaced these everyday appliances. With the intense popularity of the iPod, most assumed it was only a matter of time until phones doubled as music players. What's truly amazing about Smart Phones is just how much -and what type of things- they do. The eventual inclusion of internet access, games, and the usual electronic conveniences coming to cell phones has been widely expected, but with the iPhone as its pioneer, Smart Phones are changing consumer's expectations of what a phone should do. With yet another infectious ad campaign, Apple has let America know that for almost any need imaginable, "There's an app for that."

Looking for a restaurant? Want to tune your guitar? Need to tie a double fisherman's knot? The apps store offers solutions, both free and paid, to a vast array of problems. On July 10, 2008 Apple launched the App Store, making the iPhone the most customizable phone ever. Sure, other Smart Phones had internet access and some even had full keyboards, but iPhone owners can go to the App Store on their phone and download any number of apps; games, utilities, music players and navigational tools. Anything that isn't effective can be deleted as quickly as it was downloaded, and anything not yet invented is probably in the works. Other Smart Phone companies followed suit, creating their own versions of the App Store or entering into new, innovative deals. Rio Caraeff, the executive VP of Universal Music Group's eLabs division, told Billboard Magazine that Apple's innovation has "created a tremendous sense of urgency among the [device manufacturers] and among the operators that don't carry iPhones that they have to be more innovative... it's a tremendous psychological and economic factor that is motivating everybody else to up their game."

Even more exciting than fake a X-Ray application -called X-Ray FX- is the potential the App Store (and its competitors) brings to the music industry. The popularity of music stream-

ing services has skyrocketed as a result of the App Store, doubling the registration rate of one such service, Pandora. To gain revenue from its newest platform, Pandora has been incorporating audio ads into its music streams. Ailing programs gained overnight success from the App Store and other mobile offerings. The Shazam music ID application uses a microphone to identify any song that is playing and many times gives the user a link to buy the song. As a result of its placement in an App Store advertisement and its release on the G1 Android phone last year, the company's users almost doubled.

Artists including Soulja Boy Tell'Em, Death Cab for Cutie, Lady Gaga, Pink and Akon have created apps that offer streaming songs, videos, blog posts, news, photos and even the distance from the band to the fan's location. The popularity of these apps shows the fan's desire for an increased connection, as well as the immense marketing potential that exists in mobile applications. Artists like the Presidents of the United States of America see a business opportunity and are selling a three-dollar app that lets fans stream their entire catalogue. Labels are taking notice and are hoping to develop more sophisticated artist apps to generate profit.

There are lyric database apps, the Guitar Hero mobile game, DJ scratching apps, and some semi-respectable (for a phone) recording applications. The options are seemingly endless and a concert tickets app has to be on the way. Smart phones represent a new way to directly market music and possibly the closest access the industry has ever had to its fans. The newest iPhone software update included capabilities for subscription-model apps and in-app payment so that developers can generate more than a one time profit.

In the past year iPhone users have downloaded over 800 million applications. This means that in the past year those same people have opted to let their phones do 800 million things they never expected their phones to do before. So the next time you're struggling to find an old household item, take a peek at your Smart phone first. Because you never know, there could be an app for that.

## BUSINESS ARTICLES

### Pandora Makes the Case for Internet Radio

By Mark Schafer

Pandora is an innovative interactive internet radio service created by the Music Genome Project, which in turn was created by Tim Westergren and others in the year 2000. The MGP is a system of organizing music based on more than 400 attributes that describe a song. Those attributes are then used to compare songs to each other and recommend music similar to any given song.

This technology was then applied to a new music service called Pandora, which started as a subscription service before moving to a free, ad-supported model. The site, which falls somewhere between regular internet radio and music streaming sites like MySpace and Last.fm, allows users to create custom radio stations that tailor themselves to the person's musical preferences.

A user simply types in the name of their favorite artist and song to create a new 'station,' and that song or artist then starts playing. There are also more general, genre-based stations provide on the home page. When the first track is over, another song similar to that starting track begins to play. The user can give that track a thumb's up or down, providing Pandora with feedback its software will consider when selecting future tracks. One can even pause the music and skip songs (though there is a limit of 6 skips per hour, per station).

The effect is that Pandora is not only an internet radio station, but a music recommendation engine. By selecting tracks similar to the user's existing tastes, it is bound to play music by bands the user is already a fan, as well as music they've never heard of, but may very well love. Pandora also provides lyrics and general information about a song alongside links to buy the music from iTunes, Amazon, and Amazon MP3. It also allows you to "bookmark" tracks to help you remember the songs you like. Pandora even provides a button to buy all tracks in your bookmarks all at once from Amazon or iTunes.

It doesn't end there. Pandora is also available on mobile phones and in the home. The service offers apps for the iPhone and Blackberry, among others. The apps allow users to create stations and listen to music anywhere they get reception. Users can use their existing account, give thumb's up and down, skip tracks, and more on the app's streamlined player, just like on the service's website. Of course, it also

provides a link to the iTunes store to encourage impulse purchases of music discovered via the app. Pandora can also be used without a computer or iPhone, using a number of music players and home theater products that offer access to Pandora.

Pandora is considered to be an internet radio station, which is quite distinct from terrestrial and satellite radio stations from a licensing perspective. Traditional radio broadcasters do not have to pay any kind of royalty outside of the public performance blanket licenses provided by ASCAP, BMI, and SESAC. Satellite radio, for its part, has to pay a small percentage of its gross revenues in exchange for broadcasting copyrighted sound recordings (on top of blanket licensing fees it pays to the perform rights organizations).



Unfortunately for Pandora, this internet royalty rate has been the subject of much upheaval and controversy in the past few years. In March of 2007, the Copyright Royalty Board set rates for various licenses, including internet radio broadcasts. The rates applied retroactively to the beginning of 2006 and rose each year until 2010, starting at .08 cents per song and finally reaching .19 cents per play.

At a fraction of a penny per play, these royalties seem incredibly low. When extrapolated across the millions of individual songs broadcast over services like Pandora, the cost quickly becomes considerable. The important point is that the calculated number of plays is not based on how many times the song is actually played, but on how many individual listeners hear the music streamed over the internet.

As soon as the CRB made its decision, there was instant opposition to the ruling from all webcasters, from Pandora to public radio sta-

tions. Despite their appeals, the CRB refused to reconsider the rates it had set. SoundExchange, a nonprofit entity set up the RIAA to collect royalties for use of master recordings, had supported the royalty rates.

The royalty obligation for some radio stations went up by as much as 1200% as a result of the CRB's ruling. For some webcasters, that meant they were expected to pay more than 100% of their total revenue just for performance royalties. Obviously, most webcasters saw this as a threat to their very existence and many have shut down. Pandora threatened to shut down if something wasn't done to reverse this decision.

A major breakthrough came, however, in late 2008 when Congress passed a law called the Webcaster Settlement Act. The bill, later signed into law by the former President Bush, struck down the CRB's royalty rate and cleared the way for private negotiations between internet broadcasters, terrestrial broadcasters that simulcast on the web, and SoundExchange. Interestingly, SoundExchange actually supported this bill, despite the fact that it had originally supported the CRB's royalty rate.

In February 2009, those negotiations concluded successfully when SoundExchange reached an agreement with the National Association of Broadcasters, an organization representing terrestrial radio stations. That agreement provided for the payment \$1.50 for every song heard by 1,000 people. This rate will rise to \$2.50 in 2015. It is very important to note that this agreement only applies to traditional stations that simulcast their programming over the internet, in parallel to their regular broadcast.

This means Pandora is still stuck in limbo. The successful repeal of the CRB's royalty rates was a major victory for the company, but Pandora and other internet radio broadcasters have not yet reached an agreement with SoundExchange. It is certain that negotiations are underway, but there is no certainty about what kind of agreement will be reached. To add intrigue to the whole thing, the deadline for a negotiated agreement set by Congress passed on February 15th. The parties have agreed to continue talks beyond this deadline. It seems sure that the growing popularity of Pandora will put the onus on SoundExchange to strike a mutually beneficial deal.

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## BUZZWORD: PRICE ELASTICITY OF DEMAND

By Peter Alhadeff

With the introduction of variable pricing by Apple this month, the economics of the business may change dramatically.

Prior to the introduction of variable pricing, the “lets-put-it-out-there-and-see-if-it-sticks” approach to selling recorded music was dominant. Price hardly mattered, for the labels could not optimize selling prices to maximize their revenue. As a result, pricing considerations based on demand were largely non-existent and major label distributors never really got involved in the business of differentiating song values for the consumer. As the price mechanism was ineffectual for recorded songs, over time it may have impacted sales negatively because prices always provide useful clues both to buyers and to sellers.

Now all of this has changed--see “Labels Control Prices At Last” in the current issue of MBJ. In effect, an economic concept will enter the daily life of the business that could conceivably revolutionize the marketing of recorded music. That concept is the Price Elasticity of Demand or PED, and its calculation and monitoring, both at regular intervals and on a per song basis, will be the key to the new pricing paradigm for recorded music.

Firm or strong demand for a product, also called “inelastic” demand, implies less consumer sensitivity to a song’s price increase. Megastar releases are in this category. In particular, a percentage rise in the sale price of a megastar song likely reduces quantity demanded by a smaller percentage, and guarantees sellers higher revenue. If you raise the price of the most beloved music out there, the sellers of those hits should likely come out better off because people won’t stop buying that music.

Soft demand for a product, also called “elastic” demand, implies more consumer sensitivity to a song’s price. Many back-catalog songs are in this category. In particular, percentage drops in the sale price of a back-catalog song will likely boost demand, offering sellers a chance to collect more revenue. For such songs, discounts are the path to maximize sellers’ revenue.

All of this is basic Economics. To measure the price elasticity of a song, we would take the ratio of the percentage change in the quantity of downloads observed for that song in a given period and divide that number by the percentage change in the price during that same period. If that fraction, ignoring its sign, is less than one, we would classify demand as firm or “inelastic”. If it is greater than one we would classify that demand as soft, or “elastic”.

For example, if a song’s downloads at the iTunes Store drops by 20 per cent when the price of that song is pushed up from \$0.99 to \$1.29, a 30 per cent increase, the label will gross more than before. If, with the same 30 per cent price increase, the drop in downloads were more than 30 per cent, then the label needs to reclassify the song at the regular price of \$0.99 or even experiment with the discounted price of \$0.69.

That is why the recorded music business will be looking at price data very closely in the future. Factoring a history of demand for a song (or artist) and pricing music closer to its potential market value should, in the end, have a positive impact on demand, help a label’s bottom line, and, not least, influence the charts.

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If the licensing complications Pandora has faced from the CRB and SoundExchange seem like a headache, it gets worse. Pandora is only licensed in the United States, disallowing use in major markets like Canada, Europe, Japan, and Australia. The website determines a user’s location based on IP address and people outside of the USA are simply greeted with a page apologizing for the inconvenience, but Pandora is not available outside of the United States. Though based in the U.S., the company is subject to the laws of the territory where the listener is located, requiring the company to block foreign users or risk running afoul of local laws.

The reason is that, of course, Pandora is obligated to secure permission from rights holders and pay royalties to them when they broadcast music over the internet. As we’ve seen, internet radio is a new entity and workable licensing schemes have not been arranged in many territories. For example, Pandora devotes a lot of time on the FAQ (frequently asked questions) section of its website to explaining why Pandora cannot be accessed outside the United States. It claims that they cannot operate in the United Kingdom because they “are being asked to pay per track/stream rates that equate to over 80% of our gross revenues.”

After all this complication, it almost seems amazing that Pandora hasn’t just thrown in the towel by now. They are currently paying extremely high royalties and are only allowed to broadcast to a small fraction of their potential global audience. But, especially with the success of their iPhone application, Pandora’s popularity just keeps growing. And the larger they get, the harder it will be for the international music industry to resist bargaining with the company. So despite everything, expect Pandora to be around for a long time to come.

## MODEL WORK

### On 'Music Like Water' How To Adjust Copyright Law To Fit a New Music Distribution Model

*Model Work features the best paper of a major assignment from an MB/M class. The candidates are chosen by the professor(s) of the course, then the MBJ editorial board chooses from blind submissions. The following piece was written for Ed Blomquist's Music Publishing class. \*Note: all essays are edited specifically for placement in the MBJ.*

By Michelle Comeau

According to reports from the International Federation of Phonographic Industries (IFPI) and from Nielsen Soundscan, the demand for recorded music is as high as ever. However, 2008's year-to-date sales as reported by Soundscan, while reflecting huge growth in digital album and track sales, show an ever-increasing slump in overall album sales since 2000. (1) Clearly, new music distribution and pricing models are needed both for the purpose of serving the modern music consumer and so that both publishers and record labels can sell more product. The only obstacles lie in the current US Copyright law, which has been changed over the past eight years to adapt to new digital distribution models, but has not changed enough to allow a truly successful and legal distribution model to emerge.

Some music futurists, like Gerd Leonhard and David Kusek, have written books detailing propositions for newer distribution models. Gerd Leonhard even attempted to launch a company called Sonific, in cooperation with another of his companies, Project Playlist, that would use ideas from his new model proposition. What he and other music futurists believe is that music is evolving into a service—not a product—that should be made as available as running water, as ubiquitous as possible, at no more of an inconvenience than a monthly utility bill and at a very inexpensive price. His reasoning is that while the demand for recorded music is clearly higher than it ever has been, consumers' willingness to pay for it at the prices currently offered is lower than ever.(2)

To support these statements, Nielsen Soundscan's "State of the Industry" report shows that music still accounts for 57% of all entertainment purchases in the year 2008 (entertainment purchases covering the categories of music, home video, and books). Last year, music accounted for 59% of all entertainment purchases. However, dividing the music purchases into categories tells a different story. The

percentage of ringtone sales in relation to music purchases has increased 167% from 2007, single track downloads have shown a 50% increase from 2007 and a 33% increase from 2005 to 2006, while the percentage of full length purchases in the music purchase category have shown a 13% decrease from 2005 to 2006 and a 27% decrease from 2006 to 2007. These relationships are reflected also when comparing sales percentages in each category from Quarter 1 of 2007 and Quarter 1 of 2008.(3)

Furthermore, Soundscan reported that 80% of all new release albums (a total of 450,344) were purchased less than one hundred times in 2007. Only 37% of total album sales (187 million) were from 2007 new releases. Overall, full album sales were down 10%. Physical CD sales are currently down by 31% since 2004, but digital downloads have increased by 490% since then. Digital album sales (physical albums sold via internet) have increased 50% from 2007, not including non-traditional album sales (which encompass album downloads, TEA album sales from track downloads, mail order/venue purchases, etc.). Non-traditional album sales are up 666% from 2001 (specifically, digital album downloads are up 312.5% from 2004), while physical album sales from chain retailers are down 37% from 2001 and sales from independent retailers are down 50% from 2001.(4) According to Kusek and Leonhard, 1200 US music retailers closed their doors between 2000 and 2003 alone due to the sharp decline in physical album sales.(5)

These figures may seem devastating overall, but what they show is that digital sales, whether people are downloading full albums, tracks, or ringtones, are ever-increasing. The presence of new music distribution companies on the internet is growing: while Apple's iTunes is the most well-known in the US and has presence in several other countries, others like Rhapsody, based on subscription models, are gaining foothold. Even more innovative models like imeem, based on the idea of playlists, have been successful because of their compatibility with social networking platforms. Recently, MySpace Music launched its online store, but solid sales results are yet to be seen. All of these business models are faulty, but some of the fault can be attributed to US Copyright law and to the cooperation (or lack thereof) from copyright owners, namely publishers and record labels.

Earlier this year, the Copyright Royalty Board announced that they would keep the statutory mechanical rate at 9.1 cents per unit sold (with the exception of ringtones, which have a rate of 24 cents per unit sold).(6) Since 1976, the royalty rates have operated on a sys-

tem that poorly reflects market inflation or deflation, and they have been a source of woe for publishers, labels, songwriters, and now, newer digital music distribution companies. Record labels and digital distributors would argue that the royalty rate is too high for them to afford, particularly since recorded music sales have been dropping steadily over the past eight years overall. Meanwhile, publishers and songwriters believe the royalty rate should be increased for the same reasons, and also for the purposes of reflecting the inflation of the US economy while the economy is in recession—in essence, the cost of living or the cost of doing business. This year's ruling, while there was no comment from the Copyright Royalty Board regarding the reasons for their decision, seems to have been made because no one could find a justifiable reason for either increasing or decreasing the statutory rate. Thus, the same problems still exist—no matter what the price of a phonographic copy of a song, the royalty will always be the same amount, which does not allow for any flexibility in the pricing of digital music. Both the distributors and the consumers are screaming for lower prices, but the distributors cannot oblige their customers because they would not be able to make any profit if they were to do so.

In Japan, mechanical royalties are based on an RSP calculation (retail selling price). Their current rate is 5.6% RSP, though the fairness of that percentage is again debatable, and depends upon who argues for it.(7) The principle of the idea, though, is that the distributors can dictate the price without much worry about covering their business costs or making a profit, because the royalty payments will adjust with their prices. Distributors may more easily satisfy their customers' desires for nearly free music and may adopt a subscription model the same as or similar to Leonhard's "Music Like Water" idea, while publishers, labels, and songwriters will still be paid for their copyrighted works. However, these parties should expect a much smaller income from mechanical royalties because of these prices.

This prospect of a smaller income has frightened many record labels, and was the major source of failure for Leonhard's Sonific/Project Playlist business model. Because the labels were either unwilling to license their catalogs for distribution at such low prices, or charged exorbitant licensing fees that Sonific could not afford, the company was forced to shut down because they could not cover the costs of doing business, even if consumer demand for their services were increasing.(8) MySpace Music has not had these issues because despite having

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## MODEL WORK *(contd.)*

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a nearly unusable music distribution platform, record labels have trusted MySpace's marketing power. One fatal mistake they almost made, however, was not even attempting to secure licenses for music from independent labels. Fortunately, they remedied this error after complaints from companies like IODA.(9)

As far as other distribution models based on individual digital track sales or bundled digital album sales, iTunes has been the most successful. Wal-Mart adopted their model with slightly lower per-track prices, but has not made as many sales as iTunes has since launching their service. However, iTunes's success is only the tip of the iceberg. Whatever success they've had in selling digital downloads, it is overshadowed by the ever-growing presence of internet music piracy. Though IFPI's last piracy report was published in 2006, it still shows that the level of P2P (peer-to-peer) downloading via bit torrent and file transfer sites reaches far beyond the number of legal digital track or album downloads. For example, they estimate that over 20 billion tracks were illegally downloaded in 2005 alone, while only 180 million tracks sales had been reported for the same year.(10) Also, while digital track sales only accounted for 4% of the recorded music market, iTunes weighed in carrying about 70% of total digital track sales.(11) Considering that these numbers represent track sales alone, it is easy to see that iTunes has only made an insignificant dent in the music industry with its pricing and distribution model.(12) These numbers imply that prices are still too high for most consumers, particularly when one is paying \$0.99 for each song. To fill one of Apple's 80 GB iPods with .mp3 files by buying tracks from their iTunes store, it would cost roughly \$13,300 if one estimates that each track is about 6 MB in size.

Another huge fault in many digital distribution models, particularly iTunes, is DRM (Digital Rights Management.) DRM uses digital copyright protection on each track sold through iTunes, with the exception of some labels (such as EMI) who have agreed to sell their music through iTunes DRM-free. Each track downloaded, as a result of DRM, can only be used on the computer to which it is downloaded, and cannot be transferred to other devices the buyer may own. The same is true for many of Sony's physical releases, which cannot be copied to computers because of the copyright protection formatting on the discs. While these companies are simply trying to prevent the illegal distribution and selling of their product, they are also obstructing the fair use of a copy of a copyrighted work. Once the copy is sold,

the owner of the copy may make other copies for personal use, so long as they are not renting, selling, leasing, or lending the copies to others, without infringing on the copyright of the work.(13) Making it impossible for the owner of a copy of a copyrighted work to transfer their own copies of that work to their own personal devices is unfair and should be made illegal.

While there are several more subsections of US Copyright law that could be changed to reflect and assist in the growth of the changing digital music industry, those regarding the mechanical royalty rate and fair use of copyright works should be the first to be amended. Technology is growing faster than laws are changing, which means that there is more potential for copyright infringement and illegal activity the longer it takes for US Copyright law to adjust. There is also less room for innovation and growth in the areas of the music industry that deal with copyrighted works as long as the same old-fashioned laws still apply. Furthermore, the US and those countries who signed the treaty at the Berne Convention in 1988 should work together to create consistent copyright laws such that newer business models can more easily develop and operate on a global level. These actions will ensure a better future for music consumers and music business entrepreneurs.

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## BUSINESS ARTICLES

### Surveying the Digital Frontier



By Sawyer Stoltz

It is no surprise that the music industry has been in a state of severe tumult the past couple of decades, mostly attributable to digital technology. From 2007 to 2008 alone, the number of CD buyers decreased by 17 million, and while digital download purchases are on the rise, they do not come near to making up for the loss of CD revenue. With today's media-saturated society, the general public appears to be more interested in popular culture than actual music itself, thus fueling the trend of file sharing and single downloads as opposed to purchasing an artist's complete album. This spike in technology and need for instant gratification has taken its toll on the major record labels; however, the long-term effects may prove to be positive for the music industry. Although sales are down, the amount of people listening to recorded music has never been higher. The future of the music industry comes down to the need for restructure of business models in order to exploit the new avenues of commerce that technology has created.

Recently, to compensate for the diminishing album sales that have resulted from song-by-song downloads, iTunes has implemented a three-tiered pricing system ranging from 69 cents to \$1.29 for "hits" or new releases. However, many music industry veterans are opposed to Apple and the major record label's decision to introduce variable pricing. According to Ted Cohen, former EMI executive, "This will be a PR nightmare. It is for the music industry what the AIG bonuses are for the insurance industry." The manager of Nine Inch Nails suggests that it would make more sense to, "Try to price [music] cheaper instead of squeezing the handful of people who are still willing to pay for music." Ultimately,

the fear is that increasing the price of many popular tracks will irritate the consumer and consequently harm sales. In the first week of the implemented price changes, iTunes reported that their revenue went up although sales of songs in their Top 100 chart decreased by a margin of 0.5%. Despite a short-term increase in revenue, it is difficult to say whether or not iTunes will benefit from their new pricing system.

While digital music retailers continue to adapt to the new market, NPD's music tracking surveys have indicated a spike in teenager's (ages 13 to 17) use of online listening sources such as Pandora and MySpace Music. In 2008, 52% of teens listened to online radio, an 18% increase from the previous year. Due to the fact that most teens (around 70%) already own a portable music player and have built a music library, they are less likely to purchase new music. In fact, NPD's MusicLab survey revealed that most teens that listen to a song they like on MySpace Music are more likely to return to the site to listen to the song again, while only 1% claimed they would purchase the song. The trends consumers are demonstrating indicate that business models need to evolve, adapting new revenue streams such as "brand- and ad-supported music."

Some music services, such as Lala, have taken a different approach by combining the concepts of iTunes music store and MySpace's ad-supported model, offering people the purchase of streaming music for ten cents. Taking this a step further is Swedish music service, Spotify. Now only available in Sweden, Norway, Finland, France, Spain, and the UK, Spotify offers free music streaming service. Revenue

is generated through "radio-style" advertisements alongside digital display ads, though the company also offers a subscription service premium account that is free of advertising. With major licensing deals from Universal Music Group, Sony BMG, EMI Music Group, and more, Spotify has a promising future in the music market.

Though Lala and Spotify are both experiencing rapid expansion, the site-based services are eagerly awaiting various options for mobilization. Lala co-founder Bill Nguyen mentions that, "Web services don't make sense unless they're eventually mobile," and tags, "It helps that the iPhone is out there leading the way." While it is obvious why both companies would like an iPhone presence, there is much debate over whether or not Apple would allow such apps to exist due to their service competition with the iTunes store.

With companies like Spotify, the "future" of the music industry does not seem so distant. Though not available in the U.S. at this time, Spotify's model caters to the consumers while maintaining steady revenue—something record companies have been unable to achieve. We are not there quite yet, but the cloud-based, on-demand streaming service theory, in which videos and music will be readily available anywhere, is likely to be the new format in which media is consumed. It is Lala, Spotify, and similar companies that will be at the forefront of this movement, initiating a new era of digital music.

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- Guitar Hero Goes Mobile
- Google, Universal Team Up for Vevo

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