

RUNNING HEAD: MECHANICAL RIGHTS REVIEW

A Policy & Legal Review:

Mechanical Rights Applied In a Global Digital Landscape

Berklee Online

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Abstract

In this paper, the author will explore the current music laws and policies around mechanical rights, licensing and royalties. She will note what needs to be (or has been more recently) reviewed and considered in the current global digital landscape as well as make suggestions as to a framework to follow when determining approach for fairness, efficiency, and accountability to include recent developments with the Music Modernization Act and its impact on songwriter's earnings..

Introduction

It's important to make a distinction between mechanical and performance rights, licenses and royalties. The term "mechanical royalty" dates back to 1909 Copyright Law when reproducing on a player-piano roll (Zimmerman, 2005). Mechanical royalties are paid out to publishers and songwriters -- with the publisher(s) being paid first -- when someone duplicates, makes a copy of, downloads or streams the underlying composition. Performance royalties are paid out to whoever owns the master recording that's being "played" -- which could either be the label or the performing artist (if not signed or he/she has managed to keep their own rights).

To make things more complicated, the performing artist may also be the songwriter for the composition being performed, meaning this individual could earn both mechanical and performance royalties. And there could be several writers of one composition, which means that tracking for compositions is generally harder to do than for recordings.

Streaming fundamentally changes how creators earn royalties, shifting from larger, front-loaded payments to something more closely resembling an annuity. Creators should earn just as much money, but over a longer period of time. Since writers don't sell merch or have live performances like performing artists, the cash flow from streaming is extremely important to them and some can't afford to wait (Mulligan, 2019). Thus, the discussion related to mechanical rights and royalties has its own unique challenges to address in the digital age for publishers and songwriters -- and why it's the author's focus.

Current Laws & Policies

General Overview

For the first recording and distribution of a song to be legal, the record label, download or streaming provider must first get authorization through a mechanical license from a publisher or copyright owner. Otherwise, they can be fined up to \$150,000 per work. After this, another party may obtain a compulsory mechanical license to re-record or cover the same composition (Zimmerman, 2005).

However, it can be hard to find a writer and, in this case, an attempt at least needs to be made with filing a Notice of Intent with the Copyright Office, which many in the industry might call their “saving grace.”

The computation of royalties from this license is based on a statutory rate set by law, and is meant to be periodically reviewed to reflect changes in the economy -- yet the author believes this needs to be done more frequently given globalization and the fast advancement of new technology. As noted in the Royalty Exchange article, the rate is regulated via the U.S. Copyright Act by a panel of three judges called the Copyright Royalty Board (CRB). These judges re-evaluate every 5 years and hear from various interested parties such as the Nashville Songwriters Association International (NSAI), the National Music Publishers’ Association (NMPA) and Association of Independent Publishers (AIMP), the Recording Industry Association of American (RIAA), and the Digital Media Association (DiMA).

The statutory rate started on December 31, 2005 at 8.5 cents per song or 1.65 cents per minute of playing time, whichever was greater (Zimmerman, 2005). Then, in 2006, it went up to 9.1 cents per song and stayed for 12 plus years (Royalty Exchange, 2019). Being in a somewhat transitory period from physical to digital, it might have made sense the length of time held off to determine the permanence of certain technology application and players in the space. For reference, iTunes came on the scene in 2001 and Spotify launched in 2008 -- although streaming was around before this -- so it hadn’t yet been 5 years passed when streaming blew up (in the U.S. at least). That being said, when 2011 hit, the idea of applying a blanket license to streaming should have been considered more seriously in the author’s

opinion. The Music Licensing Collective (MLC) won't even begin work until 2021, so streaming services are seemingly still beholden to writers until this time.

There has since been debate over setting proper market benchmarks, being that mechanicals weren't determined by the free market alone. Some in the industry say streaming is more of a replacement for retail than, say, radio. The author believes a single sale or download is different from a stream -- one is paying for access over ownership in the latter case. It would be inaccurate to base streaming platform compulsory license rates off of what is deemed appropriate for physicals with higher reproduction costs, since the marginal cost presumably is lower with streaming platforms. The closest comparison for rate setting might be that of Pandora's interactive radio at this point in time -- though the definition of "interactivity" is largely up for debate, especially as to its weighted importance in determining rates.

Also, keep in mind, the "free" market is one that's skewed by major players' favorable deals. Reduced rates are negotiated between labels and publishers such as the "3/4 rate," which is paid by labels on "controlled compositions" -- where the label's recording artist may own at least in part because he or she is also the composer. Publishers may accept to encourage covers to get more payout on the song. Labels may also only pay mechanical royalties for products sold as opposed to products shipped or negotiate down for promotional copies -- however, with selling less CDs, this is less beneficial to them than it used to be (Zimmerman, 2005). Writers are impacted by this as well, because their songs need to stand on their own without having an entire album with increased odds that at least one song would speak to a potential buyer and justify the higher cost and presumably more mechanical royalties paid out to publisher and associated songwriter from the labels.

While mechanicals are often paid directly to the publisher, they are sometimes paid through collection services of a mechanical rights agency, such as the Harry Fox Agency (HFA), which is the licensing subsidiary of the National Music Publishers' Association (NMPA), and Music Reports Inc. (MRI) who handles notices for the likes of Apple, Amazon, Microsoft, and Pandora. With HFA, the

publisher is charged a commission of approximately 4.5% of the gross mechanical royalties collected. In either case, the collected royalties are then split between the publisher and the copyright owner, following their own songwriting agreement (Zimmerman, 2005).

If a songwriter signs with a music publisher, the publisher gets 100% copyright and royalty collection excluding any writer's share of public performance income (which is handled by PROs and where 50% goes directly to the writer). The publisher splits 50/50 with the songwriter. If any advances provided by publisher, the writer's 50% will be put toward recoupment. In co-publishing agreements, the songwriter who owns half the song copyright, the writer receives 75% of income (Royalty Exchange, 2019).

In nearly every country outside the U.S., the music publisher does not have the ability to collect mechanical royalties directly from the labels. Instead, labels are often required to pay royalties to a collection rights society, to which the publisher must belong in order to receive those royalties. Sub-publishers are frequently involved, working on behalf of the original publisher by joining the society in question, directly registering the song, and collecting the royalties before disbursing the monies to the original publisher. As a result, payments to the songwriters can take up to a year or more (Zimmerman, 2005). Rather than the frequent pass-off, having one authority -- notice I didn't say person -- in charge of all payments from a song may be a better route to go. Otherwise, it's like a game of telephone.

What's an interesting consideration is that in many developed nations mechanical and performance rights may be bundled. For example, in France, they both are collected and paid out through the same entity, SACEM. Another example is The Netherlands where it's bundled and paid through BUMA/STEMRA (Royalty Exchange, 2019). When we consider streaming, it almost seems natural to see BMI and ASCAP controlling both sides of a copyright -- but publishers are resistant, fearing songwriters will demand direct payment of some of the mechanical rights from the society (as already happens in

Europe) rather than the money passing through the publisher (Cooke, 2019). Still, this may be the transparency option which is needed to pinpoint those publishers not doing their job.

Any inefficiencies or mistrust with the societies might be remedied with something like blockchain technology. But inherently, the societies will be bias toward implementing something that makes them fearful of losing their jobs.

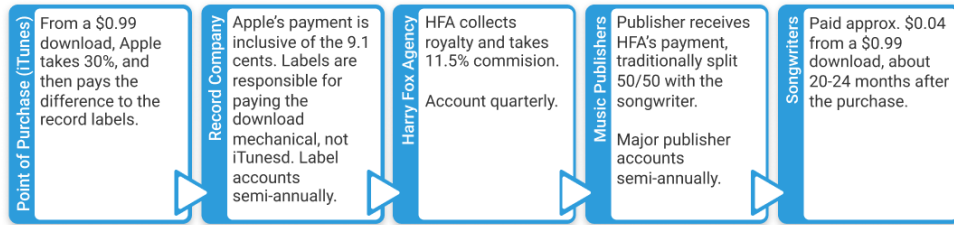
The other concern is with too much consolidation, we run into the risk of forming oligopolies. Still, this seems somewhat naive to the fact that co-writers may be on different sides of the planet or that music can be performed in multiple territories at the same time -- which means there are more players in our space than we may be considering when we look at just one territory or country. Why not first consolidate and then decentralize down from there, so it's a hybrid model? If we formed an overarching global committee and have its subsidiaries be located in different territories, that might be better for scalability as well as creating a structure for checks and balances. Right now, it seems like a bunch of fragmented parties trying to work together without the umbrella to guide in any one direction.

Digital Music Landscape

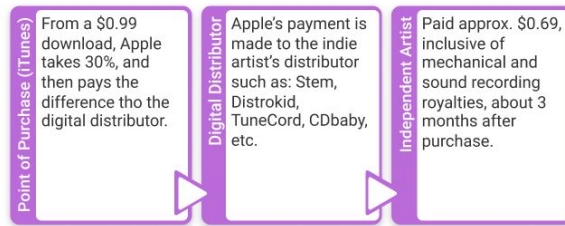
So where does the rise of digital fit into the mix? Streaming revenue is projected to increase from 11.2% in 2018 to 15.1% by 2022, which is a 44% increase over five years. On-demand or interactive streaming is primarily licensed and paid by the streaming service, but they pay fractions of a penny per stream. The payments for streaming mechanicals may be about \$0.06 per 100 on-demand streams. The average per-stream royalty for both composition and recording on Spotify is half a penny. The sound recording average is about \$0.0038 per stream and that leaves \$0.0012 to the composition which is then a 50/50 split between performance and mechanical (Royalty Exchange, 2019).

A pro for writers in the digital age has been they're able to cut out many of the middle parties that have hindered the speed of payment. For downloads, the first image below shows the flow if one has a

publisher and the second one shows the flow if one stays indie. Then, the very last image shows traditional physical sales flow -- so one can see how the time period and amount changes in each case.



(Royalty Exchange, 2019 - a)



(Royalty Exchange, 2019 - b)



(Royalty Exchange, 2019 - c)

Digital aggregators and distributors have made it possible for artists to get more of their cut (with some allowing members with a subscription to keep 100% of their royalties), if they chose to opt out of signing up with Harry Fox. No wonder the collection societies are scared of becoming obsolete in the age of streaming. We'll reserve the debate of PROs trying to bundle syncing in what they manage for another time, since that's more performance rights based concerns -- but it arises from the fear of being obsolete.

Without getting too much into downloads -- because after all, iTunes is on its way out, physical and permanent downloads fall under the traditional mechanical royalty payment structure. But before one gets too excited, a controlled composition clause -- the same one mentioned earlier -- may give the record label a 25% discount on mechanical royalties. So this is one area of a writer's contract to keep an eye out on, or else he or she will be negotiating for royalty bumps tied to extensions or sales numbers. In the past, even without the clause, record labels paid reduced on physical product due to a "reserve" on mechanical payments around 25-35% -- meaning not paying mechanicals on physical returns.

However, on the plus side for writers, the clause is virtually unenforceable for streaming royalties -- because the streaming services had the burden of paying direct (Royalty Exchange, 2019). Next, we'll look at how the Music Modernization Act (MMA) will shift that burden back from the streaming services to the writers. With more than 500 songwriters and publishers seeking punitive damages for Spotify's failure to pay mechanical royalties back in 2017, this would appear to be a smart move (Dunitz, 2017).

Music Modernization Act

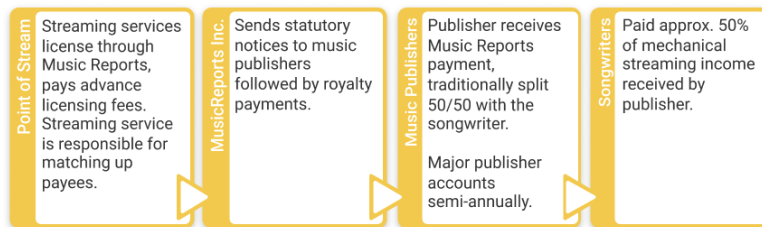
The MMA, signed on October 2018, provides for the creation of a new organization called the Mechanical Licensing Collective (MLC) which is intended to change the way that mechanical licenses are granted and royalties are collected from the digital service providers. It will create a new, all-encompassing centralized database that will issue blanket licenses for the use of all music on the various streaming and download platforms. This way it's easier for these services to license without fear of infringement (Royalty Exchange, 2019). What we have to remember is that while the database is public, there will be someone responsible for the initial inputs.

Keeping in mind the inherent bias that will exist with the MMA if the NMPA is put in charge of the MLC, the author believes more diversity in the Collective is needed. If we make the ties, NMPA to Harry Fox who represents major music publishers (70% of the market), will indies be properly represented? It's uncertain how MLC will operate in conjunction with Harry Fox and Music Reports.

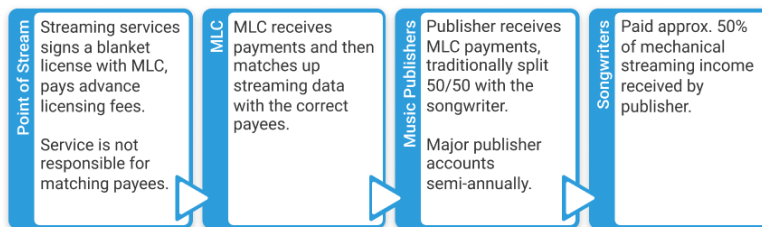
With the committee leaning more toward publishers, they get to decide which songwriters sit alongside them. They also have motivation not to put too much effort into cleaning up data and matching songwriters to pay out the black box, because that money becomes theirs if they wait long enough (Unknown, 2019).

Another downside for artists is that the Act has the effect of rejecting potential legal claims on unpaid mechanical royalties. Applications filed before January 1, 2018 will be dismissed. Removing the ability of copyright owners to institute legal proceedings for statutory damages in infringement suits against unlicensed digital distributors filed after December 31, 2017 may be unconstitutional (Unknown, 2019).

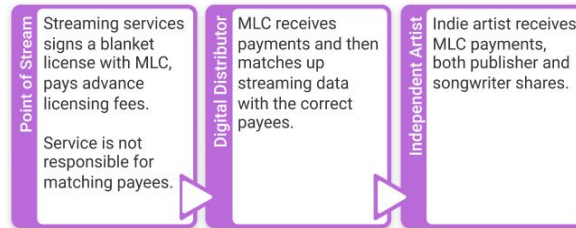
There are still many advantages to MMA -- but sticking to the focus of mechanicals for songwriters, below is an image of how streaming services have been paying writers followed by an image of a revised flow based on the creation of the MLC. And then the last image is a flow for those independent artists who control their own copyright, which -- no surprise -- seems like the best scenario for them. If the MLC can get past the biases, it could really benefit songwriters.



(Royalty Exchange, 2019 - d)



(Royalty Exchange, 2019 - e)



(Royalty Exchange, 2019 - f)

In the past, the judges were barred from considering other free market rates (such as what a song could earn in a TV show or movie). Another advantage is, under the new MMA law, judges will be able to consider rates under a willing-buyer, willing-seller standard. This means a fair-market value will be considered in future mechanical royalty rate proceedings, which has never been done before. The hope is that this will cause mechanical royalty rates to rise (Royalty Exchange, 2019).

An Adjusted Framework

It would seem the inefficiencies and lack of accountability arise from too many cooks in the kitchen and a reliance on manual processing, which could be addressed with these three steps:

1. Standardization
2. Digitization
3. Universalization

This is easier said than done, but it's not that the industry isn't working towards the above.

Standardization

As mentioned in McDonald's article, disparity and conflict lie within rate differences country to country (including streaming) -- although still often blanket licenses -- and it would be hard to say that all should adjust to the same rate because economic conditions may be very different between. In U.S. and Canada, we work of the penny rate, meaning a fixed rate per unit. In Europe, mechanical royalties are

based on percentage known as PPD or published price to dealer, or record company sales price to retailers. The effective rate currently is 8.712% of PPD. But writers and publishers will more than likely need sub-publisher(s) or affiliating directly in a foreign territory (if allowed) -- and they will take a commission of 10-20% gross, which doesn't include creative licensing services.

International streaming services pay a fee based on percentage of annual revenue to the mechanical collection society which is responsible for matching payments. Since the MLC is actually modelled after this, we could say that we're getting closer to a standard global process in that regard.

Digitization

One has to remember to obtain licenses and register with MLC, or they could end up with unclaimed royalties in yet another black box that currently sits for roughly 3 years, depending on the country. But with the delay in updating for the digital age, the author would think the years should be extended until policies and processes can catch up -- because the reporting and tracking isn't fully in the writer's hands. Hopefully, through standardization, digitization and universalization, the black box problems will start to diminish -- but the effort is extensive and tedious.

The problem is that no song can be properly licensed or fully registered until everyone agrees on what share they own. Incomplete registrations that show only a portion of the ownership, changes in the ownership shares after a release, conflicting claims of ownership, and songs with uncleared samples or interpolations all clog the systems of ASCAP, BMI and HFA as well as the digital service providers that rely on those organizations, creating a nightmare of paperwork and confusion for everyone in the entire music ecosystem. "Paperwork" is the keyword here, since you can't have oversight on each individual.

Universalization

So, how do we hold people accountable? A centralized database? But what good will the centralized database do if the data going into it is inaccurate or incomplete from the get-go?

This is where a smart contract in a blockchain platform can come in handy -- but in order for it to work, it would have to be applied at the start when a recording is made and perhaps notifications of incomplete data can be sent to the respective parties who might not be educated on what should be entered and why. This means it can be programmed to not only let someone inputting know they made a clerical error based on the standards of metadata which are required, but also notify the songwriter so they can stay up on any hold-ups and push where they need to in order to get paid in a more timely manner.

In the arguments around consolidation, it's clear that forcing people to pay a collection society would not go over well and neither would a cap on the number of publishers involved since each knows their local opportunities best. So, the author believes no matter how laws and policies change for setting rates and managing licenses, the movement toward a clean universal database is mandatory to ensuring enforcement of copyright law and the speedy and accurate execution of payouts to the appropriate parties.

Conclusion

Some want streaming services to pay out 50% to labels and artists and 50% to publishers and writers. Of course, labels won't give up all fruits from prior negotiations like equity, guaranteed fees, cash advances, and larger royalty payout -- unless deals are cut with Merlin and A list songwriters start demanding the same cut. If labels don't have the content, they'd be forced to adapt. For PROS to upend their entire system to card out for streaming royalties is unlikely, but artists will start moving toward Kobalt and more transparent publishers as they start seeing what they could earn.

The MMA was a step in the right direction, but it still leaves us in the hands of those who might not serve the indie community fully, which means that independents will still need to be watchful of their monies. There's still a good amount to consider when it comes to devising equitable policies for digital.

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