Digital Platforms Roundtable

October 12, 2019 | 9:45 am – 11:15 am

Program Description
Prominent attorneys, each experienced in their respective practice areas, will interview experts in each of
the Video Gaming, Television (including so-called Subscription Video On Demand platforms, such as
Netflix and Hulu), and Music Publishing and Recording (including the Music Modernization Act and the
Music Licensing Committee being established thereunder) platforms in a round table manner for an in-
depth review of the evolution of digital platforms and the current status of exploitation methodologies and
an examination of licensing trends and new and developing revenue sources, culminating in a panel-wide
“state of the digital entertainment industry” discussion.

Speakers

- **Video Games**: Azar Koulibaly, Esq., Senior Attorney, Microsoft, Seattle, WA
- **Interviewer**: Seth Steinberg, Digital Arts Law, San Francisco, CA
- **Recorded Music**: Michael Olsen, EVP Operations and Business & Legal Affairs, Entertainment
  One, Nashville, TN
- **Digital Music**: Bill Colitre, VP Business & Legal Affairs, Music Reports Inc., Los Angeles, CA
- **Interviewer**: Henry Root, Lapidus, Root, Franklin & Sacharow, Santa Monica, CA
- **Streaming**: Peter Dekom, a Law Corporation, Los Angeles, CA
- **Interviewer**: Elke F. Suber, Assistant General Counsel, Microsoft, Redman, WA

Program Materials
1. Metadata for Rights Management-A Guide for Legal Practitioners, by Bill Colitre, V.P. Counsel,
   Music Reports, Inc.
2. LA Lawyer-May 2019 Entertainment Issue: Take the Tempo up, by William B. Colitre
3. LA Lawyer-May 2017 Entertainment Issue: Streaming Revenue, By Bill Colitre
4. Article-When Film is Not Much More Than a Bathtub Ring, Television is for the Elderly, an “Digital”
   Does Not Refer to Fingers or Toes, By, Peter DeKom
2019 Annual Conference Sponsors
October 11-13, 2019 | Las Vegas, NV

J.P. Morgan
J.P. Morgan Securities

Platinum Level

Gold Level
Cassels Brock Lawyers
msk
Dickinson Wright

Mandell Menkes LLC
Venable LLP
Wilson Sonsini Goodrich & Rosati
Professional Corporation

Fox Rothschild LLP
Greenberg Traurig

Silver Level
Barnes & Thornburg LLP
Green Hasson Janks

JAMS
Local Solutions, Global Reach

rockwellgroup

Webinar Sponsor
Swanson, Martin & Bell, LLP
I. Introduction

International entertainment attorneys understand that clean, high-quality metadata is essential to transparent, efficient, and reliable global royalty collection. But many practitioners may lack sufficient familiarity with challenges faced by operations teams throughout the music supply chain sufficient to give them confidence in deal making related to metadata and its use. This article surveys the specific challenges inherent in collecting, disseminating, and using music rights metadata in international royalty collection, with the hope that a greater understanding of good metadata hygiene will help the reader ensure timely, accurate, and transparent royalty payments for rights holders, as well as reducing costs, infringement risks, and balance sheet liabilities for licensees. Part II describes these challenges in detail. Part III provides some prescriptions and best practices that can help practitioners find better metadata outcomes.

II. Metadata & Its Challenges

A. Types of Metadata

Metadata is data about data, comprising “the information we create, store, and share to describe things, [allowing] us to interact with these things to obtain the knowledge we need.”\(^1\) When practitioners seeking transparency in rights administration and royalty accounting speak of “metadata,” they mean data describing intellectual property such as a sound recording or a musical composition.

This article assumes the reader is familiar with the elements of a sound recording or “track” metadata row:

- **Title**
- **ISRC**
- **Artist**
- **ISNI**
- **Label**
- **Distributor**
- **Album**
- **UPC**
- **Catalog Number**
- **Duration**

… etc.

…and those of a musical composition or “song” row:

- **Title**
- **ISWC**
- **Composer**
- **ISNI**
- **Composer’s PRO**
- **Publisher**
- **Publisher’s PRO**
- **Share**
- **Administrator**

… etc.

The illustrative samples shown above trail off with ellipses because there is no universally adopted standard for a complete set of metadata fields that describe a recording or a song. In fact, most supply chain participants have their own preferred sets and configurations of metadata fields, none of which ever manages to be ideally complete. Moreover, the samples above assume that the song in question has only one composer and is owned by only one music publisher. In reality, most songs are co-written by multiple composers and co-owned by multiple publishers.
Additionally, supply chain participants often insert proprietary identifiers into these rows to accomplish data management tasks otherwise made difficult by the lack of reliably available and unambiguous identifiers. For example, digital service providers (“DSPs”) typically assign their own unique identifiers to recordings (e.g., Apple’s “ADAM ID”) and publishers often include their own unique song codes (e.g., UMPG’s “PIP code”). Music Reports, Inc. currently manages the most comprehensive proprietary identifier in the ecosystem—the “Songdex ID,” which identifies more than 30 million songs and pivots through their ties to a set of more than 150 million distinct recordings.

B. Metadata Sources

Metadata challenges literally begin at the source and compound along the supply chain. Creators generally have the privilege (and responsibility) of choosing their collaborators and naming their creations, but too often are under-educated about the metadata they should be managing, how to communicate it through the supply chain, and the critical role metadata plays in their eventually receiving accurate royalties.

Most working songwriters in the United States are affiliated with a performing rights organization (“PRO”), and to the extent they are currently signed to publishing agreements, will be able to identify the publishing entities associated with each new song they publish. If a songwriter worked alone, we also know that she (or her publisher, if that is their contractual arrangement) owns a 100% “share” of the copyright in this new song. But in the case of a collaboration or interpolation, this certainty rapidly recedes. Not only do such situations require agreement to share splits, and the communication of such splits through the metadata supply chain, but it often takes time for collaborators to agree their splits.

On the sound recording side, about 30,000 new works are injected into the global music supply chain every day, most via so-called “digital distributors.” Some of these are distributed with the help of a label, while some are self-distributed by the artist. More challenges arise for the songwriter, as the title of her song may differ from the titles of one or more recordings made from it. Perhaps the title of the song is “Bad Blood,” but the title of the recording is “Bad Blood (feat. Kendrick Lamar).” Even if the title is the same for both the song and recording, the creator’s own name may have changed. If the songwriter is also a performer, she must now commit to the description of herself as the featured artist on the recording. For Joni Mitchell perhaps this is simple—but for Annie Clark, professionally known as “St. Vincent,” there is immediate divergence. Moreover, if the artist is working with a band, it is typically the band name that appears in the metadata, leading to later challenges of disambiguation.

Copyright Owners and distributors then take up the metadata baton. A music publisher, operating as a “publishing administrator,” may add its own internal proprietary identifier (such as UMPG’s “PIP code”), and might in some cases register the work with copyright authorities, producing a copyright registration number.

Turning again to our hypothetical track metadata row, a record company typically assigns its “label” or “imprint” name to the release, as well as a “catalog number” unique to the record company. Moreover, in the late 1980s, the recording industry devised a “unique” identifier for sound recordings and videos, called the International Standard Recording Code (“ISRC”), which labels and digital distributors typically obtain for their works from territorial registrars.

By this stage in the supply chain, the set of metadata is reasonably complete. But once these metadata rows are poured into the massive catalogs of a Collective Management Organization
(“CMO”), the likelihood of confusion grows. It is not uncommon for a large CMO or PRO to manage the works of many “John Williamses,” or hundreds of songs called “You.” Therefore, the need for unambiguous identifiers increases significantly. In some cases, publishers, labels, or administrators may turn to the International Standards Organization (“ISO”) to develop standardized global identifiers like the ISRC or its counterpart for songs, the International Standard Works Code (“ISWC”), for songs.

CISAC, the collective rights management industry confederation, has made multiple contributions to the disambiguation of creators, including its proprietary Interested Parties Information System identifier (“IPI”), which evolved out of an earlier proprietary system called the CAE list. More recently, CISAC also collaborated on a similar party identifier adopted by the ISO called the International Standard Name Identifier (“ISNI”).

C. Uses of Metadata and the Matching Challenge

We have now seen that metadata builds up in accreted layers, beginning with creators, becoming enriched through the activities of copyright owners and distributors, and augmented by a range of administrators, CMOs, and copyright users themselves. But beyond mere identification of works and parties, what are some major uses of metadata? Here are some examples:

1. Communicating rights. A publisher must communicate its repertoire information through the supply chain to inform its commercial partners, like its CMO/PRO, of the intellectual properties it manages. Traditionally, repertoire information is communicated from one administrator to another via a “Letter of Direction” (“LOD”). An administrator affiliated with ASCAP, a US PRO, might inform the society that the administrator has assumed the administration of a new publishing catalog and “directing” the society to pay them for performances of the new repertoire. Such repertoire might be wholly new to the world, or simply have shifted from a prior administrator. Such LODs are typically accompanied by a list of works in the subject repertoire, most commonly an electronic spreadsheet or other file output from the new administrator’s content management system. Such lists are essentially just rows of metadata. Then, when ASCAP wants to communicate its body of works to foreign societies with which it has reciprocal agreements, it typically uses an analogous process, delivering the data in a much higher-volume format established by CISAC called Common Works Registration format, or “CWR.”

2. Evaluating the license status of works. A licensee of a library of 10,000 karaoke masters must determine which subset of specific masters he can use, and in which territories, given the ten publishing licenses he has. To do this, he must first tie every master to a record of its underlying musical composition, research the copyright ownership of any and all shares of that composition, and determine whether all of those shares fall within the grant of his licenses in a given territory.

3. Allocating performance royalties to songwriters. A PRO must account to its members for in excess of 100,000 recordings performed on a webcast platform in a given month. Webcasters in the United States often have no access to complete sound recording metadata. This is because they are the beneficiaries of a blanket statutory sound recording license under Section 114 of the U.S. Copyright Act, such that they are not required to have a direct relationship with record labels from whom they might obtain clean metadata. Therefore, when the PRO receives reporting from a webcaster, they may receive nothing more than poorly-formatted rows of track metadata, hand-coded by an intern, based on information inconsistently
selected from the back of a CD jewel case. The PRO must review this impoverished track metadata, which is unlikely to contain an identifier like an ISRC, and try to match it to the song(s) embodied in that recording.

4. Allocating mechanical royalties to publishers. A subscription streaming company must account to its mechanical licensors for billions of distinct plays of sound recordings in a given month and determine which should be accounted for under a statutory license and which are subject to a negotiated direct license. In the U.S., the majority of leading DSPs outsource this task to Music Reports, but a handful use the Harry Fox Agency and one performs the task itself. These organizations must possess the IT infrastructure to receive, store, and process billions of rows of metadata. They must then match the track metadata to a robust database of information about their underlying songs, which describes the discrete shares of ownership those songs, while separating out any tracks that contain non-musical works or public domain compositions. They must then identify the current owners of all of those song shares and, as with the karaoke example, apply the correct license terms to each share, which means they must also store such terms. In the U.S., the licensee (or its vendor) has the primary obligation to perform all these steps and to render accurate accountings to the licensors, which the licensor may audit. In the U.S., all of this work must be accomplished, and statements and payments rendered, by the 20th day after the close of the month.7

These four examples barely scratch of the surface, but they have a common element: matching.

D. The Many Challenges of Matching

The most central function in international music rights administration is matching sound recording rows to musical composition rows. People do not listen to musical compositions or “songs”, they actually listen to recordings of songs. Therefore, the assets managed by music licensees are sound recordings or “tracks” far more often than they are songs, and the reports licensees send licensors show track usage, not song usage. Administrators must match incoming track metadata to song metadata to perform almost any licensing or accounting function.

Matching tracks to their underlying songs sounds simple, but it is devilishly difficult to do. To begin with, one must have sufficiently rich metadata to identify the tracks themselves, but sound recording metadata is notoriously poor and messy. Next, one must have a rich, accurate, and harmonized database of song ownership.8 Assuming good track metadata and the existence of a robust song database, matching can be accomplished in one of two ways. Ideally, one constructs a table of tracks matched to songs over time and stores a unique identifier for each master (such as an ISRC) and each song (such as an ISWC). Then matching is as simple as searching a unique track identifier and receiving the corresponding song in return. But given the deficiencies in track-level metadata—and the arrival of 30,000 new tracks in the digital music ecosystem each day—a more laborious approach, called syntax matching, is virtually always necessary to accomplish the task competently.

Syntax matching uses machine algorithms to compare the values of one record with the values in another record and determine, to some degree of mathematical certainty, whether the two records are identical. Machine learning is beginning to be layered on top of existing processes so that these algorithms can be improved over time. However, because computers can only do so much with poor metadata, some amount of manual research remains necessary to make finer matching decisions than machines can currently be trusted to accomplish.
In either case, the five greatest challenges to matching are: (1) Data Lag; (2) Data Lack; (3) Data Loss; (4) Data Pollution; and (5) Data Volume.

1. **Data Lag.** As we’ve seen above, there is a temporal dimension to the dissemination of music data through the supply chain, especially on the song side of the equation. Songwriters take time to agree their shares and inform their publishers; publishers take time to organize and enrich their song data and communicate it to their administrators and CMOs; administrators and CMOs take further time to consolidate, organize, enrich, and disambiguate their song data and harmonize it with one another’s databases. Each step adds lag, and all at a time when the track may already be seeing exploitation in the market and may contribute to a poor outcome: that one or more shares in the song cannot be attributed to an owner, and associated royalties fail to reach their true owner in due time or at all. Data lag also affects the track side of the equation. Distributors often send track-level metadata in successive waves of updates, first including only sketchy information (e.g., an album with only numbers as placeholders, rather than track titles) and adding more detail later. This forces administrators to perform additional work over time to get optimal matching results.

2. **Data Lack.** Although it should be obvious, it is often overlooked that without a database of music publishing rights to work with there is nothing to match track rows to. Therefore, song administrators must maintain robust data about songs and possess the ability to work dynamically with that data, e.g., in the form of relational databases that can be queried in flexible ways. Since very few licensees maintain such databases, they cannot be expected to perform matching exercises competitently on their own. Turning to our karaoke service example, the service will either have to convince all ten of its licensors to provide their full repertoire information or rely on a third party vendor like Music Reports that has such a database. From the copyright owner’s perspective, it is simply impossible to deliver metadata to everyone in the world who asks for it; only those with a track record of responsibly curating metadata and resolving conflicts among copyright owners have earned the effort required. While some rights owners may feel that it is sufficient to leave works database management to their CMO, this is short sighted. CMOs rarely cooperate with licensees to accomplish the sort of task our karaoke operator requires. A reliable third party can reduce administrative friction for the licensee and antitrust objections from competition authorities; this directly increases asset value for rights owners, whose works will reach the market more quickly and whose royalties will be paid more efficiently.

3. **Data Loss.** When the shortest path for a party in the supply chain is to manually enter data, the party will tend to drop fields in order to save time. IT teams sometimes omit whole columns of metadata to save space or save time. If either the track or song row lacks a unique identifier that can be tied to the other, there is no possibility of matching using the unique identifier strategy. Moreover, since syntax matching methods are more effective when they have more complete rows to match, gaps in either row undermine the speed, efficiency, and accuracy of syntax matching.

4. **Data Pollution.** When supply chain participants misuse standard identifiers, the market experiences “data pollution.” ISRC abuse is a common form of such pollution. The ISRC standard is intended to be applied only once to a recording or video, regardless of where or how that asset is distributed. In practice, however, many recording
distributors assign multiple ISRCs to the same asset. In other cases, different distributors assign the same ISRC to different recordings, deeply wounding the value of a “unique” identifier. At the extreme, at least one distributor famously created its own codes that had the format and characteristics of ISRC numbers, but which lacked any official status. Moreover, the ISRC system lacks a central registry, contributing to the proliferation of idiosyncratic or inaccurate ISRCs and making quality control difficult. The ISRC system is taking steps to heal itself, and remains an important contribution to the efficient administration of music. But this aspect of ISRC highlights that reliance solely on ‘unique’ identifiers is not yet sufficient for competent rights administration.

5. **Data Volume.** Finally, the advent of streaming has exponentially expanded the volume of data that must be matched. Where once there were at most millions of records sold in a year, now there are billions of streams a month on a single streaming service. The French collective management organization, SACEM, reportedly processed over one trillion transactions in 2017. There are many nested sub-challenges in this category, including the necessity of a high-capacity data infrastructure (such as cloud-enabled storage and processing capabilities), the need to employ experienced data management personnel to develop and manage many interrelated systems (some not yet capable of automation), and the sheer problem of file management. As an example of the latter, a single streaming service with two tiers of activity and 10 licensors in 30 European territories (not to mention the rest of the world) must issue 600 usage reports per month, each describing hundreds of millions or even billions of track plays. In each case, CMOs must receive and respond to these reports by issuing claims files, which the service must in turn receive and process. Meanwhile, from the perspective of a CMO, they must receive and process these enormous files from the dozens of DSPs operating in their territory in order to ensure that they are invoicing properly against any minimum guarantees they may have received and are able to pay their writers accurately. Note that the choreography and inherent lag of these exchanges involves another set of temporal problems.

In the first decades of the digital music age, music rights administrators and CMOs were not well positioned to develop these types of systems and staffs, which are extraordinarily costly to establish, maintain, and update in a quickly evolving technology landscape. Hence, we are seeing the development of a specialized tier of data management companies to help with the task, among them Music Reports, ICE Services, SACEM’s URights platform, and BackOffice.

III. **How can Attorneys Contribute to a Healthy Metadata Ecosystem?**

The above context should help practitioners better conceptualize the metadata supply chain so that they may find opportunities for better data hygiene in daily practice. Counselors are encouraged to devote as much attention to reviewing and negotiating the reporting protocols, attached to the end of license agreements, as they devote to royalty and audit provisions. Beyond these generalities, here are some specific practice suggestions.

A. Advise clients that own copyrights that metadata is in many senses the most relevant manifestation of their claim to ownership of intellectual property.
- They should curate their metadata as they would the title documents to their house or vehicle, even more so if they forego official registration of their works with their national copyright registry.
- Owners, including self-published songwriters and self-distributed artists, must recognize that they bear primary responsibility for managing their own intellectual property. This point cannot be stressed enough by those who work in music rights administration: it is simply not reasonable for copyright owners to expect parties downstream in the supply chain to inform the world of the owner’s ownership of the copyright or supply the basic metadata critical to administering it.
- Time is of the essence. The longer rights owners delay making arrangements with their collaborators and pushing their metadata through the supply chain, the greater the danger use of their works will not be identified and their royalties will be delayed or never recovered at all.

B. Register your clients’ works. Although formalities are not required to perfect copyright protection in most nations, the owner—not those downstream in the digital supply chain—is best placed to associate herself with works she owns. Moreover, since various “blanket” and “compulsory” licenses are common, the matters of infringement and accounting are distinct. While formalities may not be required for protection against infringement, good metadata hygiene, including the practice of actively registering metadata with supply chain participants, is necessary for efficient accounting and royalty payment settlement. That creators by and large seem to take little interest in or responsibility for their metadata, however, suggests they have taken the Berne Convention’s prohibition on formalities farther than was intended, rendering them unhealthily dependent on others to look after their property rights. Perhaps Berne’s prohibition on formalities should be revisited in some way to clarify this distinction.

C. Incorporate good metadata hygiene in administration and license agreements. Contracts should specify, to the maximum degree negotiable, reporting and accounting formats that require clear and complete metadata, inclusive of both international standard and proprietary identifiers. Ideally, contracts should specify remedies when compliance is lacking.

D. Take care when moving catalogs. If a client’s catalog is moved from one administrator to another, ensure that all of the metadata the first administrator possesses, including copyright registration numbers, is transferred to the new administrator. If possible, insist that the relinquishing administrator affirmatively inform its commercial partners that it has released claims to moved works at its next catalog update opportunity, and consider auditing their catalog information after they have had a reasonable opportunity to adjust their records.

---

2 This article is admittedly U.S.-centric in nature. By convention in other territories, it may be the case that one’s CMO is the ‘owner’ of certain rights from the moment of creation.
3 Id.
7 Outside the U.S., the converse arrangement is built on the same core matching exercise. Taking for example an E.U.-based CMO, the licensee has the obligation to receive reports of usage from a licensor, perform the same matching of tracks to songs, and then prepare a claim file in response indicating solely those shares of works it has the mandate to manage, and an invoice for the royalties generated by that activity.

8 Remember that a song with four writers and four publishers will result in four distinct rows of song metadata that must be disseminated to and consolidated by any administrators constructing a holistic songs database, which is itself a herculean task.


Acknowledgements: The author would like to thank the following people who contributed their time and expertise to this article: Jim Griffin, Mark Isherwood, Paul Jessop, Peter Klauser, Brigitte Kueng, FX Nuttall, and Sebastian Spring. Thank you for sharing your expertise!
TAKE THE TEMPO UP

Challenges posed by how to structure royalties for on-demand streaming and issues related to public performance rights played an important role in the Music Modernization Act’s evolution

Following a 15-year period of decline and stagnation,1 the business of recorded music is now in its third year of sustained double-digit growth.2 The Recording Industry Association of America (RIAA) recently reported that U.S. revenues grew 12 percent in 2018 to $9.85 billion.3 Of that figure, over 75 percent came from streaming access models, including subscription on-demand (the largest and fastest growing driver, which for the first time exceeded 50 percent of total industry revenues). Meanwhile, revenues from ownership models, including digital downloads and compact discs, have continued to decline precipitously, creating headwinds to overall growth. The “record business” is now but a series of niche-oriented ancillary products like vinyl for disc jockeys and collectors’ box sets, but the business of recordings is rapidly growing in a proliferating array of new digital forms.

The business saw profound legal change as well. Perhaps most significantly, in 2018, rights owners and digital music services forged the Music Modernization Act (MMA),4 the most extensive change to U.S. Copyright Law in 20 years.5 This new law will create for the first time a mechanical licensing collective for digital music services in the United States, ending a period of dramatic class action litigation over the way in which these services had (or had not) obtained mechanical licenses. The cessation of this litigation dissipated a dark cloud over the sector and portends greater opportunity for new music startups to begin, which may help to sustain growth as the business cycle begins to mature.

Revenue from streaming models comprises three components (as tracked by the RIAA) in which virtually all growth is now concentrated. Foremost is subscription on-demand (which includes premium on-demand services like Spotify and Apple Music, as well as offerings with limited catalogs or functionality, like Amazon Prime and Pandora’s Plus tier) in which revenues grew 32 percent to $5.4 billion. The next component is comprised of noninteractive digital and customized radio services (including Sirius XM Satellite Radio, Inc. (Sirius XM), and the webcasting service from Pandora Media, LLC (Pandora) which also grew 32 percent to exceed a billion dollars for the first time at $1.2 billion. Finally, the often controversial

William B. Colitre serves as vice president and general counsel of Music Reports, Inc. He also has served as counsel to numerous leading producers as well as artists, publishers, digital aggregators, music services, and consumer products companies.
advertising-supported on-demand streaming services (primarily YouTube, Vevo, and the ad-supported tier of Spotify) grew 15 percent to $760 million. This third category comprises one-third of the estimated 1.2 trillion streams that occurred in 2018 but only 8 percent of revenues. It is important to understand the business and legal aspects of the two largest of these market components from the perspectives of labels and music publishers, as well as the consumers’ shift from ownership to access of music.

Domination of Subscription On-Demand
At the end of 2016, on-demand streaming services had less than 23 million subscribers in the United States.6 Two years later that number has risen to over 30 million, and the services are now adding a million subscribers a month.7 In its first eight years, through June of 2016, Spotify grew to serve 100 million users worldwide, of which 50 million were subscribers. In the roughly 20 months that followed, the service more than doubled in size to 207 million users, of which 96 million are subscribers, and turned in its first quarterly operating profit.8 Meanwhile, its closest competitor, Apple Music, grew even faster,9 from about 20 million subscribers to nearly 60 million.10 One source recently calculated that, globally, the three major record labels alone collected $19 million per day in 2018.11 Taking a longer view, on-demand subscription streaming produced $800 million in 2014 revenue, meaning that the 2018 revenue of $5.4 billion represents 575 percent growth in five years.12

The recorded music business, as opposed to the live performance side of the business, comprises two subsectors: sound recordings—controlled by record labels—and music publishing—controlled by music publishers and collective management organizations. From the perspective of the legal practitioner, not much has changed for the business of master recordings in the past two years. Digital music service providers (DSPs) still must license record labels and distributors the rights to reproduce, distribute, and publicly perform recordings, not to mention the album artwork, trademarks, and name and likeness rights that accompany those recordings. This must still be done on a voluntary, negotiated basis, as there is no statutory compulsory license for these rights.

On the business side, exploding revenues from subscription on-demand streaming put the negotiations over these rights in a pressurized state. The recordings side of the business is highly concentrated, with three major record labels and a handful of major distributors of sound recordings on the licensor side of the equation, and a handful of heavyweight DSPs on the licensee side: Spotify, Apple, Amazon, Google, and Pandora (recently acquired by Sirius XM13). In the past two years there has been a raft of notable developments in the market that add to this dynamic, a few of which are described here.

Spotify had its initial public offering on the New York Stock Exchange, after which the labels mainly sold off their ownership stakes in the company and shared the proceeds with their artists;9 also, although Universal Music Group is still holding its shares, Taylor Swift used her clout to secure a commitment from the label to share its stock sale proceeds with artists irrespective of their royalty advance recoupment status.15

Thus, now no longer entangled by these ownership stakes, both the licensor and licensee sides are positioning themselves for a round of major license renewal negotiations with potential impacts for the whole sector. For example, Spotify is now beginning to allow artists to directly distribute music on its service without needing to go through a label or distributor. While this step is of little material impact thus far in terms of lessening Spotify’s dependence on the labels, it has made labels nervous, prompting threats.16

Several services are significantly expanding into non-music content, such as podcasting and sports broadcasting,17 which tends to lessen the services’ dependence on the labels. Meanwhile, labels suddenly are attracting very strong valuations18 and retrenching.19 Globally, expansion into emerging markets is gaining pace, creating both tension between labels and DSPs over how best to monetize emerging economies20 and intriguing combinations, e.g., the mutual investment between Spotify and Tencent Music, Spotify’s Chinese analog.21 Moreover, separately, entirely new models of music consumption are springing up, such as the socially driven “lip sync video” phenomenon, typified by emerging platforms like Bytedance, whose Tik Tok service was formerly known as Musical.ly.22

The next two years will prove interesting for industry observers as these dynamics play out in ways that may shape the landscape for decades to come. Practitioners will have to think fast and creatively to develop the industry expertise, global licensing strategies, and contract forms to deal with rapidly evolving models requiring complex and novel combinations of multi-territorial rights.

By contrast, not much has changed for the business of music publishing in the past two years, but the legal framework underpinning the “mechanical reproduction rights” aspect of the business has been radically restructured and more profound changes are currently under discussion in relation to the “public performance” right. What has changed in the music publishing business is that, while still growing, the pace of music publishing has now been outstripped by that of recordings. The recorded music business in general saw decline and stagnation between 2000 and 2015, but this was not entirely the case for music publishing. Even as people shifted away from owning records and digital downloads, steadily eroding publishers’ income from mechanical licenses, growth in the live performance sector was strong,23 as was growth in revenues from the public performance right in general. All through this period, the major public performing rights societies, including the American Society of Composers, Authors and Publishers (ASCAP) and Broadcast Music Inc. (BMI) in the United States, posted gains virtually every year.24 In fact, viewed through a global lens, the single largest revenue component of the music business is collections of public performance monies by members of the Confédération Internationale des Sociétés d'Auteurs et Compositeurs, or CISC, an international confederation of collecting societies, which made up approximately a third of the total recorded music business in 2017.25 That business is growing at 6 percent per year,26 however, compared with the 12 percent noted above for recorded music.

With respect to the law, on the other hand, music publishing has had something of an annus mirabilis. Among other developments, Congress enacted an omnibus revision of the Copyright Act primarily focused on music licensing, there was a profound revision of the royalty rates and terms for on-demand streaming at the Copyright Royalty Board, and the Second Circuit issued a watershed decision on the antitrust consent decrees that govern ASCAP and BMI.

Music Modernization Act
Throughout the evolution of the on-demand streaming business, a debate raged in the background over whether a stream of a song (which one might expect to constitute a public performance) also implicates the reproduction and distribution rights in that song.27 As early as 2008 the record labels, the music publishers, and the digital services—who were party to the first proceeding before the Copyright Royalty Board to set rates and terms for on-demand streaming—agreed that such rights (to-
gether called the “mechanical right” in the parlance of the industry, should apply.

Moreover, they agreed that the DSPs should be responsible for licensing the right from publishers, whereas the labels had traditionally licensed such rights when they distributed physical phonorecords. Finally, they agreed that the compulsory mechanical license available under Section 115 of the Copyright Act should apply to such use, so long as the DSPs could identify the song in every recording they used and find at least one of the song’s co-owners with a written notice of intention (NOI) to obtain a compulsory license. This agreement never had the force of law, though.

Moreover, since none of the DSPs had a database containing all such song information, nor are the Copyright Office records complete, the DSPs found little comfort in this agreement. They first turned to the Harry Fox Agency, which traditionally had issued mechanical licenses to labels, but the agency had only ever affiliated a minority of publishers. The DSPs then turned to Music Reports, Inc., a music rights administration technology company, which operates Songdex®, the world’s largest database of music rights information. Working with Music Reports, the DSPs were able to issue NOIs for over eight million recordings as early as 2003, enabling the first full-catalog on-demand streaming services to launch in the United States. The services’ catalogs today average 50 million recordings.

With statutory damages as high as $30,000 per work infringed, mistakes in a catalog of millions of recordings could be extremely costly. Moreover, some DSPs, driven by marketing imperatives to grow their catalogs to encompass any recording a user might want to hear, released recordings for which they had not yet sent NOIs. This pattern went on for some years, until publishers hit back in 2015, filing several class action lawsuits against Spotify and the Rhapsody service—which had recently rebranded as Napster—seeking billions of dollars in damages.

The industry thus faced a legal crisis affecting the one business model growing fast enough to bring the industry back to health: on-demand streaming. Motivated by this dramatic impasse, a massive legislative effort was undertaken, beginning with a proposed compromise between the DSPs and the publishers in which the DSPs would get a waiver of past liability and a blanket license for mechanical rights going forward in exchange for allowing the publishers to build a mechanical licensing collective to manage the royalties it generated. Furthermore, the DSPs would pay for the building and operation of the new collective, called the Mechanical Licensing Collective, and be entitled to access a database of recordings matched to songs that the MLC would construct.

A fuller description of the MMA and the compromises involved in its enactment is beyond the scope of this article, but among other things, the MMA buried the hatchet on the question of whether an on-demand streaming service would be liable for copyright infringement if it contained a copyrighted work.

Ownership vs. Access, 2011-2018

U.S. estimated retail dollar value in millions, net after returns, per year (Data source: RIAA)

Access  Ownership  Total


Phonorecords III, Streaming, and Beyond

Just as the MMA legislative effort was getting started, a major Copyright Royalty Board (CRB) proceeding was coming to a close. Every five years, industry participants have an opportunity to agree on rates and terms for the compulsory mechanical license for the next five-year period. If they are not able to do so, the CRB convenes a proceeding to hear evidence and set rates.

In the most recent of these proceedings, dubbed “Phonorecords III,” the parties decided to square off and litigate. After hundreds of hours of testimony from experts and economists, the CRB issued a dramatic ruling calling for a significant reordering of the way in which royalties for on-demand streaming services had been

DSPs that participated in the proceeding have filed an appeal from the CRB’s decision with the D.C. Circuit, prompting warlike rhetoric from songwriters and the National Music Publishers Association (NMPA).

The second largest revenue segment of the music business—the noninteractive streaming audio business—has primarily seen significant development on the business front. For example, in 2016, the largest webcaster, Pandora, began to offer an on-demand streaming subscription service as an “upsell” option to its free, advertising-supported webcasting service. Previously, Pandora had always been able to rely on a blanket license for the sound recording performances and ephemeral reproductions it needed to operate its webcasting service. For the first time needing to enter into deals directly with the record labels, Pandora now had the opportunity to negotiate directly with the labels for variations on the statutory performance right for webcasting, and the labels were able to receive their royalties directly from Pandora, bypassing SoundExchange, the sole collective authorized to collect statutory sound recording performance royalties in the United States. This rerouting of royalties around SoundExchange has deeply impacted the collective’s revenues and raised questions about the future of the organization in a
world increasingly focused on interactivity. Due in part to a settlement with Sirius XM, however, SoundExchange managed to turn out record distributions in 2018.36 The future may contain other challenges for SoundExchange, however. For the entire history of the collective, the vast majority of SoundExchange's receipts have come from two payers: Pandora and Sirius XM. These two companies have recently merged, creating a company with massive audience reach in the car and on desktop computers and mobile devices. The companies' businesses are highly complementary, and they may now benefit from the ability to coordinate efforts in connection with future royalty rate proceedings.

Now firmly in the background of the streaming access business, the collapse of physical and digital download ownership models continues at a relatively consistent rate of 25-28 percent per year.37 As was true two years ago, sales of digital downloads continue to fall faster than the sales of physical phonorecords, significant rebounds have occurred in nostalgic formats like vinyl records and even cassette tapes,38 though far too small to change the overall trend away from ownership. Putting these trends in context, digital download sales surged in the 2000s due primarily to the success of Apple's iTunes store and accompanying iPod and iPhone product lines. However, the market for CDs remained broad and entrenched until as recently as 2011,39 when digital formats drove the majority of U.S. revenues for the first time. In the end, digital downloads proved to be merely a "bridge technology," preparing consumers for the behavioral migration toward access models by accustoming them to listening to music through computers and mobile devices—withstanding random access to huge libraries and smooth playback for their workouts.

From 2011 to 2016, ownership models, e.g., physical phonorecords and permanent downloads, slowly gave way to access models like subscription and noninteractive streaming.40 Finally, in 2016 through the present, access models have surged, driven primarily by strong adoption of on-demand subscription plans. (See table on page 35.) Many factors no doubt contributed to this sudden change in consumer behavior, but these factors likely included the strong market penetration of smartphones and the accompanying market for mobile phone apps, the broad adoption of 4G/LTE mobile connectivity plans, and generational change—i.e., the children born in 2000 turned 16 and sought music through the phones now ubiquitous among teens.

Given that ownership models now account for a mere 23 percent of industry revenues, even if subscription adoption begins to slow from its current torrid pace, it is unlikely that the decline in ownership models will provide a meaningful drag on the market any longer. It is predictable that digital downloads will all but disappear in the next 2-3 years, while physical sales will settle into a relatively consistent single-digit market share component representing mainly gifts and collectables.

Public Performance Rights
Because essentially all access models depend on compensable public performances of musical compositions, it is worth taking a moment to examine this increasingly volatile area of law. In the U.S. performing rights sector, ASCAP and BMI may have regretted requesting that the Department of Justice review their consent decrees in 2014, which they likely had hoped to see loosened or terminated. The DOJ's review in fact resulted in a closing statement that further restricted how they license compositions fractionally owned by multiple parties.41 The DOJ "clarified" its interpretation of the decrees as explicitly prohibiting ASCAP and BMI from issuing licenses solely to their controlled share of a given work, because "only full-work licensing can yield the substantial procompetitive benefits associated with blanket licenses that distinguish ASCAP's and BMI's activities from other agreements among competitors that present serious issues under the antitrust laws."42

In reaction, BMI filed suit with the U.S. District Court of the Southern District of New York on the "fractional licensing" issue, arguing that their business practice had always been to issue licenses solely for the shares of works they control, as opposed to licenses to use the entire work (as is permitted, but not required, by U.S. copyright law). The court ruled in favor of BMI, and that ruling was then affirmed by the Second Circuit in December of 2017.43 Going forward, as the societies' existing licenses in effect with their licensees expire, the societies may seek to substantially reorder the way in which they grant and value licenses. This ruling has created concern in the licensee community, which includes powerful interests such as the National Association of Broadcasters and the Consumer Technology Association. These groups fear that as their existing licenses terminate, they will be faced with less certainty about the works for which they have total licensing coverage, less leverage with professional rights organizations (PROs), and potentially higher costs of administration. Even if the costs of license administration are traditionally borne by licensees, they may inevitably be passed on to licensees. Moreover, there is nothing to prevent the emergence of new PROs, increasing the front-end transaction costs of securing licenses.

The DOJ's closing statement did, however, suggest that a legislative review of the matter might be in order, and ASCAP took that approach. It joined the effort to craft the MMA,44 and the resulting law made three significant adjustments to the way public performance rights are licensed in the United States. First, the consent decrees that have governed the activities of ASCAP and BMI since 1941 had always provided that if those societies and their licensees were ever unable to come to agreement on the rates and terms of a license, they could turn to a specific judge with continuing jurisdiction in the Southern District Court of New York. The MMA introduced a procedural rule called "the wheel," which requires that the Southern District Court of New York rotate judges with every new application to the court, and prevents any judge from working on more than one matter simultaneously.45

Second, the PROs also regretted a choice they made in 1995 to add Section 114(g) to the Digital Performance Rights in Sound Recordings Act.46 That provision prohibited the use of sound recording performance royalty rate evidence in proceedings to set rates for musical composition performance rights. When sound recording performance rights for digital audio transmissions were first added to the Copyright Act, the PROs had been concerned that such evidence might be used to argue for lower performance royalties for musical compositions. Since then, however, sound recording owners have been successful in winning royalty rates far higher than those achieved by composition owners, who now see the introduction of such evidence in their own proceedings as a potential benefit.

Early drafts of the MMA simply deleted this prohibition, but following negotiations with the National Association of Broadcasters, the provision of this provision was revised to indicate that such evidence may not be used "except in...a proceeding to set or adjust royalties for the public performance of musical works by means of a digital audio transmission other than a transmission by a broadcaster."47 The effect is that future rate court proceedings involving FCC-licensed broadcasters will continue to exclude this evidence, but proceedings involving digital audio transmissions will permit it. Time will tell whether this evidentiary rule will significantly
change the outcome of such proceedings.

Third, the actions repeatedly taken by ASCAP and BMI to seek repeal of the consent decrees moved the licensee community to seek assurances that no such action would be taken without a thorough deliberative process. Section 105 of the MMA takes several steps toward this goal: 1) the DOJ must timely brief the U.S. House of Representatives and Senate Judiciary Committees regarding the status of any consent decree review involving a PRO; 2) the DOJ must share with members of Congress any information or pertinent documents related to the review; and 3) the DOJ must submit to the chairmen and ranking members of the House and Senate Judiciary Committees a written notification of its intent to move for the termination of a consent decree before the plan is in place to do so and provide information regarding the impact of the proposed termination on the market for licensing of public performances that would result, together with a report on the process used by the DOJ to review the consent decree, and a summary of any public comments received during the review.

This portion of the act was timely. In 2017, President Donald Trump appointed Makan Delrahim to lead the Antitrust Division of the Department of Justice. In a statement to the NMPA, Delrahim stated that “the ASCAP and BMI consent decrees are among 1300 legacy judgments the Antitrust Division has on the books...the Antitrust Division has recently set out to review many of these longstanding judgments to make sure they’re not doing more harm than good.” At the present time, stakeholders are anxiously waiting to hear whether the DOJ will move to amend the decrees or bring a new proceeding, or perhaps whether Congress will take action to change the status quo. In any event, now that the question of mechanical licensing has largely been resolved by the MMA, focus is turning to the “performance right” in an era where the lion share of revenue is now coming from streaming access business models.

Though access has replaced ownership, to the dismay of some vinyl lovers, exciting new business models have broken through to drive steady growth. Although it is uncertain how long and how steep that growth will be, it is clear that major new developments in the law and business of music lie ahead.

---

6. Friedlander, supra note 5.
10. BILLBOARD STAFF, supra note 7.
20. Tim Ingham, The Average Spotify Subscriber Pays $8.50 a Month — and Record Labels Hate It, WOLLING (Continued on page 30).
Take Up the Tempo
(Continued from page 37.)

STONE, Jan. 11, 2018, available at https://www.rolling
stones.com/music/music-feature/the-avengers-specific
subscriber-in-paying-5-50-a-month-and-recording
shares-it-776925.
21 Jon Russell, Spotify and Tencent agree to swap
stakes in their music businesses, TECHCRUNCH (Dec.
8, 2017), https://techcrunch.com/2017/12/08/spotify-
tencent-share-swap.
22 Louise Matsakis, A Beginner’s Guide to TikTok,
how-to-use-tik-tok.
23 Mark Mullan, Do Not Assume We Have Arrived
At Our Destination, MUSIC INDUSTRY BLOG (June 15,
2017), https://musicindustryblog.wordpress.com/tag/
artist-income.
24 Will Page, $25 Billion: The Best Number To Happen
To The Global Music Business In A Very Long Time,
MUSIC BUSINESS WORLDWIDE (Dec. 10, 2015), https://
www.musicbusinessworldwide.com/25-billion-the-
best-number-to-happen-to-the-music-business.
25 CISAC Global Collections Report (Nov. 8, 2018),
file:///C:/Users/Bill%20Collee/Downloads/2018-CISAC
+Global+Collections+Report-FNL%201.pdf.
26 Id.
27 See Todd Larson, Don’t Believe the Hype: Spotify
is Right to Challenge Mechanical License Demands
for Interactive Streaming, BNA’S PATENT, TRADEMARK
www.wel.l.com/-media/files/pdfs/2017/dont-believe
-the-hype-spotify-is-right-to-challenge-mechanical
-license-demands-for-interactive-streaming.pdf (survey-
   ing the substantial evidence against the then gen-
erally held understanding that mechanical rights are
   implicated by on-demand streaming).
28 See https://www.musicreports.com; see also https://en
.wikipedia.org/wiki/Music_Reports, last accessed March
10, 2019.
29 See Collee, supra note 5, at 22.
32 Murray Sassen, A 44% Streaming Royalty Rise is
now Locked in for Songwriters in the US—So Long
as the Likes of Spotify Don’t Declare War, MUSIC
BUSINESS WORLDWIDE (Feb. 6, 2019), https://www
.musicbusinessworldwide.com/a-44-streaming-royalty
-rise-is-now-locked-in-for-us-songwriters-so-long-as
-the-likes-of-spotify-dont-declare-war.
33 Id.
34 Tim Ingham, Watt...Spotify is ‘Airing Songwriters’?
What the Heck is going on, MUSIC BUSINESS
WORLDWIDE (Mar. 8, 2019), https://www.musicbusinessworld
wide.com/podcast/watt-spotify-is-airing-songwriters
what-the-heck-is-going-on.
35 Ed Christman, A Look At SoundExchange’s 2017
Financials From Its IRS Filing, BILLBOARD, Jan. 5, 2019,
available at https://www.billboard.com/articles/busi
36 Ed Christman, SoundExchange Flirted With a Billion
in Payouts to Artists and Labels in 2018, BILLBOARD,
/articles/business/8496698/soundexchange flux-
2018-artists-labels-distributions.
37 Joshua P. Friedlander, RIAA 2018 Year-End Music
(last accessed Mar. 8, 2019).
38 Noah Yoo, Cassette Sales Grew 23% in 2018,
/cassettes-sa..
All in the Game

Los Angeles lawyer Duran Parsi explores potential copyright issues arising from the explosive growth of esports
page 26
CELEBRITY INFLUENCE ON BRANDS
page 28

Brexit Film & TV
page 10

Publicity Rights Estate Planning
page 13

Streaming Revenue

Los Angeles lawyer Bill Colitre traces the emergence of digital technology in the music industry and discusses its impact on revenue and the framework of legal rights
page 20
by BILL COLITRE

STREAMING REVENUE

Music rights owners and agents experience unprecedented speed, transparency, and efficiency with digital services

AFTER 15 YEARS of decline, the business of recorded music is arguably in its healthiest state since 1995. (See “Recorded Music Developments 1995 - Present” on page 23). The Recording Industry Association of America recently reported that overall revenues grew a robust 11.4 percent in 2016—a welcome return to significant growth for the industry.¹ The primary business model of recorded music is now one of access to licensed services based on sponsor or subscription revenue rather than one of physical goods sold by units. As this new positive economic cycle for recorded music begins, it is worth surveying the legal structures that frame the primary revenue sources involved.

Currently, rights owners and their agents are experiencing unprecedented speed, transparency, and efficiency in accounting and revenue recognition. As examples, digital service providers (DSPs) like Pandora² and Spotify³ make geographic music consumption statistics available to artists on their platforms daily, record companies receive reports of consumption from their on-demand streaming partners weekly,⁴ and publishers receive reporting on the interactive streaming of their compositions monthly, within 20 days after the close of the month.⁵

These reports are based on extremely granular perceive data (as opposed to “per spin,” as is traditional for broadcast radio). Because the Internet is based on one-to-one connectivity, it is now possible to know very quickly not only that an album has sold or that the promoted single from the album has been broadcast but also that the third track on the album has unexpected heat and should be considered for secondary promotion. For music publishers, mechanical rights payments typically are now received 45 days after the close of the applicable quarter, whereas in the days of physical distribution, these royalties were received several quarters in arrears, after complex and obscure reserves calculations had been made to accommodate retailers’ right to return physical goods held on consignment.⁶ Perhaps most importantly, each “listen” on a streaming service is individually logged under the eyes of third-party auditors,⁷ creating a certified, high-resolution data set documenting music listening behavior and narrowing to a historical low the number of opportunities for nefarious accounting practices. Independent organizations like BuzzAngle⁸ and Nielsen⁹

Bill Colitre serves as general counsel and head of business development and royalty services for Music Reports, Inc. He also has served as counsel to numerous leading producers as well as artists, publishers, labels, digital aggregators, music services, and consumer products companies.
are now able to report with extreme granularity many hundreds of billions of streams by type (audio, video, on-demand, noninter- active, ad-supported, subscription) in nearly real time.

There are numerous fronts along which the business and law of the recorded music industry are still rapidly evolving. Two audio streaming segments are of particular interest, as they are now the largest parts of the recorded music business: on-demand streaming and noninteractive webcasting.

One cautionary note on downloading: sales from the downloading of singles and albums remain significant—together still comprising $2.3 billion in 2015—even as they are now declining faster than CD sales (perhaps because the “possession” of a downloaded file does not serve the same desire for artifacts that CDs do). The decline in these significant segments will create a stiff headwind against revenue growth until their cycles have fully tapered off, so the streaming segments of the business will have to demonstrate a great deal of growth in order to maintain the pace of total industry growth set in 2016. Prevailing predictions still expect relatively flat revenue growth for recorded music through 2020.

**On-Demand Audio Streaming**

Between its launch in October of 2008 and June of 2016, 100 million people worldwide had come to know on-demand streaming through the Spotify service based in Stockholm, Sweden. Approximately 50 million of these users are paying subscribers, while the rest receive the service with advertising inserted throughout the experience. Spotify’s nearest competitor, Apple Music, launched June 30, 2015, and has already exceeded 20 million paying subscribers; Apple Music does not have an advertising supported tier. At $10 per month per subscriber, these two services alone represent well in excess of $300 million a month in gross subscription revenue globally. It is difficult to find clear comparative statistics, but various indicators suggest that ad-supported on-demand streaming produces significantly less revenue, though the ad-supported segment still contributes a material incremental amount on top of subscription revenue.

The rights underpinning this business are primarily the rights to use the sound recordings (which the services obtain from recording distributors) and the musical compositions embodied in those sound recordings (which they obtain from music publishing adminis-

**Musical Compositions**

With respect to the musical compositions used in these streaming services, the identical consumer activity (on-demand streaming) implicates a remarkably different legal framework. Again, the primary activity involved is the transmission of an audio file from a server to a listener, suggesting the right of public performance (which, in the case of musical compositions, is not restricted to digital audio transmission). While the public performance right is common to interactive and noninteractive services, more emphasis in connection with on-demand streaming is arguably placed on the rights of reproduction and distribution. During the 2000s, a debate emerged as to whether the rights of reproduction and distribution are implicated at all by the mere transmission of an on-demand stream through a service not designed to retain a copy of the song at the receiving end. Numerous structural features of the music business as it evolved over the twentieth century helped shape that debate, including the fact that early in the century music publishers in the United States had evolved separate collective management organizations subscriber floors. This structure is overshad-owed, however, by substantial advance royalty payments that are often tied to “most favored nations” clauses that cause them to ratchet upwards under certain circumstances. To the extent not recouped by royalty earnings during a given contract period, these advance payments constitute a form of “breakage” in favor of the label, and for a long time it was not clear whether the labels intended to

**At this stage of the business cycle a set of relatively stable business models and new legal frameworks have emerged, edging out the traditional physical records business. While the business is certainly no less complex than it has ever been, this new paradigm has come with enormous benefits for consumers in terms of access, as well as for rights owners in terms of direct, rapid, and transparent accounting.**
around the public performance right and the so-called “mechanical” right, each of which has differing flows of revenue as between music publishers and songwriters. It was apparent early on that a business built on access would inevitably erode a business built on unit sales, which would consequently shift the relative economics of the performance societies vis-à-vis mechanical rights administrators. Moreover, the mechanical right in the United States is the subject of a statutory license, the fees for which are set by Copyright Royalty Board (CRB) arbitration proceedings every five years. The debate was settled in the context of the proceeding known as “Phonorecords I,” during which the parties—including the labels, publishers, and digital music services—agreed that the mechanical right would apply, agreed that it would be licensable pursuant to the Section 115 compulsory mechanical license, and established a royalty formula for this use that persists to the present time. As of this writing, the successor to that proceeding, Phonorecords III, is before the CRB, its trial phase having just been completed, and a final determination expected by December 2017. This proceeding will set rates and terms for the period 2018 through 2022. In the traditional physical record business, mechanical license royalties flow to publishers from record retailers through the record labels. For example, a label may obtain a mechanical license for a song from a music publisher and have one of its contracted artists interpret that song into a recording, which would then be sold wholesale to retailers. The statutory royalty rate operates effectively as a ceiling, because if the publisher does not agree to terms, the label can avail itself of the Section 115 license for making and distributing phonorecords. These royalties then flow back to publishers through the same chain, via the labels. This arrangement is fraught with data and accounting challenges that have led to historical underpayment problems, culminating most recently in a $264 million late fee settlement in 2009 referred to as the “Memorandum of Understanding” between the labels and publishers. As the on-demand streaming services emerged in the early 2000s, however, this structure shifted. Because the services are actually producing and distributing copies of compositions in this new “access” business, it falls to them to obtain the required mechanical licenses. Therefore, the labels must obtain mechanical licenses to make (and sell any physical or downloaded copies of) the recordings, and the DSPs must obtain separate mechanical licenses to operate their on-demand streaming businesses. Consequently, the publishers are now in direct privity of license with the parties exploiting their songs at the retail level for the first time in the history of the recorded music business. The services have a range of options in obtaining these licenses. They can contract directly with publishing administrators, collectively license via, for example, the Harry Fox Agency, which represents a group of affiliated publishing administrators, or avail themselves of the statutory license by sending each publishing administrator a Notice of Intention to Obtain a Compulsory License. In practice, most DSPs license their services using some combination of these approaches. The primary challenge, however, is that sound recordings are largely controlled by a relatively manageable group of distributors and each tends to be owned by a single party, whereas there are at least 57,000 publishing administrators who tend to own compositions in fractional shares. This creates an enormous transactional challenge in terms of licensing, license administration, and royalty accounting. This challenge, and the consequences of imperfection in meeting it, were laid bare in late 2015 and early 2016 when two class action lawsuits were filed against Spotify, and a separate $30 million settlement was announced with the National Music Publishers Association. The issues raised in these disputes bear a striking resemblance to those raised in the labels’ late fee settlement.

The royalty rates currently applicable to on-demand streaming services vary according to the type of offering a service provides. The rate that generally applies is roughly 10.5 percent of defined service revenue after application of several greater-of and lesser-of comparatives involving, among other things, a penny-rate per subscriber and a metric designed to maintain a rate that is roughly 21 percent of what the service pays to the labels for the corresponding sound recording rights. From this amount, monies paid by the applicable licensee for public performance rights are deducted, because they also flow back to publishers and songwriters. Each month, licensees are required to perform this calculation to arrive at a total royalty pool, which is then divided by the number of plays on the service to arrive at a per-play rate. The per-play rate is then applied to each

<table>
<thead>
<tr>
<th>Recorded Music Business Developments</th>
<th>1995 - Present</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>CD ROM drives become standard on computers, and Columbia House adds CD ROMS to marketing program.</td>
</tr>
<tr>
<td>1999</td>
<td>Napster triggers flood of peer-to-peer sharing of audio files.</td>
</tr>
<tr>
<td>2000-2010</td>
<td>After initial unprecedented windfall rise generated by CD sales, music industry revenues fall.</td>
</tr>
<tr>
<td>2015</td>
<td>Streaming revenue emerges as the largest segment of recorded music revenue (34.3 percent).</td>
</tr>
<tr>
<td>2016</td>
<td>Recorded music revenues finally return to growth with strong double-digit showing (11.4 percent).</td>
</tr>
</tbody>
</table>

6. Id.
7. Id.
play of a song on the licensee’s service, with adjustments for songs greater than five minutes in duration. According to the moving papers of the parties available at press time, a primary debate in the current Phonorecords III proceeding is whether this formula should continue, perhaps with adjustments, or be replaced by a simpler penny-rate per play or a pool based on a penny-rate per subscriber.

NonInteractive Audio Streaming

More people are likely familiar with non-interactive, advertising-supported webcasting services—for example, Pandora and iHeart Radio—which collectively have hundreds of million users in the United States alone. Pandora is the clear category leader in this segment: across all music streaming services, it held 25 percent of time spent listening, edged out only by YouTube. Some of these services are simply simulcasts or near simulcasts of traditional over-the-air broadcast radio stations, while others are programmed by computer algorithms designed to conform to individual listeners’ tastes and afford a limited number of “skips” forward.

As with on-demand streaming, the primary right type implicated by these services is the public performance of sound recordings via digital audio transmission. However, when these transmissions are not interactive, they are eligible for a compulsory license to publicly perform sound recordings by means of digital audio transmission, as well as a corresponding right of ephemeral reproduction, which addresses the server copies from which such streams emanate and any incidental reproductions made during the course of the transmission across the Internet. As with the Section 115 statutory mechanical license, these two statutory licenses are the subject of Copyright Royalty Board proceedings every five years. The most recent proceeding, governing rates and terms for the period 2016-2020, was styled “Web IV” and concluded in December 2015.

The Web IV proceeding considered a wide range of issues in determining the rates and terms for the applicable period. Among them was whether the penny-rate per-performance royalty structure that has prevailed since the first proceeding to determine such rates and terms should continue or be replaced with a greater-of-formulation taking into consideration a percentage of the licensees’ revenues. In the end, the per-performance model was retained, at a rate of $0.0017 per stream in 2016, indexed to inflation for the years 2017-2020.

If less than two-tenths of a penny sounds small, all those streams add up. All royalties generated by the Sections 112 and 114 statutory licenses are collected and dispersed by SoundExchange, an agency deemed the sole “Collective” by the judges of the Copyright Royalty Board in the context of the second proceeding to set rates and terms for webcasters. SoundExchange distributed a record $883.9 million in royalties in 2016, although it is not clear exactly how much of that sum was attributable to advertising-supported webcasting because the figure includes other business models eligible for the Sections 112 and 114 licenses that are not broken out (such as Sirius XM satellite radio and residential digital music services like Music Choice). It has been speculated that the majority of that figure is from webcasting and that more than half was paid in by Pandora alone. Whether Pandora’s payments to SoundExchange will remain as high is uncertain, given reports that Pandora has shifted its licensing strategy in connection with its move into subscription interactive streaming, which would require at least some licensing direct from the labels, and not pursuant to the statutory licenses.

Licensing Compositions

Virtually all of those streaming sound recordings (excepting, for example, comedy sketches) embody musical compositions that also must be licensed. Whereas on-demand streaming by industry-wide agreement implicates the mechanical right, the noninteractive streaming market is entirely focused on the public performance right.

Musical composition public performance rights licensing is traditionally managed in the United States by performing rights organizations (PROs). Although most territories have only one such organization, the United States traditionally has three: the American Society of Composers, Authors and Publishers (ASCAP), Broadcast Music, Inc. (BMI), and the smaller Society of European Stage Authors and Composers (SESAC). Recently, however, the notable artist manager Irving Azoff founded a new PRO called Global Music Rights (GMR), and there are signs that other entities may be planning to begin administering U.S. public performance rights on a collective basis as well.

Because they constitute collective bargaining units with significant market power, ASCAP and BMI were sued by the U.S. Department of Justice (DOJ) during the middle of the last century (ASCAP in 1941; BMI in 1966) under the Sherman Act and have labored ever since under consent decrees administered by the U.S. District Court for the Southern District of New York. In recent years, antitrust scrutiny of the PROs has led to major shifts in the performance rights landscape that had been relatively stable for several decades prior.

Since its inception in 1927, SESAC has managed to avoid coming under DOJ scrutiny, perhaps because its repertoire was small enough, relative to that of ASCAP and BMI, that its impact on the market evaded government review. Recently, however, the Television Music License Committee and the Radio Music License Committee (RMLC) that negotiate collectively with the PROs on behalf of their respective industries, have challenged SESAC in private antitrust actions. Notably, in 2014, the RMLC won a ruling against SESAC in the Eastern District of Pennsylvania that may also impact GMR and any future PROs that may emerge in the United States. SESAC sought a motion to dismiss the claim by RMLC that SESAC violated Section 2 of the Sherman Antitrust Act because it monopolized the relevant market, i.e., the market for SESAC’s repertoire, through anticompetitive conduct. In denying SESAC’s motion to dismiss, the court found that the RMLC’s complaint “cogently portrays how SESAC allegedly obtained and preserves its monopoly power through exclusionary conduct...by obtaining a critical mass of must-have works, selling them exclusively in the blanket license format, discouraging direct licensing by refusing to offer carve-out rights and obscuring the works in its repertoire.” The case subsequently settled, and SESAC agreed to become subject to a binding arbitration regime with the RMLC, roughly echoing the rate-setting procedure set forth in the consent decrees for ASCAP and BMI.

DOJ Review

In 2014, ASCAP and BMI requested that the DOJ review the consent decrees, hoping to have them limited or eliminated. During the process, however, it emerged that the PROs had differing views from the DOJ on how the PROs’ blanket licenses operate with respect to compositions fractionally owned by multiple parties in which one or more of those parties are affiliated with different PROs. Thus, rather than substantially reducing or eliminating the decrees, the DOJ interpreted the existing consent decree as prohibiting ASCAP and BMI from issuing licenses solely to their controlled share of a work. They effectively interpreted all existing ASCAP or BMI grants of license as extending to the whole of the work, regardless of the PRO’s controlled share. In reaction, BMI filed suit with the U.S. District Court of the Southern District of New York on the “fractional licensing” issue, and the court ruled in favor of BMI. The DOJ then appealed that ruling to the Second Circuit, where it currently resides. ASCAP, meanwhile, has elected to take a legislative approach to the matter.

Against this background, a licensee must seek licenses from each of ASCAP, BMI, SESAC, and GMR, each of which controls separate repertoire. The rates and terms of such licenses with ASCAP and BMI are well
known, as they have typically been set through the public process dictated by the consent decrees. The most recent precedent for noninteractive audio streaming was effectively 1.85 percent of revenue for ASCAP and 2.5 percent for BMI. Not subject to consent decrees, SESAC and GMR are free to negotiate their rates through private, free-market negotiations; therefore, comparative figures are not readily available.

Thus, at this stage of the business cycle, a set of relatively stable business models and new legal frameworks have emerged,ouding out the traditional physical records business. This evolution has replaced a “unit sales” business model with a range of services based around access to streaming music, whether on a noninteractive or on-demand basis and whether advertising-supported or subscription-based. While the business is certainly no less complex than it has ever been, this new paradigm has come with enormous benefits for consumers in terms of access, as well as for rights owners in terms of direct, rapid, and transparent accounting. Looking to the future, however, the lack of profitability among the leading streaming music services constitutes a dark cloud over prospects for long-term stability in the business. It remains to be seen whether there is sufficient market demand for these emerging models to scale to profitability, or whether further drama lurks in the offing.


5 See 17 U.S.C. §115(c)(5); 37 C.F.R. §210.16(g)(1).


7 See 37 C.F.R. §210.16(f)(1)(v)(b) (monthly statement of account (MSOA) prepared by third party must be accompanied by certification that the MSOA was prepared using “processes and internal controls” subject to examination by CPA applying recognized accounting standards).


7 See Todd Brabec & Jeff Brabec, PRO Licensing - Multiple Choices, Considerations and Results, AIMP ARTICLES, http://www.aimp.org/aimpArticles/7/PRO_Licensing_Multiple_Choices_Considereations_and_Results (last visited Mar. 8, 2017).


14 Id. at 3.


---

ROSS MEDIATION SERVICES

Integrity | Commitment | Success

SPECIALTY AREAS

- Real Estate
- Mortgage & Lending
- Trusts & Estates
- Construction
- Personal Injury

- Business/Commercial
- Escrow/Title/Agency
- Workplace
- Multi-Party
- Professional Liability

BARRY ROSS, ESQ., MBA
818.840.0950
www.ROSSmediation.com

---

THE NATIONAL ACADEMY OF DISTINGUISHED NEUTRALS

The Nation’s Top Litigator-Rated Civil Mediators & Arbitrators

View 900+ detailed bios and available dates calendars, free roster at www.NADN.org

Proud ADR Partner to the National Plaintiff & Defense Bar Associations

The Voice of the Defense Bar

---

The world's leading immigration law firm right here in Los Angeles

FRAGOMEN WORLDWIDE

A world of difference in immigration. From visas and work permits, to advisory services and corporate compliance, we work with each client to understand their business and immigration priorities. As the industry leader in immigration law, we're here in Los Angeles working with individuals, investors (EB-5), families, small startups, mid-size local companies and large corporations in the state's most prominent industries.

Fragomen, Del Rey, Bernsen & Loewy, LLP
444 South Flower Street Suite 500 Los Angeles, CA 90071

Mitch Wexler, Partner • mwexler@fragomen.com
Chad Blocher, Partner • CBlocher@fragomen.com
Michael Boshnak, Partner • MBoshnak@fragomen.com
When Film is Not Much More than a Bathtub Ring, Television is for the Elderly, and “Digital” Does Not Refer to Fingers or Toes

By Peter Dekom*

“I’ve never felt the nervous energy in Hollywood that I’ve felt over the last 12 months, and it increases every day. There’s an uncertainty about the future, because the change is happening in an incredibly dramatic way... I make a show for Apple. They sell a million more phones — how are you ever going to connect those two things? With Amazon and Apple, they don’t ever have to be just in a profitable business on movies and TV shows. That’s crazy! And it makes people go nuts, because people have worked so hard to put a business model around content, and now they’re competing with people who don’t need to make that profit.”

Horror master producer, Jason Blum, NY Times, June 20, 2019

We all thought new content delivery technologies, as disruptive as they always are, were at least going to give consumers more choices and creative film and television talent more outlets... that the demand for content would explode and the dollars would follow in hot pursuit. It sort of did. Sort of. While the world focused on those technologies – driven by the foundation of that 1/0 “digital” construct combined with the growth explosive bandwidth and ubiquitous delivery devices – what most of us missed was the virtual eradication and displacement of our underlying business models.

Oh, we wrote about them... piecemeal. Napsterization was a popular phrase. Streaming was interesting, advertiser or subscriber based adding “on-demand” so we get new terms like AVOD or SVOD. Hybrid models. We watched the rise of social media, MySpace died as Facebook and Twitter soared. Compact device delivery systems faded into the deep recesses of collectors and luddites, evidenced by the demise of Blockbuster. We used cool new words, like over the top (OTT), but even that usage faded.

In the background, in just over a decade a mail-driven DVD rental company morphed into a massive behemoth worth, as of this writing, $130 billion, a player worth more than most major studios. Impressive but not the significance that we should be focused on. We forget that in 2000, Netflix offered to sell itself to Blockbuster for $50 million! What Netflix really did was force a pervasive and dramatic change in every aspect of the film and television business model. They were the snowball that unleashed the avalanche. But with that snowstorm, Netflix now faces an existential battle in the upcoming streaming wars discussed below.

*A graduate of Yale University and the UCLA School of Law, Mr. Dekom has practiced entertainment law for over four decades, being named by each of the Century City Bar Assn, ABA Forum on the Entertainment & Sports Industries and the Beverly Hills Bar Assn as entertainment lawyer of the year.

© Peter Dekom, 2019
I. The Migration of Independent Films from the Big Screen to Consumer-Based Digital Platforms.

With about 4,000 new English-speaking feature-length independent motion pictures still being produced annually, you’d guess that that world is robust and lucrative. Guess again. Under 1% of that batch ever find anything close to a genuine release anyway, and most of that product finds its way onto the small screen, digital or otherwise. Well-structured documentaries are doing better than in recent years, although competition for distribution is still horribly competitive, but dramatic fare is struggling. With a few exceptions – *my category of five*, where sharing the experience with an audience has value or where an older audience still make the trek: truly spell-binding horror films, fall-on-the-floor hard comedies, faith-based/"patriotic" specialty releases, films that made a splash overseas and films targeting kids (especially animated) – the U.S. theatrical market (release in movie theaters) is all-but-closed to indies, particularly those with modest to lower budgets. Hot preexisting IP rules, and most writers don’t have the money to option those titles.

While soft money has absorbed some of the financial pain of film and television production, the fall in demand for indies internationally is not good news for lawyers whose bread and butter is based on these films. This is also particularly challenging to filmmakers who have typically relied heavily on international territorial presales to provide production capital (usually discounted by banks relying on completion bonds). International buyers increasingly add the demand for a wide theatrical release in the United States as a precondition to payment, but U.S. distributors have learned that smaller films cannot compete against the mega-productions from Hollywood majors. The scoundrel: marketing and distribution costs for a domestic theatrical opening have skyrocketed. U.S. theatrical deals for indie films have become as rare as hens’ teeth. Some films, however, are either so inexpensive or have such an obvious international cachet that they can avoid this U.S. release mandate. Feel the digital alternative quivering in the background yet?

Where an indie still needs that U.S. theatrical release (many international buyers insist on a wide US theatrical release as a precondition to their minimum guarantees), it is often required to put up all releasing costs to open their film – $15 million and up for a release on at least 1500 screens – without getting a dime in the way of an advance against their production costs. Many of the distributors who are open to indies also require an advance of six figures against the ultimate distribution fee and often require that all the ancillary exploitation flow through their deal as well. Traditional majors are picking up almost no independents for theatrical release these days.

So, as US theatrical is drying up for produced feature films, television, particularly from the digital streamers, has become the practical “first screen” for seriously-themed independents – if they are lucky enough to find a buyer even in that medium. Most of those films will simply sit on a shelf until the filmmaker relents and places their production on some lesser digital channel...
pretty much creating a financial disaster for the financiers who made the film happen. But make no mistake, in a world of high-flying and very expensive fantasy filmmaking, even the most established filmmakers wanting to continue with dramatic fare are often forced to deal directly with telecasters and not major studios for financing.

A few still get the big screen as the main show (like Quentin Tarantino); most do not. Getting on that big screen is elusive. Dealing with the devil – digital telecasters with the money and willingness to finance dramas – creates a very different agenda than studios focused on high-production value big-screen releases. These established filmmakers may accept that primary exploitation of their babies may require a small screen emphasis, but they want their sunshine moment on the big screen too. Unfortunately for these filmmakers, this new digital television universe is viewed as “the enemy” by all the big US movie theater chains.

Motion picture exhibitors, who have fought each wave of motion picture viewing – from cable television to all forms of home media – believe that they are facing an existential crisis. Most experts agree that at 40,000 screens, the United States is 15,000 screens too many. But movie theaters are not easily repurposed and generally have a single occupant. An office building can be reconfigured. A hotel can become an apartment building. But what can you do with a multiplex with raked auditoriums, a stage focal point and a projection booth?

Exhibitors see high profile filmmakers as a wedge, as large caliper brakes, in the battle between their big screens and the incredible power of the digital behemoths with more money than they know what to do with. The fight centers around streamers using these uber-creative filmmakers and talent to force a theatrical release... and the exhibitors’ insistence that those new digital (and other) networks to honor a full 3-month US theatrical only window. Academy Award nominee, Roma, found only 21 days of exclusivity, which pleased neither filmmakers nor the theater owners.

With a pile of high-profile features coming down the pike, both Amazon and Netflix have to cater to the demands of this level talent. But the big chains are unrelenting in demanding a full normal window. Even as Netflix strained to allow a 42-day exclusive US theatrical run for its “big” movies, the biggest chains balked. Three months or nothing. With a $159 million budget Martin Scorsese gangland film, The Irishman, slated for a November 2019 release, the inability to achieve a truly wide release without losing that marketing hook of an early streaming window, it is difficult to see how Netflix can hope to generate returns at least to break even.

The other rather obvious reality is the economics of television are predicated on consumer loyalty, whether advertising or subscription driven (or both). While movies are always popular to some level, there are lots of available titles anyway, and viewers tend not to spend more than 30% of their viewing time on services like HBO, Netflix and Amazon on movies. What drives these telecasters is the addiction of continuity that only happens with series productions. To filmmakers focused on one-shot movies, this commercial reality denigrates the value of their
dramatic efforts unless there is a resulting series... or if the one-shot is so exceptionally high profile that it increases subscription or ad rates. Add binge viewing to this reality, and one-shot dramas become worth even less to telecasters.

So, as the digitization of home viewership has completely altered the business model, the underlying values of owning and controlling this direct-to-consumer digital streaming medium have become increasingly “must-haves” for the major studios and networks of old. That streaming services are voracious acquirers of content has placed a new value on massive libraries and the ability to access hordes of high-profile talent able to create those highly desired series. And while there are currently about 520 scripted English-language series being produced, more than half of that content is underperforming. Everybody wants “the good stuff.” And that is why the economics of the film and television industry have altered, creating perhaps the biggest economic change in our industry... ever.

II Consolidation and Exactly Who is Paying for That?

The future seems to belong to those who control the most content. Netcasters like Netflix, Amazon and Hulu have staggering values, easily competing with old-world content monoliths. With 5G mobile access just around the corner, the ability to view elegant, rich media content, delivered with almost no latency at download speeds that start at 10 times 4G speeds, being able to provide massive of “whatever I want, when and wherever I want it” has become a corporate goal for major media players around the world. Younger eyes – Y and Z generation – have no issues with a small, smart phone screen... older viewers, it’s a push! Tablet-size?

Here are the numbers behind the trend: “U.S. consumers are expected to spend a combined $26 billion on music and video subscription services this year, according to new estimates from the Consumer Technology Association. That’s up from $20.4 billion in 2018, and nearly twice the amount spent on such services in 2017.

“Propelled by the continued success of Apple Music and Spotify, domestic music streaming revenue alone is expected to reach $8.4 billion this year. This represents a 33% growth over 2018 results... Revenue from paid video streaming services on the other hand is expected to be up 25% year-over-year, to the tune of $17.7 billion for 2019. The Consumer Technology Association credits live TV services with some of the momentum for paid video streaming.” Variety.com, July 15, 2019. And that’s the goldmine the biggest players have their eyes focused on.

But is there a limit? Consumers are being charged left and right for online/mobile subscription fees while some streamers have managed to bury those fees with bundled packages (internet carriers/mobile providers, Web-retailer/streamer Amazon, etc.). Cable is/was expensive, but is the aggregation of cord-cutting alternatives turning out to be even pricier? Add an expected recession, and will the cord cutters start paring their selections to just a few “vital” services?
Those with the most “best” content? Will AVOD (advertiser-supported video on demand streaming) grow? Or will advertiser skepticism and more reflective metrics create further credibility, and hence revenue, challenges there too?

We all sense that the numbers on the wall for traditional pay television are not particularly encouraging; many such services have added digital subscription services (OTT, over-the-top) as insurance policies. “Subscriptions to traditional pay TV remained flat at 65 percent, says [accounting/consulting giant] Deloitte [in the survey noted below], which changed the way it asked about pay TV, so the 2017 data is not directly comparable to 2018’s... Many households (43 percent) have both pay TV and a streaming subscription. More than half (52 percent) of Generation X consumers (ages 36-52) do.

Let’s start with the big picture: “Last year, half of Americans aged 22 to 45 watched zero hours of cable TV. And almost 35 million households have quit cable in the past decade... All these people are moving to streaming services like Netflix (NFLX). Today, more than half of American households subscribe to a streaming service... The media calls this ‘cord cutting.’

“This trend is far more disruptive than most people understand. The downfall of cable is releasing billions in stock market wealth... Combined, America’s five biggest cable companies are worth over $750 billion. And most investors assume Netflix will claim the bulk of profits that cable leaves behind... So far, they’ve been right. Have you seen Netflix’s stock price? Holy cow. It has rocketed 8,300% since 2009, leaving even Amazon in the dust...

“But don’t let its past success fool you... Because Netflix is not the future of TV. Let me say that one more time... Netflix is not the future of TV... But for now, let’s talk about Netflix’s biggest problem...Netflix changed how we watch TV, but it didn’t really change what we watch... Netflix has achieved its incredible growth by taking distribution away from cable companies. Instead of watching The Office on cable, people now watch The Office on Netflix.

“This edge isn’t sustainable... In a world where you can watch practically anything whenever you want, dominance in distribution is very fragile... Because the internet has opened up a whole world of choice, featuring great exclusive content is now far more important than anything else...

“Netflix management knows content is king. The company spent $12 billion developing original shows last year. It released 88% more original programming in 2018 than it did the previous year... And spending on original shows and movies is expected to hit $15 billion this year... It now invests more in content than any other American TV network... To fund its new shows, Netflix is borrowing huge sums of debt. It currently owes creditors $10.4 billion, which is 59% more than it owed this time last year.” Stephen McBride writing for Forbes.com, May 21, 2019.

You mean make or break content like HBO’s Game of Thrones? Or like that massive accumulation of content that Disney controls that will soon be Netflix worst nightmare? We know. Traditional
television is fading fast. Content consumption patterns are changing almost as fast as the weather. Through all of this, Netflix continues to borrow heavily, debt predicated on continued growth. But what happens when a market gets saturated – not very many households left to sell – or new competition puts pressure on pricing and choice? See some serious issues down the road for Netflix? Exactly how fast is all this going to happen anyway? Faster than most think.

“Traditional pay-TV subscriptions do continue to trend downward. Last year, the major pay-TV providers lost about 2.9 million subscribers, after accounting for about 640,000 new subscribers to streamed live TV services such as Sling TV and DirecTV Now, according to Leichtman Research Group. Overall 89.1 million subscribe to pay TV, down from 92 million in 2017, the research firm says.” USA Today, March 19, 2019. But it’s not just the major pay services that are suffering; it’s a macro-trend. And entertainment conglomerates are more than acutely aware of these changes, as I will illustrate in greater detail later.

As we have seen, most recent reports illustrate how “cord-cutting” is just accelerating across the board, and clever repackaging into fewer available networks (“skinny bundles”) isn’t stemming the hemorrhaging. “The pace of cord cutting is continuing to accelerate this year, according to a new Convergence Research Group report, with 4.56 million TV households opting to ditch pay TV. By the end of the year, 34% of U.S. households won’t have a traditional TV subscription, according to the research company’s latest ‘Battle for the American Couch Potato’ report.

“In the report, Convergence estimated that the pay TV industry will see a 5% decline in pay TV subscribers in 2019. That’s up from 4% in 2018, when an estimated 4.01 million U.S. subscribers ditched their TV service. Based on the top 66 online video services, the number of streaming subscribers will actually surpass the number of traditional pay TV subscribers this year (households can subscribe to both).

“Attempts to convert cord cutters to skinny bundle subscribers won’t pay off for the industry, Convergence predicted. ‘With ARPU [average revenue per user] half the traditional TV average, lackluster margins, programming gaps and technical issues, live multichannel OTT provides little counter to category killers Netflix & Amazon that sell at lower price points and essentially without advertising,’ the report outlined. ‘We believe a number of OTT plays, including large and niche, will fail due to insufficient subscriber traction, cost, and competition.’

“Altogether, online video services are poised to bring in $22 billion in 2019, up from $16.3 billion in 2018, according to the report. Last year, that revenue already grew by 37%. However, even with this growth, traditional pay TV is still expected to bring in more than 3 times as much money per household, and more than 4 times as much across the entire industry, as much as over-the-top video.” Variety.com, April 22, 2019

Desperation is driving some providers to attempt to stem their losses by increasing the prices of even their cheapest skinny bundles, which in turn drives away potential subscribers. “The price for the cheapest DirecTV Now bundle went from $35 to $40 last summer, and the telco phased
out virtually all of its promotional pricing, which allowed some wireless subscribers to stream DirecTV Now for as little as $10 per month.

“The latter already contributed to significant defections over the holiday quarter. Over the past two quarters, AT&T lost a total of 350,000 DirecTV Now subscribers. It’s likely that the service will see additional cancellations from price-sensitive customers in the coming months: AT&T further increased the price of the cheapest DirecTV Now bundle to $50 per month in April...

“[Even] new entrants [like Hulu and YouTube TV] may not be immune to defections as the prices for these so-called skinny bundles are getting fatter across the board. Sports-focused fuboTV announced a $10 price hike in March, and Hulu and YouTube TV both raised their prices by $5 over the past couple of months.

“These massive pay TV defections are increasingly impacting the media industry at large. Discovery reported a 4% decline in subscribers to its cable networks for Q1, despite the addition to online TV bundles... [Research firm, BTIG, LLC’s analyst Richard] Greenfield expects that cord cutting will also ‘negatively impact broadcast and cable network programmer retrans/affiliate revenues’ in the current quarter. And he doesn’t expect online TV bundles to make up for those losses, despite the fact that programmers get paid more per online subscriber since ‘churn is dramatically higher’ for online bundles.” Variety.com, May 3, 2019. The ship is sinking, and moving the leaks around isn’t going to reverse the obvious.

The trends are even more pronounced, particularly as you look at millennials and Gen-Z: “For example, 70% of Gen Z households had a streaming subscription, closely followed by millennials at 68% and Gen X at 64%. About 70% of Gen Z and millennials stream movies compared with 60% of Gen X viewers on a weekly basis. Some 96% ‘MilleXZials’ multitask while watching TV.” Variety.com, March 20, 2019.

When you mix in the general population, the streaming numbers are less pronounced. “Parks Associates' OTT video research finds household spending on subscription OTT video services has held steady for three years, averaging just under $8 per month since 2016. Given the growing adoption of OTT video services over the past three years, these figures suggest that adoption of multiple services or expensive services by some consumers is offset by a larger base of consumers who either subscribe to one or two relatively inexpensive services, including 30 percent of consumers who do not spend any money on OTT video services.” MENFN.com, March 20, 2019. For those households with streaming services, they average a much larger $38 per month, which is growing fast.

Thus, it is clear that television as a medium is rapidly migrating into “all digital,” mostly as a subscription-fee-supported format (streaming video on demand, SVOD) with some AVOD and hybrid subscription/advertising platforms in the mix. AVOD is sneaking up on the industry with
some surprising numbers. Streaming service Hulu is an A/SVOD hybrid, but “the majority of Hulu subscribers are on the $5.99-per-month ad-supported plan, which is half the price of the $11.99 no-commercials version.” Variety.com, May 29, 2019. Is this a reflection of increasing consumer price-sensitivity?

Deloitte examined these Web-delivered-content trends in its latest and 12th annual Digital Media Trends survey released on March 19, 2019, which polled 2,003 American digital consumers from December of last year through February of 2019. 69 percent of those surveyed subscribed to at least one SVOD service (up from 55 percent last year), with the average such consumer subscribing to three.

“Even as more consumers subscribe to video delivered over the internet, nearly half (47 percent) of those surveyed say they are experiencing subscription fatigue… There’s now more than 300 streaming services to choose from – up from 200-plus a year ago – and consumers may be feeling overwhelmed, says Kevin Westcott, Deloitte’s vice chairman for U.S. telecom, media and entertainment.

“Well over half (of consumers) say they are frustrated when shows they like disappear or are no longer on a streaming service and that they have to have multiple subscriptions to get what they want,’ he said. ‘So there is a little bit of subscription fatigue.’

“Those consumer sentiments could concern a marketplace that’s bracing for the arrival of two major players later this year – a Disney+ subscription service with Disney, Pixar, Lucasfilm and Marvel movies and original TV series, and an AT&T offering with HBO [to be available online solely through Warner’s nascent streaming service] and other Time Warner content – and an NBCUniversal subscription service in early 2020.

“Also growing: subscriptions to streaming music services such as Spotify and Apple Music (41 percent, up from 26 percent a year ago), and video game services including Xbox Live and PlayStation Plus (30 percent vs. 26 percent last year).

“These consumer behaviors could lead streaming providers to develop ‘the next generation of the home entertainment platform,’ Westcott said. Such services would have coveted original content, but also ‘a broad swath of entertainment options inclusive of music and games,’ he said. ‘It may not be their own content, but they have to have that available to try to keep me under their umbrella.’” USA Today.

Streaming is big business and getting bigger, $2.1 billion a month here in the United States. These numbers are great motivators. Fatigue or not, there is a rush among entertainment conglomerates, with the cash and credit to engage in the race, to aggregate as much content under one roof as possible. They believe that this is the way to ensure that as consumers
ultimately pick and choose which services to keep and which to cut, these massive content providers will be on that “must subscribe” list.

But then why is CBS, which has its eyes on its former owner Viacom, offering Lionsgate $5 billion for that mini-major’s Starz pay television channels? Until that offer, Lionsgate’s stock had plunged 40% in a single year, analysts saying it failed to replace aging motion picture and television franchises. Without Starz, what is Lionsgate anyway? It is an offer that’s simply too good to ignore, but what exactly would Lionsgate do that substantial sum? If they couldn’t manage to create value for the rest of the company, what would their business plan be going forward without their greatest asset?

For CBS? It’s content, library fare and original series. And content, even from an old-world pay service, can easily migrate to a full-digital only stream. Lionsgate countered at $5.5 billion, and the deal slid from view. Permanently? Rumors of a possible Lionsgate/MGM merger began to surface. Who knows? CBS then turned its attention to acquiring its former parent, Viacom, which owns Paramount, Nickelodeon, the MTV Networks to name just a few of its assets. CBS is hungry. It’s main network (broadcast and its streaming component) plus Showtime (pay television) just aren’t enough to compete with the rising streaming behemoths. Will Comcast’s Peacock (NBC) streaming service, launching in April 2020, be able to aggregate enough content to be competitive? So…. Time will tell who the winner and losers are, but consumers are getting new ways to receive content.

There are future trends suggesting that consumer demand for content is likely to escalate as 5G mobile services come online and as Uber, Lyft and driverless cars give passengers even more time to consume content. The volume of such content offers opportunity, but that same volume suggests that the revenue margins will only get thinner. Some are predicting that the chopping up of a consumer day, clearly referring to changing commuting patterns, will give rise to greater demand for short-form audio-visual content, mostly intended for small-screen smart phones. Certainly, Jeffrey Katzenberg’s and Meg Whitman’s billion-dollar Quibi is being built on that assumption. One way or another, the world of content control seems increasingly divided between buyer/aggregators and exit strategy sellers. Existential.

That little mobile-viewing trend just might not be so little, and 5G is going accelerate the transition. “In the United States, adults will spend an average of 3 hours and 43 minutes each day on their smartphones, feature phones and tablets this year, eight more minutes than they’ll spend watching TV, according to a forecast released [June 5, 2019] by research firm EMarketer.

“The change has been years in the making, as smartphones have become nearly ubiquitous and the ways people use their devices have shifted. Phones now let you do more than steal quick glances at social media, and streaming shows and movies on the smaller, portable screens has become commonplace... There is far more content today than there was even a couple of years
ago,’ said Monica Peart, a senior forecasting director at EMarketer, referring to the growth of streaming platforms such as Netflix and Hulu. ‘All of this is driving the need or desire to be on the smartphone.’

“The gap between the amount of time spent on mobile devices and TV has narrowed dramatically over time. Last year, American adults spent nine minutes more watching TV than looking at their phones and tablets, EMarketer said. But TV watching used to be more dominant; just five years ago, adults spent two hours more watching TV than using mobile devices, the firm said.

“The forecast follows other reports, including one by Nielsen, that indicate audiences are spending less time with traditional television. In the third quarter of 2018, Nielsen said, American adults on average spent 4 hours and 14 minutes each day on live or time-shifted TV, 11 minutes less than a year earlier. Time spent on apps and the web on smartphones and tablets in the third quarter was 3 hours and 14 minutes, 17 minutes more than a year earlier, Nielsen said.” Los Angeles Times, June 6, 2019. Which content will benefit most from the migration to this small screen? Too much content? Confusing to consumers? Overwhelming? A big shakeout? Time will tell.

While this article has focused mostly on audio-visual content, there are lessons to be learned from our neighbors in the music business. Just as digital delivery is altering the film and television industry in a huge way, changing the landscape on access to audiences and slowly replacing older models, the Napsterization of the music industry moved the big bucks for major artists to live performances – hmmm, sort of like the domination of the theatrical world (especially in the U.S.) by high-production value/”must see” motion pictures; the rest have found “new TV” – and almost totally replaced physical compact discs with downloads and increasingly rapidly by streaming services.

From a “moribund and falling” music business model two plus decades ago, the transitional growth in digital delivery has been monumental in recent years. “The global recorded music market grew by 9.7% in 2018 — its fourth consecutive year of growth — to $19.1 billion, according the latest annual report from the International Federation of the Phonographic Industry (IFPI).

“Streaming revenue grew by 34.0% and accounted for almost half (47%) of global revenue, powered by a 32.9% increase in paid subscription streaming, according to the report. There were 255 million users of paid streaming services at the end of 2018, with paid streaming accounting for 37% of total recorded music revenue. Growth in streaming more than offset a 10.1% decline in physical revenue and a 21.2% decline in download revenue.” Variety.com, April 2, 2019.

In this mad rush, what has happened to the indie film business seems to be sending a message to the entire industry: unless you are small with a powerful, oversized content reach, “small” is
getting crushed by “big and getting monolithic.” Smaller players are being squeezed, and “indies” in all aspects of the industry are getting the message. Even in the personalized public relations corner, consolidation is taking place: “Entertainment agencies PMK-BNC and Rogers & Cowan are joining forces, bringing together a client roster of more than 500 actors, musicians, producers, directors, content creators and athletes.

“This is a game changing and transformative moment for our agency, and a move that will create significant value and tremendous opportunities for our company and clients around the world,” said Mark Owens, CEO of Rogers & Cowan.” Variety.com, July 30, 2019. Bigger. More. Hitting monoliths and new consolidation efforts with new combinations and strategies. Winners. Losers.

Ah… it is clear that glomming on to content, volumes and volumes of it, is increasingly viewed by the behemoth entertainment conglomerates as their only path to survival. Owners of digital systems are be equally aware that having lots of branded content could well be the key to keeping consumers on their networks. And so it is and has been for a while.

Comcast bought NBC/Universal including all of its basic networks. AT&T bought DirecTV and then Time Warner (now WarnerMedia, which includes Turner, CNN and HBO). And then there’s the voracious Disney: In 1996, Disney bought Capital Cities/ABC for $19 billion, in 2006 Disney acquired Pixar for a combined stock and cash value of $7.4 billion, in 2009 it picked up Marvel for $4.3 billion (in 2013, $100 million more to buy out distribution rights to a few Marvel titles held by Paramount), buying Lucasfilm in 2012 for $4.06 billion, but the piece de resistance, 21st Century Fox (minus the Fox lot and some broadcast assets retained by the Murdoch family and their shareholders), was acquired by Disney for a whopping $71.3 billion.

The driving force behind such massive acquisitions? CEOs watched nothing entertainment companies grow so fast that their values equaled or exceeded the values attributed to entire major studios. Streaming and the extreme values that both Amazon and Netflix generated in a very short period of time. From its founding in 1997, Netflix has grown into the largest streaming service in the world, about 150 million subscribers worldwide as of this writing.

“Netflix — whose name has practically achieved verb status — was the fastest-growing brand from 2018-19 among American companies, according to a new study by Brand Finance, a global brand-valuation consulting firm.

“The streamer’s estimated brand value more than doubled over the past year, growing 105%, to $21.2 billion, per the study. Brand Finance calculates values of brands using ‘royalty relief’ methodology, which involves estimating the likely future revenue that are attributable to a brand by calculating a royalty rate that would be charged for its use.” Variety, March 28, 2019. The very word, “Netflix,” send quivers of fear and anger through the bodies of big-company CEOs in the
entertainment industry. Time Warner, Disney, Comcast, and AT&T CEO’s were no exceptions. Obviously. They were playing catch-up, and they clearly did not like dealing from so far behind.

There’s a lot of competition brewing, and many believe that has Netflix maxed out, at least in the U.S. market. The PwC Global Entertainment & Media Outlook 2019–2023 (released June 5, 2019) said it simply: “Netflix appears to be nearing its peak subscriber point in the U.S... The first-mover advantage in streaming video that Netflix has capitalized on to date continues to be eroded, as the industry begins to fragment, with more and more companies entering the market, from pay-TV heavyweights to specialized, niche players.” The recent acceleration of major corporate mergers and acquisitions in the entertainment space seemed to be focused on building streaming competition. The dollars involved were staggering.

After the Fox acquisition in March of this year, which required approval from governments all over the world, Disney controlled a full 27% of the U.S.-based theatrical motion picture industry, picked up a greater ownership share of Hulu (in May, it subsequently closed a deal with Comcast to buy the rest) and began a push to create a new streaming service able to compete with Netflix.

In the course of its negotiations to acquire Fox, facing competition from Comcast, Disney was forced to up its bid by $20 billion, and that extra cost literally pushed Disney to justify that extra sum by generating extra revenue fast – not really possible – or by slashing costs every way it could. In March, when the acquisition closed, it announced an immediate cut of Fox/Disney employees from top to bottom of an initial 4,000 employees, with experts predicting at another 3,000 would be let go in the near term. Disney issued a “layoff” warning on May 15, 2019.

With the two most profitable motion picture franchises in history, *Avatar* and the recent *Avengers: Endgame*, ownership of Hulu, you’d think Disney is just killing it: “Conventional wisdom may hold that the Walt Disney Co. has been firing on all cylinders, with its $71.3 billion partial merger with 21st Century Fox closed, streaming service Disney+ on pace to launch Nov. 12 and *Avengers: Endgame* rewriting the record books. But there are signs that a perfect storm of (gasp!) mediocrity for the $240 billion conglomerate may be on the way thanks to digital investments and the film calendar — at least for the short term. The third quarter earnings were less than expected, at least less than Wall Street expected. Even as Disney faced the cost of building its streaming business, the reduction was attributed mostly to disappointing theme park admissions.

“Disney CFO Christine McCarthy disclosed May 8 that the creation of Disney+ and ramp-up of ESPN+ will dent operating income to the tune of about $460 million in the current quarter alone. The company intends on spending about $2.5 billion on original and licensed content for Disney+ in fiscal 2020, rising annually to $4.5 billion in fiscal 2024. Peak operating losses for the upcoming streamer are expected from 2020 to 2022 before it hits profitability in 2024. Oh, and its $400 million investment in Vice Media is essentially worthless.
“These digital expenditures will occur as Disney services its debt load, which swelled to $57 billion post-Fox, and as its TV business suffers from 2 percent annual cord-cutting (operating income at Disney Media Networks fell 3 percent in fiscal 2018). Plus, CEO Bob Iger [completed a purchase of the remaining non-Disney stake in Hulu, which required] Disney to shell out about $5 billion to purchase Comcast's one-third stake in that streamer.

“The costs are definitely making their way to the financial statements,’ says Moody's lead analyst Neil Begley. ‘I’d say Disney is entering a high-scale investment cycle, and they’ll eventually feel a hangover.’ And Disney may also have to contend with a (relatively!) soft 2020 film slate, with *Avatar 2* pushed a year to Dec. 17, 2021, while the next *Star Wars* movie won't debut until Dec. 16, 2022.” HollywoodReporter.com, May 13th. Are you listening, entertainment bar?! How do studios respond to such pressures in their deal-making?

Here’s another little tidbit apparently under consideration, how Disney may well deploy its new and massive leverage against competitive program suppliers with their Hulu streaming service: “Most shows in the future will originate from Disney-owned studios, but where another studio wants to sell a show to the service, Hulu will ask that a Disney shop (like ABC Studios or 20th Century Fox Television) come on as co-producer, ensuring long-term profit sharing.” SeekingAlpha.com (investment analysis), June 21, 2019.

And then there’s the combined WarnerMedia AT&T debt of $170 billion generating somewhere around $6.7 billion a year in interest payments alone. It’s no secret that this new conglomerate is putting together its own massive layoff and cost-cutting plans. Turner, CNN and HBO, part of the WarnerMedia group, have already offered buyouts to long-standing employees willing to leave their companies early. Having passed global judicial and administrative reviews with little resistance, these combinations are here to stay.

Even with a very successful final season of *Game of Thrones* (WB/HBO), the post-merger world of AT&T/WarnerMedia did not begin with numbers that made anyone feel good, well beyond the massive debt noted above. With all the expect red ink, all that debt, AT&T needed to ramp up its cash flow. In March of 2019, “AT&T [began] overhauling its DirecTV Now pricing and packaging strategy — including hiking prices for existing customers by $10 across the board — a move that could lead to more subscriber losses for the company’s flagging pay-TV business.

“At the same time, AT&T [announced that it] is launching two new DirecTV Now packages: Plus, at $50 per month for up to 46 channels; and Max, $70 per month for up to 59 channels. Both include AT&T-owned HBO, HBO Family and HBO Latino along with networks from WarnerMedia (Turner), NBCUniversal, Disney and Fox, and exclude channels from A+E Networks, AMC Networks, Discovery and Viacom.” Variety.com, March 13, 2019. The old DirecTV packages were no longer available to new subscribers. A little over a month later, the initial results were in.
“AT&T missed on the top-line with first quarter 2019 sales coming in under Wall Street targets. DirecTV continued to bleed subscribers — including a net decline of 83,000 DirecTV Now customers — partially offset by 3.3% revenue growth at WarnerMedia although sales in the media segment were lighter than analysts expected.

“The telco’s revenue for Q1 of 2019 was $44.83 billion, with net income of $4.10 billion (down 12% from $4.7 billion in the year-ago period). Adjusted earnings per diluted share were 86 cents. Wall Street analysts’ consensus estimates were revenue of $45.1 billion and EPS of 86 cents.

“WarnerMedia revenue of $8.38 billion was up 3.3% year over year, below analyst estimates of $8.45 billion. Each division reporting operating income gains. Warner Bros. operating income was up 42.8% on theatrical revenue gains of 12.7% (largely from ‘Aquaman’ carryover); Turner was up 7.0%; and HBO grew 6.0% year over year.

“HBO revenue declined in the 7% in first quarter, to $1.5 billion, which was related to its ongoing carriage dispute with Dish Network since November 2018, according to AT&T. Turner revenue was down 0.4% in Q1, to $3.4 billion; Turner ad revenue dropped 6% in Q1, which AT&T said was primarily due to the shift of NCAA Final Four games (which occurred in Q2). Warner Bros. revenue was $3.5 billion, up 8.6% year over year.

“AT&T noted that the ‘Game of Thrones’ season 8 premiere broke HBO’s viewership records — and the show drove record subscribers to HBO Now — and that DC Entertainment’s ‘Shazam!’ has already grossed more than $300 million worldwide.

“Meanwhile, the AT&T Entertainment Group lost a whopping 544,000 net subscribers for DirecTV and U-verse TV, to stand at 22.4 million at quarter’s end (down 2.4% sequentially). It dropped 83,000 DirecTV Now subs, declining 5.2% in the period to 1.5 million over-the-top customers, as AT&T ended promotional pricing and hiked rates for OTT subscribers. Revenue in the Entertainment Group (which includes AT&T’s broadband and legacy wireline businesses) dropped 0.9%, to $11.33 billion, while operating income increased 12.9% to $1.48 billion.

“The company’s key Mobility wireless segment generated revenue of $17.57 million (up 1.2% year over year), with a 4.5% decline in equipment sales offset by higher service revenue. Wall Street had pegged $17.65 billion in Q1 revenue for the segment. AT&T reported 80,000 postpaid phone net adds vs. 49,000 postpaid net adds in the year-ago quarter.” Variety.com, April 25, 2019. Ouch! DirecTV also battled CBS over carriage, and that network went dark for a while at the end of July and beginning of August 2019.

Some said it was a tech/telco giant trying to compete in a non-linear story-telling world, an uncomfortable marriage at best. AT&T engineers and data-driven MBAs are making pricing, strategic and business decisions for WarnerMedia that already are generating eye-rolls and winces from their entertainment underlings. Would that mean that the Fox-Disney merger had a
better chance, since Disney was well-established in the original content space? What would the WarnerMedia streaming universe – conveniently labeled “HBO Max” – look like, and how would it generate enough content to compete with Netflix and Disney+? Shuffling continued: AT&T also moved some pieces on the board. In anticipation of HBO Max, DirecTV Now streaming will be called AT&T TV Now, as the parent company is experimenting with a skinny live TV bundle over broadband that they may label AT&T TV. Or are rumors true that AT&T is contemplating selling off DirecTV to reduce their massive debt? Is there a master plan? A clear articulable strategy?

Whatever the underlying story, the sheer dollars at risk put huge pressures on these new media structure at levels never experienced before in the entertainment industry. The industry has created new, mega-powerful combinations that seem able to dictate massive competitive changes imposed on an already-terrified Hollywood. With a hint of desperation to “make it work” at all costs. The business today bears little or no resemblance to what it looked like just three years ago.

You can bet that Disney and WarnerMedia have already started looking very carefully at reducing what they pay to produce content – are you reading this, lawyers? – pay for people who do not generate more than their cost and the spend on overhead. It isn’t going to be pretty, and it presents an opportunity, in a field of fewer networks and studios, for every such company in entertainment to pay less to providers and talent. It’s all about the big boyz now. Even as Congress moves to level the playing field to favor consumers in some arenas, like reversing the F.C.C.’s elimination of “net neutrality” requirements – which reversal allows carriers to prioritize online transmission of content or delivery (“discriminate” or “play favorites” might be better descriptions) – pro-business-crony Donald Trump has promised to veto that effort.

Feeling the pressure yet, everybody? Consolidation, merger fever and new business growth, has also redefined the talent agency business. In the spring of 2019, as agents and the Writers Guild of America (WGA) battled over the greatest profit center for all the larger agencies – a percent of the aggregate budgets/license fees paid to such agencies as “packaging commissions” plus direct content ownership – television networks and program suppliers were grinning in the hopes of getting rid of those fees entirely. Let the agents go back to the 10% of talent and rights fees that they gave up in order to get the vastly higher packaging commissions. Laughing harder because everyone was already feeling the downward pressure on talent and rights fees and payments.

It was an old story, at least as far as Hollywood was concerned. Back in the 1960s, under the John F Kennedy administration, MCA/Universal found itself in a similar bind: an agency with a massive production capacity. “In the midst of the grand jury’s [antitrust] investigation, MCA purchased Universal Pictures and its parent company, Decca Records. The government immediately went to court, seeking to block MCA's takeover of the corporation. However, after lengthy
negotiations between attorneys for the Justice Department’s Antitrust Division and MCA, a consent decree was issued and the case was considered closed. The litigation forced MCA to choose whether it wished to be either a talent agency or a production company. Considering that its production efforts yielded nearly ten times more money than the talent agency, the decision was an easy one: MCA dissolved its talent agency.” Dan E. Moldea, *Dark Victory: Ronald Reagan, MCA, and the Mob* (Viking Press, 1986), Chapter One. Cut to: present day.

Relying on revenues from personal service income, money tied to the very personal relationship between agents (who are notorious job-hoppers) and individual talent, was not a business plan that Wall Street investors and fund managers found reliable. Celebrity and fame were hardly permanent, particularly in an era of changing values. Packaging entire television series and directly owning the content itself – asset-based structures – were the stuff financiers understood.

The larger and most powerful agencies had engaged in heavily-leveraged mergers and acquisitions, and the debt levels required a growth-directed business strategy. These agencies *needed* investors now! Some agencies carried *billions* of dollars of debt. If payment deadlines passed without extension, if interest rates climbed, they faced ruin. Loyalty to individual creative talent, starting with writers, was clearly no longer the driver of the “agency” business, perhaps now a misnomer.

Amidst all of this industry reconfiguration, larger talent agencies have taken on private equity partners, diversified into parallel businesses, are as much content producers and distributors, corporate consultants with marketing and data-metrics groups, etc., etc. To create liquidity, respond to their existing investor demands for higher-level rates of return and manage large tranches of debt with approaching payback dates, there has been a pressure to turn service-driven agencies into asset play.

On May 23, 2019, Endeavor Group Holdings, Inc. (the parent of the old-world William Morris and Endeavor legacy talent agencies/later WME) filed an S-1 (intention to file a public offering) with the Securities and Exchange Commission. Did underwriters Goldman Sachs, KKR, J.P. Morgan, Morgan Stanley and Deutsche Bank Securities think this was a good time for an initial public offering on the New York Stock Exchange or did Endeavor feel pressure from its lenders? What is Endeavor anyway? A talent agency or a lot more?

“‘There are no other publicly traded companies like this,’ says Matt Kennedy, senior IPO market strategist for Renaissance Capital. Kennedy points to the company’s lack of free cash flow and a high debt-to-earnings ratio as potential red flags for investors.

“Endeavor is composed of a disparate set of assets — from Professional Bull Riders to the Miss Universe pageant to the Miami Open tennis tournament to the Frieze art fair franchise — which don’t offer a lot of natural synergies to generate economies of scale. In its IPO pitch, Endeavor
emphasizes WME’s role as a wellspring for relationships with stars such as Dwayne Johnson, who can work across the Endeavor ‘platform’ to launch live event businesses, secure endorsement deals and licensing and merchandising pacts, as well as launch a YouTube channel and a production venture, all while WME helps him land top movie and TV roles...

“The financial figures disclosed in the company’s prospectus filed May 23 with the Securities and Exchange Commission show that Endeavor is burdened by heavy debt, steady losses in some units, negative cash flow and big capital needs for start-up efforts such as Endeavor Content and Endeavor Streaming... After a spree of more than 20 acquisitions since 2012, Endeavor has more than doubled in size and now has 7,000 employees in 20 countries.

“There are questions about the long-term health of the company’s single biggest driver of earnings, the mixed martial arts giant UFC. And WME, the agency that’s central to Endeavor’s strategy of leveraging its access to top-tier talent, is in the thick of a nasty fight with the Writers Guild of America that threatens a key source of income: TV series packaging fees [charging a percentage of the budget of production plus a hefty piece of the upside; the Guild forced writers to fire their agents who would not accept a new code eschewing packaging fees in April of 2019]. The sudden loss of WME’s writer clients in April, amid the industrywide dispute, underscores the volatility of the talent representation business.” Variety.com, June 4, 2019.

That talent agency war with the Writer’s Guild would seem challenging to say the least. Was it surprising that the Endeavor offering was postponed until after the WGA’s fractious elections in September of 2019? But after the Writers Guild reelected its incumbent leadership, signaling no change in that labor organization’s stand against packaging commissions, Endeavor elected to resume its IPO, attempting to raise $620 million on a valuation of $18 billion.

The working relationship between agencies (represented by the Association of Talent Agents – ATA) and the WGA had been governed for 43 years by a negotiated Artists’ Managers Basic Agreement. When that agreement expired, the Guild set about trying to force the agencies to restore their primarily loyalty to the creative individuals behind everything Hollywood does. They demanded a new code of conduct from agencies. Packaging commissions and the ability to fund, operate and own production companies was, in the eyes of the WGA, an unsustainable conflict of interest. To the agencies, not being able to engage in this lucrative aspect of the entertainment industry represented an inability to attract and hold traditional investors, now desperately needed to support these huge new agency-based combinations.

Litigation between the Guild and ATA-member agencies intensified. Challenging traditional statutory and judicial antitrust exemptions accorded labor unions, agency giants WME, CAA and UTA claimed that the WGA had stepped outside of that exemption and was exerting unprotected market manipulation.
As of this writing, WGA has forced their members to fire their agents and attempted to allow lawyers and personal managers to negotiate for writers without licensed talent agents in the mix. But under an obviously archaic law, California forbids entertainment employment deals from being secured, or even negotiated, by anyone other than licensed talent agents... even by fully-licensed lawyers. While New York’s restrictions are less draconian (but woe to the NY lawyer who sends a client to California to work without an agent in the mix), the ATA announced to the world that they would inform the California Labor Commissioner (or its NY counterpart) as to lawyers and managers who were violating the law. Aside from being able to issue “cease and desist” letters, the California Labor Commissioner has let it be known that where there were such employment transactions, such unlicensed representatives were not entitled to be paid. Ugly! More disruptions seared through the entertainment universe.

The industry also found other material consumer patterns changing. Competition? Apples, oranges and video games? According to the April 11, 2019 Variety, “In a study of 94 countries, Eurodata estimated that average daily TV viewing time in 2018 was down only one minute from the previous year, although that number varied significantly from territory to territory – in the U.S. it decreased nine minutes, whereas in parts of Asia the number grew.

“According to Eurodata Worldwide vice president [Frédéric] Vaulpré, ‘If we put this into perspective by looking at how these figures change over the long term, in the most recent years, viewing times around the world are down slightly, but are still at a comparable level to the early 2000s. The American continent and Europe have broadly exceeded the global average since the beginning of the 1990s. Over the last 25 years, daily viewing time has been stable in North America and has even increased in South America and in Europe. TV is in good health and is also benefitting from new consumer practices.’”

Nevertheless, there are little hints in those numbers. Nine minutes less in the U.S.? What does that really mean? Netflix sees the real competition for eyeballs only in part from other television programmers... but also from the massive growth of online video gaming. Gamers now average in their mid-30s and are 45% female. Netflix’ January 17, 2019 shareholders’ report is remarkably candid, making a special reference to the changing competitive landscape: “In the U.S., we earn around 10 percent of television screen time and less than that of mobile screen time,’ the report states, noting ‘a very broad set of competitors.’ Then comes the line, ‘We compete with (and lose to) Fortnite more than HBO.’... According to Deadline, which cites Neilsen estimates, Fortnite, a free-to-play game with in-game purchases, generated the most annual revenue of any game in history, $2.4 billion in 2018...

“Video games, in summation, shouldn’t be written off. Do you know what the most lucrative piece of entertainment of all time happens to be? It’s not a movie or a TV show. It’s a
Grand Theft Auto V, which last April had sold more than 90 million units (roughly $6 billion). Now, gaming sales and movie ticket sales aren’t exactly comparable statistics, but it’s still an impressive number that is routinely lost in this conversation.” Nick Romano writing for the January 18, 2019, ew.com (Entertainment Weekly). Nine minutes... and falling. Does streaming fit into the gaming universe? Of course!

“Google has been testing a new app subscription bundle that gives users access to premium apps for one monthly price. Google Play Pass, as the subscription offering is being called, promises users ‘all play, no interruptions’... Google Play Pass, at is it being tested right now, costs $4.99 per month, and promises access to “hundreds of premium apps and games without ads, download fees or in-app purchases.”

“There seems to be a heavy emphasis on games, with some of the titles shown on screenshots including ‘Marvel Pinball,’ ‘Stardew Valley,’ ‘Monument Valley,’ ‘Threes,’ ‘Star Wars: Kotor’ and ‘Ticket to Ride,’ as well as kids games like ‘Elmo Loves 123s.’” Variety.com, August 1, 2019.

But competition battles are not just among and between entertainment conglomerates, governments and consumers. There are other forces seeking to redefine entertainment creative relationships from the ground up. Unions and trade associations, long used to some level of statutory and/or judicial relief from antitrust laws may not be happy with governmental agencies deciding to take another look at an industry that Donald Trump appears to hold in particular disdain. Try this little battle on for size: “The Justice Department has warned the Academy of Motion Picture Arts and Sciences that its potential rule changes limiting the eligibility of Netflix and other streaming services for the Oscars could raise antitrust concerns and violate competition law.

“According to a letter obtained by Variety, the chief of the DOJ’s Antitrust Division, Makan Delrahim, wrote to AMPAS CEO Dawn Hudson on March 21 to express concerns that the new rules would be written ‘in a way that tends to suppress competition... In the event that the Academy — an association that includes multiple competitors in its membership — establishes certain eligibility requirements for the Oscars that eliminate competition without procompetitive justification, such conduct may raise antitrust concerns,’ Delrahim wrote.

“The letter came in response to reports that Steven Spielberg, an Academy board member, was planning to push for rules changes to Oscars eligibility, restricting movies that debut on Netflix and other streaming services around the same time that they show in theaters.’” Variety.com, April 2, 2019. But even as some biggies are being questioned, the potential of other biggies rising and dominating looms large. Opportunities or another set of gatekeepers?

Indeed, said the agents and lawyers generating income representing talent and rights holders, there’s at least one more player who could change everything. One of the biggest companies on
earth Apple (NASDAQ: APPL)! Perhaps?! On March 25, 2019, Apple CEO Tim Cook mounted the presentation stage and, after introducing a new Apple credit card format, proceeds to tout Apple’s new streaming service. But what followed looked a whole lot like a standard “here’s what next season will look like” that the major broadcast networks had been doing for decades. The industry was underwhelmed; you could hear the sigh from executives at Netflix, Amazon, Disney and AT&T.

“How underwhelming? Netflix (NASDAQ: NFLX) was widely expected to face a tough competitor in AAPL’s new Apple TV+ video streaming service. Finally! A competitor with really deep pockets. But instead of Netflix stock taking a hit on the announcement, the script was flipped: NFLX closed up 1.45% while Apple stock was down 1.2% at the end of the day.” InvestorPlace.com, March 26th. By the time Apple made its next product announcement – iPhone 11 – in early September of 2019, it was pretty clear that the expected streaming service would be offering less than expected: “Apple set monthly prices for its TV+ video-streaming service and Arcade videogame-streaming service at $4.99, largely undercutting rivals. TV+ comes free for a year with the purchase of a new iPhone, iPad or Mac, a perk that could get more people to buy a new device or upgrade. Apple can afford to discount the services because of the profits it earns on hardware and its distribution edge over competitors, with more than 1.4 billion devices in use world-wide.” Wall Street Journal, September 10, 2019. They had promised a handy financial spending analysis tool, but that seemed delayed.

Are we having fun yet? Litigators perk up your ears. All of this consolidation may have received federal regulatory approval, but it does not vitiate private antitrust violations and the massive complexity that mergers have created for the acquiring companies. While the new behemoths might be able to mitigate the damage in new agreements with talent and rights holders going forward, these melded entities have to deal with upside agreements inherent in content deals they have now acquired. There are so many new interrelated entities, so many allocations and pricing decisions that are always questionable. No one really believes that “arm’s length” pitch. The “Chinese wall” is made of see-through paper.

First, we all need to laugh at any of these new combined studios when they use the word “precedent,” always the argument of a weak mind in stagnant times. For example, the day the 21st Century Fox/Disney deal closed, March 20, 2019, all Fox and Disney precedents died. Totally new company with a totally new structure. Still, Disney has announced all over the entertainment trades that they are placing all their high-profile content on their new streaming services, with less than subtle hints that they will be able to do this at below market rates.

Two years ago, Disney withdrew all of its Disney/Marvel shows from Netflix. Netflix also let Disney know that they were no longer interested in any Disney content, anyway. A complete
break? Not exactly. It seemed that way... until you really look: The “Walt Disney Co. parted ways with Netflix Inc. in a public declaration of war. The owner of ‘Star Wars,’ Marvel and Pixar movies would stop licensing films to the world’s most popular paid online TV network. Instead, Disney planned to keep them for its own streaming services.

“Yet the media giant left out a key detail: Under their current deal, every movie released between January 2016 and December 2018 — including epics such as ‘Black Panther’ — will be back on Netflix starting around 2026, people familiar with the matter said... Similar issues confront other media titans such as NBCUniversal and AT&T Inc., the owner of HBO and Warner Bros. Netflix, which has about 150 million subscribers worldwide, has some of their most-popular shows locked up for years.” Los Angeles Times, June 2, 2019. But the handwriting is on the wall, and clearly Disney and its competitor-brethren streaming services are not about to continue to let their product enhance Netflix for long. Big companies feeding their own new or newly acquired services are absolutely going to use their best content to drive up the values of those nascent services. Not Netflix!

Folks who made deals with upside at Fox now are stuck in the Disney universe, and Disney participants are going to watch Disney build a network, probably by placing their work into a Disney streaming network at below market and alienating the other buyers by becoming their competitor. So, Disney can also claim that there are no other buyers for their controlled content.

Why do I think Disney will be dumping its best content into their streaming service at below what that content might otherwise generate in an open bidding? Their fee structure says it all. As Netflix upped its “basic” monthly subscription plan effective in May of 2019 to $8.99, the “standard” plan (adding an additional device and HD) to $12.99 and its “premium” plan (four devices and ultra-HD) to $15.99 and Warner suggesting its HBO/Cinemax-driven SVOD service (probably going into a beta test in the fourth quarter of 2019 and fully online in the first quarter of 2020) would be between $16-17/month, Disney was looking to begin with an exceptionally low price that should attract consumers. Even as Disney was bundling its Disney+ with Hulu and ESPN Plus for $12.99/month, it still undercut both Netflix and HBO Max.

With pressure on Disney to justify its $20 billion increase from their initial offer to acquire Fox (to $71.3 billion), cost controls – from layoffs to cutting content-related expenditures – are the order of the day from both Wall Street and senior management. You can be pretty sure that they are not going to account to upside participants in a way that would reflect full market pricing for content placed on a start-up streaming service.

Disney is acutely aware of the issue. They know they will face challenges to their valuation of content from one division to another. So they have decided to “fix” their approach to upside, mirroring the Netflix practice of paying fixed per episode bonus sums for series that make it into a second or greater cycle but dumping any pretense of percentage upside. Many Beverly Hills
mansions were financed with the percentage upside from hit television shows, but the handwriting is on the wall: the gravy boat is dead in a world of multiple silos of exploitation and open and endless streaming.

“The trade-off is that Disney would control all licensing of the series to local TV stations, cable networks, streaming services and foreign broadcasters, essentially buying out whatever share of profits are generated by those sources.

“The new deal structure, the contours of which were reported by Deadline in July, is already getting pushback from agents and lawyers representing talent who believe it will substantially reduce income for creators whose shows became hits. Producers, who can get checks for their involvement in a project years after its initial run, are also skeptical.

“‘They didn’t punish Lucille Ball when ‘I Love Lucy’ was a massive hit 20 years after it was canceled,’ said Propagate Content Chairman Ben Silverman, who has an ownership stake in ‘The Office,’ which he developed the U.S. version of for NBC.” Los Angeles Times, September 12, 2019. Consolidation equals fewer, bigger conglomerates and less competition, even as a few new players enter the field.

And then there’s the short-content Quibi SVOD service from Jeff Katzenberg and Meg Whitman, noted above, that nobody seems to understand. Mostly small screen smart phone fare. Well-funded, with investments including from Warner Bros., Viacom, NBCUniversal, Sony and both U.K.’s BBC and ITV, Quibi is being sold as content for those “on the go.” But what would it look like, and how would it compete with the other streaming services? Scheduled to go live as 5G cell phones are rolling out, Quibi is betting on segmented series (two to four hours presented in ten or fewer minute bits) and mirrors Hulu in offering a variable pricing structure.

“According to Katzenberg, the service will have two pricing tiers at launch on April 6, 2020. The first will cost $4.99 with one pre-roll ad before each video segment — a 10-second ad if the video is less than 5 minutes and a 15-second ad for 5-10 minute videos. The ad-free option will cost $7.99. Whitman also said they expect to have approximately 7,000 pieces of content available within the first year...

“Quibi will pay [top content creators their] cost [of production] plus 20% up to $6 million an hour... In terms of ownership, two versions of each series will exist. The first will be the Quibi version divided into segments, which will be owned exclusively by Quibi for seven years. At the same time, the creator of the project will edit together a full-length version with no segmentation. After two years, the creator will fully own the full-length version and can sell it globally.” Variety.com, June 8th. Sounds very pricey for a start-up, but if the programming is good enough... A big maybe, even as their first effort in generating ad support seemed positive.
In mid-June of 2019, the company reported that they had booked $100 million in ad sales towards their first year of operation, two-thirds of the entire first year ad inventory. “Advertisers that have committed ad spending to Quibi include Google, Procter & Gamble, PepsiCo, Walmart, Progressive and AB InBev, according to the company.” Variety.com, June 19, 2019. A-list talent, creators and performers, were apparently drinking the Cool Ade and signing on to produce content in droves. With all these streaming services, however, most experts are focusing on Disney+ as the likely winner in the SVOD race.

“Disney+ will launch in the U.S. on Nov. 12, 2019, and will be priced at $6.99 per month, the company announced... The subscription VOD service represents Disney’s next major foray into the video-streaming wars. By pricing it well below Netflix, the Mouse House is betting it can rapidly drive up Disney+ customer base with a mélange of content that appeals to multiple demographics, including movies and TV shows from its Marvel, Lucasfilm’s Star Wars, Pixar and Disney brands.” Variety, April 11, 2019. Obvious, yes. Subtle, no. Unlike the opposite result when Apple made its streaming announcement (Apple shares down, Netflix up), Wall Street rewarded the Mouse House the day after the above announcement with a stock rise of 11.5%, dropping Netflix shares by 4.5%. And that was before they acquired all of Hulu in May of 2019, a service that accelerates Disney’s digital streaming capacity.

Want a concrete example of how premium Fox/Disney product is driving Disney+? Love The Simpsons, the longest running scripted television series in U.S. history? Starting on November 12, 2019, all 30 seasons will stream exclusively on Disney+. Seasons 31 and 32 are already ordered; by the time season 32 ends, there will be a total of 713 episodes. “In its first year, Disney Plus will offer 10 original films and 25 original series, including three ‘Avengers’ spinoffs... along with nearly all the ‘Star Wars’ movies, the entire Pixar library and family-focused movies and shows from its Fox library like ‘The Sound of Music’ and ‘Malcolm in the Middle.’

“Disney said it intended to roll out the streaming service in Europe and Asia starting next year. It expects subscribers to total 60 million to 90 million by 2024... ‘We are all-in,’ [Disney CEO Bob Iger said as he announced his plans].” New York Times, April 11, 2019. While Disney touted an investment in original productions for the channel of $1 billion in fiscal 2020, the content-devouring new channel would need to feast on Disney’s vast library at start-up-justified pricing. Represent anyone having upside in a Fox or Disney product?

Smell the opportunity... and the risks? Does the backend now involve puts, fixed payments against a percentage upside – box office bonuses in film and fixed sums as more series cycles are produced against points for TV. Litigators start your engines, from the fees one operating division of affiliate pays another – no matter what the contract appears to waive – to the allocations of revenues between commonly-controlled companies... to potential antitrust violations.
II. Conclusion

If you aren’t shaking in your shoes, you should reread the above. Add to this quagmire the impact of bankruptcies past — from MGM to The Weinstein Company — to the bankruptcies that will inevitably ripple through the entire industry. Rights and income lost, as post-Chapter 11 libraries are now bought and sold like baseball trading cards.

One more factor facing entertainment conglomerates: with limits on immigration — once the main source for population growth in the United States — there also aren’t that many new Americans born every year to replace those that have died. Based on birthrates, we’re beginning to see signs of contraction, a clear trend in Japan and Western Europe. How does that translate into our industry?

“Netflix badly undershot its subscriber forecasts for the second quarter of 2019 — posting its first net U.S. customer decline since 2011 while growth slowed considerably overseas. The company added 2.7 million subs worldwide, almost half as many as the 5 million it had projected....With the big miss, Netflix shares took a predictable hit, opening down 10% on [July 18, 2019].” Variety.com, July 19, 2019. 130,000 subscribers lost in the U.S. over a one-year period. Netflix is depending on that competitive and highly regulated overseas growth while facing massive new competition in the United States. Not pretty. Saturated markets. Ouch! The entertainment world has changed rather dramatically.

The new streaming war is going to put pressures on production costs, consumer pricing and all of that is going to hit us and our clients, with a few A+++ exceptions, hard. Try and explain these new economics facing clients. As some folks see money skyrocket, I’ve watched other writing executive producers wonder why they are being offered one-third last-years rate... even with some success. Change. It’s real. There will be winners and losers. Prepare!

Now is not the time to use those same-old, same-old forms. Most forms are going to need a ground up redo. It is also not the time to take your last deal and up it by 10% on your next; deals are likewise going to require a ground-up revaluation, from cash upfront to upside or the very necessary substitutes we need going forward.

Entertainment lawyers, unite. Change is upon us. Change like we have never seen before. Hyper-accelerating change. Prepare! One more time: Equally, now is the time to laugh, and laugh hard, when some studio or network business affairs executive utters a word that needs to be banned from the entertainment industry forever: PRECEDENT.