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A Return to the Cloud: Last Call for the Record Industry

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By

Hunter Bjorkman

Abstract:

A recent Court ruling has given music streaming services and cloud storage providers free reign to pursue a business model that will end the present day Record Industry. This paper puts forth how to capitalize on the present technological, business, and legal environment in order to revive the Record Industry.

A change in the present business model is vital to the survival of the Industry. The model connects with the other changes the world has already undertaken – a global, wireless, streaming society in the 21st century. The Record Industry business model is dead not the Industry itself. Without change on their behalf, the Record Industry’s “clients” will have no need for their financial backers as other opportunities offering greater flexibility and better payments will arise in place of the outdated business model followed by the present Record Industry. Without this change, the Record Industry is not going to make it in the next 2-3 years.
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I. Introduction

Recent Court interpretation of the Safe Harbor provision in the Digital Millennium Copyright Act (DMCA) has created a legal environment in which technology will make the physical form of music extinct. Future music will not be produced in a physical form but rather accessed from a data “cloud” through multiple platforms. As consumer and technologically driven products designed to stream and store unlimited amounts of music grow in popularity and profitability, physical albums and digital downloads, like tape cassettes and 8-tracks before them, head the way of the dinosaur. Consumers will stream music from their computers, tablets, smartphones, automobiles and homes. The transition between these two very distinct business models has already occurred and the music industry is behind with dire consequences on the horizon. However, it is not too late for the record industry to catch-up.

The answer for record labels is in creating their own platforms of shared music. These record label centric clouds will need to create a seamless mobile music environment in order to expose their artists to a massive audience. The amount of revenue gained from billions of streams and the accompanying advertisements will eclipse any need or use for a music business model based on physical music product sales. As the level of technologically driven mobility and increased societal integration continues to rise, the units of music being streamed will reach into the trillions. This not yet untapped resource of hundreds of millions of consumers listening to music through data “clouds” on multiple electronic devices is the face of music in the 21st century.

As music consumers shift from digital downloads to streaming music the record industry is still making the shift from selling physical CDs to digital downloads. In this era of clouds and streams the record industry is once again behind the times. The major labels are licensing their catalogues to various online service providers offering direct streaming and cloud storage. However, the record industry has not altered their business model to establish streaming cloud services for their artists in this new medium. In order to survive, record labels need to change their business model and how they approach cloud streaming. This article addresses how the record industry has yet to realize the new paradigm of the music industry that there is no money in content sales – content is a means to an end and it will eventually be ad-supported and free.¹

Consumer change to streaming and cloud services is still in its infancy. The music subscription model made major advances in 2010, firmly establishing itself in the market and among

consumers.\textsuperscript{2} Recently the sector has been able to take advantage of improved platform compatibility, underlying technology and broadband penetration levels.\textsuperscript{3} Today, consumers can use subscription services widely across mobile devices, vastly improving quality and the consumer experience.\textsuperscript{4} As more and more consumers switch to smartphones and tablets, the use of streaming and cloud services will continue to grow at an exponential rate. This untapped market could be used to revive the record industry, but the labels must act now.

Artists, having gained industry “buzz” via various websites and fan “buzz” via live performances, may soon not need record labels at all. Artists can license their music directly to streaming services, getting paid royalties without giving the label a cut. Currently, artists are not reaping any great benefits for licensing their songs to streaming/cloud services. However, in the coming years artists will see large royalty gains as musical portability creates twenty-four hour access for consumers to stream music by the billions and trillions. Financed by advertising cash cows, the growth of these services is changing how consumers listen to music and how revenues can be made in this new age of music business. The current legal, business, and technological environment surrounding streaming and cloud services is ripe for the record industry to either stay major players or become ghosts of the 20\textsuperscript{th} century. However, unlike the slow transition from physical records and compact discs to digital downloads; the record industry still has some time left to enter into the streaming and cloud storage businesses. This is the record industry’s chance for survival, if they don’t change with the times, it could be their last call.

II. Legal Background

A. The Safe Harbor Provision of the Digital Millennium Copyright Act (DMCA) sets the Legal Foundation for Streaming and Cloud Storage Growth.

The Safe Harbor provisions of the DMCA create limitations on liability for copyright infringement by online service providers.\textsuperscript{5} The limitations are based on four categories of conduct by a service provider: 1) Transitory communications; 2) System caching; 3) Storage of information on

\textsuperscript{2}Frances Moore, Music at the Touch of a Button (International Federation of Phonographic Industry (IFPI) Digital 2011).
\textsuperscript{3} Id.
\textsuperscript{4} Id.
\textsuperscript{5} 17 U.S.C. § 512 (1998)
systems or networks at the direction of users; and 4) Information location tools.\textsuperscript{6} Music streaming services use transitory communications to relay and play a consumer’s desired songs. Streaming services also use system caching to keep certain files available for offline use on tablets and smartphones. Additionally, cloud services store digital music files at the direction of the user and use various mobile platforms and applications to locate certain files and information within the cloud service system. These limitations are provided for the services to have a clear business plan when it comes to transmitting, storing, and locating data.

In order to qualify for these limitations a service must first qualify as a “service provider”.\textsuperscript{7} A “service provider” is defined as “an entity offering the transmission, routing, or providing of connections for digital online communications, between or among points specified by a user, of material of the user’s choosing, without modification to the content of the material as sent or received.”\textsuperscript{8} In addition, to be eligible for any of the limitations, a service provider must adopt and reasonably implement a policy of terminating, in appropriate circumstances, the accounts of subscribers who are repeat infringers.\textsuperscript{9} Essentially, to be protected, a service provider must be "innocent."\textsuperscript{10} This means, among other things, that it must implement a reasonable policy to deal with repeat infringers; it must respond quickly and appropriately to remove infringing material of which it has actual knowledge (for example, through a DMCA "take-down" notice); it must not ignore "red flags" or otherwise be willfully blind to infringement; and it must not control or benefit from the infringing activity.\textsuperscript{11} Each limitation entails a complete bar on monetary damages, and restricts the availability of injunctive relief in various respects.\textsuperscript{12}

In addition to limiting the liability of service providers, the DMCA establishes a procedure by which a copyright owner can obtain a subpoena from a federal court ordering a service provider to disclose the identity of a subscriber who is allegedly engaging in infringing activities.\textsuperscript{13} There is also a provision to ensure that service providers are not placed in the position of choosing between limitations on liability on the one hand and preserving the privacy of their subscribers, on the

\begin{itemize}
  \item \textsuperscript{6}D. Harrison, Comment, The P2P File Sharing War After Grokster: It feels like Belgium over Here, 32 Notre Dame L. Rev. 681, 704-705 (2006).
  \item \textsuperscript{7}17 U.S.C. § 512(k)(1)(a) (1998)
  \item \textsuperscript{8}Id.
  \item \textsuperscript{9}17 U.S.C. § 512(i) (1998)
  \item \textsuperscript{10}Stephen M. Kramarsky, Examining the Limits of Online Storage Provider Liability, New York Law Journal (Sept. 23, 2011), http://www.law.com/jsp/article.jsp?id=1202516588079&Examining_the_Limits_of_Online_Storage_Provider_Liability&slreturn=1
  \item \textsuperscript{11}Id.
  \item \textsuperscript{12}17 U.S.C. § 512(j) (1998)
  \item \textsuperscript{13}17 U.S.C. § 512(h) (1998)
\end{itemize}
other.\textsuperscript{14} Further, a service provider is not required to monitor its service or access material in violation of law (such as the Electronic Communications Privacy Act) in order to be eligible for any of the liability limitations.\textsuperscript{15}

1. DMCA Protections of Streaming Services as Data Conduits

Section 512(a) limits the liability of service providers in circumstances where the provider merely acts as a data conduit, transmitting digital information from one point on a network to another point at someone else’s request.\textsuperscript{16} This limitation covers acts of transmission, routing, or providing connections for the information, as well as the intermediate and transient copies that are made automatically in the operation of a network.\textsuperscript{17} In order to be protected, the service provider’s activities must meet the following conditions:

- The transmission must be initiated by a person other than the provider;
- The transmission, routing, provision of connections, or copying must be carried out by an automatic technical process without selection of material by the service provider;
- The service provider must not determine the recipients of the material;
- Any intermediate copies must not ordinarily be accessible to anyone other than anticipated recipients, and must not be retained for longer than reasonably necessary;
- The material must be transmitted with no modification to its content.\textsuperscript{18}

2. DMCA Protections of Cloud Storage Services

17 U.S.C § 512(c) limits the liability of service providers for infringing material on websites (or other information repositories) hosted on their systems.\textsuperscript{19} It applies to storage at the direction of a user and in order to be eligible for the limitation, the following conditions must be met:

i. Duty to Remove: Knowledge of Infringement

Service providers must remove infringing material upon obtaining actual knowledge that material is infringing or becoming aware of facts or circumstances from which the infringing activity

\textsuperscript{14} Id.
\textsuperscript{15} 17 U.S.C. § 512(m) (1998)
\textsuperscript{16} 17 U.S.C. § 512(a) (1998)
\textsuperscript{17} Id.
\textsuperscript{18} Id.
\textsuperscript{19} 17 U.S.C. § 512(c) (1998)
is apparent. Courts have concluded that the actual knowledge that is relevant in the safe-harbor context is actual knowledge of specific infringing material, rather than actual knowledge that the service generally is used by infringers or general awareness that infringing material is prevalent on site. The Courts have narrowed the amount of specific knowledge needed by Cloud services when their systems are used for infringing material. This clearly provides Cloud services with an ability to escape lawsuits by ostensibly looking the other way.

ii. Red Flag Test

The legislative history explains that pirate sites where sound recordings, software, movies or books were available for unauthorized downloading, public performance, or public display should fail the red flag test because the infringing nature of such sites would be apparent from even a brief casual viewing. Courts have reiterated this articulation of the standard stating that purposefully avoiding obtaining knowledge of infringement (willful blindness) constitutes red flag knowledge.

iii. The Right and Ability to Control Infringing Activity while receiving a Financial Benefit

The Safe Harbor protections provided by 512(c) do not apply when service providers have financial gain directly linked to copyright infringement. The catch is that the provider needs to have the ability to control the infringement. This leaves another loophole in which Cloud services can look the other way and plan their business model accordingly.

Infringing material need only constitute a “draw” to a service for it to constitute a direct financial benefit; such a draw need not be significant or substantial. Moreover, a current draw to a service that does not yet equate to revenue but enables future monetization is enough. Courts in the Second circuit have also held that infringing material that increases the number of users of a service creates a direct financial benefit where advertising revenue of the service is tied to the number of views of the advertising. This is especially true where evidence exists that removal of infringing material from a service decreased the service’s popularity. In general a service provider

24. See Ellison v. Robertson, 357 F.2d 1072, 1078-1079 (9th Cir. 2004).
27. See Ellison, 257 F.2d at 1079.
conducting a legitimate business would not be considered to receive a financial benefit directly attributable to the infringing activity where the infringer makes the same kind of payment as non-infringing users of provider’s service.\footnote{S. Rep. No. 105-190,105th Cong. (1998) (enacted).}

The ability to control means the ability to “stop or limit” infringement. \footnote{See Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, 545 U.S. 913, 939 (2005).} Courts in that context have stated that a right and ability to control access to a closed online system constitutes a legal right and ability to control.\footnote{See A&M Records Inc. v. Napster, Inc., 239 F.3d 1004 (9th Cir. 2001).} Also, the ability to remove infringing content equals a legal right and ability to control it, under the DMCA standard employed by these courts, a service provider must possess something more than the ability to control its system or shut down access to material generally, and what matters is a service provider’s ability to control specific infringing content.\footnote{See Ellison, 257 F.2d at 1060-61.} The ability to filter does not equate to the ability to control under the safe-harbor.\footnote{UMG Recordings, Inc. v. Veoh Networks, Inc., 620 F.Supp.2d 1081, 1099 (C.D. Cal. 2008).} The Courts have concluded that equating an ability to filter with an ability to control would impermissibly mandate monitoring by service providers as a precondition to Safe Harbor status, a requirement specifically rejected by 17 U.S.C. §512(m)(1).\footnote{Practicing Law Institute, The Shifting Sands of the “Storage” Safe Harbor of the DMCA, Patents, Copyrights, Trademarks and Literary Property Course Handbook Series, PLI Order No. 29653 (September 2011).}

iv. **Reasonable Implementation of a Repeat Infringer Policy**

The Ninth Circuit held that a service provider implements a policy if it has a working notification system, a procedure for dealing with DMCA compliant notifications, and if it does not actively prevent copyright owners from collecting information needed to issue such notification.\footnote{Id. at 214-5} The statute permits service providers to implement a variety of procedures, but an implementation is reasonable if, under “appropriate circumstances” the service provider terminates users who repeatedly or blatantly infringe copyright.\footnote{Id.} Congress made it clear that a repeat infringer policy must confront infringers with a “realistic threat” of losing access.\footnote{Id.}
v. Effect on the Industry

The DMCA has actually turned out to be an important factor in the business models of many newcomers to music streaming and cloud storage service.\(^3^7\) Mixtape and Internet radio services rely on the safety and predictability of the statutory webcasting license afforded by the DMCA.\(^3^8\) Because they are not on-demand services, they do not need to negotiate licenses with rights owners.\(^3^9\) And while on-demand services like Spotify get most of the media attention, non-interactive services, ranging from Pandora to Slacker, are proving that cool ideas can be built around a "lean back" type of listening rather than a "lean-forward" manner of accessing a large catalog of music.\(^4^0\)

B. Capitol Records, Inc. v. MP3tunes, LLC. Provides added Legal Foundation in which Streaming and Cloud Services will Flourish.

The court in *Capitol Records, Inc. v. MP3tunes*\(^4^1\) ruled that locker sites used by internet service providers did not infringe on copyrighted music as long as the online service provider gave notice to customers that did trade and store infringing copies.\(^4^2\) This recent ruling has cemented cloud storage services that stream movies, music, and data files to various consumer platforms by giving Google's Music, Apple's iCloud and others a solid legal foundation on which to expand storing and streaming music online.

The *MP3tunes* case concerns a music locker site, MP3tunes.com, founded in 2005.\(^4^3\) The features and technical implementation of the site bring out a number of issues that are central to any discussion of cloud storage, and several of these issues are addressed in the court's opinion.\(^4^4\) MP3tunes.com is not associated with any commercial music provider, so users cannot buy music online and have it appear in their "lockers."\(^4^5\) Users get music into their online storage in one of two ways: They can upload their own content from a computer or they can use Sideload.com, a search


\(^{38}\) *Id.*

\(^{39}\) *Id.*

\(^{40}\) *Id.*

\(^{41}\) *See* Capitol Records, Inc. v. MP3tunes, LLC, 611 F.Supp.2d 342 (S.D.N.Y. 2009)

\(^{42}\) *Id.*

http://www.law.com/jsp/article.jsp?id=1202516588079&Examining_the_Limits_of_Online_Storage_Provider_Liability&slreturn=1

\(^{44}\) *Id.*

\(^{45}\) *Id.*
site owned by MP3tunes.com, to search the internet for music and load that music directly into their personal storage.\textsuperscript{46} Music files uploaded from a user's computer may or may not be authorized copies.\textsuperscript{47} MP3tunes.com has policies in place that prohibit the uploading pirated music, and it bans users who are found to have repeatedly violated those policies.\textsuperscript{48} It also removes sites that carry pirated music from the Sideload.com search results.\textsuperscript{49} However, once a user has found a song through Sideload.com and “sideloaded” it into online storage, that copy of the song remains in storage even if the site is removed.\textsuperscript{50} MP3tunes.com does not proactively police its servers for copyright violations, and it does not remove “sideloaded” songs from users' storage, even when it becomes aware that those songs come from pirate sites (for example, through a takedown notice).\textsuperscript{51} MP3tunes.com also implements a "de-duplication" algorithm on its file system designed to eliminate identical copies of files from the server and replace them with "pointers" to a single file.\textsuperscript{52}

In considering the Safe Harbor criteria the Court found that MP3Tunes had a repeat infringement policy for responding to notices from copyright holders.\textsuperscript{53} They had removed infringing links to websites and had terminated the accounts of 153 repeat infringing users.\textsuperscript{54} MP3Tunes was required to comply with the takedown notice received from EMI and had done so. MP3Tunes had removed the websites from Sideload that were specified in the notice from EMI.\textsuperscript{55} However, for MP3Tunes to be required to respond to the takedown notice against the listed song titles, EMI should have provided MP3Tunes with sufficient information to allow MP3Tunes to identify and locate the infringing material, such as a web address.\textsuperscript{56}

MP3Tunes was not obliged to investigate whether songs uploaded into users’ lockers or posted on websites were infringing.\textsuperscript{57} If investigation is required to determine whether material is infringing, then those facts and circumstances are not a red flag.\textsuperscript{58} MP3Tunes did not have knowledge of circumstances that should have raised a red flag.\textsuperscript{59} Apart from websites that used a

\begin{itemize}
\item \textsuperscript{46} Id.
\item \textsuperscript{47} Id.
\item \textsuperscript{48} Id.
\item \textsuperscript{49} Id.
\item \textsuperscript{50} Id.
\item \textsuperscript{51} Id.
\item \textsuperscript{52} Id.
\item \textsuperscript{53} Mallesons Stephen Jaques and Anna Spies, This cloud has a silver lining for both EMI and MP3tunes, Lexology (Sept. 2\textsuperscript{nd} 2011), \texttt{http://www.lexology.com/library/detail.aspx?g=c6b3eb24-9bee-4c7e-8949-f3b02625f374}
\item \textsuperscript{54} Id.
\item \textsuperscript{55} Id.
\item \textsuperscript{56} Id.
\item \textsuperscript{57} Id.
\item \textsuperscript{58} Id.
\item \textsuperscript{59} Id.
\end{itemize}
term such as “pirate” in their URL, the infringing nature of websites would not be apparent from a brief or casual viewing.60

MP3Tunes did not promote copyright infringement to enhance its profits, therefore did not directly benefit from the infringing activity.61 Additionally, it did not have the right and ability to control the infringing activity, as the DMCA required something more than the ability to remove or block access to materials.62 MP3Tunes was a fully automated system and did not participate in user decisions to link websites to Sideload or store music in their lockers.63

The decision appears to have broken new ground with regard to the way in which music is stored on MP3tunes’ servers through “de-duplication”.64 MP3tunes uses an algorithm to identify and “fingerprint” songs, and if a user uploads a digitally identical song that has already been stored by another user, MP3tunes does not create a duplicate copy on its servers.65 EMI had argued that this constituted rebroadcasting of “master copies” of songs in violation of the standard articulated in the Cartoon Network LP v. CSC Holdings, Inc., 536 F.3d 121 (2d Cir. 2008).66 The court rejected this argument because MP3tunes’ algorithm only considers songs with the exact same bit sequence to be identical.67 Accordingly, “there is no ‘master copy’ of any of EMI’s songs stored on MP3tunes’ computer servers.”68 Further, unlike the technology in Cartoon Network, MP3tunes’ automatic and passive playback software is precisely the type of system routinely protected by the Safe Harbor.69

The court’s blessing of “de-duplicating” algorithms, which will allow cloud storage services to flourish without taking wasteful precautionary measures such as duplicating copies of the same song (which Google and Amazon do) or signing expensive licenses with the record industry (which Apple does).70

In addition to a partial summary judgment ruling against the record company in the MP3tunes case and in Cartoon Network L.P. v. CSC Holdings Inc. the Court’s decisions are not looking good for

60 Id.
61 Id.
62 Id.
63 Id.
64 Andrew Cocker, District Court Rules that DMCA Safe Harbors Apply to Cloud-Storage Music Locker Service Liable for Indirect Infringement, JOLT Digest (Aug. 29th, 2011, 4:41pm), http://jolt.law.harvard.edu/digest/copyright/capitol-records-inc-v-mp3tunes-llc
65 Id.
66 Id.
67 Id.
68 Id.
69 Id.
70 Id.
As distinguished from a service like Napster, for instance, the cloud service providers are legitimate businesses arguably willing to comply with the law.\textsuperscript{72} Indeed, cloud-based service providers are seeking to deliver the benefits of cloud technology to customers without running afoul of the Digital Millennium Copyright Act.\textsuperscript{73} The key distinction, is determining the intended audience of a transmission.\textsuperscript{74}

The systems used by MP3tunes and the legal protection provided to them in the Court's ruling provide the beginnings of a roadmap of permissible conduct for similar services.\textsuperscript{75} Cloud-based music storage services are entitled to substantial protection under the Digital Millennium Copyright Act.\textsuperscript{76}

### III. TECHNOLOGY BACKGROUND

#### A. Music Streaming Services

Music streaming services are either interactive or non-interactive. Both forms give the consumer a different experience and entail different licensing protocols.

1. **Interactive Services**

   Copyright owners in sound recordings enjoy full exclusive rights with regard to interactive Internet transmissions.\textsuperscript{77} A transmission service is interactive if it provides the listener with some choice of which sound recording is performed and when.\textsuperscript{78} For example, a web service would be deemed interactive if it provides a list of songs available for individual performance at the click of the user.\textsuperscript{79} The owners of an interactive service must negotiate a performance license not only with the owners of the copyrights in the transmitted musical compositions but also with the owners of the sound recordings.\textsuperscript{80} With some limitations, the sound recording copyright owner is entitled to

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\textsuperscript{72} Id.

\textsuperscript{73} Id.

\textsuperscript{74} Id.


\textsuperscript{76} Quinn Emanuel, *Trial Lawyers Litigation Update*, (October 2011).

\textsuperscript{77} W. Jonathan Cardi, Comment, *Uber Middleman: Reshaping the Broken Landscape of Music Copyright*, 92 Iowa L. Rev. 835, 851 (March 2007).

\textsuperscript{78} Id.

\textsuperscript{79} Id.

\textsuperscript{80} Id.
demand any price for such a license and may even deny permission entirely. Spotify, Rhapsody and Grooveshark are all examples of large interactive music streaming services.

2. Non-interactive Services

Non-interactive internet transmissions of sound recordings are subject to compulsory license if the transmissions conform to a detailed list of statutory requirements. The requirements limit potential infringing uses of licensed transmissions by providing the advance publication of a transmissions schedule, and by only providing the same transmission during any three hour period of more than three tracks from the same album or more than four tracks by the same recording artist. Like other compulsory licenses, the non-interactive transmission license obviates the need for the license to seek permission from or negotiate terms with the sound recording copyright owner. Unlike other compulsory licenses, however, the transmission license rate is left to voluntary negotiations between the various industry participants every two years.

These non-interactive forms of music streaming services appear more as radio stations or internet jukeboxes in which the consumer can tailor to their own tastes. Pandora, Slacker and Rdio are all large non-interactive streaming services. After years of fighting over pennies, Internet radio services reached an agreement with artists, music publishers and record labels a few years ago on royalty payments. The rates go up every year, but the broad formula is that big "pure play" companies, such as Pandora and Slacker, pay either 25% of their total revenue per year, or a little more than $.001 per song -- whichever is greater. These payments go to a music-business collection agency known as SoundExchange, which then pays 50% of it to the copyright owner (usually a record label like Warner or Sony), 45% to the artist and 5% to non-featured performers.

81 Id.
82 Id.
83 Id.
84 Id.
85 Id.
87 Id.
88 Id.
B. Major Music Streaming Service Players

1. Pandora

Pandora is a non-interactive music streaming service that allows for Internet radio built around the listeners’ tastes.\(^89\) Pandora now has more 75 million registered users, up from 20 million in 2008.\(^90\)

2. Spotify

Services like Spotify, MOG and Rd are often called "freemium" services.\(^91\) At least initially, they allow users to access their multimillion-song catalogs for free, but offer a premium subscription service at prices ranging from $3.99 to $9.99 a month that provide access without advertising, or with enhanced features like access from a smartphone.\(^92\) Unlike Apple's iTunes, listeners don't actually own their digital tracks, but instead rent access.\(^93\) Spotify has made major waves when it launched in the United States in early 2011. Coupled with its relationship to Facebook (and access to their 700 million users), Spotify is the fastest growing streaming service. Spotify has attracted more than 3,000,000 paying subscribers across all its markets.\(^94\)

3. MOG

MOG is an ad-free, subscription-supported online music-streaming service with more than 13 million songs in its library.\(^95\) If you pay and extra $10 a month, you can get its mobile app and the iPhone version of that app now works in concert with BMW and Minis to deliver MOG on the road.\(^96\)

4. Rhapsody

At $15 a month, Rhapsody gives access to over 12 million songs.\(^97\) You can stream music to anything connected to the Web or download songs to your iPhone, Android device, certain MP3 players, or computer for off-line listening.\(^98\)

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\(^{89}\) Pandora company profile, [http://www.pandora.com/corporate/](http://www.pandora.com/corporate/)


\(^{92}\) *Id.*

\(^{93}\) *Id.*


\(^{96}\) *Id.*


\(^{98}\) *Id.*
5. Grooveshark

Over the years Grooveshark has survived not only to license music from EMI and a growing number of indie labels but to become one of the more popular services in the U.S. One big difference between Spotify and Grooveshark is their respective approaches towards licensing. Spotify only offers access to licensed songs; Grooveshark, on the other hand, invites its users to upload any kind of music, and then responds to take-down notices from rights holders to remove unlicensed content. That approach has given the company a much bigger catalog, but also more trouble with rights holders. The only major label that has licensed Grooveshark is EMI, and Universal Music is battling the service in court, alleging that it facilitates copyright infringement. Much has been made about Grooveshark’s lack of licenses with most majors, but the company has deals with EMI Music and EMI Music Publishing, as well as many indies through its agreement with indie label rights group Merlin.

6. Slacker

In North America, Slacker is one of the top two radio subscription services, alongside Pandora. Slacker has seen its customer base grow seven fold since April 2010 and says it has one of the highest conversion rates to a paid service in North America.

7. Turntable.fm

Users are given a list of virtual rooms they can enter to hear DJs (other Turntable.fm users) playing songs of a specific genre. The five DJs stand on stage behind their turntables and face the crowd of avatars representing users who have entered the room.

In years past, a service like this might have met a different fate. Even people within the industry had a familiar reaction when getting a first glance at Turntable: it just can't be legal. But

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100 Id.
101 Id.
102 Id.
103 Id.
106 Id.
108 Id.
rights owners haven’t rushed to shut down Turntable; instead, the two sides have engaged in what have been described as productive talks.\textsuperscript{10} Like other social music services, the site is built to be DMCA-compliant, it may have a few legal issues to clear up, but labels and publishers have opted for conversation rather than conflict.\textsuperscript{11}

In the end, Turntable.fm will probably be hampered due to the fact that the market for passive listening - and the number of listener hours they command - is bigger than the market for services that require active participation.\textsuperscript{12} Turntable.fm certainly allows for passive listening, but that's not its strength.\textsuperscript{13} It's definitely engaging - and stands to get more engaging in the future as more people use it.\textsuperscript{14} It's well built for social networking era and it has pretty much created its own category of music service.\textsuperscript{15} And as long as people are actively engaged, Turntable.fm will have ample opportunities for sponsors and advertisers.\textsuperscript{16}

C. Cloud Storage Services

The “cloud” is now a watchword in digital music, even though the business models are still in their infancy.\textsuperscript{17} Cloud services respond to consumers’ growing interest in seamless connectivity between music and devices.\textsuperscript{18} They can either act as a “locker” to enable a consumer to access their own music collection through a range of different devices or offer that user access to a catalogue of tracks owned by the service provider which are streamed through a consumer’s device.\textsuperscript{19}

Over the past year Amazon, Google, and Apple have all launched "cloud" music services of one kind or another.\textsuperscript{20} Generally speaking, "cloud" storage simply refers to data storage that is accessible over the internet.\textsuperscript{21} Typically, the term is used to refer to storage space sold as a service

\textsuperscript{11} Id.
\textsuperscript{12} Id.
\textsuperscript{13} Id.
\textsuperscript{14} Id.
\textsuperscript{15} Id.
\textsuperscript{16} Id.
\textsuperscript{17} Id.
\textsuperscript{18} Id.
\textsuperscript{19} Id.
\textsuperscript{20} Id.
\textsuperscript{21} Id.


\textsuperscript{12} Id.
by third parties who own, manage, and control the servers to users who need a place to store their data.\textsuperscript{122} The owner of the servers leases out space at a certain price per gigabyte, often with some free space up front, and the user can store whatever he or she wants there.\textsuperscript{123} The model has been around for a many years, but it is becoming more and more popular as fast internet connections become ubiquitous and devices shed storage capacity and processing power to become cheaper and more mobile.\textsuperscript{124} Cloud storage has numerous advantages over local storage -- it ensures that all devices are accessing the same data, it largely eliminates backup and data loss issues, and it makes data available wherever there is a sufficiently fast internet connection.\textsuperscript{125}

Cloud computing is gradually revolutionizing the music industry and the way digital music is being consumed.\textsuperscript{126} Instead of buying and downloading songs over the internet, consumers are accessing them via a “cloud” in the form of on-demand streaming services.\textsuperscript{127} Music is a prominent force driving the current rush to adopt these cloud services.\textsuperscript{128} Music files are large enough to require substantial storage space, small enough to stream over relatively low bandwidth (such as a 3G wireless connection) and desirable to the consumer to be available on mobile devices.\textsuperscript{129} The enormous music libraries many consumers have amassed (through legal means or otherwise) are far too large to store on current mobile devices, so cloud storage is a perfect solution.\textsuperscript{130}

The emergence of cloud technology as an electronic content infrastructure in the music industry raises complex copyright issues.\textsuperscript{131} At stake is the balance between copyright holders' exclusive rights to reproduce and publicly perform their works versus the ability of consumers and service providers to make lawful use of the content through emerging technologies without infringement.\textsuperscript{132} The growth of centralized, cloud-based services is being driven by an insatiable

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{122} \textit{Id.}
\item \textsuperscript{123} \textit{Id.}
\item \textsuperscript{124} \textit{Id.}
\item \textsuperscript{125} \textit{Id.}
\item \textsuperscript{126} Olafur Inghorsson, \textit{The growth of cloud based music streaming}, (Mar. 21, 2011), \url{http://cloudcomputingtopics.com/2011/03/the-growth-of-cloud-based-music-streaming/}
\item \textsuperscript{127} \textit{Id.}
\item \textsuperscript{128} Stephen M. Kramarsky, \textit{Examining the Limits of Online Storage Provider Liability}, New York Law Journal (Sept. 23, 2011), \url{http://www.law.com/jsp/article.jsp?id=1202516588079&Examining_the_Limits_of_Online_Storage_Provider_Liability&slreturn=1}
\item \textsuperscript{129} \textit{Id.}
\item \textsuperscript{130} \textit{Id.}
\item \textsuperscript{132} \textit{Id.}
\end{enumerate}
\end{footnotesize}
consumer demand for content anywhere, anytime, and on any device. The cloud is enabling that to happen and as such consumer demand is rising. In the process of pursuing that ubiquitous content access model, however, copyrights are being transferred, transmitted, and distributed.

Some scholars have maintained in general that cloud-based service providers were serving as passive, neutral conduits, while other scholars suggested that the electronic storage locker concept was an end-run around public performance rights that lends itself to infringements. The Court’s ruling in MP3tunes puts these arguments to bed as it further defines the obligations of cloud services in protecting infringement on copyrights. Cloud technology is offering consumers a more efficient way to store entertainment content. The cloud is a viable business model due to both the growing consumer use of mobile devices and technologically driven innovation in seamless application of wireless data retrieval across multiple platforms.

The federal court ruling in MP3tunes.com clears the way for Google and Amazon to continue their recently launched cloud services. Their decisions not to obtain licenses from every major record label before launching their online music lockers will not result in lawsuits. As the judge ruled in MP3tunes, an online music locker is eligible for a Safe Harbor in the digital copyright law that protects a company from copyright liability over illegal music uploaded to its service as long as it removes that material when notified.

1. Apple iCloud

Apple's iCloud capabilities come with the latest version of iTunes and let you share songs across multiple devices. Apple negotiated licensing agreements with the four major record labels before rolling out its service. The service determines which songs in a user’s music collection

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133 Id.
134 Id.
135 Id.
136 Id.
137 Id.
138 Id.
140 Id.
141 Id.
144 Id.
are available in the iTunes store, and music with a match is added to iCloud. Users upload any music not matched by iTunes, which Apple said is faster than starting from scratch. Once a user’s collection is uploaded and stored in iCloud, it can be streamed and stored on any mobile device. The service allows the storage of music collections including imported tracks from a CD and digital music files previously downloaded from elsewhere.

2. Google Music

Google Music allow users to upload and stream music, video and other files from remote servers to a variety of devices, including smartphones, tablets, and computers. Google went ahead and launched its services without across the board major label licensing, much to the recording industry's consternation. Google Music streams your stored music (up to 20,000 songs) from the Cloud, either via a Web browser or an app on your Android phone. Using the app, you can also "pin" any music and have it available for off-line listening.

Additionally, Google is offering 13 million tracks for sale, from three of the four major recording companies — Vivendi SA’s Universal Music, EMI Group Ltd. and Sony Music Entertainment — and a host of independent labels. Warner Music Group was the major recording company left out. Google Inc. will sell songs on the Android Market, its online store for apps, movies and books. The service aims to roll out to some 200 million Android users globally.

3. Amazon Cloud Player

Amazon's Cloud Player allows users to upload and stream music, video and other files from remote servers to a variety of devices, including smartphones, tablets, and computers. Following Google’s lead, Amazon went ahead and launched its services without licensing, much to the recording industry's chagrin. Amazon faced threats of legal reprisal by record labels for its haste, but the Court’s ruling in MP3tunes absolves cloud storage companies of copyright infringement.

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146 Id.
147 Id.
148 Id.
150 Id.
151 Id.
152 Id.
153 Id.
154 Id.
156 Id.
Amazon and Google now have leeway to expand their features. Amazon Cloud Drive and Google Music initially required users to manually upload their entire music catalog and store separate copies of each track, an extremely lengthy process for consumers. The ruling, however, opens up a way for those services to simply match songs already on servers, saving hard disk storage costs. This also allows Google and Amazon to match Apple’s service, which already has the ability to match songs on iTunes with a cloud-based music locker, due to Apple’s negotiations with music labels before it announced iCloud. As a result, Amazon and Google’s service may more strongly compete against Apple, which initially offered a level of convenience to cloud-music users with large libraries to upload.

IV. Record Labels are Not Changing with the Current Technological, Legal, and Consumer Landscape

A. The Record Industry is Behind the Times with Dire Consequences

The record industry has been out of touch for too long. The need for change is now if the record industry is interested in surviving in the new millennium’s music consumer landscape. Record labels fear this court ruling will so drastically change the legal landscape of musical copyright law that it could end a whole industry. Sadly, the record industry will end due to not changing their business models to work hand in hand with the legal protections of technological innovation and consumers taste for how they listen to music.

The record industry, which saw U.S. music sales and licensing revenue plummet from $14.6 billion in 1999 to $6.3 billion in 2009, needs to find an answer to still-declining sales of CDs, and the fact that just 44% of U.S. internet users say recorded music is worth paying for. Additionally, worldwide revenues for CDs, vinyl, cassettes, and digital downloads dropped 25% from $38.6 billion in 1999 to $27.5 billion in 2008, according to the International Federation of the Phonographic Industry (IFPI). A recent example is the breakup of one of the “Big Four” record labels, EMI.
Citigroup Inc. agreed to sell EMI Group's recorded music and publishing businesses in separate transactions for a combined $4.1 billion. Vivendi SA's Universal Music Group will buy EMI's record labels, home to Katy Perry and Coldplay, for 1.2 billion pounds ($1.9 billion), and a Sony Corp.-led group that includes billionaire David Geffen will pay $2.2 billion for the publishing unit. Clearly, the record industry is in a downward spiral to irrelevance.

![US Music Sales, $M](image)

The record industry is transferring from a business of selling CDs to one of digital downloads, meanwhile, consumers are shifting from downloads to streaming. As the more lucrative income, i.e. downloads, declines, pressure will be placed on streaming revenues to rise. As a way to preserve what portion of the download business they can, the labels will not allow subscription services to be a better value proposition. This thinking is a one-way ticket to becoming extinct in the new music business of the 21st Century.

**B. Artist Problems: Who pays Whom What?**

Artists are getting paid so little money by subscription services, but artists are getting paid so little money by record labels as well. Broad royalty estimates that apply to both Pandora-style radio and MOG-style subscriptions are broken down like this: Let's say MOG has 1 million subscribers and everyone's paying $10 per month = $10 million dollars; and let's say the labels get

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164 Id.


167 Id.

60% of that = $6 million dollars.\textsuperscript{169} Now, each label gets their piece of 60% based on frequency of plays, so if Warner Music was 30% of all plays in a given month, then Warner gets 30% of that 60% = $2 million dollars.\textsuperscript{170} They get a lump sum of money and once they get that money, it is up to them to distribute it internally.\textsuperscript{171}

C. No transparency in Payments Frustrates both Labels and Artists

Non-interactive streaming services offer a number of different types of songwriter/publisher royalty structures for streaming depending on the type of service the consumer have selected (e.g., $.00025 for one free stream and $.0003 for premium subscription, among others.)\textsuperscript{172} There are also royalty plans that pay the music publisher and songwriter a percentage of subscriber receipts or advertising revenue (e.g., from 4% to 15%) and some that guarantee that the royalty will be the greater of a set penny rate per stream or a pro-rata percentage of receipts.\textsuperscript{173}

Interactive streaming services are equally as non-uniform. There are a number of variables involved in the actual calculations for a particular service and offering including revenue of the applicable service, the costs of content, numbers of subscribers, performance rights fees paid to ASCAP, BMI and SESAC as well as the aggregate number of plays all musical composition during the applicable royalty accounting period.\textsuperscript{174} As for the formula itself, the actual royalty is arrived at by taking the greater of (a) the applicable percentage of the service’s revenue or b) the lesser of i) the service’s record label master recording royalty payments or ii) a set per subscriber monthly amount.\textsuperscript{175} These royalty calculations vary in amount depending on what the service offers e.g., standalone non-portable streaming only, standalone portable, free-non-subscription, etc.\textsuperscript{176}

How much do streaming services pay artists? It’s a question that has been asked a lot lately of services such as Spotify, Mog, Rdio, Rhapsody and even iTunes.\textsuperscript{177} The biggest problem with the question is that it cannot be answered accurately.\textsuperscript{178} The most obvious reason is because subscription

\textsuperscript{169} Id.
\textsuperscript{170} Id.
\textsuperscript{171} Id.
\textsuperscript{172} Jeffrey & Todd Brabec, Music Money and Success: The insider’s guide to making money in the music business 406 (Schrimer trade books 7th ed. 2011).
\textsuperscript{173} Id.
\textsuperscript{174} Id. at page 404
\textsuperscript{175} Id.
\textsuperscript{176} Id.
\textsuperscript{178} Id.
services do not directly pay artists because in the digital music supply chain, at least one intermediary exists between a streaming service and an artist.\footnote{179 Id.} Subscription services need be concerned only with paying the rights holders with whom they have negotiated licensing deals.\footnote{180 Id.} How much money artists ultimately are paid for streams or purchases depends on a number of factors such as royalty rates, ownership and contractual terms and a streaming service could only answer the first one: royalty rates.\footnote{181 Id.} If an artist owns the master recordings (and effectively acts as its own record label) the only intermediary between subscription service and artist is the distributor.\footnote{182 Id.} All distributors take a cut of some sort - either a flat fee or a percent of sales or the artist can license the recordings to a record label, but what the label pays the artist vary from deal to deal.\footnote{183 Id.} There is little transparency about how -- and if -- that money makes its ways to artists.\footnote{184 Id.} Subscription services could help artists, but they can't tell labels what to do with their licensing payments.\footnote{185 Id.} Artist frustration with streaming and cloud service royalty rates opens the door for record labels own platforms of music. Using their own streaming platform, record labels could have transparent detailed breakdowns of subscribers, listeners, and ad-clicks.

D. Record Label Revenue Models are Outdated

While some of the cloud-based streaming music service providers are charging a premium for mobile streaming, Pandora and Spotify, among others, are offering free ad-supported versions. To obtain a large subscriber base it seems that free opt-in services with mobile ads will be the model of choice for the masses, while a smaller segment of users will prefer to pay a premium to obtain ad-free music streaming to their handsets.\footnote{186 Id.} This is the platform direction the record labels need to take in order to stay relevant.

It is important to note, that Coldplay, Lady Gaga, and Adele have all eschewed streaming services and have still sold millions of records. However, artists like these are the last vanguard of rock stars which command millions of (older) fans who still buy physical records.

\footnote{179 Id.} Id. \footnote{180 Id.} Id. \footnote{181 Id.} Id. \footnote{182 Id.} Id. \footnote{183 Id.} Id. \footnote{184 Id.} Id. \footnote{185 Id.} Id. \footnote{186 Olafur Ingthorsson, The growth of cloud based music streaming, (Mar. 21, 2011), http://cloudcomputingtopics.com/2011/03/the-growth-of-cloud-based-music-streaming/}
E. Artists Independence: No Need for Labels

Artists will no longer want or need the middleman record Label. The labels aren’t producing actual physical product and broadcast radio will become extinct and nostalgic. Artists will have no need for labels. Artists can almost do anything by themselves these days, musical branding and band buzz are as easy to build as a brand new Facebook or Tumblr page. Google is appealing to independent artists who release their own music, allowing them to upload songs, biographical information and artwork to the store after paying a one-time $25 fee with Artists keeping 70% of all sales.\(^\text{187}\) This growth in cloud storage and interactive streaming of entire albums, certain tracks, and back catalogs will continue to grow for the Artist with or without record label help.

V. Record Labels Need to Create their own Cloud and Streaming Platforms to Survive in the 21st Century Music Marketplace.

A. Cut Out the Middleman

1. Relevance

The record industry’s narrow view of the market does not take into account the internet as the new medium for which new methods of marketing must and will be developed.\(^\text{188}\) The money the music industry has spent to fight music-sharing online through the courts, through trawling the internet, and through lobbying could have all been spent on finding the model that makes streaming compatible with profitability.\(^\text{189}\) Grooveshark and competitors such as Spotify and MOG are not sharks circling the music industry but rather their very livelihood depends on a thriving ocean of artists.\(^\text{190}\) The current streaming service heavyweights have created a model that the record industry can follow and make even bigger revenue streams. By owning the rights and not simply licensing to streaming services, record labels will get an enormous boosts in revenues from both premium subscriptions and advertising revenue.

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\(^{188}\) Sara Steelet, Comment, UMG Recordings, Inc. v. Mp3.com, Inc.; Signaling the need for a deeper analysis of copyright infringement of digital recordings, 21 Loyola of Los Angeles Ent. L. Rev. 31, 47 (2000).


\(^{190}\) Id.
It is rumored in the record industry that major labels plan to abandon the CD-format by the end of 2012 and replace it with download/stream only releases via music services.¹⁹¹ This is smart, in that CD's cost money, even when they don't sell because there is stock storage to be paid; a label also pays money to distributors when CDs get returned to the labels when not sold and so on.¹⁹² In short, abandoning the CD-format will make it possible to just focus on the release and the marketing of it and no longer focus on the distribution.¹⁹³ When record labels abandon the CD they must have a platform to distribute their own music through streaming or cloud service. Otherwise, the record labels will lose all power to the streaming services themselves as they will control artist exposure and payment amount. It will not make any financial sense for artists to join record labels – when they can make more money licensing directly to the services and don’t need a record label to push records anymore. The streaming services will start “signing” artists to exclusive deals. The lucrative advertising and subscriber revenue that could be obtained from a popular, major artist releasing albums exclusively on a certain online service provider is staggering.

2. Mobile Platforms: What the Consumer Wants

Currently, due to the amount of time Americans spend on the road, the traditional formats of radio listening and using CDs in the car remain the dominant methods consumers use to interact with music.¹⁹⁴ Nearly two out of three Americans say that the majority of their music listening takes place in the car.¹⁹⁵ Even so, adaptive-streaming and on-demand-streaming radio is now gaining more traction in the market, complementing the pay-per-download format popularized by services like iTunes and AmazonMP3.¹⁹⁶ A tipping point is approaching when vehicles and portable devices move from a tethered connection to a more integrated one.¹⁹⁷ Smart devices streaming music could end up being the largest threat to CDs and broadcast radio since the dawn of digital music.¹⁹⁸ More than half (53%) of music consumers listened to music in their cars on CDs, which is down four percentage points over the prior year.¹⁹⁹ Nearly a third (29%) listened to music using a smart device.

¹⁹² Id.
¹⁹³ Id.
¹⁹⁴ The NPD group, Digital to Car integration the largest threat to CDs and broadcast radio since the dawn of digital music, San Francisco Chronicle (Oct. 19th, 2011), http://www.sfgate.com/cgi-bin/article.cgi?f=/g/a/2011/10/19/prweb8891405.DTL
¹⁹⁵ Id.
¹⁹⁶ Id.
¹⁹⁷ Id.
¹⁹⁸ Id.
¹⁹⁹ Id.
- including the iPod touch, iPhone, or Android smartphone -- an increase of nine percentage points since last year. The 3.5 hours per week consumers spent listening to music on smartphones also rose 9% compared to a year-ago; whereas listening to music on CDs and dedicated portable music players declined by a similar amount.

The fast-growing consumer adoption of smartphones is the latest boon to the music business, especially streaming services. With an always-on internet connection and great audio playback capabilities, the typical smartphone is an ideal internet radio device, and according to a survey by TargetSpot, 45% of internet radio listeners listened on a mobile phone or smartphone. Due to its enormous penetration and coverage, the mobile phone has become the device of choice for enabling cloud-based music services. In the past year Pandora’s registered user base has nearly doubled, mainly due to the smartphone apps, which are nearing 80 million users. Spotify, with its approximately 10 million users is planning on launching a Pandora-like mobile streaming music service, expecting a significant growth in its user base.

Even Apple has had trouble staying ahead of the curve of progress. While iPods have almost completely crushed any MP3 player competition, iPod sales are on a downward slope of their own. According to the latest Apple quarterly figures, iPod sales showed a 27% decline year-over-year. All of those sales have gone to the iPhone because virtually everyone in the market for an iPod has a mobile phone. iPod sales might soon decline to the point that iPod’s qualify for the endangered species list. Apple’s current big push is iCloud and making iCloud the dominant storage site for users’ music, and iPods do not sync to iCloud. Unlike the record industry, Apple will make up for the lost iPod sales with increased sales of iCloud-friendly mobile devices.

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200 Id.
201 Id.
203 Id.
204 Id.
205 Id.
206 Id.
207 Id.
209 Id.
210 Id.
211 Id.
212 Id.
213 Id.
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215 Id.
216 Id.
217 Id.
3. Car Factor

Current models of several cars, including the Ford Edge, the Audi A6 and the Lincoln MKX, can all stream audio.\(^\text{214}\) Ford's strategy is to use smartphones as the primary interface with about a dozen Ford cars, SUVs and trucks now support the company's Sync AppLink technology, which lets you control certain Android, iOS or BlackBerry applications.\(^\text{215}\) Current AppLink-enabled applications include Pandora, iHeartRadio and iCloud.\(^\text{216}\) Several other automakers have followed Ford's lead, offering voice-enabled smartphone app integration with select 2012 models including Buick IntelliLink, BMW ConnectedDrive, Cadillac Cue, Chevrolet MyLink, Mini Connected and Toyota Entune.\(^\text{217}\) Eventually cloud-based applications will run on your car in the same way they do on your computer or your smartphone today.

4. Profitability

In today’s music streaming world, there is profit potential in giving it away for free.\(^\text{218}\) Companies like Pandora, which generated $67 million dollars of revenue in the 2\(^{nd}\) quarter of 2011 Q2; and Spotify with over three million paying users, don’t charge for entry-level service.\(^\text{219}\) Instead, these music innovators found a way to monetize music indirectly through advertising and other means.\(^\text{220}\) Music still comes at great cost — music streaming services still pay high licensing fees to labels — but as the economics shift, licensing fees are likely to decline.\(^\text{221}\)

The US is the largest digital music market in the world.\(^\text{222}\) In 2010, revenues from digital channels accounted for almost half of record companies’ US trade revenues, driven by a combination of increasing digital revenues and the sharp decline in CD sales caused in part by the closure of physical retail stores across the country.\(^\text{223}\) There has been continued strong growth in the

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\(^{214}\) John Brandon, *The connected car arrives*, Techworld (Oct. 27\(^{th}\), 2011, 6:53am),

\(^{215}\) Id.

\(^{216}\) Id.

\(^{217}\) Id.

\(^{218}\) Hany Nada, *Music for nothing and the fans for free*, (Oct. 28, 2011, 5:10 pm),
http://allthingsd.com/20111028/music-for-nothing-and-the-fans-for-free/?refcat=media

\(^{219}\) Id.

\(^{220}\) Id.

\(^{221}\) Id.


\(^{223}\) Id.
performance rights sector, with an increasing number of consumers accessing digital broadcasts through services such as Sirius XM satellite radio and Pandora.\textsuperscript{224}

Global online music revenue from end users is on pace to reach $6.3 billion dollars in 2011, up from $5.9 billion in 2010; with an online music revenue is forecast to reach $6.8 billion dollars in 2012, and grow to $7.7 billion dollars in 2015.\textsuperscript{225} Meanwhile, sales of physical music, such as CDs, continue to slide, with sales set to drop from US$15bn in 2010 to US$10bn in 2015.\textsuperscript{226} The desire for access to and consumption of music and content continues to grow at exponential rates as consumers opt for connected devices such as media tablets, smartphones and connected media players.\textsuperscript{227} Streaming music services is the clear driver in the online music industry for the coming years.\textsuperscript{228} Estimates are that streaming music services will account for nearly one-third (27\%) of end-user online music spending in 2015.\textsuperscript{229} Online distribution revenue will start to overtake physical revenue by 2015 and stakeholders in the music industry will continue to realign their businesses to maintain their places in the value chain.\textsuperscript{230} There seems to be no end to Consumers continued use of applications, devices and services that provide them with multiple ways of discovering, consuming and communicating about music.\textsuperscript{231}

SoundExchange, the Washington D.C.-based non-profit performance rights organization collects statutory royalties for digital transmissions and pays to member artists and labels.\textsuperscript{232} Its royalties involve only artists and labels, not music publishers.\textsuperscript{233} SoundExchange paid out a record $88 million to 18,300 artists and labels in the third quarter of 2011.\textsuperscript{234} The size of this latest payout shows that digital performance royalties are continuing to grow at a good clip.\textsuperscript{235} A quarterly payout

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{224} Id. \\
\item \textsuperscript{225} John Kennedy, Online Music Sales to hit $6.3 billion as physical music sales decline, Silicon Republic (Aug. 11\textsuperscript{th}, 2011), \url{http://www.siliconrepublic.com/new-media/item/24397-online-music-sales-to-hit/} \\
\item \textsuperscript{226} Id. \\
\item \textsuperscript{227} Id. \\
\item \textsuperscript{228} Id. \\
\item \textsuperscript{229} Id. \\
\item \textsuperscript{230} Id. \\
\item \textsuperscript{231} Id. \\
\item \textsuperscript{232} Glenn Peoples, SoundExchange paid out a record $88 million in Q3, but big money is still going uncollected, Billboard (Oct. 25\textsuperscript{th}, 2011), \url{http://www.billboard.biz/bbbiz/industry/publishing/soundexchange-paid-out-a-record-88-million-1005436152.story} \\
\item \textsuperscript{233} Id. \\
\item \textsuperscript{234} Id. \\
\item \textsuperscript{235} Id. \\
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of $88 million implies an annual payout to artists and labels in the area of $350 million. The SoundExchange paid out $249 million in all of 2010 and $156 million the prior year.

Most recently, SoundExchange has partnered with CD Baby to match its list of unclaimed royalties to the digital distributor's membership. The two parties have identified 12,806 recording artists and 1,574 labels affiliated with CD Baby who are collectively owed more than $1 million. This week, CD Baby began sending emails to all matched artists and labels that explain to register with SoundExchange to get paid. The partnership with CD Baby is just the latest attempt by SoundExchange to move unclaimed royalties. Earlier this year it partnered with The American Federation of Television and Radio Artists (AFTRA) to identify 6,126 AFTRA member artists who were owed a cumulative $3.6 million in back royalties. It also teamed up with Facebook marketing startup RootMusic to reach the nearly 7,500 RootMusic artists who were owed $5.3 million in back royalties.

Since its launch in 2001, Rhapsody has generated hundreds of millions of dollars in royalties that have been paid out to record labels, music publishers and their representatives. Royalties have been the company's greatest cost since launch. We've worked hard over the years to obtain direct licenses from music publishers, including from many writers who license their work directly to us or via a trusted administrator. In fact, we often hear from songwriters that Rhapsody royalties help them stay afloat in an era of diminishing sound recording royalties. We have seen some of the artist income numbers being reported, and we agree, they seem awfully small - particularly those cited as generated by some of the free services. However, to look at these numbers through the lens of a single transaction is myopic. If an artist sells a download, they may get a bigger cut, but they only are paid once. By contrast, royalties are paid each and every time a track is streamed on

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236 Id.
237 Id.
238 Id.
239 Id.
240 Id.
241 Id.
242 Id.
243 Id.
244 Id.
245 Id.
246 Id.
247 Id.
248 Id.
249 Id.

John Irwin, Streaming services are cutting big checks for rights holders, Billboard (Oct. 25th, 2011), http://www.billboard.biz/bbbiz/industry/digital-and-mobile/streaming-services-are-cutting-big-checks-1005432232.story
Rhapsody. Each stream is a singular, recorded, secure transaction that creates infinite potential for artists and writers to be compensated over time pursuant to their agreements with their representatives.

5. Growth: Trillions of Plays, Billions of Listeners

Today, streaming music is a small percentage of all music listening, but it is growing -- it is the future. In the coming years, on-demand music will be available on every consumer device imaginable: in the home, in the car, virtually everywhere a music fan goes. As the industry continues to evolve, the hundreds of millions of streams being delivered today will become billions and then trillions of streams - each one generating compensation to the artist, writers and others responsible for the recording. These are the early days, the potential for compensation is huge as more and more people engage by streaming from legal services instead of stealing their music.

Subscription music services, like Rhapsody and Spotify, are expected to grow significantly by 2016 due to the increased ubiquity of smartphones. According to a study released by ABI Research, the number of subscribers to streaming music applications is expected to top 5.9 million by the end of this year, and by 2016, that figure is expected to grow to more than 161 million subscribers. 6 million to 161 million in 4 years is growth at unimaginable levels. The revenue is going to grow and grow, including the international music industry and the continued rise of “connected” countries which will take the number of streams, mouse clicks, and revenue to new heights. The record labels need to see these figures as a reason to make a fresh start on a new life.

VI. Conclusion

In order for the record industry to survive in the next 5-10-20 years, record labels must provide consumers with a platform for music from their own label. This platform would eliminate the need and expense of using a “middleman” streaming or cloud service. The record industry continues to bleed to death by letting other companies profit on the advertising fees and traffic streaming brought by record industry product. The money made selling records and downloads is only going to continue to dwindle. Selling material records and downloads is not a positive business model for future operations and the record industry must start providing their own streaming and cloud services. Failure to change will result in the end of the record industry as we know it.

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250 Id.
251 Id.
253 Id.