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IS IT RIGHT TO ASK SPOTIFY TO PAY MECHANICAL ROYALTIES WHEN NO COPY OF THE MUSIC WAS MADE?

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ABSTRACT

On-demand interactive streaming on platforms like Spotify, Apple Music, and Amazon Music are increasingly becoming the most popular way for people to consume music. Consequently, licensing songs to streaming services is proving to be an important revenue source for songwriters. Traditionally, a songwriter receives mechanical royalties for record sales and downloads as well as public performance royalties when their song gets airplay on radio stations. Streaming a song on a device raises the question of whether the songwriter gets mechanical or performance royalties. The music industry standards of practice in the United States stipulate that a stream splits evenly between mechanical and public performance. But the Music Modernization Act (MMA) did not mandate such an even split. In fact, digital streaming does not involve reproducing and distributing music where mechanical license is needed. This paper first explains why the 50-50 split lacks statutory support and then proposes an appropriate fix.

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INTRODUCTION

Songwriters are compensated mainly by mechanical and public performance royalties. The latter is appreciated by songwriters because the monies collected will not be recouped by the publishers. As music streaming services become the most significant source of revenue for songwriters, it is worth examining how income is distributed. When a song is streamed, the streaming service pays the songwriter 50 percent mechanical and 50 percent public performance royalties. But songwriters want a larger portion of public performance royalties. This article will first introduce the basics of songwriter royalties. It will then demonstrate that the current distribution of songwriter royalties lacks statutory support. Finally, the article will conclude by proposing a proper solution to the baseless distribution.

I. BACKGROUND

A. Spotify-like streaming service drove the growth of the music industry

After more than twenty years of gloomy winter caused by piracy, the music industry is booming again. According to the International Federation of the Phonographic Industry (IFPI), the global recorded music market grew by 7.4 percent in 2020, with total annual revenue of US \$21.6 billion.¹ Meanwhile, Goldman Sachs estimated the entire music industry's revenue (live, recorded, and publishing) will increase to \$131 billion in 2030.²

According to IFPI, growth has been driven by streaming, especially through paid subscription streaming revenues.³ At the end of 2020, the number of paid subscription accounts stood at 443 million, pushing revenue from streaming services to \$13.4 billion, or 62.1 percent of total global recorded music earnings.⁴

¹ See *IFPI Issues Global Music Report 2021*, IFPI (March 23, 2021), <https://www.ifpi.org/ifpi-issues-annual-global-music-report-2021/>.

² See Jimmy Stone, *The State of the Music Industry in 2020*, TOPTAL: FIN. <https://www.toptal.com/finance/market-research-analysts/state-of-music-industry> (last visited Dec. 31, 2021).

³ *IFPI Issues Global Music Report 2021*, *supra* note 1.

⁴ *Id.*

Even investment giant KKR joined the ever-growing music business.⁵ KKR acquired music publishing copyright from famous artists and songwriters across multiple genres.⁶

B. Although the music industry is hotter than ever, songwriters are left with less income and influence

Spotify pays songwriters and publishers \$0.001 per stream.⁷ If a song gets played one million times, its songwriter gets \$1000. In reality, the songwriter will probably receive less than \$1000 because these earnings are split between the songwriter and the publisher.

C. Songwriters make money from four copyright licenses

In the music industry, there are generally two categories of royalty-generating copyright claims: compositions and sound recordings.⁸ Composition includes lyrics, musical notes, and melody. Sound recording refers to the recording of an artist's performance of a song. Typically, a songwriter owns the copyright of the composition while an artist owns the copyright of the sound recording. In this article, we focus on the songwriter's part.

Before reviewing how songwriters collect royalties, we need to understand the relationship between songwriters and publishers. Typically, songwriters work with publishers to administrate the rights.⁹ The songwriter signs over the copyright to the publisher, and, in return, the publisher finds users, issues licenses, and collects money.¹⁰ Traditionally, except for public performance royalties, the publisher splits all other income evenly with the songwriter.¹¹

A songwriter is compensated for the use of their composition through four main sources of income: (1)

⁵ See Anne Steele, *KKR Buys Into Producer Ryan Tedder's Music Catalog*, WALL ST. J. (Jan. 11, 2021, 6:33 AM), <https://www.wsj.com/articles/kkr-buys-into-producer-ryan-tedders-music-catalog-11610364781>.

⁶ *Id.*

⁷ See Jeff Price, *The Definitive Guide to Spotify Royalties 7*, <https://vi.be/files/research/the-definitive-guide-to-spotify-royalties-by-jeff-price-3.pdf>.

⁸ Lydia Pallas Loren, *Copyright Jumps the Shark: The Music Modernization Act*, 99 B.U. L. REV. 2519, 2521 (2019).

⁹ DONALD S. PASSMAN, *ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS* 220 (10th ed. 2019).

¹⁰ *Id.* at 220–21.

¹¹ *Id.* at 221.

mechanical royalties, (2) public performance royalties, (3) synchronization royalties, and (4) print royalties.¹²

Mechanical royalties are paid to copyright owners for the manufacture and distribution of records with the song.¹³ So, mechanical rights are the rights to reproduce songs in the record.¹⁴ Usually, the higher the record sales, the more the songwriter gets paid.¹⁵ But the rate at which the songwriter is paid is considerably low due to the Copyright Act. Section 115 of the Copyright Act provides that once a song has been recorded and released to the public, the copyright owner must first license the song to anyone who wants to use it in audio-only recordings.¹⁶ Only then may the copyright owner issue this said license under a statutory rate.¹⁷ Mechanical royalties are collected by the publisher, who then transfers them to the songwriter.

Public performance royalties, on the other hand, stem from public performance rights. Each public performance of a song requires the songwriter's permission.¹⁸ Such royalties are triggered whenever songs are used in radio and television broadcasts, live theatres and concerts, and business establishments.¹⁹ However, songwriters and publishers do not deal directly with those who want to use their songs.²⁰ Instead, they are represented by performing rights societies or Performing Rights Organizations (PROs).²¹ PROs make deals with radio stations, TV stations, nightclubs, and others and collect the public performance royalties.²² Examples of PROs include ASCAP (American Society of Composers, Authors and Publishers), BMI (Broadcast Music, Incorporated), SESAC (Society of European Stage Authors and Composers), and GMR (Global Music Rights).²³ After collecting the public performance royalties, PROs use it to pay its operating expenses before distributing the monies to songwriters and publishers.²⁴

¹² David M. Jenkins, *The Singer/Songwriter Wears Two Hats: An Introduction to Music Copyrights and the Singer/Songwriter's Sources of Income*, 18 DUPAGE COUNTY B. ASS'N BR. 22, 24 (2006), <https://www.dcba.org/mpage/vol180206art5>.

¹³ PASSMAN, *supra* note 9, at 215.

¹⁴ *Id.*

¹⁵ *Id.* at 231.

¹⁶ 17 U.S.C. §115.

¹⁷ *Id.* at 215-17.

¹⁸ See PASSMAN, *supra* note 9, at 225.

¹⁹ *Id.*

²⁰ *Id.* at 226.

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*

One important point is that unlike other royalties, songwriters are paid their share (50 percent) of public performance royalties directly by the PROs.²⁵ A songwriter's public performance royalties do not flow through a publisher.²⁶ This direct channel benefits the songwriters because there are no delays in the payment and the monies are not subject to recoupment of the publishing advance.

Synchronization royalties come from licensing to use music in "timed synchronization" with visual images like in films, TV programs, commercials, video games, etc.²⁷

Print royalties include royalties from the sale of hard copy sheet music, digital sheet music, and lyrics.²⁸ An example of an entity that pays print royalties is a website that provides downloadable sheet music or reprinted lyrics.²⁹

II. ARE INTERACTIVE STREAMS RECORD SALES OR RADIO BROADCASTS?

Streaming services present a question to the music copyright world: if a song is streamed on any device, does that trigger a mechanical or a performance royalty?³⁰ The PROs argue that streaming a song is akin to listening to it on radio, and thus counts as a performance.³¹ On the other hand, those on the mechanical side of the debate contend that one cannot stream a song without making a copy on the streaming service's server, and caching it on a mobile phone.³² This latter perspective necessitates mechanical licenses because its interpretation of streaming involves reproductions of the song.³³

Approaches to this issue vary by country. Most of Europe considers streaming to be 75 percent performance and 25 percent mechanical.³⁴ In the United Kingdom, however, streaming is considered 50 percent performance and 50 percent mechanical.³⁵

Two areas of this debate present general points of agreement. First, permanent downloads should be counted as mechanical only.³⁶ When one downloads a song, they have

²⁵ *Id.* at 227.

²⁶ *Id.*

²⁷ *Id.* at 242.

²⁸ *Id.* at 260–62.

²⁹ *Id.* at 262.

³⁰ *Id.* at 232.

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 233.

unrestricted access to the song. Additionally, just like sales of CDs, downloads involve song reproductions since downloading creates a copy of the song.

Second, non-interactive audio streaming should be counted as performance only.³⁷ Non-interactive streaming functions like radio stations, which do not allow users to choose what songs they want to listen to.³⁸ So, like radios, non-interactive streaming only necessitates payment of performance royalties.

That said, one may argue that a non-interactive streaming provider still has to make a copy of the song on their server, thereby qualifying the process as a mechanical reproduction.³⁹ Section 112 of the Copyright Act allows radio stations and transmitting organizations to make sever copies of recordings for broadcast without a mechanical license.⁴⁰ Yet, they still must obtain a performance license to broadcast the song.⁴¹ The industry is now settled that non-interactive streaming services only need the performance and not the mechanical license.⁴²

The question remains though: how is on-demand interactive streaming like Spotify characterized? Interactive streaming providers, such as Spotify, Apple Music, and Amazon Music, allow users to play any song at the user's preference.⁴³ Like radio stations and non-interactive streaming services, interactive streaming also requires the making of a copy of the song on the server. But as discussed above, section 112 allows several copies without a mechanical fee. Therefore, the only difference between non-interactive streaming and interactive streaming is that interactive streaming enables users to play a given song at any time.

The Music Modernization Act (MMA) explicitly states that “[a]n interactive stream is a digital phonorecord delivery,” making it both a mechanical copy and a public performance.⁴⁴ The Music Modernization Act (MMA) was passed in 2018, which updated the copyright law for the purpose of making statutory licensing more fair for creators and more efficient for digital music providers.⁴⁵ The MMA even created a

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.* at 234.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ 17 U.S.C. § 115 (e)(13) (2018).

⁴⁵ See *The Music Modernization Act*, U.S. COPYRIGHT OFFICE, <https://www.copyright.gov/music-modernization/> (last visited Jan. 14, 2023).

compulsory mechanical license for streaming.⁴⁶ Further, the MMA set up a new organization called Mechanical License Collective (MLC) to collect the compulsory mechanical royalties from those interactive streaming service providers.⁴⁷ Following collection of these mechanical royalties, the publishers then file claims with the MLC for their royalties.⁴⁸ Since the law requires the interactive streaming service providers to fund the MLC, no deductions for operating expenses or commissions are levied.⁴⁹

A. The United States music industry treats an interactive stream as half mechanical and half performance without statutory support

Based on the language in the MMA, the U.S. music industry treats an interactive stream as 50 percent mechanical and 50 percent performance. For example, Spotify paid, per dollar in revenue, \$0.06 for mechanicals and \$0.0612 for public performance to songwriters and publishers for their compositions.⁵⁰ Apple music paid \$0.0675 for mechanicals and \$0.0675 for public performance per dollar in revenue.⁵¹ But this 50-50 split approach lacks statutory support.

The MMA does not mention any 50-50 split requirement. The MMA has provided extensive instructions on how to rate and collect mechanical.⁵² The statute, however, does not state that an interactive stream should be 50 percent mechanical and 50 percent public performance, nor does it clarify why an interactive stream is a digital phonorecord delivery. Exploring why a stream is considered a mechanical copy is necessary.

The music industry fraternity argues that since streaming has replaced CD sales, it should be treated as mechanical.⁵³ As

⁴⁶ PASSMAN, *supra* note 9, at 217.

⁴⁷ *Id.* at 240.

⁴⁸ *Id.* at 241.

⁴⁹ *Id.*

⁵⁰ *How Does Music Streaming Generate Money?*, MANATT (Oct. 12, 2016), <https://www.manatt.com/insights/news/2016/how-does-music-streaming-generate-money>.

⁵¹ *Id.*

⁵² See PASSMAN, *supra* note 9, at 231-237 (discussing that compulsory rates for interactive streaming are set by the Copyright Royalty Board (“CRB”) and that mechanical royalties are equal to the excess of the product of the compulsory rate and the digital service provider’s revenue, over the number of public performance royalties).

⁵³ “Songwriters and publishers certainly have a strong argument for the application of mechanical licensing to interactive streams. They asserted that interactive streaming is the future of music distribution and serves as a substitute for CD and download sales, which do generate mechanical royalties.” Cameron Berkowitz, *Streaming in the Free Market: Releasing Songwriters From the Compulsory Mechanical License*, GRAMMY.COM (2019)

the CD market continues to shrink, stakeholders in the music industry try even harder to survive. Seeing a disruptive innovator like Spotify rising quickly, the old players want a slice of the pie. But this argument is hardly convincing. The increasing popularity of streaming does not justify the additional royalties. A business cannot charge something it does not sell simply because the business is losing money.

The only strong argument is that the user's unrestricted access to songs at any time equates streaming to having a copy of the song. As such, streaming should be treated as a mechanical reproduction. Digital Service Providers (DSPs) like Spotify allow users to search for preferred songs on the providers' databases, and then play the songs on the apps via mobile phones or other electronic devices. A user may pause, rewind, and replay the song unrestricted. This level of control over the song makes streaming more like a mechanical reproduction. It is important to explore whether this is a correct characterization of mechanical reproduction and whether control over a song is meaningful.

- B. A stream on Spotify does not fit the statutory definition of reproduction under the Copyright Act because a stream is not a material object and cannot last permanently

A songwriter's mechanical reproduction license comes from the exclusive right to reproduce the copyrighted work under section 106 of the Copyright Act.⁵⁴ Section 106(1) grants copyright owners the right "to reproduce the copyrighted work in copies or phonorecords."⁵⁵

According to the definitions set out in section 101, phonorecords are defined as "material objects in which sounds, other than those accompanying a motion picture or other audiovisual work, are fixed by any method now known or later developed. . . ."⁵⁶ Copies are defined as "material objects, other than phonorecords, in which a work is fixed by any method now known or later developed."⁵⁷ Therefore, a reproduction must be (1) a material object, in which (2) the copyrighted work is fixed.⁵⁸

First, a reproduction of a copyrighted work must be a material object. According to the Merriam-Webster

(Winner of Entertainment Law Initiative writing competition) (on file with author).

⁵⁴ See 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.02 (rev. ed. 2022).

⁵⁵ *Id.* § 8.02[B][1].

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.* § 8.02[B][2].

dictionary, a “material” object is something “physical rather than spiritual or intellectual.”⁵⁹ Thus, a performance or oral rendition of the work is not a reproduction.⁶⁰ On the other hand, a CD record is clearly a reproduction because a CD is a tangible physical object. A digital download may also be a material object because an mp3 or any other digital audio file is essentially a series of binary information stored in a physical memory.

Second, a work must be “fixed.”⁶¹ A copy or phonorecord must be “sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration.”⁶² Therefore, the reproduction must last more than transitory duration.⁶³ For example, a CD record can technically last forever if one takes good care of the CD. A downloaded mp3 file may also last permanently because it is stored in a non-volatile memory such as read-only memory (ROM), hard disk drives, or flash memory. These kinds of memory devices can retain stored information even in the absence of electric power.

An interactive on-demand stream would probably meet the “material object” requirement but fail the “fixed” requirement. On-demand streaming involves making a copy of the work on the DSP’s server and caching it on a user’s device. Making a copy on the DSP’s server, like a digital download, fits both reproduction requirements. But this process represents a small fraction of what streaming entails. Only one copy of a media file is needed on the DSP end, and most streaming happens on the user end. Furthermore, making such copy on the DSP end, like giving a copy to radio stations, is also subject to the statutory license available for ephemeral copies contained in § 112(e) of the Copyright Act.

An interactive on-demand stream would fail the “fixed” requirement. The second part of the streaming process entails caching the work on a user’s device. Caching is the process by which copies of files are stored in a temporary location in order to be accessed more quickly. A user need not download the whole song every time they want to listen to it on a streaming service. Caching stores songs temporarily on users’ devices. Because the song is stored temporarily in volatile memory such as Random Access Memory (RAM) and cache memory, it fails the permanence requirement. In fact, there is no permanence in DSP services. If the DSP ceased to operate, the user could no longer access the song.

⁵⁹ *Material*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/material> (last visited Dec. 31, 2021).

⁶⁰ See MELVILLE B. NIMMER & DAVID NIMMER, *supra* note 52, § 8.02[B][1].

⁶¹ *Id.* § 8.02[B][2].

⁶² *Id.*

⁶³ *Id.*

Therefore, interactive on-demand streaming does not meet the reproduction requirements under the Copyright Act. Reproduction only happens when a copy is made on the DSP's server. The same can be said for radio stations, whether physical or online, since they need to make a copy on their servers so that the song may be played. These radio stations do not need to get a mechanical license but only a public performance license.

C. Viewing an interactive on-demand stream as 1 percent mechanical and 99 percent performance would benefit songwriters

The MMA forcefully characterizes an interactive stream as a digital phonorecord delivery.⁶⁴ But as discussed above, an interactive stream fails to meet the definition of phonorecord or copy and the requirement of reproduction. Therefore, making an interactive stream half mechanical and half performance goes against the statutory definition under section 101 of the Copyright Act. Under this definition, an interactive stream is not mechanical at all. If Congress were to require DSPs to get additional license from songwriters, it should at least create a new category of licensing rather than impose an erroneous definition of interactive stream.

Even if we were to embrace the idea that an interactive stream is somehow both a mechanical reproduction and a public performance, a 50-50 split is still unjustifiable. As noted, making a copy on the DSP side is just a small element of the streaming process. Thus, the split should be significantly indexed toward performance versus mechanical (e.g., 99 percent performance and 1 percent mechanical) since public performance exists on every user ends-on any user's device.

A 99-1 split also helps songwriters. Because a songwriter's public performance royalties do not flow through a publisher, there would be no delay in the payment to songwriters and the monies are not subject to recoupment of the publishing advance.

III. CONCLUSION

The United States music industry treats an interactive stream as half mechanical and half performance. This 50-50 split, however, lacks statutory support. The MMA only requires an interactive stream to be both mechanical and performance, yet it does not outline specific percentages.

⁶⁴ 17 U.S.C. § 115 (e)(13) (2018).

Taking a closer look to the Copyright statute reveals that an interactive stream probably does not fit the definition of mechanical reproduction. Thus, an interactive stream should be considered highly performance-based rather than the current 50 percent mechanical 50 percent performance split.