SAVING THE SPOTIFY REVOLUTION:

RECALIBRATING THE POWER IMBALANCE IN DIGITAL COPYRIGHT

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ABSTRACT

Many believed that Spotify would revolutionize the music industry, offering a legal alternative to file sharing that compensates musicians for use of their digital music. Why, then, have artists been abandoning the Spotify revolution in droves? Because the revolution has a dark side. Since Spotify is partly-owned by major record labels, it has a serious conflict of interest with independent artists. Spotify's lack of transparency about its financial flows gives musicians further reason to question whether the service has their interests in mind, particularly in light of the microscopic royalties Spotify has paid artists to date. This climate of suspicion has caused many artists to abandon the service and pursue alternative means of digital distribution and promotion. Even listeners have begun leaving Spotify on account of how it treats artists. Ironically, Spotify has managed to alienate the very audiences it needs as allies: artists, who supply Spotify's "unlimited" song library; and listeners, who fund the service through subscriptions and advertising. As such, the Spotify revolution is destined to fail—an unfortunate reality, as the streaming music business model has great potential to benefit artists and serve the underlying goals of copyright.

I argue that the most effective way to save the Spotify revolution is through a compulsory licensing scheme. This is because the primary impediment to Spotify changing its treatment of artists is its insulation from competitive pressures, which ultimately stems from the major labels' formidable bargaining position in digital sound recordings. The labels have assumed a gatekeeping function in streaming music, demanding corporate equity in exchange for access to their sound recordings, which every streaming service needs to build a comprehensive catalog. As a result, the streaming music market has very few participants, all of which are partially controlled

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by the major labels. Compulsory licensing would make the major labels' sound recordings more readily accessible to would-be streaming services. A more competitive marketplace will lead to greater transparency and fairer treatment of artists—and will ultimately enable the Spotify revolution to succeed.

INTRODUCTION

When Spotify reached the U.S. market in mid-2011, commentators acclaimed that "the future of music" was here.[2] Finally, legal access to a nearly unlimited catalog of music had become possible.[3] Although sharing many of the same characteristics as its illegal peer-to-peer predecessors like Napster, Spotify claimed to have an objective that distinguished it from other file sharing sites: compensating artists.[4] With potential to be the holy grail of music—unlimited songs for listeners with a paycheck for artists—Spotify seemed to be on track to revolutionize the music industry for consumers and musicians.

Why, then, have independent artists been abandoning this revolution in droves? Because the revolution has a dark side. Artists began growing suspicious of the service after receiving microscopic royalty checks.[5] Though artists have urged it to divulge how it calculates royalties, Spotify has been far from forthcoming with artists about its financial flows, giving artists all the more reason to distrust the service.[6] Further cementing this climate of suspicion is the fact that the U.S. major record labels partly own the service, meaning that the labels, as shareholders, did not necessarily have artists' interests in mind during negotiations with Spotify.[7] Left in the dark, artists must make a seemingly lose-lose choice: stay on Spotify and collect miniscule royalties, or leave the service, forgoing Spotify revenue and exposure. Many musicians have chosen the latter, abandoning Spotify

2. Randall Roberts, *Critic's Notebook: With Spotify, the Future of Music is Here*, POP & HISS: THE LA TIMES MUSIC BLOG (Jul. 22, 2011, 5:34 PM), http://latimesblogs.latimes.com/music_blog/2011/07/critics-notebook-with-spotify-the-future-of-music-is-here.html.

3. *Id.* ("[U]nlimited access to a huge chunk of the world's recorded music library . . . has become reality.").

4. Tom Krazit, *@ F8: Highlights from Mark Zuckerberg's Keynote Address*, PAIDCONTENT (Sept. 22, 2011, 9:51 PM), http://paidcontent.org/2011/09/22/419-f8-highlights-from-mark-zuckerbergs-keynote-address/ (noting that Daniel Ek, creator of Spotify, "[S]tated [his service]'s goal was to help people discover more music while fairly compensating artists.").

5. *See infra* Part II.A.iii.

6. *See infra* Part II.A.ii.

7. *See infra* Part II.A.i.

and pursuing alternate avenues of spreading their artistry. Even listeners have begun leaving Spotify on account of how it treats artists. Ironically, Spotify has managed to alienate the very audiences it needs as allies: artists, who supply Spotify's "unlimited" song library, and listeners, who fund the service through subscriptions and advertising. As such, the Spotify revolution is destined to fail; yet Spotify continues to bow to the interests of the major labels.

While artists may have good reason to be distrustful, the technology is not the problem. By reducing distribution costs for artists and improving the public's access to creative works, the streaming music business model could serve copyright's goals of promoting creation and dissemination.[8] Further, Spotify could be a viable way for musicians to monetize digital recordings if its user base increases through network effects.[9] With promise to benefit artists, the Spotify revolution does not need to be stifled—it needs to be saved by recalibrating the power imbalance in the digital music market.

This Note argues that the most effective way to save the Spotify revolution is to enable a competitive marketplace through compulsory licensing.[10] Because of the dangerous combination of the labels' market share and their holdout right under copyright law, the major labels sit as a formidable gatekeeper of the streaming music market, deciding who will enter and on what terms.[11] This has resulted in a marketplace consisting of only a handful of key participants, all of whom are part-owned by the major labels.[12] I contend that a compulsory licensing scheme, similar to those already in place in the Copyright Act for other music markets, would dissolve the labels' gatekeeping ability, for it would make the labels' catalogs available to any potential streaming service.[13] Further, it would prevent the labels from leveraging copyright ownership into streaming service ownership.[14] A more competitive marketplace will lead to greater transparency and fairer treatment of artists—and will ultimately enable the Spotify revolution to succeed.

8. *See infra* Part III.A.

9. *See infra* Part III.A.

10. *See infra* Part III.C.

11. *See infra* Part III.B.

12. *See infra* Part III.B.

13. *See infra* Part III.C.

14. *See infra* Part III.C.

I. THE SPOTIFY REVOLUTION: STREAMING MUSIC AS AN ALTERNATIVE TO FILE SHARING

A. Napster: An Illegal Means to the Inevitable End of Music Sharing

Napster, the forerunner of digital music sharing, made its debut on June 1, 1999, before the days of Spotify, Pandora, and even iTunes.[15] Napster's software allowed users around the globe to share music libraries with one another.[16] Reaching nearly sixty million users and forty million songs within its first year of operation,[17] Napster offered a virtually limitless song collection. While Napster wasn't the first music sharing service to emerge online,[18] it was the first to gain widespread use because of its innovative utilization of peer-to-peer technology.[19] Napster's predecessors required users to download entire files from a single intermediary;[20] in contrast, Napster's peer-to-peer client connected users directly during the file transfer process, meaning that mp3 files never passed onto Napster's servers.[21] This

15. Tim Wu, *When Code Isn't Law*, 89 VA. L. REV. 679, 728 (2003) ("The beta version of Napster debuted on June 1, 1999. Napster's revolutionary design was a response to the legal and technical problems of the web-based companies. As one commentator noted, '[Napster] was written to solve a problem—[legal] limitations on file copying.'") (quoting Clay Shirky, *What is P2P . . . And What Isn't?*, THE O'REILLY NETWORKS (Nov. 24, 2000), *available at* http://openp2p.com/pub/a/p2p/2000/11/24/shirky1-whatisp2p.html).

16. Nicholas M. Menasché, Note, *Recording Industry Missteps: Suing Anonymous Filesharers As A Last Resort*, 26 PACE L. REV. 273, 280 (2005) ("Napster, the first filesharing program to receive national attention, enabled users to: '(1) make MP3 music available for copying by other Napster users; (2) search for MP3 music files stored on other users' computers; and (3) transfer exact copies of the contents of other users' MP3 files from one computer to another via the Internet.' Napster's free MusicShare software and its system of servers enabled this process.") (quoting A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1011 (9th Cir. 2001)).

17. *Id.* (noting that Napster's sixty million users were sharing about forty million songs by 2000).

18. Wu, *supra* note 14 at 727 (describing earlier, more primitive, file-sharing solutions that relied on a centralized server).

19. Menasché, *supra* note 16 at 280.

20. *See* Wu, *supra* note 15 at 727.

21. Lital Helman, Note, *When Your Recording Agency Turns into an Agency Problem: The True Nature of the Peer-to-Peer Debate*, 50 IDEA 49, 68 (2009) ("Napster's technology was the first file-sharing software designed for exchanging music files that allowed transfer of such files among its users without crossing its server. Napster's site included only indexes of the songs that were actually residing on other users' hard drives").

feature gave Napster two distinct advantages. First, its file transfer process was much faster than that of its rivals, who relied on a centralized host to process requests.[22] Second, because Napster itself did not process file transfers, it had a colorable argument against copyright infringement liability.[23] Consequently, it managed to stay afloat for over two years.

Given that nearly three-quarters of the files exchanged through Napster were songs owned by major labels,[24] it was not long before copyright owners hauled Napster into court for copyright infringement.[25] Unfortunately for Napster, the Ninth Circuit did not agree that its unique features absolved it of copyright infringement liability.[26] Unable to sustain in court-ordered system monitoring for copyright infringement and unable to persuade the major labels to license their repertoire, Napster filed for bankruptcy in 2002.[27]

Napster's demise hardly marked the end to file sharing, though. Other services like Aimster and Grokster followed in Napster's footsteps.[28] As with Napster, copyright holders brought these services to their knees through partially successful—and more significantly, expensive—litigation.[29] Rights holders didn't limit their courtroom warfare to file sharing services. The Recording Industry Association of

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22. *Id.*

23. *See* Sony Corp. v. Universal City Studios, Inc., 464 U.S. 417 (1984) (holding that since Betamax technology was capable of substantial noninfringing uses, constructive knowledge could not be imputed to manufacturers due to manufacturer's sale to general public).

24. Helman, *supra* note 21, at 68 ("About seventy percent of the materials exchanged utilizing Napster's platform were copyrighted works owned by record companies, who sued Napster for contributory and vicarious infringement").

25. A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004 (9th Cir. 2001) (alleging both direct and contributory copyright infringement).

26. *Id.* at 1020-21 (noting that while *Sony* forbade imputing constructive knowledge on Napster, since its software was capable of substantial non-infringing use, the record showed that Napster had actual knowledge of infringement on its service).

27. Helman, *supra* note 21, at 68-69.

28. *See* Mark A. Lemley & R. Anthony Reese, *Reducing Digital Copyright Infringement Without Restricting Innovation*, 56 STAN. L. REV. 1345, 1359-66 (2004) (discussing Aimster and Grokster).

29. *See* Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd., 545 U.S. 913 (2005) (holding that Grokster was liable for contributory copyright infringement for distributing software with the object of promoting its use to infringe copyright); In re Aimster Litig., 334 F.3d 643 (7th Cir. 2003) (affirming district court's granting of preliminary injunction on basis that recording industry had demonstrated a likelihood of prevailing on the merits of its copyright infringement claim).

America (RIAA) also embarked on an extensive, unpopular lawsuit campaign against individual file sharers.[30] The recording industry's repeated choice of litigation over licensing showed that the major labels viewed file sharing as the industry's number one enemy. Yet, despite the RIAA's expensive game of whack-a-mole, file sharing lived on as new services like LimeWire emerged to replace those put under.[31]

While the major labels viewed file sharing as a threat, other music industry stakeholders thought quite differently—that file sharing represented a healthy market that was simply in need of monetization. Industry leaders like Eddie Schwartz, renowned songwriter and President of the Songwriters Association of Canada (SAC), noted that file sharing is simply the modern manifestation of the innate, inevitable human urge to share music.[32] Rather than wasting energy trying to stop the inevitable music sharing phenomenon, says Schwartz, the industry should focus on how to monetize it.[33] Over the past several years, scholars and industry leaders have proposed a number of models for monetizing existing file sharing activity. Schwartz and SAC have advocated for an opt-in blanket license, issued to end users via their Internet service providers (ISPs).[34] For a nominal monthly fee of around $5, users would have the right to download as many files as they wished.[35] Others have

30. *See* Helman, *supra* note 21, at 70.

31. Menasché, *supra* note 16 at 283-84 (noting that programs like LimeWire and Bearshare emerged and instead of a central server model, these programs "rapidly pass along search queries from machine to machine along the network--making it legally difficult to stop since there is no one computer in charge").

32. *Our Proposal: Summary*, SONGWRITERS ASSOC. OF CANADA (Jan. 2011), http://songwriters.ca/proposalsummary.aspx ("People have always shared music and always will. The music we share defines who we are, and who our friends and peers are. The importance of music in the fabric of our own culture, as well as those around the world, is inextricably bound to the experience of sharing.").

33. *Id.* ("Rather than continuing to engage in increasingly futile efforts to stop people from using new technologies to share music, we at the Songwriters Association of Canada believe this massive use of creators' work should be licensed just as live performances and broadcasting, also initially considered infringement, were ultimately licensed in the past. In both these previous examples, new business models, dynamic growth, and decades a wonderful music ensued").

34. *Id.* ("ISPs would partner with collectives in order to facilitate the licensing process. Access and content could be bundled. The proposed license fee would appear as a line item on monthly Internet access statements sent to consumers by ISPs").

35. *Id.* ("Private individuals and households who wish to music file-share would be licensed to do so in conjunction with an agreement to pay a reasonable monthly license fee. The license would cover the private,

suggested proposals from a mandatory "music tax" to wholesale copyright reform.[36] While these proposals have generated much discussion, none have been implemented, probably because each would likely require substantial legislation.[37]

Although the power of congressional inertia largely stifled these proposals, an innovative entrepreneur in Sweden would soon introduce a legal alternative to file sharing that required zero legislative intervention.

B. *Spotify: A Legal Alternative to File Sharing*

Music streaming service Spotify opened its digital doors to listeners in Europe in October 2008.[38] Spotify was the brainchild of Daniel Ek, a then-27 year old web entrepreneur who had already been running tech startup companies for ten years prior to starting Spotify.[39] A former Napster user himself, Ek "saw an opportunity to create something that made it easier for people to do the stuff that they were already doing, but legally."[40] Ek aspired to create a legal music sharing service that possessed many of the desirable features of its illegal predecessors.[41] To realize his vision, Ek recruited the creator of the popular file sharing client uTorrent to develop Spotify's peer-to-peer system.[42] Just as Ek envisioned, Spotify provides much

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noncommercial sharing of music, between two or more parties, using any Internet-based file-sharing client . . . [C]onsumers may opt out if they self-declare not to music file-share").

36. *See* Neil W. Netanel, *Impose a Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing*, 17 HARV. J.L. & TECH. 1 (2004); Ankur Srivastava, *The Anti-Competitive Music Industry and the Case for Compulsory Licensing in the Digital Distribution of Music*, 22 TOURO L. REV. 375, 394-95 (2007).

37. Although the SAC proposal could theoretically be accomplished through voluntary licensing, it is unlikely that such an approach would be successful in light of the major labels' negotiating history.

38. Neal Pollack, *Spotify Is the Coolest Music Service You Can't Use*, WIRED (Dec. 27, 2010), *available at* http://www.wired.com/magazine/2010/12/mf_spotify/all/1 ("Spotify launched in October 2008 and began its European invasion").

39. *Id.* ("Ek has been running tech companies for more than a decade. The first was a web design business he launched in 1997, while still a teenager living in a Stockholm suburb. He later worked as the CTO for Stardoll, a virtual paper-doll site for tween girls; started an advertising company that got purchased by the Internet marketing outfit TradeDoubler; and was part of Tradera, a Swedish auction company, which eBay bought in 2006").

40. *Id.*

41. *Id.* ("Ek wanted to create a legal service that offered the convenience and immediacy of file-sharing programs like the original Napster").

42. *Id.*

of the same appeal as illegal file sharing clients. It gives users access to a nearly limitless catalogue—15 million songs, as of July 2011.[43] Further, the service enables users to easily share songs, albums, and playlists with other Spotify users via Facebook integration.[44] Unlike its illegal counterparts, Spotify does not allow users to download mp3 files without first purchasing them in addition to the monthly subscription.[45] So, although the service does not give users absolute control over discrete files, Spotify does offer two other key features of file-sharing clients: access and sharing.

Spotify wasn't the first streaming service on the block: Rhapsody, a paid music subscription service, opened in 2001, seven years before the advent of Spotify.[46] Spotify differs from most of its competitors, though, in its "freemium" philosophy—attract users with a limited-feature, free version of your product, then convert a percentage of these users to a premium, paid subscription version.[47] Sean Parker, founder of Napster and a recent Spotify investor, described at a recent tech conference how freemium works for Spotify:

> You end up building a music library that's 100 times bigger than anything you've ever had, and at that point you have no choice—we've got you by the balls. If you want that content on your iPod, you're going to have to pay for it; if you want that content on your iPhone, you're going to have to become a subscriber.[48]

Spotify offers three tiers of accounts: Spotify Free, Spotify Unlimited, and Spotify Premium.[49] Spotify's free subscription gives

43. Dan Check, *Spotify vs. Girl Talk: What Is Spotify's Music Catalog Missing?*, SLATE (Jul. 22, 2011,5:53 PM), http://www.slate.com/blogs/browbeat/2011/07/22/spotify_vs_girl_talk_what_is_spotify_s_music_catalog_missing_.html.

44. *What is Spotify?*, SPOTIFY, http://www.spotify.com/us/about/what/ (last visited Nov. 24, 2011).

45. *Music Purchases*, SPOTIFY, http://www.spotify.com/us/about/features/music-purchases/ (last visited Nov. 24, 2011).

46. Curt Woodward, *Rhapsody at 10 Years: Surviving Long Enough to Face a Herd of New Competitors*, XCONOMY (Nov. 30, 2011), http://www.xconomy.com/seattle/2011/11/30/rhapsody-at-10/ (describing Rhapsody as "one of the original subscription music services in the U.S." and recognizing its existence since 2001).

47. Katherine Heires, *Why It Pays to Give Away the Store,* BUS. 2.0, Oct. 1, 2006, *available at* http://money.cnn.com/magazines/business2/businese2_archive/2006/10/01/8387115/indext.htm (describing freemium and detailing steps for how to effectively make money from the freemium model).

48. Pollack, *supra* note 37.

49. *Get Spotify Free*, SPOTIFY, http://www.spotify.com/us/get-spotify/open/ (last visited Nov. 24, 2011).

users access to the service's entire music catalog, but limits the number of songs a user may play each month.[50] The free account is advertising-funded, featuring both audio and graphic advertising formats.[51] Since Spotify has not released a standardized rate sheet, nor have any of Spotify's advertising contract terms become public, it is not clear how much the service makes per month from advertising revenue. Spotify Unlimited provides an unlimited, advertising-free listening experience for $5 per month.[52] At $10 per month, Spotify Premium includes features like offline listening, a mobile app, enhanced sound quality, exclusive content, early album releases, and sound system compatibility.[53]

C. How Musicians Make Money on Spotify

Though inspired by illicit file sharing activity and sharing many of the characteristics of illegal peer-to-peer clients, Spotify aims to accomplish something that Napster and its peers did not: monetizing music on artists' behalf.[54] Spotify's activities implicate three rights under U.S. federal copyright law: the public performance, mechanical, and sound recording rights.[55] Spotify acquires licenses from the intermediaries who manage these rights.[56] These intermediaries, in turn, pay a share of royalties to artists and songwriters based on pre-existing contracts.

Since streaming music requires that copies of songs be made, Spotify must pay mechanical royalties owed to songwriters and publishers because U.S.C. § 106(3) gives the owners of musical works the exclusive right to reproduce "phonorecords."[57] Unlike other licenses required for streaming, the mechanical license is compulsory, so Spotify does not negotiate with anyone, but simply pays mechanical royalties to the Harry Fox Agency, an agency that collects

50. *Id.*

51. *Advertising*, SPOTIFY, http://www.spotify.com/us/work-with-us/advertisers/ (last visited Nov. 24, 2011).

52. *Get Spotify Free*, *supra* note 48.

53. *Id.*

54. Krazit, *supra* note 3.

55. *See* 17 U.S.C. § 115 (2010); *See also* 17 U.S.C. § 114; 17 U.S.C. § 106 (2002).

56. *Id.*

57. 17 U.S.C. § 106(3) (2002)."Phonorecords" are "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, and from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device." 17 U.S.C. § 101 (2010).

mechanical license royalties on behalf of rights holders.[58] Harry Fox, in turn, pays royalties to rights holders, after retaining a small percentage fee.[59] In contrast to the public performance and sound recording licenses, it requires absolutely no bargaining over royalty rates. All Spotify must do to obtain a mechanical license is pay the statutory rate to Harry Fox.[60]

Since streaming music counts as a "public performance" under the Copyright Act,[61] Spotify must license the public performance right for its entire catalog. However, Spotify does not negotiate these licenses directly from publishers or songwriters; rights holders generally delegate this responsibility to a performing rights organization ("PRO").[62] Thus, to secure the public performance right for musical works, Spotify negotiates with PROs, who distribute royalties to songwriters and publishers on a pro rata basis.[63] Spotify reached deals with PROs such as, the American Society of Composers, Artists and Producers (ASCAP);[64] Broadcast Music Inc (BMI);[65] and the Society of European Stage Authors and Composers (SESAC)[66] right before the service's U.S. launch. These licenses were more difficult for Spotify to obtain than the mechanical license since the public

58. Ed Christman, *Harry Fox Agency Inks Deal With Spotify for Publishing Licensing, And More*, BILLBOARD (Jul. 18, 2011), http://www.billboard.biz/bbbiz/industry/publishing/harry-fox-agency-inks-deal-with-spotify-1005281812.story; *About Harry Fox Agency*, HARRYFOX AGENCY, http://www.harryfox.com/public/AboutHFA.jsp (last visited Nov. 24, 2011) (noting that Harry Fox Agency is the leading mechanical licensing agency in the U.S.).

59. *Id.*

60. *Id.*

61. 17 U.S.C. § 101 (2010) (to perform a work publicly means "to transmit or otherwise communicate a performance . . . to the public, by means of any device or process, whether the members of the public capable of receiving the performance or display receive it in the same place or in separate places and at the same time or at different times").

62. *See* AL KOHN & BOB KOHN, KOHN ON MUSIC LICENSING (Aspen 3d. Edition 2002) (noting that ASCAP and BMI control performance rights for almost all the music performed in the U.S.).

63. *See infra* notes 63-5.

64. Billboard Staff, *ASCAP Announces U.S. Licensing Agreement With Spotify*, BILLBOARD (Jul. 14, 2011), http://www.billboard.biz/bbbiz/industry/publishing/ascap-announces-u-s-licensing-agreement-1005277172.story.

65. *BMI Inks Spotify to Licensing Deal*, ALL ACCESS (Jul. 25, 2011), http://www.allaccess.com/net-news/archive/story/94194/bmi-inks-spotify-to-licensing-deal.

66. *SESAC Finalizes Deal With Spotify*, SESAC.COM (Jul. 22, 2011), http://www.sesac.com/News/News_Details.aspx?id=1575.

performance rights are not technically compulsory. Nonetheless, the two biggest U.S.-based PROs, ASCAP and BMI, are subject to antitrust consent decrees that effectively compel them to license.[67] If Spotify had not been able to reach an agreement with ASCAP or BMI, the New York district court, designated as the "rate court," would have judicially determined the terms of the agreement based on a "willing buyer, willing seller" standard.[68]

In addition to royalties for the public performance right—a right owned by publishers and songwriters—Spotify must pay royalties to the owners of sound recordings in accordance with 17 U.S.C. § 106(6), which gives sound recording owners the exclusive right to "perform the copyrighted work publicly by means of a digital audio transmission."[69] Under the Digital Right in Sound Recordings Act, a service provider is eligible for a statutory compulsory license of a sound recording if the service is "non-interactive," whereas "interactive" service providers must negotiate directly with rights holders.[70] A service is interactive if it "enables a member of the public to receive a transmission of a program specially created for the recipient, or on request, a transmission of a particular sound recording, whether or not as part of a program, which is selected by or on behalf of the recipient."[71] Internet radio services like Pandora are "non-interactive" because they give listeners minimal input into what they hear.[72] In contrast, since Spotify allows users to build individualized playlists and play songs on demand, it is an

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67. *See* United States v. American Society of Composers, Authors & Publishers, 1941 Trade Cas. (CCH) para. 56, 104, 1941 U.S. Dist. Lexis 3944 (S.D.N.Y. 1941); United States v. Broad. Music Indus., 1940–1943 Trade Cas. (CCH) para. 56,096 (E.D. Wis. 1941).

68. For a description and example of a "rate court" setting agreement terms, *see* David Oxenford, *Rate Court Determines ASCAP Fees for Large Webcasters - Some Interesting Contrasts with The Copyright Royalty Board Decision*, BROAD. LAW BLOG (May 1, 2008), http://www.broadcastlawblog.com/2008/05/articles/internet-radio/rate-court-determines-ascap-fees-for-large-webcasters-some-interesting-contrasts-with-the-copyright-royalty-board-decision (examining a 2008 New York district court decision where the court set agreement terms between ASCAP and Yahoo, AOL, and Real Networks for use of ASCAP's composers' music).

69. 17 U.S.C. § 106(6) (2002).

70. 17 U.S.C. § 115 (2010).

71. 17 U.S.C. § 114(j)(7) (2010).

72. Ari Z. Moskowitz, *Predictability and Interactivity: An Examination of Arista Records, LLC v. Launch Media, Inc.*, 38 AIPLA Q.J. 471, 496 (2010) ("Pandora, by far the best-known Internet radio service today, implemented technology similar to LAUNCHcast, such as prohibiting rewinding and limiting the number of times a user can skip a song, in order to remain within the bounds of a noninteractive service").

"interactive" service provider that must negotiate licenses with sound recording owners.

Spotify has direct deals with the major U.S. labels—deals that took over two years to negotiate.[73] Spotify does not negotiate directly with independent labels or artists, but rather, contracts with artist aggregators[74] like CD Baby, who in turn have contracts with independent artists,[75] and the Merlin Network, a rights agency that represents independent labels worldwide.[76] The amount intermediaries pay to artists is determined by pre-existing contracts. Undoubtedly, sound recording licenses are the most difficult licenses for Spotify to obtain. Unlike the mechanical and public performance rights, which are both essentially compulsory, the sound recording right is completely negotiable. Thus, Spotify had the difficult task of persuading sound recording owners—in particular, the major labels—to license their libraries.

D. Spotify's "U.S. Invasion": Persuading the Major Labels

Spotify was not available in the U.S. until late 2011, when it finally closed deals with the major record labels.[77] Getting the major labels on board was critical to a successful U.S. launch, for without the major labels' catalogues, Spotify's library would have indeed been spotty.[78] Despite the major labels' blemished history of attempting to chokehold music distribution,[79] ASCAP, BMI, and SESAC had already licensed its libraries to other music streaming services like Rhapsody and Rdio for use in the United States. Persuading the labels to join Spotify was not a pipe dream.

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73. *See infra* Part I.D.

74. An "artist aggregator" is a company that serves as a one-stop shop for independent artists seeking to distribute their music. Artist aggregators help artists distribute their music through physical CD sales, mp3 downloads, and streaming services. For an example, *see About CD Baby*, CDBABY.COM, http://www.cdbaby.com/About (last visited Nov. 24, 2011).

75. *Artist Page*, SPOTIFY, http://www.spotify.com/us/work-with-us/labels-and-artists/artist-page (last visited Nov. 24, 2011).

76. *Welcome to Merlin*, MERLIN NETWORK, http://www.merlinnetwork.org/home/ (last visited Nov. 24, 2011).

77. *See* Roberts, *supra* note 1 (describing initial reaction to Spotify's American debut).

78. *See 2010 Quarter 1 Marketshare for Major Music Labels*, ROUTENOTE.COM (Mar. 26, 2010) (reporting that major labels had over 80% combined market share in 2010).

79. *See* Srivastava, *supra* note 35, at 394-95. (discussing how major labels used cooperative marketing programs to monopolize CD distribution).

But Spotify was different from these other streaming services in one critical respect—its "freemium" philosophy. For the first two years of Spotify's existence, the U.S. major labels spoke out against freemium streaming services, concerned about Spotify's single-digit free-to-paid conversion rate.[80] Even as late as February 2010, Warner Music CEO Edgar Bronfman, Jr. reported to *Wired* that "this sort of 'get all the music you want for free and then maybe we can—with a few bells and whistles—move you to a premium price' strategy is not the kind of approach to business that we will be supporting in the future."[81] Nonetheless, Spotify persisted through two years of arduous negotiations, finally striking deals with the majors in mid-2011—a point to be discussed more below.[82]

With the major labels on board in the U.S. market, the Spotify ship was sailing toward success. Or was it? As it turns out, artists have not shared Daniel Ek's optimism about the service's potential to welcome in a golden age of music—and with good reason.

II. DESTINED FOR DOWNFALL: WHY THE SPOTIFY REVOLUTION WILL FAIL

At first glance, it seems puzzling that musicians would not be cheering on a service designed to monetize digital music. A closer look shows why artists indeed have reason to fear Spotify. The U.S. major record labels are significant shareholders in the service; this means that they have insider influence over Spotify and suggests that the labels' incentives were not aligned with those of artists when they were negotiating license agreements.[83] Spotify's refusal to be transparent about its financial flows suggests that money is passing by artists and disappearing into the 'black box' of shareholder (i.e. major label) profits.[84] The fact that independent artists earn paltry royalties worth fractions of a cent makes this possibility even more

80. Ben Sisario, *Spotify Steps Closer to U.S. With Universal Deal*, N.Y. TIMES MEDIA DECODER BLOG (Jun. 10, 2011, 6:42 PM), http://mediadecoder.blogs.nytimes.com/2011/06/10/spotify-steps-closer-to-u-s-with-universal-deal ("Throughout their long negotiations with Spotify, American label executives were concerned that the company's conversion rate of free to paid users was too low, and that the company was giving away too much music").

81. Pollack, *supra* note 37.

82. *See* Brendan Greeley, *Spotify Wins Over Music Pirates With Labels' Approval*, BLOOMBERG (Jul. 14, 2011, 10:46 AM), http://www.bloomberg.com/news/2011-07-14/spotify-wins-over-music-pirates-with-labels-approval-correct-.html.

83. *See infra* Part II.A.i.

84. *See infra* Part II.A.ii.

likely.[85] As music listeners increasingly substitute streaming music for mp3 purchases, independent artists are left with the choice of remaining on the service and earning pennies or abandoning the services and potentially earning nil on recorded music.[86] Many artists have chosen the latter, leaving Spotify in hopes of finding other ways to monetize their music.[87] Similarly, once-loyal customers have begun defecting from the service, disturbed by its treatment of the artists they love. Ironically, Spotify has managed to alienate the very people whose interests they claim to advocate—the same people on whom they rely for success. Without the buy-in of musicians, Spotify cannot realize its vision of providing "[a]ll the music, all the time,"[88] nor can it expect to attract avid music fans, who care about artist compensation.

A. The Dark Side of Spotify

1. Conflict of Interest with Artists

From their monopoly over CD sales to their litigious battle against file sharing, the major record labels have a long history of trying to maintain a chokehold on music distribution. Not much has changed with the emergence of streaming music, as the major labels have an ownership stake in Spotify.[89] A search of Sweden's corporation records database confirmed that both the major labels and the Merlin Network purchased about 18% of Spotify— worth $250 million at that time[90]—for a little less than $10,000.[91] This has two powerful implications.

First, equity means a seat at Spotify's board of directors' table. With a reputation for maximizing profits at the expense of artists, the major labels are hardly a musician's first choice for a director of Spotify. Second, the major labels, as copyright holders and shareholders, earn money from Spotify from two sources: 1) royalties, which are shared with artists; and 2) profits, which are not shared

85. *See infra* Part II.A.iii.

86. *See infra* Part II.B.

87. *See infra* Part II.B.

88. *What Can Spotify Do?*, SPOTIFY, http://www.spotify.com/us/about/features/ (last visited Feb. 21, 2012).

89. Helienne Lindvall, *Behind the Music: The Real Reason Why the Major Labels Love Spotify*, THE GUARDIAN MUSIC BLOG (Aug. 17, 2009, 10:03 AM), http://www.guardian.co.uk/music/musicblog/2009/aug/17/major-labels-spotify.

90. Glenn Peoples, *Is Spotify Really Worth 1 Billion?*, BILLBOARD (Feb. 22, 2011), http://www.billboard.biz/bbbiz/industry/digital-and-mobile/is-spotify-really-worth-1-billion-1005043612.story.

91. Lindvall, *supra* note 88.

with artists.[92] This means that the labels' interests were not aligned with artists' interests during negotiations with Spotify. In other words, the labels may have been happy with lower-than-fair royalty rates, since they stood to earn money from Spotify through other avenues.

For both of these reasons, Spotify has an inescapable conflict of interest with artists, one that has not gone unnoticed by the independent music community. For instance, independent label Prosthetic Records announced in mid-September that it would be pulling its artists from Spotify because "[i]ndependent labels are getting the short end of the stick."[93] Prosthetic noted that since the major labels have an equity stake in Spotify, artists at major labels are effectively treated with preference over independent artists.[94] According to Prosthetic, "Spotify as it's currently configured will 'kill . . . smaller bands that are already struggling to make ends meet.'"[95]

2. Lack of Financial Transparency

Suspicious of Spotify for its involvement with the major labels, artists and fans have expressed a desire to know where the money goes once it passes into Spotify's hands. Nonetheless, Spotify has resisted releasing information about how it allocates revenue. Spotify gives canned, general responses to inquiries about its financial flows, saying that it "ha[s] deals with all the major record labels and recording rights institutions to ensure that artists receive compensation for being part of Spotify,"[96] or that it, "respect[s] creativity and believe[s] in fairly compensating artists for their work. [Spotify has] cleared the rights to use the music you'll listen to in

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92. *See* Pascal-Emmanuel Gobry, *How Spotify's Business Works*, BUSINESS INSIDER (Oct. 12, 2011), http://articles.businessinsider.com/2011-10-12/research/30269526_1_spotify-revenues-cost (detailing how Spotify makes its money and describing how it must pay royalties to record labels).

93. Vince Neilstein, *Breaking: Prosthetic Records Will Pull Artists From Spotify*, METALSUCKS (Sept. 16, 2011, 1:00 PM), http://www.metalsucks.net/2011/09/16/breaking-prosthetic-records-will-pull-out-spotify.

94. *Id.*

95. Jason Roche, *Prosthetic Records is the Third L.A. Metal Label to Pull Their Catalog Off of Spotify*, LAWEEKLY BLOGS (Sept. 16, 2011 5:00 AM), http://blogs.laweekly.com/westcoastsound/2011/09/prosthetic_records_also_pullin.php.

96. Spotify Forum, GETSATISFACTION, http://getsatisfaction.com/spotify/topics/does_the_artists_i_listen_to_get_paid (last visited Nov. 24, 2011).

Spotify."[97] As one band put it, "we have no idea how they carve up the money. *They only disclose this information to the [m]ajor record labels.*"[98]

Spotify's silence about its revenue allocation raises several questions. The first is: how big is the copyright royalty pie? It is unclear whether and to what extent both of Spotify's revenue sources—advertising and subscriptions—contribute to royalty payments. How much does Spotify allocate to royalties, and how much disappears into the proverbial 'black box'—that is, money not attributed to royalties which remains with Spotify's investors (including the major labels)?[99]

The second question is: how does Spotify divide up the copyright royalty pie among intermediaries? Since mechanical royalties are fixed by statute, Harry Fox Agency's slice of the pie is fairly ascertainable.[100] How Spotify doles out the rest of the pie is difficult to determine, for its contracts with the PROs, labels, and artist aggregators hide behind non-disclosure agreements.[101] Without more information, independent artists are left to suspect they are treated less favorably than major label artists. Some commentators believe that major label artists "get much better streaming rates than the [independent artists]."[102] Others have surmised that major label

97. Sasha Muller, *The Sinister Side of Spotify*, PC PRO BLOGS (Mar. 5, 2010), http://www.pcpro.co.uk/blogs/2010/03/05/the-sinister-side-of-spotify.

98. Mike Masnick, *How Much Does a Band Make From Various Music Platforms?*, TECHDIRT (Sept. 11, 2011, 1:57 PM), http://www.techdirt.com/blog/casestudies/articles/20110911/00284415891/how-much-does-band-make-various-music-platforms.shtml (emphasis added).

99. Lindvall, *supra* note 88. ("For artists who 'signed up to a label' there's a tangible risk that revenue which comes from a possible sale of shares by the label would end up in the proverbial 'blackbox' (non-attributable revenue that remains with the label). There's growing concern about this in the artist management community and, a few weeks ago, Bob Dylan decided to pull his back catalogue from UK streaming services. The only Dylan albums currently on Spotify are Bob Dylan's 60s Live, A 30th Anniversary Concert Celebration, a tribute compilation and a few tracks that are featured on movie soundtracks.").

100. 17 U.S.C. § 115 (2010).

101. Ben Rooney, *Spotify Will Find U.S. Tough to Crack*, WALL ST.J. TECH-EUROPE BLOG (Jul. 14, 2011, 3:45 PM), http://blogs.wsj.com/tech-europe/2011/07/14/spotify-will-find-u-s-tough-to-crack.

102. Lindvall, *supra* note 88; *see Should You Put Your Music On Spotify?*, LIVE UNSIGNED BLOG (Jul. 12, 2011, 1:57 PM), http://www.liveunsigned.com/blog/2011/07/should-you-put-your-music-on-spotify (asserting that "the major labels had to get a higher rate to get them on board with Spotify").

artists get a cut of advertising revenue, whereas independent artists do not.[103] As one artist put it, if the major labels did, in fact, "use their large catalogs as leverage to earn higher rates per stream . . . [t]his moves the music industry in the opposite direction of the past decade, possibly to a much worse, unbalanced landscape."[104]

Each of these questions gives artists and music fans more reason to wonder whether artists are getting a fair cut of Spotify's revenue.[105]

3. Paltry Payouts to Independent Artists

Layers of non-disclosure agreements may disguise the mechanics behind Spotify's financial flow, but thanks to the Internet and a growing multitude of outspoken and disgruntled artists, it is no longer a secret that artists earn miniscule royalties from Spotify's service. This fact amplifies concern about Spotify's lack of transparency, reinforcing the fear that money may be disappearing into the 'black box'.

A number of artists began opening their accounting books to the Internet community to reveal what they earned on Spotify. One independent band, Marwood, made its actual account statements from CD Baby available to the public, which showed a per-stream rate of $0.0008.[106] Financial reports from another band, Only Seven Left, revealed another troubling fact: not only were its songs earning royalties worth peanuts, but the same song earned substantially different royalty rates during the same day.[107] For instance, on

103. *See* Zoe Keating, *Zoe Keating on Spotify, Fairness to Indie Artists & Music's Niche Economy*, HYPEBOT (Sept. 2011), http://www.hypebot.com/hypebot/2011/09/zoe-keating-on-spotify-fairness-to-indie-artists-musics-niche-economy.html ("[T]he word on the street is that majors receive profits from Spotify's advertising revenue and indies do not."); *see also* Aubin, *Another Label Leaves Spotify*, PUNKNEWS.ORG (Nov. 14, 2011, 6:00 PM), http://www.punknews.org/article/45174 (asserting that indie artists "only get a 50% share of ad revenue on a pro-rata basis which has been relatively inconsequential").

104. Cameron Mizell, *Spotify From a Musician's Perspective*, MUSICIANWAGES.COM (Sept. 27, 2011), http://www.musicianwages.com/the-working-musician/spotify-from-a-musicians-perspective.

105. A third, related question—though independent of Spotify's revenue allocation—is how do intermediaries in turn pay artists and songwriters? Although artists are aware of the terms of their contracts, listeners are not. This creates a third layer of opacity about financial flows for listeners, who care about artist compensation. *See infra* note 154.

106. DIGITAL DISTRIBUTION SALES SUMMARY, http://cl.ly/2h0H0d393D3R3f1f2Z1o/o (last visited Nov. 24, 2011).

107. DIGITAL DISTRIBUTION SALES SUMMARY, http://www.digimuziek.nl/nieuws/wpcontent/uploads/2011/06/bramosl1.png (last visited Nov. 24, 2011).

January 15, 2011, its song "Safe & Sound" earned $0.0011 per stream in one instance and $0.0106 per stream in another.[108] Yet another band, Uniform Notion, divulged its earnings to the blogosphere, but added some context by calculating what it stood to earn from one Spotify listener:[109]

> With Spotify, we'll get 0.003 EUR per play.
>
> If you listen to the album all the way through, we'll get 0.029 EUR.
>
> If you listen to the album 10 times on Spotify, we'll get 0.29 EUR
>
> If you listen to it a hundred times, we'll get 2.94 EUR
>
> If you listen to the album 1,000 times (once a day for 3 years!) we'll get 29.47 EUR![110]

To highlight the absurdity of Spotify's royalties, the website *Information is Beautiful* released a chart entitled "Selling Out," which depicted how much artists earn online from various sources.[111] The chart showed how many units—be it CDs, mp3s, or music streams—the artist would have to sell per month to make minimum wage in the United States.[112] Where a signed artist would need to sell about 4,000 CDs or 12,000 mp3 downloads to reach minimum wage, the same artist would need to deliver over 4 million streams on Spotify.[113] Just five days after the *Information is Beautiful* chart hit the Internet, British newspaper *The Guardian* released an article in early 2010 entitled "*Sell 1m records today and you'll earn a half-sucked gobstopper covered in fluff.*"[114] The article reported that superstar

108. *Id.*

109. *How Much Does a Band Make From Various Music Platforms?*, TECHDIRT (Sept. 12, 2011, 1:57 PM), http://www.techdirt.com/blog/casestudies/articles/20110911/00284415891/how-much-does-band-make-various-music-platforms.shtml.

110. *Id.*

111. *How Much Do Artists Earn Online?*, INFO. IS BEAUTIFUL (Apr. 13, 2010), http://www.informationisbeautiful.net/2010/how-much-do-music-artists-earn-online.

112. *Id.*

113. *Id.*

114. Sam Leith, *Sell 1m Records Today and You'll Earn a Half-Sucked Gobstopper Covered in Fluff*, THE GUARDIAN (Apr. 18, 2010, 5:30 PM), http://www.guardian.co.uk/music/2010/apr/18/sam-leith-downloading-money-spotify.

Lady Gaga's payout from 1 million Spotify streams of her hit song "Poker Face" was a mere $167.00.[115] $167.00 may be a little better than a gobstopper covered in fluff, but if that is the royalty payout for an international pop star like Lady Gaga, how could an independent artist expect to make any money from Spotify's service?

4. "Climate of Suspicion": Artists Left in the Dark

Spotify's lack of transparency about its financial flows, combined with its involvement with the major record labels and its paltry royalty rates, creates what Patrick Rackrow, chairman of the British Academy of Songwriters, Composers and Authors ("BASCA"), calls a "climate of suspicion" within the music community:

> [T]here is no clear trail that can be established so that the songwriter can trace back what they ought to have got. These things are behind a blanket of secrecy, and that is extremely worrying. The danger is that these deals all become so secret that the mist that descends creates uncertainty, creates fear. That allied to the fact that the sums being paid through are very small creates a climate of suspicion. I think that harms Spotify, it harms the writers' perception of Spotify and this is a service that they want to support.[116]

As Rackrow suggests, Spotify's behavior degrades its reputation among artists and writers, threatening to convert would-be advocates into abandoners.

B. *Turning Allies Into Enemies: Artists & Listeners Defecting From Spotify*

With a blanket of secrecy over their eyes, musicians must make an ill-informed, seemingly lose-lose choice. Should artists stay on Spotify and collect miniscule royalties from their music? Or, should they leave the service, forgoing Spotify revenue altogether? Spotify advocates argue that artists who drop out of Spotify are "totally missing the point," because they forgo the benefits of the service in exchange for nothing.[117] While Spotify royalties may be worth peanuts, "no royalties . . . seems worse than little royalties . . ."[118] Furthermore, if a band leaves Spotify, it is more difficult for

115. *Id.*

116. Ian Youngs, *Songwriters Condemn Spotify*, BBC (Apr. 12, 2010), http://www.bbc.co.uk/6music/news/20100412_spotify.shtml.

117. Mike Masnick, *Labels Dropping Out of Spotify Are Totally Missing the Point*, TECHDIRT (Sept. 23, 2011, 6:47 AM), http://www.techdirt.com/articles/20110922/11224716052/labels-dropping-out-spotify-are-totally-missing-point.shtml.

118. *Id.*

potential new fans to discover them—and no band earns money in obscurity.[119]

But many artists fervently believe that when it comes to Spotify, nothing is far better than something, even when that 'nothing' is illegal downloading. By leading listeners to believe that artists are being fairly compensated, Spotify's system threatens to devalue music even more than unauthorized file sharing. According to NoiseTrade founder and recording artist Derek Webb, this is because "when you get music illegally it's at least implicit in the transaction that what you're doing is potentially harmful to the artist. But with Spotify, your conscience is clear because you're either enduring ads or paying to use the service and access the music."[120] Another artist agreed that it is Spotify's measly streaming rates, not music "theft," that threatens to devalue music: "I honestly think a better model IS invalidated illegal downloading, rather than validated streaming. Might sound weird. But I'd rather you steal from me than insult me by saying that my music is worth nothing."[121]

Although Spotify is often characterized as the ultimate promotional tool, many artists feel that they're better off giving their music away. An artist who uploads its music to a BitTorrent can include a customized promotional PDF in the zip folder.[122] Additionally, an artist who puts his music on a pay-what-you-want site like NoiseTrade gets his fans' email addresses.[123] As one commentator eloquently put it, "[i]f that "something" is essentially peanuts, and if an artist's involvement in such a system helps maintain, or even expand, an exploitative power structure, in the long-term it would be better for artists to forgo the peanuts."[124]

Concerned music fans have also been defecting from Spotify on account of its treatment of artists. In writing about how a prominent

119. *Id.*

120. Derek Webb, *Giving it Away: How Free Music Makes More Than Sense*, DEREKWEBB.TUMBLR.COM (Dec. 1, 2011), http://derekwebb.tumblr.com/post/13503899950/giving-it-away-how-free-music-makes-more-than-sense.

121. Thurston, Comment to *Spotify, File-Sharing and Incomplete Statistics*, NEW MUSIC STRATEGIES (Nov. 20, 2011, 8:51 AM), http://newmusicstrategies.com/2011/10/12/spotify-file-sharing-incomplete-statistics.

122. *Spotify, File-Sharing And Incomplete Statistics*, NEW MUSIC STRATEGIES (Oct. 12, 2011), http://newmusicstrategies.com/2011/10/12/spotify-file-sharing-incomplete-statistics.

123. Webb, *supra* note 119.

124. *The (Pretty Damn) Weak Arguments for Spotify*, MUSIC IS MED. BLOG (Sept. 26, 2011), http://mimtunes.wordpress.com/2011/09/26/the-pretty-damn-weak-arguments-for-spotify.

independent label had recently chosen to leave Spotify, one music industry blogger decried Spotify's lack of transparency from a consumer's point of view:

> Until we know how much Spotify is making from ad income, how much they're making from premium subscriptions (as opposed to free memberships) and the total of how much they're paying out in royalties — in addition to their operating cost / overhead — it's impossible for anyone to say whether their royalty rates are fair or not. If Spotify doesn't have much money coming in, well, then their payout rates could in fact be quite fair; on the flip side, if they're making bank on ads and pocketing the profit, not cool. I've said it before and I'll say it again, because it's very important: Spotify needs to be forthcoming with 100%, no-bullshit transparency. It needs to happen now. Or else it'll be clear they're hiding something.[125]

This blogger's rant echoes the common-sense intuition of many Spotify critics: if they aren't telling us anything, then they must be hiding something. Many such critics have shut down their Spotify accounts to protest what they believe is an exploitation of artists.[126]

In short, Spotify is hardly fulfilling its prophecy of revolutionizing music for artists. To the contrary, by driving away the very constituencies on whom it depends—artists and listeners—Spotify may be laying the foundation of a self-fulfilling prophecy: its own demise.

III. SAVING THE SPOTIFY REVOLUTION: RECALIBRATING THE POWER IMBALANCE IN DIGITAL COPYRIGHT

A. *The Reason: A Revolution Worth Saving*

As things stand, artists are well-justified in distrusting the digital jukebox Spotify. Could Spotify nonetheless be beneficial to artists and the listening public under different conditions? The streaming music business model serves copyright's constitutional goals of promoting the creation and dissemination of works. Further, as streaming music gains traction through network effects, services like Spotify could start to make sense out of cents through the multiplication effect. With potential to benefit artists, the Spotify revolution is a revolution worth saving.

Streaming music serves copyright's underlying constitutional goals of incentivizing the creation of new works and promoting their

125. Neilstein, *supra* note 92.

126. *E.g.*, Joe Minihane, *Why I'm Quitting Spotify*, JOEMINIHANE.COM (Jul. 27, 2011), http://joeminihane.com/2011/07/27/why-i%E2%80%99m-quitting-spotify.

dissemination to the public. The Progress Clause authorizes Congress to enact copyright laws to promote "Progress."[127] Part of "Progress" is the creation of works themselves, which have the power to expand society's knowledge base and influence culture.[128] "Progress" also embodies dissemination, for true societal progress cannot occur unless the public is exposed to the works.[129] As a low-cost, decentralized distribution model, streaming music promotes the creation of new works by giving even fledgling artists an opportunity to deliver their music to a worldwide audience.[130] This incentivizes the creation of an abundant, diverse selection of music, giving listeners a broad range of choices.[131] Further, through reducing distribution costs, file sharing promotes dissemination, giving everyone in society, regardless of socioeconomic status, access to music.[132]

While fractions of a penny don't add up to much when only a fraction of music listeners are plugged into Spotify, simple mathematics show that once Spotify's membership base grows, the numbers could start to make sense, even with royalties set at current rates. An artist's monthly revenue on Spotify can be simplistically modeled by the following equation, $\boldsymbol{R} = \boldsymbol{s} \ \boldsymbol{x} \ \boldsymbol{n}$, where $\boldsymbol{R}$ is equal to monthly revenue, $\boldsymbol{s}$ is equal to the per stream royalty rate, and $\boldsymbol{n}$ is equal to the number of streams the band receives that month.

Imagine a hypothetical independent band comprised of four members, whose goal is for each band member to make minimum wage—$1,160 per month, per member, or $4,640 per month total.[133] Assume the band expects for half of its revenue to come from ticket sales, traditional CD sales, and merchandise sales, and the other half to come from Spotify royalties. And assume a per-stream royalty rate

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127. U.S. CONST. art. 1, §8, cl. 8.

128. *See* LYDIA LOREN & JOSEPH MILLER, INTELLECTUAL PROP.: CASES & MATERIALS, at 312 (describing how creation fits into "Progress" and stating "copyright law is meant to provide an incentive . . . for creation").

129. *See id*; Eldred v. Ashcroft, 537 U.S. 186, 244 (2003) (Breyer, J., dissenting) (discussing how the First Amendment encourages dissemination and the importance of not depriving the public of information).

130. *C.f.* Helman, *supra* note 21, at 100 (discussing similar benefits of file sharing).

131. *Id.*

132. *Id.*

133. *Minimum Wage*, Dep't of Labor, http://www.dol.gov/whd/.

minimumwage.htm#.UHN5shXA-Sp (last visited Oct. 8, 2012) ("The federal minimum wage is $7.25 per hour . . ." When multiplied by four, representing the four complete weeks in a month, the result is a minimum wage per month of $1,160).

of $0.0008/stream, as suggested by the data discussed above.[134] The band's monthly revenue could be modeled as follows: $2,320 = $0.0008 x n. For the band to reach its monthly goal of $2,320 on Spotify, the band must achieve 2,900,000 streams per month. The band could achieve this level of success if 2,900,000 unique users listen to their music once, if 580,000 fans listen to their music five times, if 290,000 fans listen to their music ten times, or some other combination. This is no small goal, and certainly seems unrealistic under current conditions: Spotify's user base barely exceeds 3 million users, and it is questionable that many users would stream a band ten or more times a month. However, if Spotify's user base grows, this goal could be attainable.

Skeptics may look to the size of Spotify's current user base and its poor financial performance as evidence that there is not enough demand for a streaming music service to survive. What this fails to recognize, however, is that new technology services like Spotify often take years to catch on because they rely on *network effects*— the phenomenon in which the value of the service rises exponentially as the number of connected users increases.[135] With a combination of patience and innovation, network effects can cause a service to spread like wildfire once it reaches a critical point.[136]

A modern-day example of network effects is Facebook. If Facebook had just one user, it would be meaningless . But if that one user recruited 99 friends to join Facebook, the website would increase in utility because each user would have 99 other people with whom to interact. Compared to the time of its inception, current-day Facebook is infinitely more useful with its 750 million users—almost half of the world's Internet-connected population.[137] With those numbers, Facebook has transcended its original yearbook concept to become more like a comprehensive world directory where you can find anyone.

Examining the growth pattern of Facebook helps demonstrate how a service with network effects gains traction. In its inaugural year of 2004, Facebook had almost 1 million users.[138] At that time, the service was limited to Ivy League networks and had minimal

134. *See supra,* Part II.A.iii.

135. *Global Swap Shops*, THE ECONOMIST (Jan. 28, 2010), *available at* http://www.economist.com/node/15350972?story_id=15350972.

136. *Id.*

137. *Internet Users in the World*, INTERNET WORLD STATS, http://www.internetworldstats.com/stats.htm (last visited Nov. 24, 2011).

138. *Timeline*, FACEBOOK, http://www.facebook.com/press/info.php?timeline (last visited Nov. 24, 2011).

features, such as user profiles with "walls."[139] Facebook's user base grew to 5.5 million in 2005, when the service expanded to high schools and added a photo application.[140] In 2006, Facebook expanded to work networks and added the news feed feature, growing its user base to 12 million.[141] Facebook reached the 50 million user mark in 2007 as it began to establish an international presence and launched its mobile application.[142] The service doubled to 100 million users in 2008, the year when Facebook chat launched.[143] By 2009 the service had over 350 million users and a robust database of applications.[144] In 2010, the service had 500 million users,[145] and in 2011, Facebook had reached 750 million users. indeed a critical mass compared to the world's population of 6.7 billion people.[146] As this brief history shows, Facebook did not reach ubiquity overnight. Yet once the service began to catch on, its user base and revenue grew exponentially. This is because social media is a market with network effects: the more users that enter the system, the more beneficial it is to other would-be users to enter.[147]

Like Facebook, Spotify is a service with network effects. Its sharing feature is useful between two friends, but has the potential to revolutionize how society shares music as the service achieves further penetration. The more people that join Spotify, the more popular the service will become, and therefore, the more desirable it will be to potential users to subscribe. And fittingly, Spotify's integration with Facebook—the premier social networking service, thanks to network effects—will help Spotify permeate the online world much more quickly than it could otherwise. In fact, after Facebook integrated streaming music providers into its news ticker, Facebook users shared their songs 1.5 billion times in a six-week period.[148]

Notwithstanding these network effects, Spotify's growth won't explode without a critical mass of users. Some sources believe that the service has already achieved that critical mass with its entry into

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

147. *Global Swap Shops*, *supra* note 134.

148. Brian Anthony Hernandez, *Facebook Users Shared Their Songs 1.5 Billion Times in 6 Weeks*, MASHABLE (Nov. 8, 2011), http://mashable.com/2011/11/08/music-apps-facebook-open-graph.

the U.S. market.[149] Assuming it has not yet reached this turning point, Spotify may need to continue innovating and improving its service to attract more users.[150] Furthermore, to offer a product that is truly a substitute for music ownership, Spotify will need to continue *growing* its music library—a goal that it cannot achieve so long as it continues driving away artists.

With the potential to be a viable money-making channel for artists, and supporting copyright's constitutional goals, the Spotify revolution is one worth saving.

B. *The Problem: Spotify's Insulation From Pressures to Change*

To determine the best course for saving the Spotify revolution, it is worth considering why natural market and political forces have not compelled Spotify to change already. As it turns out, Spotify is insulated from many of the pressures that companies often endure. Sheltered from the winds of change, Spotify has been able to sustain its practices of non-transparency and poor compensation of artists.

One such source of pressure is the law: legislative and regulatory enactments could, in theory, require Spotify to make more disclosures or pay higher royalty rates. As a privately held company, Spotify is not required to disclose information about its finances to the public or to the Securities & Exchange Commission, and therefore remains free

149. Eliot Van Buskirk, *Spotify Usage Explodes: The Social Network Effect*, EVOLVER.FM (Sept. 30, 2011, 12:26 PM), http://evolver.fm/2011/09/30/spotify-usage-explodes-the-social-network-effect.

150. Critics have already pointed out a number of areas for improvement. Classical music listeners in particular have been disappointed with Spotify's lack of gapless playback between tracks: instead of playing an album with the amount of silence between tracks that the artist intended, Spotify inserts an additional second or two of silence, disrupting the flow of an otherwise seamless playback. *See* Kirk McElhearn, *Why Spotify Sucks for Classical Music*, KIRKVILLE (Jul. 15, 2011), http://www.mcelhearn.com/why-spotify-sucks-for-classical-music. Others have criticized Spotify's search engine as "lackluster." *See* Zosia Boczanowski, *Spotify: Not Out of the Woods Yet*, MUSIC BUS. J. (Oct. 2011), http://www.thembj.org/2011/10/spotify-not-out-of-the-woods-yet. Some users would like to see new features, including: a parallel browser-based application rather than requiring users to download a desktop application, analytics tools to help artists understand Spotify's effectiveness as a promotional tool, and better filters on the mobile application, to name just a few. *See Id.*; *Data, or Lack Thereof*, UNIFORM MOTION (Sept. 27, 2011), http://uniformmotion.tumblr.com/post/10726176237/data-or-lack-thereof; MisterReally, Posting of *As an iPhone User I Want to Filter My Playlists With Ease*, SPOTIFY FORUM (Nov. 19, 2011, 11:23 AM), http://www.spotify-forum.com/viewtopic.php?f=9&t=2045&sid=60254b5dc5962b63bf8199ed6806eb4d. For more suggestions from users on improving Spotify, *see generally Ideas/Improvements*, SPOTIFY FORUM, http://www.spotify-forum.com/viewforum.php?f=9 (last visited Nov. 29, 2011).

to be non-transparent about its financial flows.[151] Since it only streams licensed music at technically bargained-for rates, Spotify is in compliance with copyright law.[152] Moreover, no regulations directly address streaming music.[153] The current legal framework, therefore, does not require Spotify to change.

A second potential source of pressure is rights holders, as Spotify depends upon the cooperation of artists and labels in building its music library. In theory, rights holders could use their veto power under copyright law to pressure Spotify into more favorable terms; the problem is that Spotify already has the buy-in—both figuratively and literally—of the major labels, which collectively own a monopoly share of sound recordings.[154] With the vast majority of the world's music locked down under contract, Spotify is well-poised to attract millions of subscribers, as it has managed to do.[155] Hardly threatened when independent artists leave the service, Spotify has the bargaining power to offer adhesion-style licenses to independent labels on a take-it-or-leave-it basis.

A third potential source of pressure is consumers, as some listeners care where the money goes when they pay for music.[156] If the money makes it into the pockets of the artists themselves, listeners may be more likely to pay up.[157] One would think, then, that more music fans would be boycotting Spotify. Yet, as Webb has observed, Spotify may have consumers duped.[158] Spotify gives listeners a false

151. *See, e.g.*, WILLIAM MEADE FLETCHER, 1 FLETCHER CYC. CORP. § 56 ("Numerous laws and regulations, especially securities laws and regulations, apply to publicly-held corporations but not to privately-held corporations.").

152. *See* 17 U.S.C. § 106(6) (2002).

153. *See generally* Patents, Trademarks, and Copyrights, 37 C.F.R. §§ 1.1 - 90.3 (2012).

154. *See 2010 Quarter 1 Marketshare for Major Music Labels*, ROUTENOTE BLOG (Mar. 26, 2010), http://routenote.com/blog/2010-quarter-1-marketshare-for-major-music-labels (reporting that major labels had over 80% combined market share in 2010).

155. Glenn Peoples, *Business Matters: Spotify Rising, Now at 10.2 Million Monthly Average Users*, BILLBOARD (Dec. 14, 2011), http://www.billboard.biz/bbbiz/industry/digital-and-mobile/business-matters-spotify-rising-now-at-10-1005678832.story.

156. *E.g.*, majestic12, Posting of *Does The Artist I Listen To Get Paid?*, GET SATISFACTION, http://getsatisfaction.com/spotify/topics/

does_the_artists_i_listen_to_get_paid (last visited Dec. 13, 2011) (asking Spotify, "[A]m i [sic] just paying spotify [sic] or is some of that money going back to the artists?").

157. *Id.*

158. Webb, *supra* note 120.

impression that artists are reaping substantial financial benefits from the service. So long as consumers harbor this belief, they likely will not be a source of pressure for Spotify.

A fourth kind of pressure one might expect Spotify to encounter—and perhaps, the most significant in saving the Spotify revolution—is competitive pressure. Broader competition would increase innovation in streaming music, for more firms means more creative thinkers. Moreover, competitive pressures would likely give Spotify an incentive to be fairer and more transparent, as transparency itself could become a point of differentiation, one used to attract listeners concerned about the plight of artists.[159] Yet, Spotify faces very little direct competition at all, for an insurmountable barrier to entry stands in the way: the major labels, who control the majority of sound recording rights. The touchstone of streaming music is access over ownership, so the attractiveness of a streaming service depends largely on the breadth of its catalog.[160] To be successful, a service must license a seemingly endless library of music. At the very least, a streaming service needs the major label catalogs, which account for the vast majority of recorded music. Of course, the labels' near-oligopoly gives them a formidable collective bargaining position, particularly since copyright law grants the owners of sound recordings an absolute right to negotiate—or to refuse to negotiate—with interactive services like Spotify.[161] This means that the major labels are effectively the gatekeepers of streaming music, deciding who will enter the market and on what terms.

The gatekeepers have been very guarded as to whom they will let pass through the doors. To date, Spotify has only a handful of direct competitors, such as MOG, Rdio, and Rhapsody. At least two of these, MOG and Rdio, are part-owned by the major labels, meaning that they are plagued by the same problems as Spotify.[162] This state of affairs strongly suggests that the major labels will not license a streaming service unless they wield control over its vision. Undergirded by the constitutional purpose of progress, copyright law

159. Helman, *supra* note 21, at 97-98 (2009) ("Transforming the power balance can also increase the transparency in distribution of royalties to artists. The accounting system utilized by the labels is unconventional, to put it mildly. The key according to which royalties are distributed among artists is often in the exclusive possession of the labels, and the artists' power to object to the figures is often impractical.").

160. For a discussion of several popular streaming services and their respective music catalogs, *see* Alexandra Fletcher, *Assessing 10 Music-Streaming Services*, PASTE (AUG. 1, 2011, 11:00 AM), http://www.pastemagazine.com/blogs/lists/2011/08/10-best-music-streaming-services.html.

161. *See* 17 U.S.C. § 106(6) (2002).

162. *See* Helman *supra* note 20.

should not enable goliath rights holders like the major labels to leverage their market position to stifle the distribution of *all* musical works. Would-be entrants to the streaming music market should be able to access the major label catalogs at a price lower than their souls.

So long as Spotify remains numb to external pressures—particularly, competitive pressures—it is unlikely it will change its ways.

C. *The Solution: Applying Competitive Pressure Through Compulsory Licensing*

The best avenue for saving the Spotify revolution is creating a competitive marketplace, one that the major labels cannot control by leveraging their copyright portfolios. Enabling non-label-controlled competitors to emerge will pressure Spotify to consider being more transparent with artists.[163] Greater transparency will require Spotify to be fair in its dealings with artists. With the blanket of secrecy swept away, artists will have greater trust in Spotify as a tool that can revolutionize music, not just in general, but for the music makers themselves.

The great wall to entry, as discussed earlier, is the combination of the labels' market power and holdout right.[164] While antitrust enforcement could, in theory, be a tool to target the major record labels' market power, it would be very difficult to develop a viable antitrust claim without stronger evidence of collusive anticompetitive behavior.[165] A cleaner solution is to curb the major record labels' holdout right by making sound recording licenses compulsory for interactive services. Although copyright law has distinguished between interactive and non-interactive services since the inception of the sound recording right,[166] the distinction is not well-justified in light of its underlying legislative history.

Sound recordings were not protected under federal law until 1972, when Congress amended the Copyright Act of 1909 with the Sound Recordings Act of 1971.[167] Passed in reaction to phonorecord piracy,

163. *See id.* ("Transforming the power balance can also increase the transparency in distribution of royalties to artists. The accounting system utilized by the labels is unconventional, to put it mildly. The key according to which royalties are distributed among artists is often in the exclusive possession of the labels, and the artists' power to object to the figures is often impractical.").

164. *See supra* Part IV.A.

165. Srivastava, *supra* note 35, at 446; *see* Sherman Act, 15 U.S.C. § 1 (2004) (prohibiting agreements that unreasonably restrain trade).

166. *See* 17 U.S.C. § 115 (2010).

167. PUB. L. NO. 92-140, 85 STAT. 391 (1971) (codified as amended in scattered sections of 17 U.S.C.) (Act effective Feb. 15, 1972).

the Act conferred upon sound recordings the exclusive rights of reproduction and distribution—but not public performance.[168] The Act's drafters contemplated including a public performance right, but ultimately declined to include it in favor of the broadcaster lobby.[169] As digital technologies advanced and proliferated, the performance right for sound recordings came back to the discussion table.[170] The Copyright Office noted in a report that "[s]atellite and digital technologies make possible the celestial jukebox, music on demand, and pay-per-listen services," and that "[s]ound recording authors and proprietors are harmed by the lack of a performance right in their works."[171] Legislative discussion on the issue ensued,[172] and in 1995, Congress enacted the Digital Performance Right in Sound Recordings Act ("DPRA"), which granted sound recording rights holders the exclusive right "to perform the copyrighted work publicly by means of a digital audio transmission."[173]

As briefly mentioned in Part I,[174] the Act differentiates between interactive and non-interactive services: whereas non-interactive services are eligible for a compulsory license with rates set by statute, interactive services are not eligible for the compulsory license, and must negotiate directly with rights holders.[175] Non-interactive services include Internet radio providers like Pandora; interactive services include on-demand providers like Spotify.[176] The legislative history indicates that Congress distinguished between the two categories of providers out of a perception that "[i]nteractive services, which allow listeners to receive sound recordings 'on-demand', pose the greatest threat to traditional record sales."[177] Thus, Congress felt "in order to provide a comparable ability to control distribution of their works, copyright owners of sound recordings must have the right to negotiate

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168. Rebecca F. Martin, *The Digital Performance Right in the Sound Recordings Act of 1995: Can It Protect U.S. Sound Recording Copyright Owners in A Global Market?*, 14 CARDOZO ARTS & ENT. L.J. 733, 737 (1996).

169. *Id.*

170. *Id.*

171. *Id.*

172. Digital Performing Right in Sound Recordings Act of 1995, 17 U.S.C. §§ 106 (2002).

173. 17 U.S.C. § 106.

174. *See supra* Part I.C.

175. 17 U.S.C. § 115 (2010).

176. *See id.*

177. S.REP. NO. 104–128, at 24 (1995), *reprinted in* 1995 U.S.C.C.A.N. 356, 371.

the terms of licenses granted to interactive services."[178] Congress contemplated the idea that the DPRA could stand in the way of technological innovation. To this end, the legislative history makes clear that Congress intended "to provide copyright holders of sound recordings with the ability to control the distribution of their product by digital transmissions, *without hampering the arrival of new technologies.*"[179] Ironically, the DPRA does exactly the opposite of what Congress intended with respect to streaming music. By stifling competition in the streaming music market, the DPRA is hampering technological development and hindering artists' ability to effectively monetize their music.

Congress should modify the DPRA to make sound recording licenses compulsory for interactive services. Compulsory licensing would eliminate the labels' gatekeeping function, giving emerging streaming services access to the labels' catalogs. Moreover, the labels would no longer be able to leverage copyright ownership into streaming service ownership. By its current language, the DPRA is enabling majoritarian rights holders to prevent the use of sound recordings. Hampering instead of helping technological innovation in streaming music, the DPRA is exceeding the bounds of its legislative findings and working against its intended purpose of helping rights holders monetize their digital recordings. Moreover, it is working against the underlying constitutional goal of copyright, the dissemination of creative works.[180]

VI. CONCLUSION

Spotify, and streaming music generally, have great potential to revolutionize music for listeners *and* artists. So long as the major labels possess the strong combination of oligopoly market share and holdout power, though, they will remain the gatekeepers of streaming music, demanding equity as the price of admission. Further, streaming services like Spotify, insulated from competitive pressures, will likely continue in non-transparency and poor treatment of artists. Creating a compulsory licensing scheme for streaming music will foster the competitive climate necessary to compel the transparency and fairness necessary for a truly successful, artist-focused Spotify revolution.

178. *Id.*

179. *Id.*

180. U.S. CONST. art. 1, § 8, cl. 8 ("To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.").