TRANSCRIPT

LegalMindsTV Exclusive Interview:

"Music and Film Licensing in the Current Digital Environment"

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To view the video of this interview, visit:
http://legalminds.tv/index.php/2009/12/16/music-and-film-licensing-in-the-current-digital-environment/

Before we get started, Marc, please tell me a little bit about the focus of your practice?

I do a lot of work in the music, film and entertainment area in general. And because of my background at Prodigy, I do a lot of work related to the Internet.

Have advances in technology changed the ways the music is consumed, distributed, purchased right now?

Technology has changed the entertainment industry dramatically, most dramatically in the music business in particular. 50% of what was the recorded music business in 2001 has gone -- the number of units sold is down by that much, the revenue is down by that much, jobs are down that much. But music is consumed, listened to, played, streamed, downloaded and copies are made more than ever before.

What impact has this had on other the film industry?

The challenge in the film business is to make sure what happened to the music business doesn't happen to the film business. And the television business has actually adapted pretty well to the new changes in technology. They've repurposed their content onto lots and lots of sites.

What else can the film industry learn from the music business?

How can the film industry clients learn from the music business is to take the Internet seriously, not ignore it, embrace it, use it to advance what you're trying to accomplish. At the same time, try to protect your content and change your business model in a way so that there is revenue appreciation as opposed to reduction.

So what can the music industry do now to respond the these changes in technology?

The music industry's challenges are pretty much past where they can be restored to the level they saw it before. In my view the music industry has to recognize that its revenue stream and business model has changed fundamentally. It will likely never come back to the same level it was before and it has to adapt its model to achieve financial success.

What can they do to help accomplish this?

They've tried to do that with a "360 deal," which is where a company takes all rights to an artist including recordings, publishing, touring, merchandising, personal appearances, even management in some cases. By making 360 deals, the company acquiring the rights to the artist recognizes that while the record itself is the engine that pulls the train, in the absence of a record none of the other avenues or revenue streams are available. So what they've recognized is that they should have a piece of them. A question from the artist's perspective of course is whether or not the company that's acquired those rights has the ability to exploit them or not, and that's the tension.

So in these 360 deals, you typically represent the artist?

Usually, we represent the artist, but there are a fair number of smaller record companies that we represent who acquire those rights.

So how do you protect clients' interests in a 360 deal?

When we represent an artist, and the artist has been offered a 360 deal from a company where he has to grant all of his rights to a particular company and allow that company to participate in all the revenue streams, the way we try to protect the artist is to evaluate whether or not the company has the ability to work in each one of those fields, first. And second, to the extent they don't have that ability, we'll put in performance specifications, minimum income requirements, minimum standards that need to be met in each area. Of course, that's a negotiation. There is no guarantee that the company is going to grant those rights, but you try to negotiate the deal as best you can.

Are there any significant differences when it comes to international licensing?

When we're approached by a company which seeks to exploit rights, in particular in music, on an international basis, there is a different set of rules and industry norms that apply both in the U.S. and in Europe and for the rest of the world. Focusing on a company that's going to offer music rights on the Internet, which is clearly a borderless opportunity, one has to clear rights in every single territory in which the music is offered. So, if you just put up a site and allow everyone in the world to come to it, you have to clear the music in every country in the world. So, the first premises, you need to select those countries from which a user can access the site and those countries are the ones in which you clear the music. In most countries of the world, it used to be that you would clear blanket licenses for the master recordings from various local societies, and you would clear performing rights and mechanical rights for the reproduction of the underlying song from one or two societies in a territory.

How does this differ from how you clear rights in the US?

In the U.S., the rule is very different because while there are performing rights societies, there is no way or no place to clear the underlying mechanical rights, which is the right to reproduce the record. And there is no place to clear all of the masters unless you're operating a non-interactive radio station in effect.

What that means in the U.S. is you have to identify every publisher of every song, one song at a time, and you have to identify the owner of the label or the master recording, one song at a time. I've been involved in clearing songs where there are 20 publishers on a single song, which means you've to get 20 licenses to offer the one song. That's the U.S. experience.

The European experience used to be that you would go to a society in France, a society in Germany and a society in Spain and you'd clear your rights for that territory. Now, the European Union has changed its rules, so not only do you have to do that, clear territory by territory, but certain publishers have withdrawn their digital rights from those societies and granted them to another society to grant rights across all of Europe. So, you now have to clear a territory by territory, 27 times, plus another six or seven pan-European licenses if you want all the music for Europe. What we're faced with here at the end of 2009, beginning of 2010, is a landscape that's shifting a very, very difficult opportunity to clear music and one which requires a great deal of thought and planning and unfortunately capital.

In addition to obviously requiring a great deal of capital, what are some of the other challenges faced by companies entering the music space?

I think today, startup music businesses who want to offer rights, really need to plan very carefully and establish a niche that's different from the dominant players. The challenge in the music business for downloads is there is Apple (NASDAQ: AAPL) iTunes and then everybody else. And there really is no substantial Number 2, people may suggest Amazon (NASDAQ: AMZN) as a Number 2, but the likelihood of them taking over iTunes is relatively small in our view; it's a very, very difficult business.

Can you talk a bit about some of the new business models for music startups?

New business models are a challenge - to determine which one is going to be successful. It’s clear that the pay-for-download is moderately successful in terms of restoring the industry to what it used to be in the music business. Apple iTunes does that and does it well, they’ve served billions of downloads. Now, you’re faced with other models that come along like subscription where you can listen to any song you want if you pay a monthly fee, or the old ad-supported model seems to have fallen by the wayside. I was heavily involved in one company where it was ad-supported, and it just couldn’t make it. There were other companies recently that have been involved in an ad-supported model that have also failed or been sold for less than the size of the initial investment. So, it appears ad-supported is going by the wayside. What people seem to talk about more is something called "freemium," which is a cross between free and premium, where you get something for free, but if you want the full benefit of the site’s offering you pay a monthly fee. That’s sort of a hybrid between the subscription monthly fee basis and the free, and you provide both.

Why do you think the ad-supported models have have been unsuccessful in the music business?

The ad model probably failed for a number of reasons. At the end of 2009, beginning of 2010, the adverting market has disappeared. The amount of advertising spent is much lower. The benefit of advertising on the Internet hasn't gone away -- you have an ability to target much more effectively than you do on a television advertisement. So that's still available, so the Internet still holds promise for advertising.

Now the revenue or the opportunity or the capital needs to come in to actually buy the ads and then be targeted to the users. Mind you the people who would go to sites for music, which are advertising-supported, are those most desirable in the world because they're younger people, 15 to 20, they make their lifelong brand selections at that age, and you pick up your toothpaste when you are in that age bracket and you stay for life. So, influencing those consumers is very important.

So the advertising market kind of dropped out, but those customers were still quite valuable. So was there was not enough financial runway to ride out the ad recession?

As to why various companies failed in an ad-supported model, it's really an analysis of each one. The challenge in the music business is that the music business itself, the owners of the content place a certain minimum value on their rights and won't sell it below that value. And so therefore, the ability to match the advertising dollars to that minimum value creates a gap, and that gap needs to be filled by capital. And with the downturn in the overall credit market and the downturn in the economy in general, there wasn't capital to fill that gap. The notion was that over time while the value of the music would stay constant, the value of the advertising would go up and eventually there would be a profit. So, the initial partnership concept that some sites brought in saying, "there was no minimum value, we'll just partner with you on a percentage basis," wasn't well received.

How have some of the changes you've mentioned in the music business impacted how you advise your clients as they look forward a few years over the horizon?

These changes in business models, the credit environment and the capital availability have impacted the way we advice clients in a number of ways. The first is to make sure they have a business plan that makes sense. The second is to make sure they have the capital to withstand peaks and valleys in the response to their offering. And the third thing is that they really do have to have a long-term vision, it's no longer like it was in the dot-com boom of ten years ago.

How does this advice apply to your film industry clients?

The opportunities in film funding and financing and distribution have also been changed dramatically by the changes in the economic environment. While ad-supported concepts exist in film because you can get sponsors to help you promote a film, the financing structure has changed because nearly every state in the country has recognized that film is an environmental friendly jobs creator, and therefore they provide tax credits or tax benefits to production in their state. For example, Michigan offers 40% or 42% of tax credit back to you for qualifying expenses. New York's is 30%. California even has one. Plus there are many jurisdictions around the world who also offer tax incentives for production there. Producing the film, however, is only part of the answer. If one produces a film, it may not get distribution because many of the independent distributors have folded up, and the major studios have folded up their independent arms as well. So, while one can produce the film with relatively little equity -- making a foreign sales deal and borrowing against that, making a tax credit deal and borrowing against that, finding a gap financier who's actually a lender and then putting the small amount of equity in -- you now have a film that may never get distributed which means that all of your investors, even though they're small, may not get their money back. It's a very challenging environment. It makes for interesting discussions with new clients.

What do you think the future holds for the entertainment industry?

In terms of what the future holds, I think it's very important to look at 2010 as a clean slate. I think the opportunity exists for high quality music offerings, high quality film offerings, with and without the Internet. And thoughtful and meaningful products will end up coming to the marketplace in a way that has never happened before.