

# Blockchain for the music industry

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# The issue of transaction costs

- 1937: The Nature of the Firm, R. H. Coase, *Economica*, New Series, Vol. 4, No. 16. (Nov., 1937), pp. 386-405.
  - *A firm is likely therefore to emerge in those cases where a very short term contract would be unsatisfactory.*
  - *Changes like the telephone or the telegraph will tend to reduce the cost of organising spatially will tend to increase the size of the firm.*
- Transaction costs – all costs needed for establishing the market price
- The existence of transaction costs and attempts to lower them is used to explain how decisions are made in enterprises and to explain their size

# Collection societies

- Collective management of copyright with the aim to reduce transaction costs
- KEA European Affairs, *The Collective Management of Rights in Europe. The Quest for Efficiency* (2006):
  - *Essentially collective management enables right owners and users to jointly access lower transaction costs. By reducing transaction costs, collective management increases the range of rights that are traded. Facilitating trade is the key function of collective management bodies as transaction costs will often be a deterrent to unilateral action (in particular for individuals and small businesses) with the result that no trade occurs. The more right owners join a collecting society the further potential of reducing costs exists given the scope for gains from economies of scale.*

- KEA European Affairs. Licensing music works and transaction costs in Europe. Final study (2012):
  - *According to the estimations based on the survey, an online music platform aiming to provide multiterritorial services in Europe would have to invest at least €230,000 in transaction costs alone to get a licence for a catalogue of more than one million titles (s. 50)*
  - *The transaction costs analysis indicates that negotiation with major publishers and record producers usually takes much longer than with independents and CMOs (s. 51)*
  - *The Czech start-up i-legalne, the first licensed Czech online music service operating from 2008 to 2011, failed to succeed in the market partly due to the high advances and minimum guarantees requested by major publishers (Interview and Kovalik 2011). In certain cases, they may conclude other agreements for instance including majors as part of share holders, as is the case for Spotify or the Czech service Musicjet (s. 52)*
  - *the more innovative the business model, the bigger the transaction costs makes things particularly difficult for online music start-ups (s. 52)*

- Dr B. Biga (red.) Raport Centrum Analiz Klubu Jagiellońskiego 1/2017. *W czyim interesie? Funkcjonowanie organizacji zbiorowego zarządzania prawami autorskimi w Polsce.* (EN: Cui bono? Polish report concerning the collective copyright management in Poland, 2017)
- System flaws
  - Acting under a statutory privilege (the right to collectively manage copyright, to collect royalties based on the price charts, also the right to represent non-associated entities, collecting copyright levies apart from the royalties)
  - Lack of competition
  - Lack of supervision and social inspections
  - Lack of binding deadlines for distributing royalties
  - Administrative costs (set-off) for the collection societies not limited
  - Payment of royalties by the artists performing their own works
  - For users: the need to pay royalties multiple times (there is a number of collection societies, multiple royalties from different users for the same piece), obscure royalties' pricing methods

- Flaws resulting from practice of CS
  - Abuse of rights: collecting royalties in connection with such events as the World Youth Day, in small hair salons etc.
  - Accumulating huge sums (ZAIKS accumulated over PLN 1 bln of short-term investments; in 2015, the collection societies collected PLN 611 mln)
  - Redistribution of moneys to the right-owners delayed by years, even after the claims expire (until 2015, approximately PLN 3 mln potential payments expired)
  - On average, 19% of the collected royalties is set-off as administrative costs (i.e. withheld by the collection societies)
  - Salaries for the collection societies' employees amount to PLN 9-10 thousand per employee
  - The collection societies have „bad press” (one the societies bought a palace in Janowice, in 2013, which was followed by the campaign „I will not pay for palaces” in connection with the talks around copyright levies for buying smartphones and tablets)

# Directive 2014/26/EU

- Directive (PE) 2014/26/EU of February 26, 2014 J.L. EU. 20.3.2014 L 84/72, which had to be implemented until April 10, 2017 (in Poland, it was not implemented until that date; in April (04.13.2017) appeared the first draft of implementation Act)
- The main areas of regulation:
  - Challenging flaws of the collection societies (the aim of the Directive: to „lay down requirements applicable to collective management organisations, in order to ensure a high standard of governance, financial management, transparency and reporting”)
  - Multi-territorial licenses (introducing advanced technology as a standard)
  - Dispute resolution (also ADR)

# Directive 2014/26/EU

- Multi-territorial licenses (definition): means a license which covers the territory of more than one Member State (in the Polish draft Act – pertaining to music and lyric-music works for the purposes of on-line use)
- KEA and EU point to high transaction costs of the collection societies and the difficulties when negotiating the big producers – EU response to this difficulty is creating bigger collection societies, with a stronger negotiating position – and big data high tech
- EU response to the flaws of the collection societies resulting from the privileged position and lack of supervision: more reporting requirements, statements concerning conflict of interest, vesting organization rights in the right-owners (General Assembly, deciding on the general investment policy, risk management policy), time limits (9 months for payment of right-owner remuneration)

# Blockchain as the alternative

- Independent artist perspective (according the UJOMusic texts)
  - The lack of mobility of copyrights from the artist point of view
  - There is no way to influence collection societies
  - There is no competition between the collection societies which brings a negative impact on the quality of management
  - Fragmentation of rights (split rights)
  - Problems when sampling, remixing
  - Some artists do not have websites (i.e. lack of basic digital infrastructure)
- 2015: UJOMusic (pilot program starring singer: Imogen Heap, album Tiny Human, using Ethereum protocol); during one year, the contract was executed 8506 times

# What next?

- November 7, 2016 UJOMusic announced that Alpha platform is suspended, all efforts were directed towards working on the new platform, open for all artists; update: launching date for releasing the platform July 2017
- HBR experts say that blockchain is only a foundation for future applications (Marco Iansiti, Karim R. Lakhani, The Truth About Blockchain, HBR 1/2 2017)
- *TCP/IP unlocked new economic value by dramatically lowering the cost of connections. Similarly, blockchain could dramatically reduce the cost of transactions. It has the potential to become the system of record for all transactions. If that happens, the economy will once again undergo a radical shift, as new, blockchain-based sources of influence and control emerge.*
- Spotify is reported in April to be investing in blockchain, so are certain collection societies (SACEM, ASCAP, PRS for Music)