

‘The Online Bonanza: Who is making all the money and why aren’t they sharing it?’

A speech by Paul McGuinness at MIDEM’s first International Manager Summit.

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Good afternoon and thank you for giving me this opportunity. I don’t make many speeches and this is an important and imposing occasion for me. What I’m trying to do here today is identify a course of action that will benefit all: artists, labels, writers and publishers.

I have been managing the best known of my clients U2 for exactly 30 years. Sure we’ve made mistakes along the way but the line up hasn’t changed in 31 years. They are as ambitious and hardworking as ever, and each time they make a record and tour, it’s better than the last time. They are doing their best work now. During that time the music business has been through many changes.

At the beginning U2’s live appearances were loss making and tour support from our record label was essential for us to tour and that paid off for the label as U2’s records went to No.1 in nearly every international territory starting in the mid 80s and I’m happy to say that continues to the present day. They have sold about 150 million records to date and the last album went to No.1 in 27 territories.

U2 own all their masters but these are licensed long term to Universal with whom we enjoy an excellent relationship. With a couple of minor exceptions they also own all their copyrights, which are also licensed to Universal. U2 always understood that it would be pathetic to be good at the music and bad at the business, and have always been prepared to invest in their own future. We were never interested in joining that long humiliating list of miserable artists who made lousy deals, got exploited and ended up broke and with no control over how their life’s work was used, and no say in how their names and likenesses were bought and sold.

What U2 and I also understood instinctively from the start was that they had 2 parallel careers first as recording and song writing artists, and second as live performers. They’ve been phenomenally successful at both. The Vertigo Tour in 2005/2006 grossed \$355m and played to 4.6m people in 26 countries.

But I'm not here to brag. I'm here to ask some serious questions and to point the finger at the forces at work that are destroying the recorded music industry.

People all over the world are going to more gigs than ever. The experience for the audience is better than ever. This is proved by the upward trend in ticket prices, generally unresisted. The live business is for the most part healthy and profitable. Bands can gig without subsidy. Live Nation, previously a concert and venue company is moving into position with merchandising, ticketing, online, music distribution as one of the powerful new centres of the music industry.

So what has gone wrong with the recorded music business?

More people are listening to music than ever before through many more media than ever before. Part of the problem is that the record companies, through lack of foresight and poor planning, allowed an entire collection of digital industries to arise that enabled the consumer to steal with impunity the very recorded music that had previously been paid for. I think that's been a cultural problem for the record industry – it has generally been inclined to rely for staff on poorly paid enthusiasts rather than developing the kind of enterprise culture of Silicon Valley where nearly every employee is a shareholder.

There are other reasons for the record business's slow response to digital. The SDMI (Secure Digital Music Initiative) of the 90s pan industry, was a grand but ill-fated plan to try and agree rules between the content and technology industries. It went nowhere. SDMI, and similar attempts at cooperation by record companies, have partly been thwarted by competition rules. The US government has sometimes been overzealous in protecting the public from cartel-like behaviour.

I love the record business, and though I may be critical of the ways in which the digital space has been faced by the industry I am also genuinely sympathetic and moved by the human fallout, as the companies react to falling revenues by cutting staff and tightening belts. Many old friends and colleagues have been affected by this. They have families and it is terrible that a direct effect of piracy and thievery has been the destruction of so many careers.

Nonetheless there is one effective thing the majors could do together. I quote from Josh Tyrangiel in Time Magazine: -“The smartest thing would be for the majors to collaborate on the creation of the ultimate digital-distribution hub, a place where every band can sell its wares at the price point of its choosing”.

Apple's iTunes, despite its current dominance is vulnerable. Consumers dislike its incompatibility with other music services, and the labels are rebelling against its insistence on controlling prices. Universal the largest label in the world has declined to sign a long term deal with iTunes. "There's a real urgency for the labels to get together and figure this out," says Rick Rubin of Columbia Records."

There is technology now, that the worldwide industry could adopt, which enables content owners to track every legitimate digital download transaction, wholesale and retail.

This system is already in use here in Cannes by the MIDEM organisation and is called SIMRAN. Throughout this conference you will see contact details and information. I recommend you look at it. I should disclose that I'm one of their investors.

Meanwhile in the revolution that has hit music distribution, quality seems to have been forgotten. Remarkably, these new digital forms of distribution deliver a far poorer standard of sound than previous formats. There are signs of a consumer backlash and an online audiophile P2P movement called "lossless" with expanded and better spectrum that is starting to make itself heard. This seems to be a missed opportunity for the record industry shouldn't we be catering to people who want to hear music through big speakers rather than ear buds?

Today, there is a frenetic search for new business models that will return the record business to growth. The record companies are exploring many new such models – some of the may work, some of them may not.

Sadly, the recent innovative Radiohead release of a download priced on the honesty box principle seems to have backfired to some extent. It seems that the majority of downloads were through illegal P2P download services like BitTorrent and LimeWire even though the album was available for nothing through the official band site. Notwithstanding the promotional noise, even Radiohead's honesty box principle showed that if not constrained, the customer will steal music.

There is some excitement about advertising-funded deals. But the record companies must gain our trust to share fairly the revenues they will gain from advertising. Historically they have not been good at transparency. Let's never forget the great CD scam of the 80s when the majors tried to halve the royalties of records released on CD claiming that they needed this extra margin

to develop the new technology even as they were entering the great boom years that the CD delivered. It's ironic that at a time when the majors are asking the artists to trust them to share advertising revenue they are also pushing the dreadful 360 model.

As Allen Grubman, the well-known New York attorney said to me recently...

“God forbid that one of these acts in a 360 deal has success. The next thing that will happen is the manager gets fired and the lawyer gets sued for malpractice.”

Maybe it would help if they were to offer to cancel those deals when they repair their main revenue model and the industry recovers, as I believe it will.

But that's an issue for the future, when we're out of the crisis. Today, there's a bigger issue and it's about the whole relationship between the music and the technology business. Network operators, in particular, have for too long had a free ride on music – on our clients' content. It's time for a new approach - time for ISPs to start taking responsibility for the content they've profited from for years. And it's time for some visionary new thinking about how the music and technology sectors can work as partners instead of adversaries, leading to a revival of recorded music instead of its destruction.

It's interesting to look at the character of the individuals who built the industries that resulted from the arrival of the microprocessor. Most of them came out of the so-called counterculture on the west coast of America. Their values were hippy values. They thought the old computer industry as represented by IBM was neanderthal. They laughed at Bell Telephone and AT&T. They thought the TV networks were archaic. Most of them are music lovers. There are plenty of private equity fund managers who are Deadheads.

They were brilliantly innovative in finance and technology and though they would pay lip service to “Content is King” what many of them instinctively realized was that in the digital age there were no mechanisms to police the traffic over the internet in that content, and that legislation would take many years to catch up with what was now possible online.

And embedded deep down in the brilliance of those entrepreneurial, hippy values seems to be a disregard for the true value of music.

This goes back some decades. Does anyone remember Abbie Hoffman? He was one of the “Chicago 7” the ‘Yippies’ of the Youth International Party who

tried to disrupt the 1968 Democratic Convention in Chicago and got beaten up and put on trial by Mayor Daley's police. He put out a book with the title "Steal this Book". I think he has a lot to answer for.

I've met a lot of today's heroes of Silicon Valley. Most of them don't really think of themselves as makers of burglary kits. They say "You can use this stuff to email your friends and store and share your photos". But we all know that there's more to it than that, don't we? Kids don't pay \$25 a month for broadband just to share their photos, do their homework and email their pals.

These tech guys think of themselves as political liberals and socially aware. They search constantly for the next "killer app". They conveniently forget that the real "killer app" that many of their businesses are founded on is our clients' recorded music.

I call on them today to start doing two things: first, taking responsibility for protecting the music they are distributing; and second, by commercial agreements, sharing their enormous revenues with the content makers and owners.

I want those technology entrepreneurs to share their ingenuity and skill as well. Our interests are, after all, steadily merging as lines get more and more blurred between the distributors of content, the makers of hardware and the creators of content. Steve Jobs is now in effective control of the Walt Disney Studio and ABC Television so his point of view may be changing now that he owns content as well as selling those beautiful machines that have changed our world. Personally I expect that Apple will before too long reveal a wireless iPod that connects to an iTunes "all of the music, wherever you are" subscription service. I would like it to succeed, if the content is fairly paid for. "Access" is what people will be paying for in the future, not the "ownership" of digital copies of pieces of music.

I have met Steve Jobs and even done a deal with him face to face in his kitchen in Palo Alto in 2004. No one there but Steve, Bono, Jimmy Iovine and me, and Lucian Grainge was on the phone. We made the deal for the U2 iPod and wrote it down in the back of my diary. We approved the use of the music in TV commercials for iTunes and the iPod and in return got a royalty on the hardware. Those were the days when iTunes was being talked about as penicillin for the recorded music industry.

I wish he would bring his remarkable set of skills to bear on the problems of recorded music. He's a technologist, a financial genius, a marketer and a music lover. He probably doesn't realize it but the collapse of the old financial model

for recorded music will also mean the end of the songwriter. We've been used to bands who wrote their own material since the Beatles, but the mechanical royalties that sustain songwriters are drying up. Labels and artists, songwriters and publishers, producers and musicians, everyone's a victim.

For ISPs in general, the days of prevaricating over their responsibilities for helping protect music must end. The ISP lobbyists who say they should not have to "police the internet" are living in the past - relying on outdated excuses from an earlier technological age. The internet has moved on since then, and the pace of change today means a year in the internet age is equivalent to a decade in the non-internet world.

Remember the 1990s, when the internet was being called the Information Superhighway? At that time, when the US Digital Millennium Copyright Act and the EU Electronic Commerce Directive were drawn up, legislators were concerned to offer safe harbours restricting the responsibilities of ISPs who acted as a "mere conduit". This was a different era: only a few hundred thousand illegal files could be accessed from websites. There was no inkling at that time of the enormous explosion of P2P piracy that was to follow. If legislators had foreseen that explosion, would they have ever offered immunity for so-called "mere conduits" and, in doing so, given ISPs a decade of excuses for refusing to protect our content?

And as it turned, the "Safe Harbour" concept was really a Thieves' Charter. The legal precedent that device-makers and pipe and network owners should not be held accountable for any criminal activity enabled by their devices and services has been enormously damaging to content owners and developing artists. If you were publishing a magazine that was advertising stolen cars, processing payments for them and arranging delivery of them you'd expect to get a visit from the police wouldn't you? What's the difference? With a laptop, a broadband account, an MP3 player and a smartphone you can now steal all the content, music, video and literary in the world without any money going to the content owners. On the other hand if you get caught stealing a laptop in the computer store or don't pay your broadband bill there are obvious consequences. You get nicked or you get your access cut off.

It is time for ISPs to be real partners. The safe harbours of the 1990s are no longer appropriate, and if ISPs do not cooperate voluntarily there will need to be legislation to require them to cooperate.

Why does all this matter so much? Because the truth is that whatever business model you are building, you cannot compete with billions of illegal files free on

P2P networks. And the research does show that effective enforcement – such as a series of warnings from the ISP to illegal file sharers that would culminate in disconnection of your service – can address the problem.

A simple three strikes and you are out enforcement process will see all serial illegal uploaders who resist the law face a stark choice: change or lose your ISP subscription.

Fortunately, there has recently been some tremendous momentum to get ISPs engaged – notably in France, the UK, Sweden, Norway and Belgium. President Sarkozy's plan, the Olivennes initiative, by which ISPs will start disconnecting repeat infringers later this year, set a brilliant precedent which other governments should follow. In the UK, the Gowers Report made it clear that legislation should be considered if voluntary talks with ISPs failed to produce a commitment to disconnect file-sharers. I'd like to see the UK government act promptly on this recommendation. In Sweden the Renfors Report commissioned by the Ministry of Justice, also came back with clear and firm recommendations for requiring ISP cooperation. And in the courts, the Sabam-Tiscali ruling spelt out, in language as plain as could be, that ISPs should take the steps required to remove copyright-infringing material from their networks. The European Union should now take up the mantle and legislate where voluntary intra-industry agreement is not forthcoming. This is the time to seize the day.

ISPs don't just have a moral reason to step up to the plate – they have a commercial one too. IFPI estimates say illegal P2P distribution of music and films accounts for over half of all ISP traffic. Others put the figure as high as 80 per cent. This is traffic that is not only destroying the market place for people who are trying to make a legitimate living out of music and films, it is hogging bandwidth that ISPs are increasingly going to need for other commerce, especially as a legitimate online market for movies develops.

I think the failure of ISPs to engage in the fight against piracy, to date, has been the single biggest failure in the digital music market. They are the gatekeepers with the technical means to make a far greater impact on mass copyright violation than the tens of thousands of lawsuits taken out against individual file-sharers by bodies like BPI, RIAA and IFPI. To me, prosecuting the customer is counter intuitive, though I recognise that these prosecutions have an educational and propaganda effect, however small, in showing that stealing music is wrong.

ISPs could implement a policy of disconnection in very quick time. Filtering is also feasible. When last June the Belgian courts made a precedent-setting ruling obliging an ISP to remove illegal music from its network, they identified no fewer than 6 technologies which make it possible for this to be done. No more excuses please. ISPs can quickly enough to block pornography when that becomes a public concern.

When the volume of illegal movie and music P2P activity was slowing down their network for legitimate users recently in California, Comcast were able to isolate and close down BitTorrent temporarily without difficulty.

There are many other examples that prove the ability of ISPs to switch off selectively activity they have a problem with: Google excluded BMW from their search engine when BMW started to play games. This was a clear warning to others not to interfere. Another show of power was Google's acceptance of the Chinese Governments censorship conditions. The BBC has spent a fortune on their iPlayer project and the ISPs are now threatening to throttle this traffic if the BBC doesn't "share costs of iPlayer traffic". All this shows what the ISPs could do if they wanted. We must shame them into wanting to help us. Their snouts have been at our trough feeding free for too long.

Let's spare no effort to push the ISPs into taking responsibility. But that's only one part of the story. There's a huge commercial partnership opportunity there as well. For me, the business model of the future is one where music is bundled into an ISP or other subscription service and the revenues are shared between the distributor and the content owners.

I believe this is realistic; the last few years have shown clear proof of the power of ISPs and cable companies to bundle packages of content and get more money out of their subscribers. In the UK, most ISPs offer different tiers of services, with a higher monthly fee for heavy downloaders. Why are there 'heavy' downloaders? Isn't that our money? News Corporation offers free broadband to light users if they take at least a basic Sky Television package for £16 a month.

Looking at the events in the last year, this revenue-sharing model seems to be taking hold in the music business.

Universal – U2's label - recently struck a deal with Microsoft that sees it receive a cut of the revenues generated by sales of the Zune MP3 player. It's unfortunate that the Zune hasn't attracted the sort of consumer support that the iPod did. We need more competition.

Under the agreement, Universal receives US\$1 for every Zune sold. When you consider Radio Shack sells Zune players for US\$150 you'll see that Universal has asked for less than one per cent of revenue - for a company that is supplying about a third of the US market's chart music at the moment. This isn't really enough, but it's a start, I suppose and follows from the U2/Apple deal, the principle that the hardware makers should share with the content owners whose assets are exploited by the buyers of their machines. The record companies should never again allow industries to arise that make billions off their content without looking for a piece of that business. Remember MTV?

Nokia has announced it will launch 'Comes With Music', a service that effectively allows consumers to get unlimited free downloads of songs for 12 months after they buy certain premium Nokia phones. At the end of the 12 months consumers will be able to keep the songs they download. Nokia gets to supply premium content and Universal gets to boost competition in the digital marketplace, to make it more competitive and open new channels to customers. A proportion of the revenue generated by sales of the handsets will flow back to Universal. The question must be asked; will they distribute that revenue fairly? Do artists trust the labels? Will artists, songwriters and labels trust the telcos and handset companies?

These are obviously commercial deals driven by self-interest. But there is a moral aspect to this too. The partnership between music and technology needs to be fair and reasonable. ISPs, Telcos and tech companies have enjoyed a bonanza in the last few years off the back of recorded music content. It is time for them to share that with artists and content owners.

Some people do go further and favour a state-imposed blanket licence on music. Let me stress that I don't believe in that. A government cannot set the price of music well any more than a rock band can run a government. The market has to decide. The problem with the global licence proposed in France two years ago was that it would not have worked in practice. But it is in France recently that legislators have been most innovative and have shown most willingness to act to support recorded music rights. France leads the world on this.

So far I've focused mainly on the role of ISPs. But there are similar issues in mobile too. The mobile business accounts for half the world's digital music revenues and, crucially, is starting out from a much better position than the internet music market. You only have to look at a market such as Japan to see the amazing potential of mobile music for getting to the young demographic.

I believe that in mobile music we have the chance to avoid the problems that have bedevilled the recorded music industry's relationship with ISPs: and I'm not talking just of their tolerance of copyright theft. Other problems, like the lack of interoperability between services and devices; the lack of convenient payment mechanisms except via credit cards - which of course are not available to all music users; the hacking and viruses that have undermined people's trust in online payment. All these problems can be avoided in the mobile sector, this is a task that should command the support and cooperation of labels, artists, publishers and writers. We're all in the same boat here.

That's a lesson for the mobile industry internationally. Don't go the way that many of the ISPs have gone. Mobile is still a relatively secure environment for legitimate content - let's keep it that way.

So, to conclude – Who's got our money and what can we do?

I suggest we shift the focus of moral pressure away from the individual P2P file thief and on to the multi billion dollar industries that benefit from these countless tiny crimes – The ISPs, the telcos, the device makers. Let's appeal to those fine minds at Stanford University and Silicon Valley, Apple, Google, Nokia, HP, China Mobile, Vodafone, Comcast, Intel, Ericsson, Facebook, iLike, Oracle, Microsoft, AOL, Yahoo, Tiscali etc, and the bankers, engineers, private equity funds, and venture capitalists who service them and feed off them to apply their genius to cooperating with us to save the recorded music industry, not only on the basis of reluctantly sharing advertising revenue but collecting revenue for the use and sale of our content. They have built multi billion dollar industries on the back of our content without paying for it. It's probably too late for us to get paid for the past though maybe that shouldn't be completely ruled out. The U.S. Department of Justice and the EU have scored some notable victories on behalf of the consumer, usually against Microsoft. They have a moral obligation to be true, trustworthy partners of the music sector. To respect and take responsibility for protecting music. To work for the revaluation, not the devaluation of music. To share revenues with the community fairly and responsibly, and to share the skills, ingenuity and entrepreneurship from which our business has a lot to learn.

And the message to government is this: ISP responsibility is not a luxury for possible contemplation in the future. It is a necessity for implementation TODAY – by legislation if voluntary means fail.

There's more exciting music being made and more listened to than at any time in history. Cheap technology has made it easy to start a band and make music. This is a gathering of managers; our talented clients deserve better than the shoddy, careless and downright dishonest way they have been treated in the digital age.