

‘Why won’t the ISPs stop defending the past, start embracing the future and partner the legitimate music business?’

A speech by Paul McGuinness at Music Matters

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Good morning. I am delighted to have this chance to address the Music Matters conference in Hong Kong. I don’t get up on stage like this that often and I don’t usually live my life in the limelight, even though I manage people who do. It is a good rule of thumb that when it is the manager and not the artist getting the headlines, then something is out of kilter. Well there is certainly something out of kilter in the music business today.

I’m here because I believe in something quite passionately. I would like to identify a course of action that will benefit all: artists, labels, writers and publishers, big and small. The recorded music industry is in a crisis and there is crucial help available but not being provided by companies who should be providing that help - not just because its morally right but because its in their own commercial interest.

I have been managing the best known of my clients, U2, for exactly 30 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 always understood instinctively that they had 2 parallel careers – first as recording and songwriting artists, and second as live performers. They’ve been phenomenally successful at both.

U2 have also been good at business and at investing in their own future. We were never interested in joining that long, humiliating line of artists who made lousy deals, got exploited and ended up broke and with no control over how their life’s work was used and how their names and likenesses were bought and sold.

U2 has succeeded gradually over time from modest beginnings 30yrs ago, they have seen their records consistently reach No. 1 across the world since the 1980s, and continue to do so. They have sold about 150 million records to date and the last album went to No.1 in 27 countries. The Vertigo Tour in 2005/2006 grossed \$355 million and played to 4.6 million people in 26 countries. At the same time we have an excellent relationship with our record company, Universal. U2 own all their own master recordings which are licensed to Universal and the copyrights to all their songs which are also licensed to Universal.

People often wonder whether the era of the international superstar band is over. I don’t believe it is. Even as I speak, there’s probably a group in Paris or Dublin or

London or New York or Tokyo or Beijing practising in a room right now, today, that are figuring it out a new way, themselves, and they will be big stars all over the world in a couple of years and they will have done it a different way to their predecessors - that's the exciting thing about this business.

The people who make it tend to have this extraordinary skill set of artistic and creative talent but they are also intuitively marketing people and politicians; in close touch with young culture, they think about style and all the other elements of that equation. When those skills and talents come together, you get the magic of an Elvis Presley or Faye Wong or Jay Z. They are always extraordinary people. If you could spot them in advance, it would be great but you can't which is why you have A & R departments who try it with many, knowing that not everyone is going to succeed globally and most will fail.

Meanwhile record companies are reinventing themselves for a much more complicated world. Their star-building function has taken a battering, but I can't see the need for the record company ever going away. They bring to the mix unique and invaluable skills - of A&R, marketing, financial management and career-building. Sure, some artists, like Radiohead and Madonna, have proved that at different points in the artist's career they may not all need all those functions all the time. The truth is that there is always a long list of artists who are either succeeding with their record deal, or desperate to get one.

So what is the challenge facing the future of our business? Let me start with great news. Music consumption is soaring. At the same time as more people are listening to and enjoying music than ever before, more people are making it, playing and recording it. Almost anyone with talent can now record, market and distribute their songs for next to nothing. It is fantastic how the digital world has democratised the relationship between artist and audience in this way.

More good news is that, although the recorded music business is far from thriving, it is helping to drive a much larger group of businesses which are. IFPI did some interesting maths. They worked out that if you combine the total economic activity of the music sector and the businesses that it drives you have a sector worth around 155 billion dollars— that's nearly eight times the size of the recorded music business. And most of that business grew healthily last year. Live music was up 9%, music publishing up 5%, sales of portable devices up 16%, music revenues from public performance up 13%, musical instrument sales up 9%.

The recorded music business is itself, however, in a crisis. Growth of digital sales is not offsetting the decline of physical CDs. Sales of the blockbuster artists that have traditionally funded investment in large rosters have sunk dramatically. There has

been real pain right across our business, thousands of livelihoods put at risk and jobs lost.

Amid this gloom, there are also great reasons to be optimistic. The digital music business today is vibrant and full of experimentation and innovation. Record companies are full of the people with the right expertise to face the opportunities and challenges of the revolution we are going through. In the past I always felt they were over-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.

The record business is redefining its role in relation to virtually everything and everyone – its consumers and its partners, the live industry, management companies and artists. But – and here I speak with 30 years experience as a manager - record companies have to look at themselves too. Fairness, transparency, morality and efficiency have never been more precious qualities for them to prove than now. In a fast-declining market, we are being asked by the recorded music companies to accept that they will distribute fairly their new income streams from advertising or from subscription services bundled into telephone devices. The recorded music companies must earn the trust they are asking for from artists.

It's hard to forget that these are the same corporations that perpetrated the old 50% CD royalty scam in the 80s and to this day still have contracts full of packaging deductions and breakages clauses. Executives at the major labels (and some of the small ones) should stop this nonsense once and for all and provide clear, easily understood contracts and accounting statements which will make clear where the money comes from and who gets it.

I have been auditing labels and publishing companies for nearly 30 years and I can tell you I have never once found an error in the artist's favour.

Record companies are repositioning themselves. The 360 degree deal is a popular concept, but it's still fairly experimental and personally I dislike it. As Allen Grubman, the well-known New York attorney so eloquently said: "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".

The biggest challenge of all though, without any doubt, is monetising the future of recorded music at a time when money is being sucked out it by other parties. There is enormous interest in the idea of monetising "access" to music and not just selling individual tracks and albums. What that will look like isn't clear: maybe an iPod or

a phone with all the music available through it? Maybe a beautiful, non-clunky, subscription service that is compatible with mass market portable players and bundled into a phone or ISP bill?

No one can second guess Apple, but personally I expect that Apple will before 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. The argument seems to be about price. If the price is fair perhaps artists and labels can begin to recover from the financially devastating P2P era. Apple will take care of the ease of use. They make beautiful machines.

But the future isn't just about Apple. Recent months have seen a fair share of important initiatives: QTrax, albeit still recovering from a shaky start at Midem in January; in Europe, Nokia's “Comes with Music”; in Denmark, a fascinating world's first widely-licensed ISP music service called TDC Play; Omnifone's mobile download initiative; a venture into music downloads by MySpace; We7's free-to-consumer ad-supported service, iLike the exciting music platform on Facebook. And others.

In a world where people are not paying for content, but where the money has to come from somewhere, ad-supported services have a potentially huge role to play. I have to confess I am not a huge fan of the concept. But the business model may work. The recently-announced MySpace Music service will offer a mix of free streaming of songs and videos, supported by advertising, as well as paid-for downloads. Chris de Wolfe, the CEO of MySpace, has talked of “killing piracy with convenience”. I hope he is right. Live Nation also have big plans as they get their ticketing rights back from Ticketmaster this year in North America, next year in the rest of the world. They have discovered that when customers are online to buy tickets, they are inclined at the same time to buy other products including physical and digital music and merchandise.

Some of the best brains in the business are working on all these services. But there is a sad, unalterable fact and it has been around for some time. The market is rigged against them. You cannot monetize a business in an environment awash with unauthorized free content. And this is a crisis that is not just affecting music and record companies. It is affecting the whole world of cultural and creative content.

Earlier this year in Britain the Society of Authors, representing 8,500 professional writers, warned that book piracy will ultimately drive authors to stop writing unless radical new methods are found to compensate them for lost sales. The movie

industry, long protected simply by the technical difficulty of shifting movie files, is now waking up to much more worrying future. Internet piracy is now a bigger problem for the UK film industry than home copying of DVDs. Meanwhile the value of live sports rights on TV is currently under threat because all events are available free on the internet. The big soccer leagues are deeply worried. Man United's live TV rights are plunging in price world-wide.

Some say this is the inexorable advance of technology. But I believe the devaluation of music by the internet in recent years has been anything but inexorable. A "free music culture" is undoubtedly percolating upwards from the teenagers and college students and establishing the mindset for future generations of music consumers. But they are the symptom, not the cause. To find the cause, you just ask this - where has all the money gone?

The answer is that it has gone to corporations – cable operators, ISPs, device manufacturers, P2P software companies - companies that have used music to drive vast revenues from broadband subscriptions and from advertising. They would argue they have been neutral bystanders to the spectacular devaluation of music and the consequent turmoil in the music business; I don't believe that is true – they turned their heads the other way, watched their subscriptions grow, and profited handsomely.

Researchers estimated at the end of last year that up to 80% of ISP traffic is accounted for by peer-to-peer networks like BitTorrent and Limewire, and we know that the large majority of that traffic is unauthorised music and movies. ISPs revenues from growing broadband subscriptions have soared during the exactly the same period that has seen recorded music sales collapse. From 2004 to 2007 broadband subscription sales rose from US\$60 billion to US\$113 billion, while the music market fell by about 20% in the same period.

And if you want an idea just how much the expansion of broadband means to a large ISP, look at last year's profits of BT in the UK. Profits of £5.8 billion pounds sterling, 40% of which came from broadband and IT services. I'm not picking on BT in particular - I'm sure the situation is similar among its competitors.

Of course the champions of the ISP and technology industries that have driven these impressive revenues are not bad people. They spring from the internet free-thinking culture of California and Silicon Valley. They are fantastic entrepreneurs, wonderful engineers. Their passion for innovation and liberal hippy values in one

sense sit very well with the creativity of the music business. But at a deeper level, there is a bigger problem and it's one those brilliant minds never resolved: I'm talking about the problem of paying for music.

Today, encouragingly, there is definitely a change in the air. First, the gold rush of broadband expansion, in most developed markets at least, is over. ISPs are looking at a future where their added value is going to come not just from pipes and cables but from tiered packages of commercial content. Throughout the ISP and cable industries, the lines between distribution and content are getting blurred. Look at the fascinating position of a company like Rupert Murdoch's News Corporation – part-ISP via Sky Broadband in the UK; part broadcaster offering different levels of cable packages; part stakeholder in social networking sites via MySpace; and part music content provider as MySpace moves from the world of music discovery into the world of monetised music downloads. Part movie and TV content production via Fox Studios part sports content owners and distributors.

Apple is another example. Steve Jobs is now a serious content owner – he is effectively in control of Disney Pixar Studios, ABC TV Network and ESPN Sport. Hollywood Records is a successful record company. Steve has a better reason today than he ever had to apply that genius of his not just to beautiful machines, but also to protecting music and all his other content.

Another big change is happening, as network capacity increases and technology allows the distribution of bigger and bigger files. Movies, broadcasting, music videos and live sports are all online now. The BBC iPlayer in the UK is already estimated to be accounting for 5% of all internet traffic, and use of it has been increasing at a rate of 20% a month since its launch at the end of last year.

From being in a position where they simply couldn't get enough unauthorised free content, ISPs suddenly have reason to feel dangerously deluged by it. In the UK they have even had the audacity to demand funding for investment in new capacity from the BBC to meet the increased demand from the iPlayer. This is truly outrageous. It's like helping a shoplifter carry stolen goods from someone else's store and charging him AND the store for the service. Life must be good as an ISP: when there is a deluge of illegal content over your networks, you have no responsibility for getting rid of it; when the pendulum swings the other way and your pipes cannot cope with the traffic, you ask the content creators (and the license fee payers in the case of the BBC) to help bail you out!"

And change is happening in the corridors of government too. Governments in a growing number of countries have woken up to the catastrophe that their cultural industries are facing. They have seen the statistics, understood the inherent benefits

of a system which addresses piracy near its source, via the ISPs who can help to do something about it. For the first time there is the prospect that if ISPs do not cooperate at least with steps to help tackle copyright theft, then legislation may require them to do so. This is on the agenda in France and Britain, with discussions proceeding in other countries such as Japan and Hong Kong.

There are broadly two things I would like to see from ISPs. One is a real commercial partnership with the music business in which they fairly share their revenues. The other is action to stop facilitating mass copyright theft themselves.

Let's look first at the commercial model. Let me make clear here I'm talking about commerce here, not a state-imposed flat fee. I'm convinced the global license, with governments setting the terms and the price for music distribution, is totally unworkable. Privately-negotiated revenue-sharing partnerships are, I believe, a key model for the future.. This is where the "Comes with Music" from Nokia concept could succeed on a large scale. The signs are not perfect but they are promising. Nokia has signed up Universal and Sony BMG as partners for its "Comes With Music" phone. It is a fascinating model that needs to succeed, can succeed, and if it does, could spawn a genuine competitor to the iPod and iPhone. The business model incorporates the cost of an annual music subscription service into the purchase price of a handset. Nokia's "Comes with Music" phones may be launched in the second half of this year. The launch date has been postponed several times, but it is crucial to get it right. I hope Nokia realise that the graphics for and visual presentation of online music and mobile music have to be as good as the artists, the industry and the fan is accustomed to.

Another different mobile subscription model is Omnifone. For a small weekly fee, the company's Music Station phones offer consumers access to a library of more than 1.4 million tracks from all the majors and many independents. The service is already live with Vodafone in the UK and is being rolled out around the world.

Unfortunately no similar deal yet exists with ISPs. Today, in Denmark, there is one of the very few examples of a major national ISP launching a licensed music service where downloads are bundled into the costs of an individual's monthly subscription. The TDC Play service is free to the user and funded by a flat monthly fee that is paid to rights holders in proportion to the sale of track downloads.

Denmark is a long way from Hong Kong but I think this is an interesting deal. TDC is a major national ISP which has made an important commercial decision – it has decided that it is worth paying for recorded music in order to add value to the subscription package that it offers its customers. It is using music legitimately to gain commercial advantage over its competitors.

One way or another, ISPs and mobile operators are the business partners of the future for the recorded music business – but they are going to have to share the money in a way that reflects what music is doing for their business. That’s true nowhere more than in China. China Mobile makes hundreds of millions of dollars each year from sales of ringtones and ringback tones, yet pays a miniscule fraction of that to performers, producers and composers. That to me is not a fair business partnership.

But it’s not just about business deals. There is a very widespread support across the music sector now for ISPs to cooperate in helping curb piracy. But the lack of any concrete proposals from the ISP sector in response is quite deafening. The power of their lobby is astonishing and dwarfs the resources of the music, movie and sports industries.

Fresh thinking is desperately needed and, I’m happy to say, fresh thinking is happening. The general international legal framework is only of limited help. The ISP “safe harbour” rules put in place by legislation in the US and Europe were really designed for a different vision and a different era of the internet. They were a blueprint for developing an internet unfettered by needless regulation and in which P2P piracy was barely even imagined. They were good for the mid 1990s. Not so good for today.

In France last November President Sarkozy, acting on the now famous report by Denis Olivennes, offered a new vision of the internet, pledging that it cannot become the “Wild West”. He launched a groundbreaking plan to bring together the film, music and ISP industries, to implement a scheme to disconnect large-scale illegal file-sharers and explore the filtering of copyright infringing networks. That plan is moving forward. It will go to the National Assembly in France this summer. It has many elements which are a great model for the rest of the world.

The British government has taken up the case too. In the last few months, Britain has promised to introduce legislation requiring ISPs to help tackle online piracy if they fail to do so voluntarily. In Japan a government-supported consortium has been formed involving entertainment companies, ISPs and the national police. In New Zealand a new Bill passed in April has required greater cooperation from ISPs in curbing repeat copyright infringers.

Unfortunately, this groundswell has not visibly shifted ISP attitudes. On the contrary, there has been an enormous amount of resistance, helped by a fair amount of misinformation put out by their powerful lobbyists. For instance, no one is asking ISPs to be the police force of the internet. There will be no snooping on

people's emails. No monitoring what websites they visit. ISPs would just be reacting to rights holders' complaints when copyright infringing music is uploaded to P2P networks.

Perhaps the really telling data here is not what the regulators and legislators who are the recipients and targets of well funded ISP lobbying campaigns worldwide think, but what consumers think. Last week IPSOS published research in France showing that 3 in 4 French consumers support a scheme of graduated warnings, culminating in disconnection, for repeat copyright infringers on ISP networks. They also said the proposals would work: 90% said they would stop downloading illegally after receiving two warnings. That all strikes me as so much better a proposition than having to take legal actions against tens of thousands of individuals for illegal file-sharing. I am personally opposed to prosecuting the customers.

The alarm has been raised about rights to free speech and privacy. A serious issue if it were justified, but in fact it's just scaremongering. Of course privacy and freedom of speech are sacred rights. And so too is protection of intellectual property rights - a recent court case in Europe, involving the Spanish ISP Telefonica confirmed it. The balance can be struck and we must make every effort to strike it. We are waiting to have that discussion, to agree that balance. What are the ISPs proposing on their side? What are the solutions they would offer? Let's end the deafening silence.

And it's been argued that the ISPs don't have the means to help. I don't believe that argument stands up any longer. The modern history of the internet is chock-full of examples of ISPs intervening in the traffic on their networks when it suits them. Comcast did it in the US, throttling traffic on BitTorrent until falling foul of concerns over net neutrality. Last year, in a precedent-setting copyright case, a Belgian court ruled not only that an ISP had to stop copyright abuse on its network but also identified six technologies that could be used for filtering.

It is time to re-evaluate our expectations of the role ISPs must play in sustaining a safe and legitimate internet. This goes beyond music, and it must go beyond narrow commercial interests. Today there is a rightful concern everywhere about how to regulate the internet for young people. In Britain recently, a groundbreaking Government paper was published, the Byron Report. It identifies all the risks and harmful content that young people are exposed to online, but it mysteriously fails to propose a role for the ISPs who are best placed to solve them. Why the reticence? This letter to the Financial Times in February from Richard Yarlott suggests the answer more eloquently than I could:

“The transfer of responsibility from large corporations to parents, carers, teachers and even child-minders is the most disappointing aspect of the review. The ISPs have clearly had their say in managing its conclusions, while the search companies, the only entities capable of classifying content, are largely exonerated.”

The real problem here, I believe, is a lack of willingness by ISPs to act. That is why legislation could well have to be the answer.

This issue is really all about recognizing the value of music and fairly rewarding those who create and produce it. Value of music is an issue for other partners too, not just ISPs. Music is driving the profits of radio broadcasters and is being used as never before in a host of third party businesses. Music is ubiquitous in modern life, in stores, airplanes, gyms, hair salons, everywhere. This is a big issue internationally today, and especially in China.

You would think that the existence of basic rights to ensure that the performers and producers get a share in these profits would be taken for granted. Certainly you would be right to expect that in any country which values its musical culture, nurtures its repertoire and values its international reputation. Yet the absence of such rights in China is a missed chord. China’s commercial radio sector is worth hundreds of millions of dollars in advertising revenue. I think it is important for China’s music community and for its international reputation that that money is shared.

The same principle applies to China’s huge internet companies such as Baidu, Yahoo China and Sohu. Baidu, listed on the New York stock exchange, reports ever larger profits each financial quarter. To the artist and record companies whose tens of thousands of copyrighted tracks are being distributed in order to help generate those revenues it seems very wrong and very unfair. The legal action record companies are involved in now against Baidu and Sohu is a sad necessity. I hope they will help shape a better landscape for music and other industries in China which depend on real respect of intellectual property rights. We have a long way to go: Yahoo China has a service that has already been ruled illegal by the Chinese court but refuses to respect the judgement. What kind of respect for the law is that?

This goes far wider than just the internet companies. I would like to think that the organisers of the Olympic Games, so protective of their 95-year old logo and of their brand, would know a thing or two about doing the right thing for the respect of intellectual property. They have certainly not hesitated to enforce their rights over their own brand, as they did against the French group Carrefour. Yet when the

record companies protested repeatedly to the Beijing Olympic Committee that Sohu, the official ISP of the Olympic Games is running a massively copyright-abusing download service, they met with stony silence. I hope that will change. If music and the creative industries are to survive in the digital world, turning blind eyes to big-time copyright abuse is not acceptable. This is bad for the reputation of modern China where IP protection will become increasingly important for their own economy.

So what is the future for the music industry? Well, the world has never been so full of commentators who are so certain how it all went wrong. Most of them don't seem to have much real responsibility for putting it right.

Someone told me this joke recently. How many record execs do you need to change a light bulb? The answer used to be 40: one to change the bulb, one to hold the chair and 38 to lig on the guest list.

That world has gone. These days the answer might well be one person, but with 39 people telling him how he should do it differently and how he should change his business model if it weren't already too late, and how he should really have seen the light bulb fading years ago.

So to finish – we need new business models, yes. We have to reach the consumer in a way the consumer wants. To a very large extent that is happening already. But we also need a fair partnership between the makers and creators of the content, and those who distribute it. That partnership is about fair rewards to creators, and it is also about using the ability that ISPs so plainly have to help protect content.

The real challenge for our industry is to monetise music and avoid going out of business. The task for the ISP industry is this: to pay for content fairly and ensure that there will still BE content in the future. Building and expanding the internet only makes sense if there's going to be new content in the future. The ISPs, if they carry on the way they are will have to explain to future generations why there's nothing new to listen to but bad demos and nothing new to watch but reality TV shows.

Sometimes I think they are like latter day Medicis with the crucial difference that, as they are building their vast and wonderful cyber galleries, they are ignoring the fact that the artists are dying out and not being replaced because artists don't get paid any more. It's stupid really isn't it?

The music business once had to bear the accusation that it was full of dinosaurs who looked back to an old business model rather than embracing a new one. Today, though, it is the music business that is charting the way to the future. We are the ones exercising the brains of government about how to balance a free internet with an internet that respects intellectual property, is properly regulated and is not the Wild West. I believe President Sarkozy truly caught the spirit of the age with that statement. The visionaries and the dinosaurs have perhaps changed places. If there are dinosaurs around today, I think they are the internet free-thinkers of the past who believe that copyright is the great obstacle to progress, that the distributors of content should enjoy profits without responsibilities and that the creators and producers of music should simply subordinate their rights to the rights of everyone else.

We have not reversed the troubles of the music industry yet - but at least the dinosaurs are no longer running the show.