Online Music Licensing: From PROs, AOL and MobiTv to SoundExchange, and the CRB (American Bar Association Forum on the Entertainment and Sports Industries)

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From inception, music licensing in the digital/online space has been in a continuing state of evolution as to what is licensable, how it is to be licensed, who is to collect and negotiate fees and what is the value of music in all of the new configurations. Bearing in mind the possibility that certain primary rulings in recent online music licensing litigation could be overturned or modified, as well as the "always a possibility" of legislation in this area, the world of online music licensing, as to the performance right, the mechanical right and sound recording right seems to be settling. Though a concrete direction in a world of constantly changing business models and technological innovation is difficult, overall ground rules as well as precedents appear to be taking hold, resulting in a more stable environment for music creators, copyright owners, and music users.

Most countries of the world exist in a world of 2 copyrights in music transactions-the copyright governing the underlying musical composition (the song) and the copyright governing the sound recording (the record). The scope of rights involved in each of these separate copyrights are primarily the jurisdiction of national legislatures with the meaning and scope of these rights normally handled by each countries judiciary-whether it be courts, tribunals, copyright boards or other designated bodies. Negotiated voluntary agreements between the users of music (webcasters, broadcast television, cable, radio, satellite, etc.) and large organizations organized to negotiate and collect for multiple copyright owners (performing right organizations, mechanical right organizations, sound recording organizations, etc.) or individual copyright owners themselves play a major role in deciding what the license fees should be as well as what the scope of the license is in any media.

In situations where voluntary license agreements cannot be reached by the parties, federal rate courts (e.g. ASCAP and BMI in the U.S.), Copyright Tribunals (e.g. PRS for Music in the U.K., APRA and AMCOS in Australia and New Zealand) or Copyright Boards (SOCAN, CMRRA and SODRAC in Canada; songwriters, music publishers, record labels, websites, artists, etc. in the U.S.) decide the issues and determine rates.

At the time the Internet was just taking hold by consumers, the music business throughout the world had a long history of established rules and negotiations governing licensing and the establishment of rates. Though many of these license negotiations were restricted in the sense of territory and term, among other items, many were not (i.e. grant of the worldwide distribution right in feature film licenses).

In the area of the song, integrating the internet into licenses by copyright owners (music publishers normally) was significantly easier to accomplish than integrating master recordings. In the U.S., Copyright Royalty Judges already had a history of dealing with the setting of rates in many areas and the 2008 CRB hearing regarding the "mechanical rate", showed that the setting of rates in the online world was not only doable but also a reality.

In October of 2008, U.S. Copyright Royalty Judges, “In the Matter of Mechanical and Digital Phonorecord Delivery Rate Determination Proceeding,” set the physical and download statutory license rate to be paid to songwriters and music publishers for the period 2008-2012 at the larger of 9.1 cents or 1.75 cents per minute of playing time with the ringtone rate at 24 cents. In addition, a late payment fee of 1.5% per month was put into effect. Both the ringtone rate as well as the late payment fee were appealed with a June, 2010 decision by the U.S. Court of Appeals for the D.C. Circuit affirming both. The Royalty Judge proceeding decision was interesting as it incorporated a private settlement between the parties regarding the rates for limited downloads and interactive streaming (on demand streams). This settlement took into account a service’s revenue, applicable service type minimums, PRO royalties (ASCAP, BMI, and SESAC) and a per subscriber fee to arrive at a per work royalty allocation.

In 2012, the NMPA, RIAA and DIMA entered into an industry wide agreement for the period through 2017 for new rates regarding the 2008 configurations as well as new configurations which came into existence subsequent to the 2008 agreement. The agreement was submitted to the Copyright Royalty Judges who approved the new deal effective January 1, 2014. The new royalty bearing categories for music publishers, songwriters, composers and lyricists are Paid Locker Services, Purchased Content Lockers, Limited Offerings, Mixed Service Bundles and Music Bundles. The rates for the new categories involve the greater of a percentage of service revenue, total content costs(payments to record companies for sound recording rights) and, in the case of limited offerings, a per subscriber figure. The 2008 category rates remained the same(9.1 cents, etc.) under the new agreement.

On the record side, there has not been a long history of collective licensing efforts. A copyright for sound recordings came into effect in 1972 in the U.S. (long after the 1909 Copyright Law and exclusive rights for musical compositions) with the 1st recognition of a performance right in sound recordings coming in 1995 and 1998 via the Digital Performance Right in Sound Recording Act and the Digital Millennium Copyright Act- and then the right was a limited one applying primarily to websites, satellites and cable and not to terrestrial broadcasting. The industry's approach has been primarily to sue infringers in the online world-an approach generating among consumers not the best of publicity or results. The labels not only were slow to appreciate the fact that the physical world of sales was quickly disappearing but also did not have the history of different types of licensing negotiations and alternatives that the "song" copyright community had experienced over many years.

In recent years, U.S. Copyright Royalty Board decisions have been of help in determining the online value of sound recordings. The webcaster decisions alone have established industry wide fees and rates for non-interactive websites as well as a compulsory license in the field. Rates are either per song/per listener or a percentage of revenue or a percentage of expenses coupled with minimums. For the period 2011-2015, the Copyright Royalty Board rates for FCC broadcaster simulcasts, commercial webcasters and non-commercial and non-commercial educational webcasters are either a "per performance" rate with minimums per station or channel or a minimum only depending on the number of aggregate tuning hours streamed.

In addition to the CRB rates, SoundExchange, the sole entity designated by the Librarian of Congress and the Copyright Royalty Board to collect and administer the royalties due from non-interactive webcasting, digital cable and satellite transmissions, and satellite audio services, was given the authority by Congress via the Webcaster Settlement Acts of 2008 and 2009 to negotiate agreements separate from those set by the CRB giving many licensees a choice of rate structures to choose from. By choosing the SoundExchange rates, which run through 2015 or 2014 depending on the size of the webcaster, one is precluded from choosing any of the CRB set rates. Recent SoundExchange agreements include Sirius XM Radio, College Broadcasters, the Corporation for Public Broadcasting, the National Association of Broadcasters and certain “Pureplay” webcasters, among others.

SoundExchange distributes the royalties it receives (507 million dollars in 2012) 50% to sound recording copyright owners, 45% to featured artists and 2.5% each to non-featured musicians and non-featured vocalists (this latter 5% Digital Performance Royalties Fund is administered by the AF of M and AFTRA.)

On the interactive side (user selects the music they hear), individual negotiations prevail as sites must negotiate with the sound recording copyright owner as to what the fees should be. Some examples of the progress in this area are deals involving a percentage of gross revenue from subscribers and advertisers or a percentage of a net figure (gross minus certain expenses) with the resulting figure shared by the label with artists either on a contract royalty percentage basis or a 50/50 license split. Payments to the labels are based on their pro-rata share of activity on each site or by each licensed entity.

In the world of the song/composition performance right in the United States (ASCAP, BMI and SESAC), negotiated industry agreements have been the norm with federal rate court alternatives (mandated by Consent Decrees entered into in 1941 with the government) coming into play only when ASCAP or BMI could not come to an agreement with a music user as to "what a reasonable license fee should be". The Decree also allows any party to apply to the Court (whether or not there were any prior negotiations) and upon such application to be able to perform music for fees to be determined later. This rate court option has been in effect since 1950 with ASCAP and 1994 with BMI and represents a primary way to resolve disputes and set collective licensing rates when the parties cannot reach an agreement. SESAC, the smallest of the 3 U.S. performance right licensing organizations, is not under a consent decree with

the government nor does it have a rate court alternative; issues which are currently being discussed as part of a Southern District of New York Sherman Act antitrust action brought by a class of local television commercial broadcast stations entitled Meredith Corporation v. SESAC. Another case brought by radio broadcasters involves some of the same issues.

In the online world of music licensing, the ASCAP rate court (Southern District Court in New York) has been instrumental in deciding what the license fees should be in the online world as well as what is actually licensable by U.S. collective licensing organizations. In recent interim and final decisions involving music use by AOL, Yahoo, Real Networks, AT&T, YouTube, Verizon and others, a percentage of revenue formula has been applied taking into account, among other factors, the amount of time music is performed versus the amount of total time spent on the site for all reasons- a business unit's revenue adjusted by a music use adjustment factor multiplied by a court set percentage figure (2.5% in the initial decision).

An important issue in the ASCAP rate court cases was whether a retail wireless communications company required a public performance license for musical compositions because it provides ringtones to its customers (In Re Application of Cellco Partnerships, D/B/A Verizon Wireless) and whether the downloading of a digital file embodying a song constituted a public performance within the meaning of the U.S. Copyright Act (17 USC Section 101) (In The Matter of the Application of AOL, Real Networks and Yahoo for the Determination of Reasonable License Fees). Though the reasoning for the two separate decisions was somewhat different, both decisions by two separate Southern District Court of New York federal judges ruled against the existence of a performance right in each situation. ASCAP has filed a petition for certiorari with the United States Supreme Court on the issue of whether a digital download of a music file constitutes a public performance under the Copyright Act. There was some language in the 2009 AOL/Yahoo/Real Networks decision and final order which left open the possibility of a performance right in certain situations but subject to ASCAP's appeal of this aspect of the decision, the current state of affairs in the U.S. basically denies a performance right both in a download and a ringtone. The court did recognize the fact that a mechanical right is involved in a download of a song and in a ringtone and referred to the Copyright Royalty Board 9.1¢ writer / publisher song download rate and 24¢ ringtone rate as appropriate compensation for these type of uses. These decisions did not deal with the issue of ringbacks as there is not a download involved. Accordingly, ringbacks are licensable by performing right organizations.

The ramifications of the "no performance right in a download" ruling in these rate court licensing cases goes far beyond U.S. borders as practically every other major country of the world recognizes a performance right in a download which puts U.S. court decisions 100% contrary to the laws and practices of other country jurisdictions. In many of these countries, the separate mechanical right and performing right (referred to as the reproduction and communication right in some countries) are many times combined in a

single joint license which provides the user all of the rights it needs without having to argue the distinctions between the separate rights of copyright.

For example, PRS for Music in the U.K. issues gross revenue combined performance and mechanical licenses for music downloads (8%), music on demand services (10.5%), webcasts (6.5%), interactive webcasts (8%), and single artist webcasts (10.5%) among others. These licenses also include minimums. In Canada, pursuant to a Copyright Board decision, the total value of the bundle of rights (communication and reproduction) is 12.2% of the price paid by the consumer and or subscribers. The amounts are allocated between SOCAN (the performance rights society) and CSI, a joint venture of CMRRA and SODRAC (the 2 mechanical right societies) and are divided between the societies depending on whether the activity was a permanent download, a limited download, or on demand streaming. A recent Supreme Court of Canada decision though ruled that there was no performance right in a download.

An additional important issue and ruling came via the AT&T Wireless f/k/a Cingular Wireless ASCAP rate court litigation to determine reasonable fees for a blanket license for the public performance of copyrighted music via wireless and internet transmissions by a cellular telephone communications provider. AT&T had moved for a summary judgement on the issue of whether ringtones and ringback tones constituted fair use within the meaning of the U.S Copyright Act, 17 U.S.C, 101.

In support of its position against previews as a "fair use", ASCAP set forth numerous examples of other 3rd parties that make previews of music available on the internet. These included production music libraries, which allow potential users to search their databases via streams, samples or previews. Also, major music publishers often streamed samples of their catalogue to encourage synch licenses and songwriters and composers many times make their works available on their individual websites for promotional purposes. In addition ASCAP also described the demand for the licensing of "short forms of music" where "in many areas of music licensing, the licensee will specifically seek a license for a limited duration excerpt and that in agreements across different areas of the music business, it is often standard industry practice to expressly grant the right to make limited use of samples or previews of longer musical compositions for promotional purposes."

The Court reviewed the factors to be considered as to the use made of a work and concluded that the use of previews was not transformative, that the use is commercial and that "traditional and reasonable markets existed for the license of preview performances and other short segments of copyrighted music. Therefore, the court ruled that previews do not constitute fair use and denied the motion in its entirety. The resolution of this issue was important as ringback and ringtone previews were taken into account in both the 2010 AT&T Mobility and 2011 Verizon Wireless ASCAP settlements where a rate of 2% of the price for all ringbacks sold was agreed upon. Excluded were tones directly licensed, or acquired from others who already had a license or where record companies had acquired the performance right.

In May of 2010, a decision was rendered in the ASCAP rate court case involving MobiTv. In May of 2008, ASCAP applied to the Court to set a reasonable rate pursuant to Mobi's license application to ASCAP with a bench trial being held in April of 2009. The issue involved what is a reasonable fee for the delivery of television and audio programming to mobile telephones. The court determined in this case that a reasonable fee for a "through to the audience" license for Mobi for the years 2003 through 2011 was a revenue based fee multiplied by 4 specific percentage numbers based upon the type of content. This fee structure was a combination of the 2007 AOL / RealNetworks / Yahoo rate court formula (January, 2009 final order) of 2.5%, the ASCAP/Music Choice 2.5% of gross revenues agreement and the ASCAP 1990's post Turner litigation settlements regarding the cable industry where the percentage of revenue fees were based on the music intensity of the programming.

Specifically, the court ruled "the revenue base upon which the licensing fee will be calculated is (1) for the content that Mobi licenses from content providers, aggregates, and conveys to wireless carriers, the amounts that Mobi pays to the cable television networks or other providers to license the content, plus any revenue from advertising Mobi inserts into that programming; and (2) for the music video channels and any other channel programmed by Mobi, the payments Mobi receives from the wireless carriers for those channels, plus any revenue from advertising that Mobi inserts into that programming. The rate to be applied to that revenue base is 0.1375% for news and sports content; 0.375% for general entertainment; 0.9% for music intensive programming, to include Mobi's music video channels; and 2.5% for all-audio offerings." In October of 2010, ASCAP filed an appeal of this decision to the 2nd Circuit Court of Appeals. It is important to note that the MobiTv percentage of revenue figures (Turner/Music Choice) were subsequently agreed upon in both the AT&T Mobility (CV Service) and Verizon Wireless (V Cast and ALLtel Licensed Services) ASCAP final settlement agreements.

In September 2010, the Second Circuit Court of Appeals in the ASCAP/Real Networks, Inc./Yahoo! Inc. rate court case (AOL had previously settled with ASCAP) issued the first appellate decision in the string of online music licensing ASCAP rate court cases. The Court affirmed that a download of a musical work does not constitute a public performance of that work and further, it vacated the District Court's assessment of fees (2.5% music use adjustment factor formula) for the ASCAP blanket license and remanded the issue for further proceedings.

As to the "download issue", the Court concluded that there was no "contemporaneous perceptibility" necessary, in the Court's mind, for the existence of a performance right in the transfer of a musical file.

As to the royalty rate formula, the Court of Appeals felt that the District Court "did not adequately support the reasonableness of the 2.5% royalty rate applied to music use". The Court did not specify a particular method of developing a formula for music use revenue by the District Court in the remand but did suggest a number of considerations and approaches that might be helpful in arriving at an appropriate formula. Among them were valuing each of a services different types of music uses separately and then applying a "blended uniform rate and revisiting it periodically" as well as a variation of the BMI license utilizing multiple revenue categories apportioned into "buckets" and applying different revenue percentages to each. The latter an admittedly complicated and complex way of doing things. The Court also looked at the ASCAP/Turner agreement which involved different revenue rates based on varying music intensity as well as the 2.5% of gross revenue Music Choice/ASCAP negotiated agreement in addition to other past different media agreements by PRO's and music users.

It is important to note that there are numerous ASCAP, BMI, and SESAC voluntary negotiated agreements as well as settlements in this area, including all of the aforementioned rate court cases. These agreements include percent of music revenues as well as gross revenues, multiple revenue categories with different rates, different revenue percentages for on demand streaming, Internet radio and audio visual programming, gross revenue attributable to the service calculations, aggregate tuning hours calculations, flat fee deals, lump sum payments for past activity, different values assigned to a service's different music uses as well as minimum fees, among others. All three organizations also have standard website agreements which can be accessed via each organization's website.

Where Do We Stand Now

Of the three areas of music licensing under discussion, two of the three (mechanicals and sound recordings) seem clear, with the third (performances) on the road to some clarity.

In the mechanical licensing area, rates for physical product, digital downloads, ringtones, interactive streaming and limited downloads have been set through 2017 with five new configurations added to the previous types.

In the area of the limited performance right in sound recordings, CRB rates for cable, satellite and webcasters are in effect through 2015 depending on the category with SoundExchange separate negotiated rates extending through 2015. Further, payment formulas are in effect as to distribution of royalties to record labels, featured artists and non-featured musicians and vocalists. A remaining open question involves whether this limited right will be extended by legislation to terrestrial broadcasting.

The performance area (ASCAP, BMI, and SESAC) though remains in a state of flux with multiple different license fee negotiated and standard form formulas in effect in addition

to rate court decisions and settlement agreements with various major players including AOL, YouTube, AT&T Mobility, Verizon Wireless, Ericsson, Netflix and others. Major issues still remain including the formula for the determination of final fees, the revenue base for those fees as well as the scope, interpretation and future effect of the "no performance in a download" language of the AOL/Real Networks/Yahoo and Verizon Wireless rate court and Second Circuit Court of Appeals decisions. In addition, the issue of Direct Performance licensing has arisen as a result of the ASCAP and BMI Rate Court cases involving the background music supplier DMX as well as efforts by the major music publishers to remove their works from ASCAP and BMI for online music licensing purposes.

As you can see, rate courts, royalty boards, litigation, legislation and voluntary agreements all have a role in determining what is actually licensable in the online world as well as how much money is being made by writers, artists, music publishers and record companies.

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A CONCEPTUAL OVERVIEW OF THE AMERICAN EXCLUSIVE ARTIST RECORDING AGREEMENT:
A TRANSACTION IN TRANSISITON

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Introduction

The models, media and mediums in the music business are rapidly changing from a purchase-to-own to a license-to-use economy. Physical (CD) album sales have been trumped by digital album and single track sales which in turn are giving way to digital streaming as the preferred customer music consumption model. The future of the traditional album in any configuration is uncertain. However, most recording agreements are still structured as album deals that retain concepts and provisions reminiscent of contract standards that have existed over the past decades. The earliest recording agreements were two or three pages long. Today, a first draft of an artist recording agreement with a major recording company will be in excess of 60 single-spaced pages. Independent (smaller) company recording agreements address the same basic terms but usually with more brevity: about 15 to 40 pages. What an artist will get and what the company will give in a negotiation depend on two basic issues: What does the artist ask for and what leverage does the artist have?

The initial offer from a company is not usually a take-it-or-leave-it proposition. It will not favor the artist as much as would be expected after a professional negotiation. If the artist's representative does not ask for certain reasonable accommodations, the company will not offer them. If the artist’s negotiator is neither familiar with the customs and standards of the music business (including how a recording is made, distributed and marketed), nor the negotiation process, a smooth and civil transaction is not likely to ensue. Because of accessible and affordable technology, some artists are able to fund their own recordings and exclusively license them to the recording company. The terms of such a license may be markedly different than the terms governing an exclusive recording agreement where the company funds the recording and marketing campaign and in return becomes the owner of the sound recording copyright.

This article focuses on the latter transaction. Because of rapidly-evolving technology which has changed and continues to change consumer consumption habits, this transaction is in transition. What follows is a conceptual overview of the principal terms included in most every American album-based exclusive recording agreement:

Parties and Exclusivity

Artists may enter the agreement individually or through artist-owned entities called "loan-out" companies. Establishing and contracting through such companies protects the individual from certain liabilities. A loan-out company signs a recording agreement undertaking to furnish the services of the artist and its name is followed by the designation “f/s/o” (meaning “for services of”) its artist-owner. The record company (commonly referred to as a “label”) will require the artist (or each member of a group or band) to either enter the recording agreement individually or to sign an "inducement letter" which assures the label that the individual artist(s) will perform the personal services required under the recording agreement. "Master(s)" refer to the individual recordings or “tracks” that, when aggregated, compose an album. Copies of masters in either individual track or album forms are still called "records" or more generically “recordings.” Terms such as "LP" (long playing records), "CD" (digital compact discs), and "album" are terms that are still used to identify essentially the same thing, that is, a collection of tracks with a total playing time equivalent to the normal running time of an album (generally 35 to 45 minutes) or a CD (sometimes the same as an LP or sometimes a longer playing time, depending on the agreement).

Recording agreements are almost always "exclusive" in that the artist agrees to render exclusive recording services during the term of the agreement for the label. Nevertheless, for relationship (with the artist, or another label, or a combination of both) or promotional (paid and unpaid) purposes, a label will usually consent to the artist recording performances as a “featured” artist, "sideman," “side-artist,” “step-out,” or “non-featured performer” for another label. However, the artist’s label usually has a right of approval over each such performance.

Term

The term is not usually for a certain period of years. Rather, it is commonly defined as a series of time periods within which a number of albums must be delivered. The time period in which each album is to be delivered is called an “album cycle.” The artist agrees to record a first album within a period of time (the “Initial Period”). The artist also grants the label options to require the artist to record further albums during multiple succeeding “contract periods.” The label will want many options, usually for three to six albums in addition to the initial album. If an album is successful, the option for the following album is exercised. If not, the artist is “dropped,” which means the artist no longer is required to deliver recordings to the label and may seek a recording agreement with another

recording company. The label generally has the authority to terminate the recording agreement at any time and not release any album whatsoever. It may elect to do so if the company feels, for whatever reasons, that it cannot achieve financial success with the recording or artist.

Recording companies diversify their investment portfolios by signing multiple artists each year knowing that only perhaps one out of ten signings will result in financial success. The profits from that one success will underwrite the losses from the others. This is why signing a traditional recording agreement presents only an opportunity (and, in fact, a statistical improbability) for fame and financial success. If the artist is successful, the label will have the right to her exclusive recording services for many years. Even the most productive artists usually release an album only every two years. So, an initial period plus options for six more albums, assuming a release every two years, adds up to a term of fourteen years, which is longer than most artists' productive recording careers.

Conversely, the artist will generally want the term as short as possible so if her career is successful, the artist can renegotiate terms with the label or another recording company sooner rather than later. When a new artist assigns ownership to sound recording copyrights under the recording agreement, neither party knows whether an artist will be successful or whether the copyright will become valuable. If the artist becomes profitable for a label, upon the artist's request, certain provisions (but not the length of the term), often will be voluntarily re-negotiated to some degree to improve the artist's deal even though the label has no contractual obligation to do so. This is often done as a means of maintaining good relations with a valuable artist and sometimes as a way of resolving or avoiding disputes.

Delivery

"Delivery" of masters (usually an albums-worth) is required for payment of any balance of the initial advance money due to the artist and producer who make the recording. It also starts the time running which affects other provisions in the agreement including the length of the term. There are many incentives built into the delivery provision to ensure that the artist delivers the record company the things it needs to distribute the album for sale ("release") before any benefits start flowing to the artist. As a part of the delivery requirement, the label will want a certain number of recordings delivered. The label will require that the recordings be "technically and commercially satisfactory." This means that the label wants recordings of commercially-exploitable songs (i.e., potential hits) recorded in a sonically-acceptable manner. However, what the artist considers good music may be at odds with the label's commercial needs. If there is no

mutual agreement on this issue, the label (at least until the artist is a profitable asset) will have the final say.

Territory

When entering a contract with a major label with world-wide distribution capacity, "the universe" or "the world" is a reasonable territory as the artist usually wants the recordings to be distributed as broadly as possible. In the U.S., Universal, Sony and the Warner Music Group are the recognized remaining "major" labels. Many "major independent labels" also have world-wide and well-funded reach through major distributors or a collection of able independent distributors in various foreign territories. A small independent label may not have such a reach and therefore, the artist may reserve the right to license the masters to third-party labels in territories where the independent label has no reach or is unable to secure acceptable affiliations within a certain period of time.

Release Commitment

The recording requires the artist to deliver enough masters to enable the release of an album (usually no less than ten compositions). The artist must comply with the delivery schedule and with the requirement to deliver technically and commercially satisfactory recordings. However, the label usually reserves the right to release the recordings or not. What could be more disappointing to an artist than to deliver recordings that are never released? To prevent this, the artist will want a number of albums (or at least the first) to be "firm" which means the label must commit to funding the recording costs and release the album (that otherwise qualifies as a delivered album) or pay the artist a negotiated amount if the label decides, as is usually its contractual prerogative, not to complete the recording process and/or to release the recordings. Such a provision is called "pay or play."

Typically, the artist's sole remedy in the event that the company fails to release the album is to terminate the agreement. In some cases, the company will additionally agree to sell the unreleased recordings and assign the copyrights back to the artist in return for repayment of the recording costs of the album.

Video

Music videos remain an important promotional tool for replay on TV, on line and for use as a part of the artist's press kit. The costs to produce a video vary but for pop music videos, the amount can equal the cost of producing an album. The cost is considered a "recording cost" that is recoupable against the artist's royalties, as explained below. A label usually will agree to recoup up to 50% of

the video production costs from the sale of recordings and 100% from the sale or licensing of videos. The decision to produce a video, the budget amount, the director selection and the master/song selection is either the label's (upon consulting the artist) or is mutual between artist and label. If there is an impasse and the artist is not yet established, the label will have final say.

Creative Controls

If the label has the final say as to what the artist can record, where and how it is recorded and produced, and whether it is commercially and technical satisfactory, the artist may (rightly) feel that both the artistic and business final decisions are out of the artist's control. The extent to which an artist preserves creative control depends on the relative negotiating strength of the parties, including the artistic stature and financial importance of the artist to the label. An established songwriter/recording artist/ live performer with proven success with the label will have more leverage than an unproven new artist.

Grant of Rights

The fundamental transaction embodied in the recording agreement is the assignment by the artist to the recording company of the ownership of the sound recording and of the copyright in and to the recordings performed by the artist. Also granted by the artist is the right of the label to use the artist's name (including, in the case of a group, both the group's and individual member's names and logos and likenesses, respectively) to promote the recordings. In exchange, the label provides the funds required to make, distribute, promote and market the recordings. The ownership and control of the sound recording copyright is the central asset of the record company. The label's business is centered on the ownership of a catalog of master recordings that can be exploited in all configurations, media and mediums now known or hereafter devised. Such exploitations include those undertaken directly by the record company and those accomplished through third-party licenses.

Labels normally insist that these grants of rights extend for the life of copyright so the label can continue to promote and sell the recordings into the future beyond the end of the term, after which the artist no longer is required to deliver new recordings to the label. Under current U.S. copyright law, the life of copyright in a sound recording extends 70 years from the life of the author. If the artist has unusual leverage, a reversion of copyright (transfer back to the artist) may be negotiated, to become effective at some future date.

Web Site

A label will generally seek to own and control (at its expense) an official artist website and domain name at least until the artist is no longer required to deliver recordings to the label (no longer "signed"). Even after this period, the label will want the right to maintain a web presence for the artist as a way to continue promoting and marketing the recordings created while the artist was signed to the label. If the artist already owns a well-developed web site (as most do) the artist may be allowed to maintain that web site provided there is a link to the official label site. The label may allow the artist to use some of the artwork and design content to create continuity regarding the artist's image, promotion and marketing. The label may also allow the artist to purchase physical recordings at wholesale and sell them over the artist's official site. The label will want to exclusively control all digital download and streaming sales.

Recording Fund and Advances

"Recording funds" are the most common way labels finance recordings. From the fund, the costs of recording are paid. Any amount unspent for recording will be retained by the artist. Often, a certain minimum amount is earmarked as an "artist personal advance" to make sure that not all the fund is expended on recording costs. Alternatively, the label may fund a "recording budget" to be expended on the actual costs of recording and a separate artist personal advance. The artist personal advance assists the artist with costs of living for a period of at least the time it takes to record an album and while touring in support of the recordings. The initial recording fund, budget and artist personal advance are a negotiated. The funding for the ensuing albums and artist personal advances is usually is determined by the sales of the previous album or albums.

A fundamental concept that permeates a recording agreement is the recoupment of advances against royalties. The label takes the financial risk including both financial expenditure and providing staff and other resources, for the recording, manufacturing, distribution, promotion and marketing of recordings.. Some of these costs, such as the label's general operating expenses, are absorbed by the label. Other costs are treated as "advances" to the artist to be paid back to the label from the money that would otherwise be paid to the artist as royalties. In this way, the artist's royalties are "collateral" to secure the repayment of the advances. Once these advances are "recouped" by the label, the artist will begin receiving royalty payments.

The conceptual justification for this arrangement is that the advances are investments by the label in a very risky proposition. They are not loans. The artist is not required to repay the advances other than through recoupment. The label controls all of the revenues generated from the exploitation of the

recordings until it is recouped. By the time the label becomes recouped, it has actually already been profiting for some time. Therefore, an artist may consider that the label is over-secured. Nevertheless, given the substantial funds, staff commitment, resources and sheer luck required to successfully introduce an artist to the world market (referred to as "breaking" the artist) and to sustain a high level of success, most artists accept this arrangement.

In the negotiation, the artist's representative needs to recognize what monies are proposed to be designated as recoupable advances and to limit them. Typical advances include third-party expenses incurred by the label for the recording including studio, musician, producer, engineer, mixer and mastering costs (these expenses are often collectively referred to as "recording costs"); design and photography used for imaging and packaging of products; music videos inclusive of actor, director, and all production costs; the costs of developing an official artist web site and on-line content; at least 50% of independent (non-company staff) radio promotion; money expended to fund a live performance tour; any money retained by the artist from the recording fund or otherwise constituting artist personal advances, and other costs that the label may seek to recoup in the negotiation.

Record Costs and Procedures

The artist is usually responsible for engaging the services of the producer under a producer agreement. This agreement is negotiated between the lawyers for the artist and producer within parameters set forth in the recording agreement. The producer is in turn charged with overseeing the recording budget and recording procedure including the scheduling of studios, and the engagement of recording engineers, musicians, mixing engineers and mastering engineers. The producer submits an invoice for his services and those whom he engages to the label administrator who then pays these individuals upon receiving from them the required documentation that assigns any copyright interests or right to claims therein to the label. Those who may be entitled to receive a royalty (producers and some top-level mixers) may request and receive a "letter of direction" (LOD) which enables them to be paid their royalty directly from the label and not through the artist. It is important to note that producers usually begin receiving royalties once the recording costs (not all advances) are recouped through the artist's "all-in" royalties. The all-in royalty includes any portion the artist may assign to a producer or mixer. If a producer is famous and the artist is not, the producer may command a sizable portion of the all-in royalty, which can amount to as much as 1/3 of the total royalty.

Royalties

The artist royalty typically begins at the rate of at least 14% to 16% of the suggested retail price (or 28% 32% if the royalty is calculated based on the wholesale price, which generally is about 50% of the suggested retail price). The all-in royalty rate includes the artist's royalty as well as the producer's royalty and perhaps a royalty to a top-notch mixer. “Net sales” to which the royalty rate is applied is calculated according to language in the record contract providing for deductions that have the effect of reducing the actual amount of income on which the royalty is based. More deductions result in smaller royalties. In the digital space, some of these traditional deductions are becoming more outdated and difficult to for labels to justify.

Packaging costs for physical goods were at one time substantial. Because of efficient digital design costs, fewer physical product sales and the growth of digital download sales, these costs have declined substantially. Nevertheless, some sort of packaging deduction, up to 25% of the retail price, persists and is now considered a general overhead cost reduction for the label. Some labels do not charge such costs on digital download sales. Another arcane deduction is the application of the royalty rate to only 90% of net sales of recordings rather than 100% of the sales. This further 10% deduction is a remnant of the days when about 10% of shellac and later vinyl records were expected to be returned as having damaged in shipment by breakage or warping, the replacement of which was an additional cost to the label.

To negotiate the reduction or elimination of deductions is an important issue for the artist’s representative. Of course, a higher royalty rate can mitigate the impact of deductions. The company will be mindful that it can give here and there as long as the “penny rate” (the actual amount that is paid to the artist for each copy sold) remains within an acceptable range. The artist's lawyer must understand the money calculation and maximize the actual penny rate on each transaction.

Royalty rates generally are decreased when applied to foreign territory sales. The justification is that the costs of distributing and promoting abroad require added costs and perhaps third-party label assistance.

Escalations in royalty rates are usually granted if requested by the artist as a reward for sales at a high level. as by the time sales reach that level, the record company has recouped the recording costs and is profiting. Traditionally, the royalty escalated by at least .5% at net 500,000 copies shipped for sale or actually sold through normal U S. retail channels (“Gold Record” status according to the RIAA), and another .5% at 1,000,000 (“Platinum Record” status). With

declining sales levels and shrinking recording and promotion budgets, escalators can be negotiated at lower sales performance levels.

Under the traditional calculations, where albums are sold at retail between $12 and $15 and typical deductions are made, each percentage point equals about 10 cents so that a 14% royalty on a $15 retail CD sale would create a royalty to the artist of about $1.40. A sale at retail for less could yield the same royalty depending on whether lesser deductions are taken.

The royalty rate applies to digital download sales too. Some labels will agree to the aggregation of individual digital download track sales which are then divided by the number of tracks on the album to determine the number of equivalent “album sales” for purposes of calculating royalty escalations. As a result of recent litigation, some independent (not major) labels are actually treating download sales as third-party licenses because download sales are technically made through third-party digital aggregators and retailers. Third-party use licenses, for example for use of the master recording in motion pictures and TV soundtracks, bear a royalty , ofup to 50% of the income received by the label from the third party licensee.

The royalty rate applies to streamed music as well. Unfortunately, the amount paid by customers for such streaming rights through the various subscription services is relatively little and therefor the royalties payable to the artist are just fractions of a cent per stream. As physical and download sales decline and subscription revenues increase, the likely effect will be that the traditional recording agreement royalty and other terms will be replaced with another more realistic and practical model. Unless the streaming rates increase or the scale of customer use increases, or both, the economic model for music use and sales will be greatly undermined and may fail. The persistence of piracy world-wide also continues to eat away at the economic foundation of the recorded music and licensing business. While streaming generates little money, at least it provides a commerce model as opposed to being the outright theft of music.

Licensing Royalties

As mentioned, when the masters are licensed to third parties such as for synchronizations with visual images in TV and motion pictures, the proceeds are usually split 50/50 with the artist after deductions for specific costs of such licensing. All licensing royalty revenue is subject to recoupment of any amounts due from the artist to the label. Masters may also be licensed by the company for audio exploitations by other companies for compilations or other "couplings". (Compilations are treated in greater detail in Paul Bezilla’s article elsewhere in

this volume.) The royalty is generally pro-rated in such transactions and also is applied to recoupment.

Deficit Tour Advance

The artist should request, as an additional advance, "deficit tour support." This is an advance of money to the artist while on the road promoting an album. The deficit represents the difference between (1) the amount of money the artist is making from performance fees and merchandising income and (2) the costs of touring. The label will pay the difference as a recoupable advance so the artist can at least break even on the tour. This is a common scenario for new artists who may tour with a star performer as an opening act.Such performances do not pay well and are undertaken primarily for exposure to audience. To qualify for a deficit tour advance, the label usually requires the right to pre-approve the tour budget so it can anticipate what advance may be needed.

Artist Purchase and Sales

Sales by the artist of CDs (and even vinyl albums) at live performances are an important source of income. These sales have become impulse fan and souvenir sales that would not otherwise be made at a physical or on-line retail store. For many independent and emerging artists, these physical sales will exceed all other physical sales. Often the albums are sold to the artist by the label at wholesale and resold by the artist just like any other retailer. Artist royalties are paid on such sales and are applicable to recoupment.

As an alternative form of tour support, labels will provide CDs at manufacturing and handling costs (about $3 per CD) and allow the artist to keep whatever she can collect. In this case, no royalties are paid to the artist on such sales. Still other labels may provide a number of CDs at no cost in lieu of tour support money and even in lieu of an artist personal advance. In this scenario, if albums are sold for $10 to $15 each, the profit margin for the artist is very good. Labels will often agree to similar arrangements for physical sales over the artist-owned official website.

360 Deals / Additional Rights Provisions

Starting in about 2006, when on-line piracy had become rampant and CD sales were in free-fall decline, recording companies started changing the traditional model of limiting their commerce with artists to transactions involving the sale and licensing of recorded music. The labels reasoned that, but for the investment it made into making an artist known and perhaps famous, the artist’s other music career-related income opportunities (including music publishing,

merchandising, touring and endorsements) would not be as robust. Therefore, as a condition of signing a developing artist, the label should be entitled to participate in the whole music career (think of full 360-degree circle of the artists' activities). Today, every major label and most independent labels require that an artist grant the label the right to participate in all revenues generated through the artist's music career and in some cases even in the artist's larger non-music entertainment career.

The specific terms of label participation are negotiated and depend on the parties' respective leverage. An artist that has developed her own business, audience and commerce such that the signing may not present as much risk to the label as would signing a complete unknown, will have greater leverage. Generally, the label will seek income participation only and not ownership interests as it does with sound recording copyrights. Often music publishing income generated by a songwriter/recording artist is excluded, but not always. Merchandise, touring, personal appearance, sponsorship and endorsement participation can range from 5% to 25% of some negotiated income base. These payments are usually not applied to reduce an unrecouped royalty advance balance though the artist would benefit from such an arrangement and should request this. Income participations may extend beyond music to include participation in acting, book writing and any other revenue generated in the entertainment fields and media. In some cases, these revenue participations (music sand non music) may be reduced or terminated upon the label recouping all advances or after a certain amount of revenues from these sources have been paid to the label.

Music Publishing

A recording involves two different properties and copyrights. The recording created by those who perform and produce the recorded performances is protected by the "sound recording" copyright. The composition created by the songwriter(s) (essentially the lyric and melody) and which is embodied in the recording is protected by the "musical composition" copyright. The business of the exploitation of the sound recordings is the traditional "recording" business. The business of the exploitation of musical compositions is the traditional "music publishing" business. Songwriters (whether they are recording artists or not) may enter into publishing agreements with third-party publishing companies to assist the administration and exploitation of the musical composition copyrights. In this way, a songwriter assigns musical composition copyrights and concomitant grants of rights to a publishing company much like a recording artist assigns sound recording copyrights and concomitant grants of rights to a recording

company. (This subject is treated in greater detail in Lisa Alter's article elsewhere in this volume.)

An artist who is also a songwriter should make certain that all income due to her from all music publishing sources is not "cross collateralized." That is, the income from compositions including public performance, mechanical and synchronization royalties are not to be applied against the artist's recoupable account. If publishing is not cross-collateralized, the entire amount of royalties and other licensing fees generated from songwriting is paid directly to the songwriter or her publisher or administrator from the first sale.

Re-recording Restriction

The re-recording restriction prevents an artist from making another recording of a song that artist has recorded for the label. The label does not want a recording of the same composition by the same artist to be competing with the sound recording the artist made for the label. The restriction against re-recording is usually for a period of the longer of two or three years following the end of the term of the recording agreement or five years following the release of the original recording.

Departing Member Provision

Record companies frequently deal with bands or other groups rather than individual artists. The company will require that all members of the group individually sign the recording agreement as well as being signed by the partnership, corporation or other entity of the band. The contract addresses the possibility that one or more members of the group may depart and that others will take their places. The label retains the right to release recordings of departing members who may join other groups or release recordings as a solo artist. It also is granted rights to approve new band members.

Statements, Reserves, and Audit Rights

Royalty statements and any payments due generally are provided by the label to the artist sixty days after each semiannual period (i.e., periods ending each June 30th and December 31st). Because for physical sales retailers have the right to return albums within a period of time after receiving them from the label before paying for them, the label often has the right to create reserves against possible future returns. This passes the waiting period on to the artist. The reserve amount can vary from 20% to 30% of total sales. It must be "liquidated" (that is, payment of royalties must be made) eventually. A year from the date of the original sale is usually long enough.

An artist also is granted the right to audit the label to determine if royalties are being calculated and paid correctly. The cost of the audit is borne by the artist. A very artist-friendly audit right provides for payment of artist's audit costs in the event there is a proven 10% payment discrepancy unfavorable to artist. In the traditional physical record business, especially for a hit record, it was difficult to account for the exact manufacturing, distribution and world-wide sales of records. For a gold or platinum selling album, it would border on malpractice not to recommend an audit because significant discrepancies would be expected. Accounting for digital sales is much more accurate. Also, labels recently have modified their reporting practices so that the process is more transparent. Therefore, audits are less attractive and affordable absent the incentive of huge sales or some other suspicious circumstance. Artists are restricted to conducting an audit that "look -back" usually no more than the prior two or three years.

Conclusion

The music business is at a tipping point where technology and related digital distribution methods are meeting music consumer habits on platforms and in other ways that will eventually require a re-thinking of the exclusive recording agreement. The need for traditional recording companies, other than to market smash pop hits around the globe, is waning. The money in the traditional recorded music business is shrinking. Not since Thomas Edison invented the phonograph in 1877 has there been such a sea change. Nevertheless, for so long as the art of recording musical performances of captivating compositions moves people enough to want to repeatedly hear such recordings, there will be some level of ongoing commerce along the lines of the traditional record business. It is a near certainty that artists and recording companies will no longer make a killing with the frequency experienced in the record sales heyday of the mid 1990's.

Artists have become less dependent on labels for financing recordings. The opportunities available to artists to directly promote their music, videos and personas on-line via web sites and social media has diminished the importance of the labels as gatekeepers to mass media. With low streaming royalties and a movement away from hard-goods and download purchases, artist touring has become the key to simply making a living. In the old music economy, a tour would support album sales. In the new music economy, the recordings support the tour and accompanying merchandise sales. It may not be long before artists simply strike direct deals with streaming services leaving labels with the business of simply licensing legacy artist (oldies) catalog. With these and other issues unsettled, the exclusive recording agreement transaction between artist and label is assuredly in transition.