

NEWSLETTER

An Entertainment Industry Organization



Taking a Glance at Other Income Streams in the Music Industry...2007

by Dina LaPolt*

The President's Corner

David Hirshland

As the future of music distribution is upon us, tonight's panel is significant to our rapidly evolving industry. Please welcome our panelists and contribute to this evening's discussion of the new developments and trends of digital music distribution.

Best Wishes,
David Hirshland, President

In addition to income generated from traditional record sales, music used in films and television, and sources from music publishing, there are other income streams (some new and some not so new) available to the music industry. Please note that although the information contained in this article has been updated, it may be obsolete in a few months time as the music industry is changing so rapidly that those of us who work in it can hardly keep up! However, the one fact that remains constant is that music is now available everywhere.

In an effort to keep the confusion at a minimum, below are just a few of the descriptions for some of these formats and the

breakdown of some of the income paid to artists and songwriters and others.

Digital Downloads

According to *Billboard Magazine*, U.S. album sales dropped to 588.2 million in 2006 which is a 5% decrease from the 619 million copies scanned in 2005 which is the first time since 1993 that the U.S. sales figure has slipped below the 600 million mark. However, as grim as the foregoing may seem, the increase in U.S. digital sales hit an all time high especially the week after Christmas 2006 with a whopping 30.1 million tracks sold according to *Nielsen Soundscan* (582 million downloads sold total for 2006). This is a 51% increase from the 19.9 million digital tracks sold during the last week of the year in 2005. In addition, Fergie's popular hit single, "Fergalicious" also set a new record for the most tracks sold in a single week with 249,000 downloads.

Although there are numerous digital download services available throughout the world, the most prominent seems to be Apple's *iTunes*. Pursuant to the *iTunes* agreement with the record labels, the *iTunes* share of income is \$0.29 cents out of each \$0.99 download. The following sets forth the way in which many of the record labels in the U.S. pay third parties with respect to each \$0.99 download assuming that the recording agreement allocated the artist an

"all in" royalty rate of 15% (i.e., which includes a producer royalty of 3%, leaving a "net artist" rate of 12%):

Artist iTunes Royalty (with wholesale mark-up)

\$0.99 download single song price to the consumer

less \$0.29 to Apple

left \$0.70 x 130% (wholesale markup) x 12% (net artist net rate) = \$0.1092 cents per download

Artist iTunes Royalty (without wholesale mark-up)

\$0.99 download single song price to the consumer

less \$0.29 to Apple

left \$0.70 x 12% (net artist net rate) = approximately \$0.084 cents per download

With respect to mechanical royalties paid for digital distributions of musical compositions, although this may change in the future, record companies in the U.S. have been using a notice of compulsory license when notifying music publishers of their intention to offer digital downloads of musical compositions. This ‘notice’ usually lists the record company, the recording artist, the name of the musical composition, the identity of the songwriters and music publishers, and the expected distribution date of the ‘digital phonograph delivery’ of the song. These compulsory licenses are typically referred to as “DPD Licenses” and they are paid at the maximum statutory rate which is currently .091 cents for songs under 5 minutes or 1.65 cents per minute if the song is over 5 minutes. For recordings produced pursuant to contracts entered after 1995, the law prohibits a controlled composition provision of the artists’ contract from discounting the compulsory DPD rate, so even if there is a controlled composition clause in the contract, the singer-songwriter should receive the entire .091 cents.

WEBCASTING ROYALTIES

There are two types of licenses available for either interactive or non-interactive services. See below for a brief description of both:

A. Interactive Subscription Services

“Interactive” services enable the consumer to interact with the service to hear a specific recording and to create personalized radio stations and play lists.

Examples: *Rhapsody* (through RealNetworks) and *Napster*.

- For a monthly subscription fee, these types of services offer continual non-interrupted interactive streaming of music, which also allows the user to download tracks to a CD for a separate fee, sometimes as low as \$0.79 per download.

- Some music providers such as *Yahoo* also offer the streaming of music for

free (downloads are separate) because they are funded through advertisers. As result, the streaming of music is interrupted by its advertisers’ ads.

- Specifically, with respect to *Rhapsody*, once logged on, it plays all day long and the user can create personalized radio stations.

- Although some notable artists are missing on *Rhapsody* and some other prominent subscription services (e.g., The Beatles, Led Zeppelin, and AC/DC), they are rapidly increasing content every day.

- Generally, these services pay \$0.01 to the record label each time a recording is streamed.

- With respect to downloading, generally the *iTunes* royalty formula applies.

Please note, however, that permanent royalty rates are still being worked out between the record labels and some of their artists as the industry evolves more into the digital realm.

B. Internet Radio Stations and Non-Interactive Subscription Services

Terrestrial radio is a “regular” radio station – No performance royalties are paid to recording artists or owners and controllers of sound recordings. Performance royalties are only paid to songwriters and music publishers through ASCAP, BMI and SESAC.

- Very few terrestrial radio stations have corresponding Internet radio stations that broadcast the station over the Internet waves. (*According to Ron Gertz of Royalty Logic, only about 600 radio stations out of 16,000 were making Internet simulcasts as of September 2006*)

-Under the Digital Millennium Copyright Act of 1995 (“DMCA”), Congress provided for a “Webcasting Royalty” to be paid to the owners and/or exclusive licensees of master recordings being streamed.

-Webcasting royalties are only paid for “non-interactive” radio and subscription

services. Unlike *Rhapsody* and *Napster*’s interactive services, the consumer cannot pick and choose which particular songs or artists he wants to hear.

-The two FCC-approved non-interactive satellite digital subscription services are *XM Satellite* and *Sirius*.

In addition to *Sirius* and *XM*, there are also non-interactive music subscription services available via most digital cable television lines and similar services via satellite transmission for DirecTV and Dish Network. These services, referred to as “pre-existing satellite subscription services” (or “PES”) are MusicChoice and Muzak. Originally, there was a third PES service, DMX but they filed for bankruptcy and Capstar purchased some of their assets. It is currently under dispute whether or not Capstar can be a “PES” since it is not a successor to DMX. Other services, including *Sirius*, who are now providing background music channels to DirecTV and Dish Network have also taken the position that they can be a PES even though all PES services were named in the original 1995 statute. *NOTE: The foregoing information could be obsolete very soon.*

All these services must pay the statutory performance license fees for the master recording and must also pay the performance right organizations for the performance of the musical compositions.

PUBLIC PERFORMANCE ROYALTIES FOR INTERNET LICENSES

A. The Master Recording

With respect to the non-interactive subscription services and Internet radio stations, there are currently two collection societies that collect money for owners (or those who have the right to collect for the owners) of the master recordings and featured artists. These two collection societies are *SoundExchange* and *Royalty Logic*.

SoundExchange was the first performing rights organization in the U.S. to collect and distribute royalties to sound recording copyright owners and featured artists and they are

a not-for-profit organization governed by a board of artist representatives and major and independent label representatives.

Royalty Logic, based in Los Angeles, is an independent performing rights organization for the negotiation, licensing, collection and distribution of digital performance royalties payable to featured performing artists and sound recording copyright owners. Royalty Logic is actively engaged in promoting regulations to maximize license fee collections and royalty distributions on behalf of affiliates at the lowest possible cost.

WHO JOINS?

- Record companies or any owner/controller of sound recordings; and
- Recording artists, etc.

Featured recording artists have the same right to designate a collective as the sound recording copyright owner (i.e., their record company). Therefore, an artist can choose to be represented by a different collective than the artist's record company.

THE PROFIT SPLIT

The law provides that the statutory license revenues be split as follows:

50% to the owner of the master recording (i.e., most often the record company)

*45% to the featured artist**

5% to the non-featured musicians and vocalists (paid to the independent administrators who are responsible for paying the non-featured performers. Union membership is not required for payment)

**Please note that it has become industry custom to share a portion of the featured artist's royalty with the producer of the sound recording through a letter of direction which is attached as an exhibit to the producer agreement between the recording artist and the producer.*

SoundExchange and Royalty Logic receive license revenues from satellite, cable and Internet radio with licenses for both commercial and non-commercial services, which include track level accounting of performances to its members and the most up-to-date information on streaming and digital

transmissions. More information can be found at www.soundexchange.com and www.royaltylogic.com

B. The Musical Composition

With respect to public performance licenses only for musical compositions (rates are still being worked out for the digital delivery of musical compositions), there are three (3) performing rights organizations in the U.S. -- ASCAP, BMI, and SESAC.

ASCAP, BMI, and SESAC collect public performance income with respect to musical compositions and all have various licenses that allow these Internet services, whether interactive or non-interactive, to perform all of the songs in each of their repertory.

These Internet licenses do not allow the reproduction or distribution of the songs (which would be handled through the record company) nor do they allow the public performance of the master recordings (which would be handled through SoundExchange).

Types of Public Performance Internet Licenses

The following applies to the public performance of songs via the Internet BUT please note that a lot of these licenses are still in their "experimental stages." Accordingly, please regularly check the website of your respective performing rights organization to make sure they have the most up to date and accurate information.

ASCAP currently offers three (3) types of Internet licenses. The first is a non-interactive license that does not allow consumers to download or otherwise select particular songs. The second type of license is an interactive license that does allow consumers to download or otherwise select particular songs. ASCAP's third type of license authorizes the public performance of its songs in its repertory via wireless devices such as mobile phones. The fees paid to ASCAP by these Internet sites are based on revenue or activity of each Internet service.

For more information please log onto the ASCAP website at www.ASCAP.com and click on "Customer Licenses" on the left side of the page.

BMI's main license type is one where fees are computed on a "gross revenue calculation" where music is the primary feature of the particular site or a "music area calculation" where music is only a part of the total website traffic for that particular site. For more information go to www.BMI.com.

SESAC also offers a license that provides for fees based on the number of monthly page requests as well as whether or not there is advertising on the site. For more information go to www.SESAC.com.

The above information is excerpted from the music business person's bible, Music, Money and Success: The Insider's Guide to Making Money in the Music Industry (4th edition) by Jeffrey Brabec and Todd Brabec.

MUSIC ON YOUR MOBILE PHONE

The MobileTone formerly known as the "RingTone"

The downloading of music on cell phones has become a relatively new source of income for record companies and their recording artists. Prior to being able to download an actual master recording on to a cell phone (for purposes of this article we will refer to the downloading of master recordings on cell phones as *MobileTones*), a consumer could only download a 're-play' of that recording which was referred to as a *RingTone* and only songwriters, music publishers, and performance rights societies made any money from the traditional *RingTone*.

Before I go into an explanation of "who gets what" for every *MobileTone* download, it is important to understand how monies were paid out for the traditional *RingTone*.

Because the traditional *RingTone* was a re-play (i.e., re-creation) of a song contained on a recording, there was no use of the actual recording which is usually owned by the record company. Accordingly, record companies and their recording artists were not entitled to any sound recording royalties for the downloading of the traditional *RingTone* (although crafty record company lawyers attempted to try and stop music publishers and their songwriting recording artists from licensing the right to re-create their songs for *RingTones* by limiting the re-recording

provision in the recording agreement, few record companies were successful at this). The “traditional” *RingTone* was either a monophonic tone (i.e., single tone) or polyphonic tone (i.e., many tones) whereby the actual song was *recreated* through a series of tones/notes, most of them through MIDI (i.e., musical instrument digital interface) as opposed to the download of the *actual* master recording featuring the artist’s performances. Accordingly, only songwriters, music publishers, and performing rights societies (i.e., ASCAP, BMI, and SESAC) were receiving any income from traditional *RingTones*.

With respect to the old *RingTone* deals, an agreement was made between the cell phone carrier (such as Verizon or Cingular) or a third party cell phone aggregator (such as Xingy or Hudson) and music publishers and/or songwriters for the re-creation (i.e., re-play) of a song either monophonically (archaic) or polyphonically (preferred). The terms of these agreements were short ranging from 1 to 3 years. Although most of the deals were worldwide, the music publisher would most often try to limit the deal to the U.S. and Canada. The traditional way in which the phone carriers (or third party aggregators) paid royalties to the owners and controllers of musical compositions in the U.S. was the greater of ten cents (\$0.10) or ten percent (10%) of the *RingTone* price paid by the consumer. Accordingly, there was always a floor of ten cents (\$0.10) per *RingTone* which is a step up from what songwriters and publishers were used to being paid for each song contained on record albums pursuant to the statutory rates set by the U.S. Copyright Office (currently the rate is \$0.091 cents for under 5 minutes of playing time). Accordingly, if a *RingTone* sold for \$2.49 then the royalty paid to the owners and controllers of that particular musical composition would be \$0.25 cents. In addition, many of these older *RingTone* deals were contingent on the company’s also obtaining licenses from the respective public performance organization (i.e., ASCAP, BMI, or SESAC), and those monies will flow to the publisher and songwriter as well.

Finally in the later part of 2005 and in 2006, the U.S. caught up with the rest of the world with respect to the 3G technology required on the cell phone in order to download the actual master recording (and other content)

on cell phones. (As stated above, we will refer to master recording downloads on cell phones as *MobileTones* as opposed to *RingTones*). Because the technology has advanced so quickly, cell phone carriers now can provide customized cell phones which offer a number of personalized services such as music shops, music video channels, buying tickets to concerts through mobile ticketing, visual radio, personalization content such as wallpaper and imaging featuring your favorite artist, and editorial content. For these mobile deals, it is important to note that the cell phone carrier (i.e. Verizon, Cingular, etc) receives fifty percent (50%) of the fee paid by the consumer for each *MobileTone* downloaded. Accordingly, if a *MobileTone* costs \$2.49 to download then the carrier receives \$1.25. Please note that sometime in 2006, the carrier started paying the public performance societies (i.e., BMI, ASCAP, and SESAC) directly out of their fifty percent (50%) share (\$1.25) (*see below*) but this had not always been the case. Early on the public performance societies were being paid out of the remaining \$1.24 along with everyone else! Of course this resulted in a lower royalty paid to the recording artist.

With respect to the licensing of the song contained on the *MobileTone*, it is important to remember that the old *RingTone* deals allocated music publishers and songwriters a mechanical royalty equal to ten percent (10%) of the retail price to the consumer so they were getting really used to a \$0.25 cent royalty for every *Ringtone* sold for \$2.49. Of course, as you can imagine, record companies flipped out when they were told by music publishers that the mechanical royalty for a *MobileTone* was \$0.25 cents per download! REMEMBER, record companies are used to paying the minimum statutory rate (many times less!) for songs embodied on albums. As noted above, the current the minimum statutory rate is currently .091 cents for songs under 5 minutes of playing time. For the record company, that is a \$0.16 cent increase per *MobileTone*! The key point is that this ‘mechanical royalty’ was freely negotiated between the parties because the *MobileTone* was considered a derivative work, outside the compulsory license system of Section 115 of the U.S. Copyright Act.

Fortuitously for the labels, the newly created Copyright Royalty Board (“CRB”) had been

engaged in a ‘mechanical rate setting procedure’ since the beginning of 2006 to set the mechanical royalty rate for all Section 115 uses. The record companies argued that *MobileTones* are not derivatives but instead “cover versions” of songs which would make them subject to the compulsory license requirements. Before the labels could attempt to try and enforce their position, they needed the CRB to rule on the matter and the RIAA (lobby group in Washington for the major labels) demanded such a ruling from the CRB who referred the question to the Copyright Office. On October 16, 2006, the Copyright Office ruled that a *MobileTone* is subject to the Section 115 compulsory license system. Currently, the CRB will now proceed to set mechanical royalty rates for *MobileTones* which could be as low as the \$0.91 (or lower if the labels get their way!) that is currently paid for cover versions of songs. The songwriters and publishers, represented ostensibly by the National Music Publisher’s Association (NMPA), reacted very negatively to this ruling, as it effectively reduces their *MobileTone* income by over sixty percent (60%). In a weird quirk in the rules, the songwriter/publisher interests cannot appeal this decision to the DC Circuit Court until after the CRB sets the mechanical rate, which could happen sometime in 2007. Naturally, this has become a highly contentious issue between the RIAA and the NMPA. And this may not even be the most contentious issue raised before the CRB. In a daring move, the RIAA is also seeking a decrease in the rate for all Section 115 mechanical uses. Their filing asks for a return to the statutory rate as set in the year 1981. This would apply to both physical and online/satellite product. The statutory mechanical rate has never been reduced. If the RIAA succeeds, all songwriters and publishers will be faced with an unprecedented decrease in statutory revenue.

Portions of the foregoing section were contributed by Jay Rosenthal, Esq., co-legal counsel to the Recording Artist’s Coalition. Jay can be reached at JRose13@aol.com.

Current MobileTone Royalty Breakdown:

As for the other royalty participants of the *MobileTone*, here is a hypothetical breakdown:

Retail price to the consumer: \$2.49

Less \$1.25 to the carrier (i.e., Cingular, Verizon, etc) (representing 50% of retail)
(carrier pays the performing rights societies [ASCAP, BMI, or SESAC] 5% of retail which equals \$0.12.5 cents per download)

Leaves \$1.24

Less \$0.25 to the music publishers/ songwriters (representing 10% of retail)

NOTE: As of October 16, 2006, the US Copyright Office ruled that compositions contained in *MobileTones* (formerly the *RingTone*) is subject to compulsory licensing. We are waiting for new rates to be determined!

Leaves .99 cents to record company (then record company the Artist a portion of this amount- see below)

In addition to battling the music publishing and songwriter community, record companies are also having a battle with some of their recordings artists as to whether *MobileTones* (and downloads) constitute a sale or a license. Under the terms of a recording agreement, when the record company 'licenses' a recording featuring its artists' performance, the artist is entitled to fifty percent (50%) of net as opposed to an artist royalty. Obviously paying an artist fifty percent (50%) of the \$0.99 cents the record company is receiving for *MobileTones* (or fifty percent (50%) of what the record company is receiving from *iTunes*) amounts to far more than what they are paying their artists. Unfortunately, the "sale vs. license" battle is one in which the recording artists are losing. See below:

Sale vs. a License?

Sale:

.99 'net' to record company for a *MobileTone* download multiplied by the Artist net royalty rate as follows:

EXAMPLE: \$0.99 x 12% =
\$0.1188 paid to the artist if the Artist

License:

Artist receives 50% of the .99 'net' to record company for *MobileTone* download as follows:

EXAMPLE: 50% of .99 cents =
\$0.495 cents

By the time this article is published, much of the information in the article may have already changed as the music industry is moving at such a rapid pace. The good news is that there are plenty of new opportunities for artists- both signed and unsigned.

For the most up to date information pertaining to the music industry, please visit the following websites:
www.soundexchange.com
www.royaltylogic.com www.ascap.com
www.bmi.com www.sesac.com
www.cdbaby.net www.billboard.com
www.copyright.gov
www.recordingartistscoalition.com



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LaPolt Law is a boutique entertainment firm that specializes in representing clients in the music, merchandising, film, television, and book publishing industries. The firm's clientele include recording artists, artist and producer owned record companies, music publishers, producers, managers, film production companies, directors, writers, authors, and actors. In addition to practicing law, Dina teaches "Legal and Practical Aspects of the Recording and Publishing Industries" in the Entertain-

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