

NEWSLETTER

An Entertainment Industry Organization



ARTIST VS. RECORD COMPANY - NEW MEDIA, OLD BATTLE

By Steve Winogradsky, Esq.

The President's Corner

Ed Arrow

For more than 50 years the CCC has proudly served the copyright community in the Los Angeles area. I am honored to have the opportunity to serve as president of the CCC during this 2007/2008 season.

I moved to Los Angeles nearly 20 years ago and immediately began attending CCC dinner meetings. The knowledge I gained from informative panels, and the connections I made by networking with other members and guests, were key elements in furthering my growth in the music industry. Never before have we seen a time of such change in the intellectual property industries. Keeping abreast of new developments in our industry is critical to maintaining a successful career.

This season we begin with our annual Legal Eagles panel, in which both private practice attorneys and in-house counsel discuss current issues of importance to our industry.

In October and November we will present back to back panels relating to digital media distribution. These panels will be moderating by two of the industries leading experts in digital distribution: Chris Castle will moderate in October, and Ted Cohen in November. Each of these panels will focus on a different aspect the changes digital distribution brings to our industry. The panels will also discuss how companies and we, as individuals, must adapt to these changes. Please visit our website at <http://www.theccc.org> for information on our upcoming meetings.

I encourage you to join the CCC. An individual membership is only \$55 per year and a corporate membership is \$250 per year. Members receive a substantial discount for all dinner meetings. Corporate members are eligible for 10 member discounts per meeting. In addition, your membership helps to support the CCC. If you wish to join, please visit our website or contact a CCC officer or Board member.

Thank you.

For many years, the record companies fought the idea of digital distribution via file "sharing" by such companies as the "original" illegal Napster (not the current company) and Kaazaa, who allowed users to distribute music without any compensation to the record companies or artists whose music was being distributed. During this time, Napster and its ilk filled the vacuum created by the absence of legal alternative methods for consumers to get downloads of the music they wanted.

After a few attempts to digitally distribute music legally themselves, the major record companies finally allowed Apple Inc, and its music distribution arm, iTunes, to sell digital downloads legally on a large scale. As iTunes celebrates the sale of the 3 billionth download, a lawsuit brought by some classic rock groups questions how the record companies are paying artists for digital sales.

The action, brought by *The Allman Brothers Band* and *Cheap Trick* against Sony Records, claims that the label is using an incorrect methodology in computing the artists' royalties from these types of sales to the artists' detriment. Not long afterwards, *The Youngbloods* brought a similar suit against BMG.

Background: The typical artist agreement with a record company provides for 2 separate types of accounting of income to the artist: (1) a royalty based model, where the artist receives a percentage of the Manufacturer's Suggested Retail Price ("MSRP"), as defined and adjusted by the language of the agreement, for retail sales of the artist's recordings;

and (2) a share (usually 50%) of the net income earned by the record company licensing these recordings to a third party, such as a film company in a master recording license, or to another record company for a compilation album or soundtrack album.

How an iTunes sale is defined in the key question here. The labels claim that selling via iTunes is no different than making a retail sale by selling a physical copy in a record store or through Amazon, and the "royalty" model should be in place. After years of declining sales, they are eager to retain as much of the new media money as possible.

The artists in this suit claim that the record companies have licensed these recordings to iTunes, much as is done to another record company in the case of a compilation album, and that the artists should receive their 50% share of net income. For some artists, the difference in the income is crucial to their survival, not only as artists but on the most basic levels of having enough income to support their families.

The table shown here indicates how these two royalty models can differ greatly in the amount the artist receives from a sale through iTunes and similar services.

| RECORD COMPANY VS. ARTIST - THE ECONOMICS OF iTunes | | Labels dealing directly w/ iTunes | Labels using aggregator |
|--|-----------------|-----------------------------------|-------------------------|
| RETAIL PRICE FOR INDIVIDUAL DOWNLOAD | | \$0.9900 | \$0.9900 |
| AMOUNT RETAINED BY ITUNES | \$0.29 - \$0.34 | (\$0.315) | (\$0.315) |
| AMOUNT PAID TO RECORD COMPANY | \$0.65 - \$0.70 | \$0.6750 | \$0.6750 |
| | Averaged | | |
| LESS COMMISSION TO AGGREGATOR | 15% OF RETAIL | N/A | (\$0.1485) |
| LESS MECHANICAL ROYALTY TO PUBLISHER | | (\$0.0910) | (\$0.0910) |
| NET TO RECORD COMPANY | | ===== \$0.5840 | ===== \$0.4355 |
| EXAMPLE #1 - ARTIST GETS ROYALTY AS IF A RETAIL SALE (some artists get more or less than the 12% indicated here as the example royalty) | | | |
| ROYALTY = 12% OF RETAIL SALES PRICE | | \$0.1188 | \$0.1188 |
| EXAMPLE #2 - ARTIST GETS 50% OF NET LICENSING RECEIPTS | | | |
| 50% SHARE OF LICENSED INCOME | | \$0.2920 | \$0.2178 |
| DIFFERENCE | | (0.1732) | (0.0990) |

The two columns show the gross income, i.e., retail price of the download, less income retained by iTunes, the amount of the mechanical license paid to the publisher and (in the right column) a deduction for an aggregator's commission. Because there was no rational sense for it, the record companies have not been taking the tradition "packaging deduction" of 20 to 25% from the retail price before calculating the artist's royalty. In both columns, however, it is clear that the "net income" method pays significantly higher than the "royalty" method.

A few years ago, the owners of the Tom Waits catalog brought a similar lawsuit against Warner Bros. Records, which was Waits' label. This case was settled out of court with confidentiality agreements preventing any information about the results becoming public. Now, with this new case and Sony and BMG as defendants, pre-trial motions are being heard and, as of this date, the case is going forward.

The labels maintain that they need a higher amount of income to stay in business after years of seeing their revenues drop. The artists, claiming that they too have lost income from declining sales, feel that the accounting practices of the record companies already make it hard for artists to make any money beyond their initial advances.

How this case unfolds will have a serious impact on both sides of the debate and the entire industry may need to change as a result.

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CRB HEARINGS MECHANICAL ROYALTY RATE PROPOSALS

By Ed Arrow

The statutory mechanical royalty rate subject to section 115 of the U.S. Copyright Law expires on December 31, 2007.

Currently there is only one statutory mechanical royalty rate, and that rate was originally intended for physical products only. In 1998, the Digital Millennium Copyright Act (“DMCA”) extended the physical product rate to permanent digital downloads.

The DMCA anticipated that additional rates might be set for other types of digital mechanical reproductions such as limited downloads, on demand streams, and streaming audio.

In 2006 the Copyright Royalty Board of the Library of Congress (“CRB”) announced the commencement of the proceeding to determine the reasonable mechanical royalty rates and terms. Along with the announcement, the CRB invited interested parties to participate in the proceedings.

The primary participants these proceedings are:

Digital Media Association (DiMA)
National Music Publishers’ Association (NMPA)
Recording Industry Association of America (RIAA)

Each of the above organizations has proposed specific statutory mechanical royalty rates to the CRB.

The proposed rates are summarized on the chart below.

The CRB is expected to make their ruling in late 2008.

| | Proposed Mechanical Rates | | |
|------------------------------|--------------------------------------|------|----------------|
| | NMPA | RIAA | DiMA |
| Physical Mechanical | 7.8% of Wholesale | | n/a |
| The greater of: | | | |
| Per song (5:00 or less) | 12.5¢ | | |
| Per minute (Over 5:00) | 2.4¢ | | |
| Permanent Downloads | 7.8% of Wholesale | | 4.1% of retail |
| The greater of: | | | |
| Per song (5:00 or less) | 15¢ | | |
| Per minute (Over 5:00) | 2.9¢ | | |
| Limited Downloads | 7.8% of Wholesale | | 4% of retail |
| The greater of: | | | |
| Percentage of Revenue | 15% | | |
| Content Costs | 33.33% | | |
| Per use (per song) | .33¢ | | |
| Per use (per minute) | .064¢ | | |
| Interactive Streaming | 9.6% of public performance royalties | | No mechanical |
| The greater of: | | | |
| Percentage of Revenue | 12.50% | | |
| Content Costs | 27.50% | | |
| Per use (per song) | .275¢ | | |
| Per use (per minute) | .053¢ | | |

Source: National Music Publishers’ Association