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# Do Recording Artists Deserve a Greater Share of Revenue in the Emerging Digital Age?

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## 1. Introduction

> The founders wrote copyright protections into the Constitution because they believed that they were necessary for progress. Movies, music and books require investments of money and time. If their creators cannot make money from them, many will be unwilling or unable to keep producing. Or they may have to finance their work in troubling ways, like by building in product placements or taking money from donors with agendas.[1]

While this passage is from an editorial supporting the position several entertainment companies have taken regarding a recent case argued before the U.S. Supreme Court, it could serve as a rallying cry to recording artists to demand a greater share of the revenue their record companies derive from various digital uses of their works in this, the emerging digital age.

Currently, the music industry is on the cusp of a new paradigm that has the potential to usher in an era of prosperity for both artists and music companies. In a keynote speech at the Grammy Foundation's Entertainment Law Initiative luncheon in February, 2005, Edgar Bronfman, Jr., Warner Music Group chairman/CEO stated, "The past few years are ones in which technology innovation has resulted in part in the trampling of the rights of artists, creators, and content providers. However, I believe this can be an anomaly and that we can and will find a way through this period. One which allows music artists to write and record, music companies to invest and promote, and new technologies and new channels—whatever they may be—to bring the beauty and wonder of music to consumers everywhere and allow all of us to be paid for our efforts."[2] While such a positive statement coming from the head of one of the few remaining major

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record labels may offer encouragement to recording artists who have become victims of the industry's recent financial downturn, it does not address the need for long overdue revisions to exclusive recording artist agreement royalty provisions which perpetuate the historically unjust treatment of artists in regard to being fairly compensated for their work.

In this article I discuss the emerging digital age in entertainment and explore issues related to royalty provisions in typical exclusive recording artist agreements relative to digital uses. The analysis of these concerns demonstrates what I perceive to be a need for artists to receive a greater share of the revenue derived from such uses of their work.

In part two I analyze the current state of the emerging digital age in entertainment and its effects on the music industry. I set forth information that indicates the entertainment industry is one of the strongest components of the U.S. economy, and discuss how the emergence of new technological forms of music distribution will dramatically increase future revenues and values of music companies. I also discuss problems artists are experiencing with traditional streams of income that justify the need for them to receive a greater share of revenue generated from digital uses of their work.

Part three contains my investigations of two key contractual provisions that demonstrate how record companies typically compensate artists for the digital exploitation of their works. I argue that a greater share will more fairly compensate the artists for their contributions to these products that are such an important part of our economy.

I conclude in part four illustrating the need for U.S. artists to be compensated in a more equitable way that will encourage them to write and create music that will continue to make the United States a leader in the global entertainment market.

## 2. The Emerging Digital Age

A new era in the recording industry has rapidly developed since the beginning of the new millennium and it is destined to reshape what the industry was as little as ten years ago. Entertainment is a multi-billion dollar business that persists in showing signs of strength. A recent study by the International Intellectual Property Alliance (IIPA) reports that the core U.S. copyright industries (movies, television programs, DVDs, books, music, computer games, and software):

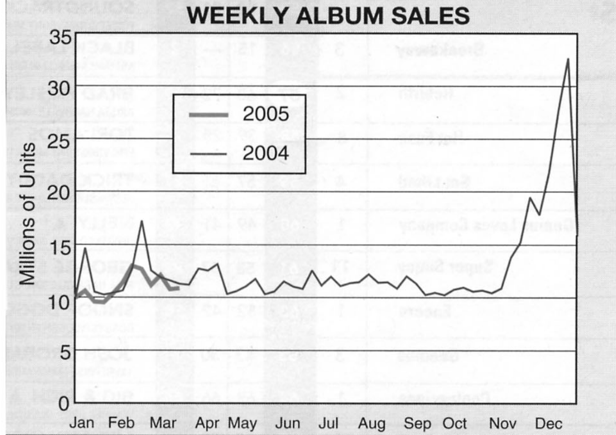
1) were responsible for 5.24% of the gross domestic product of the U.S. in 2002;
2) its share of gross domestic product grew more than two times as fast as the remainder of national economy in the past twenty-five years;
3) new job creation is three times the rate of the rest of the U.S. economy;
4) these industries represent approximately four percent of total U.S. employment (over five million workers);
5) have more international revenues than chemical and allied products, autos and auto parts, aircraft, and agriculture combined; and
6) at a time when the U.S. has a $400 billion trade deficit, the movie industry alone, unlike any other American industry, has a surplus balance of trade with every single country in the world.[3]

Music is the primary industry of the core in that it impacts each of the other industries and has the most global reach of all the entertainment businesses. The emergence of the digital era, where musical works are produced and delivered through digital means, has caused great anxiety within the ranks of recording companies and artists who argue that illegal internet peer-to-peer file sharing has decimated their earnings. While year-to-year record sales decreased from 2002 to 2003, the Recording Industry Association of America (RIAA) reported that total U.S. music shipments improved a meager two percent to 814 million units in 2004. However, according to RIAA, the industry's biggest trend and hope for the future is the sale of digital music. In 2004 more than 140 million digital tracks and 5.5 million digital albums were sold[4] and it is predicted that U.S. internet sales will increase five-fold, reaching $720 million, by 2006.[5] As digital sales increase dramatically, the sale of physical albums is declining. According to Nielsen SoundScan, sales of current albums decreased almost nine percent in the first quarter of 2005 on a year-to-year basis.[6]

The Weekly Unit Sales diagram (Figure 1) indicates that sales of digital tracks for the week ending March 27, 2005 totaled 6,355,000, a 215% increase over the same week in 2004. The Year-To-Date Overall Unit Sales section shows that through March 27, 2005, album sales were off by 8.6%

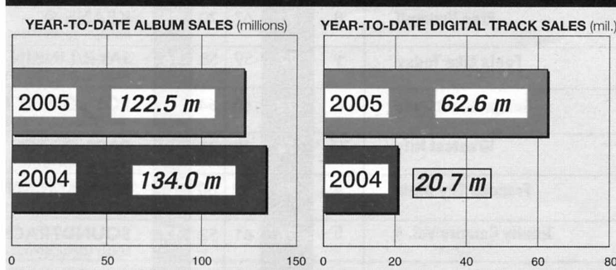
# Market Watch

**A Weekly National Music Sales Report**




## WEEKLY UNIT SALES

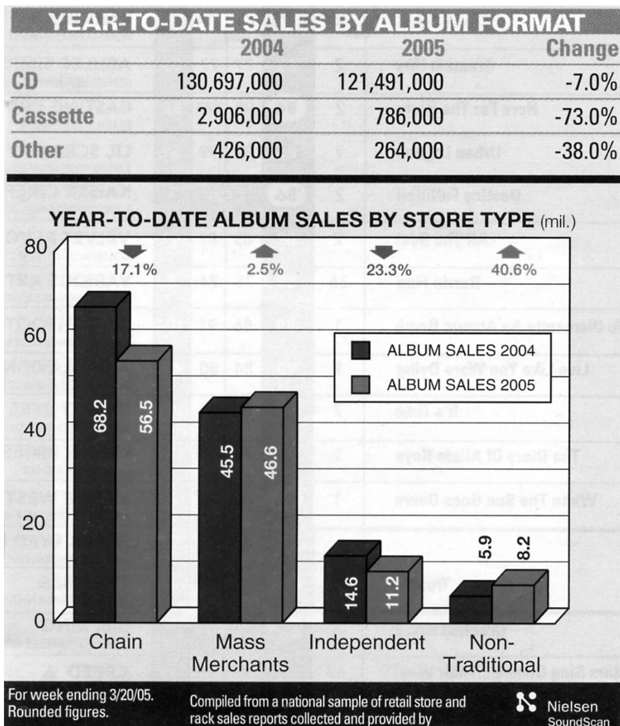
| | Albums | Store Singles | Digital Tracks |
|---|---|---|---|
| This Week | 10,913,000 | 86,000 | 6,355,000 |
| Last Week | 10,809,000 | 87,000 | 6,273,000 |
| Change | ⇧1.0% | ⇩1.1% | ⇧1.3% |
| This Week 2004 | 11,309,000 | 130,000 | 2,015,000 |
| Change | ⇩3.5% | ⇩33.8% | ⇧215.4% |




## YEAR-TO-DATE OVERALL UNIT SALES

| | 2004 | 2005 | Change |
|---|---|---|---|
| Total | 156,426,000 | 186,091,000 | ⇧19.0% |
| Albums | 134,029,000 | 122,541,000 | ⇩8.6% |
| Store Singles | 1,660,000 | 923,000 | ⇩44.4% |
| Digital Tracks | 20,737,000 | 62,627,000 | ⇧202.0% |

Figure 1. Weekly Unit Sales for the week ending March 27, 2005.[7]



**YEAR-TO-DATE SALES BY ALBUM FORMAT**

| | 2004 | 2005 | Change |
|---|---|---|---|
| CD | 130,697,000 | 121,491,000 | -7.0% |
| Cassette | 2,906,000 | 786,000 | -73.0% |
| Other | 426,000 | 264,000 | -38.0% |



Figure 1 (continued). Weekly Unit Sales for the week ending March 27, 2005.[7]

compared to the same period one year earlier. In contrast, the sales of digital tracks increased 202%.[7]

The rapid growth of the digital market is also demonstrated by significant recent spikes in the sales of digital music players and legal download services. During the first quarter of 2005 sales of Apple's digital music player, the iPod, increased to 5.3 million, a 558% increase over the first quarter of 2004 and sales from its iTunes Music Store and iPod accessories totaled $216 million.[8] In addition, Apple sold 4.6 million iPods in the last quarter of 2004[9], and a week before Christmas, iTunes enjoyed a one million track week-to-week increase in sales for the first time in its history.[10]

In furtherance of its plan to saturate the digital music player market, Apple introduced a smaller, lighter, and less expensive iPod named Shuffle in January, 2005. Heralded by supporters and critics alike for being a revolutionary technological advancement, the Shuffle offers unique features,

which allow its users to store up to one hundred digital recordings and automatically shuffle their play lists with a simple slide of a bar. Another feature is the item's low price of $99. Industry observers maintain that with iPod sales currently at 10 million units, there is significant room for growth considering the fact that over the lifetime of the Sony Walkman, over 300 million units were sold.[11] With Apple leading the way, digital sales—which currently make up about 2% of overall music sales—are predicted to increase to 7.5% by the end of 2005[12] and 25% by 2008.[13]

Although Apple is the dominant player in the digital download sales market, several other forms of digital sales are leading us into an era of digital dominance. Ringtones and master tones, the exploitation of artists' website material, and digital delivery of full tracks to wireless phones are all methods of exploitation of music that didn't exist in the last century. Yet, in just a few years, the earning potential of these uses will form the basis for resurgence in the value of music companies.

Earlier this year, Edgar Bronfman, in support of his Warner Music Group's impending initial public offering, said, "for more than a decade now, the entertainment industry has been America's second largest exporter [...] American entertainment is a worldwide business. If you factor computers in the mobile phone equation and add the explosive growth of portable music players such as iPod, you have an almost unfathomable increase in distribution platforms of music [...] We're not just talking songs anymore, but ringtones, master tones, ringbacks, and other kinds of entertainment."[14] Approximately three months after making these statements, his company, which he purchased a little over a year earlier with financiers Thomas H. Lee Partners and Bain Capital for $2.6 billion, launched an initial public offering that raised $554 million. Though not meeting its financier's expectations, it did allow the company to pay off $300 million in debt and increase its enterprise value to in excess of $4 billion.[15]

While the rise of music's digital age seems to be fueling optimism in financial markets, such optimism does not seem to extend to recording artists. Linkin Park, Warner Music Group's biggest selling act, contends that the Warner IPO will only further strain its relationship with the company. The group maintains that only $7 million of the IPO proceeds are slated for company operations. As a result, the increased company value, based in large part on projections of income generated from digital uses of their product, will only benefit the company's investors and not artists.[16] Linkin Park's concern is only one of many recent problems negatively affecting

recording artists' ability to generate income from their work. The following are four other significant problems negatively affecting artists' income that support the case for artists to receive a greater share of income from digital uses of their work as the emerging digital era matures.

## Illegal Downloading

Even though digital download sales are increasing, the effects of illegal peer-to-peer (P2P) file sharing are still wreaking havoc on the earnings of record companies and recording artists alike. R&B recording star Gerald Levert notes that sales of his recent albums have decreased almost fifty percent from those of albums released prior to 2002—in spite of him having a number one Adult R&B hit in late 2003.[17] The consequences of illegal peer-to-peer file sharing have been vigorously debated by researchers and recording industry supporters. In March of 2004, Harvard Business School Associate Professor Felix Oberholzer and University of North Carolina at Chapel Hill Associate Professor Koleman Strumpf released a report of their research into the economic effects of illegal downloading from peer-to-peer networks. The report, in part, concluded that, "downloads have an effect on sales which is statistically indistinguishable from zero."[18] Their research supports the stance of recording industry critics who maintain that the drop in record sales may be attributed to other factors, including a slowing economy, fewer new releases, and the restricted playlists of newly consolidated radio companies that came into existence as a result of the 1996 Telecommunications Act. The act allowed such companies as Clear Channel Communications to become the largest owner of radio stations in the country, growing from 43 stations in 1995 to more than 1,200 stations in 2003. Many believe the listening public's disgust with the homogenization of what was being heard from coast to coast on these consolidated radio networks might also have been a contributing factor to the huge growth of P2P file sharing and the decline of CD sales. However, regardless of the causes, Steve Mark, general counsel of RIAA, maintains that P2P technology has been the main culprit that has "decimated the music business and left in the wake innumerable lost jobs, slashed royalties for songwriters and artists, and thousands of shuttered record stores. The total, a 22% decline in CD sales since 1999, has been unparalleled in the history of the music business." Marks also avers that the Oberholzer and Strumpf report used flawed methodology which flies in face of countless other studies and plain old common sense.[19]

Although there may be other contributing factors to the decline of CD sales, evidence of the four-year decrease in top-ten selling albums leads me to conclude that the rapid growth of the illegal P2P file sharing services during that time period was a precipitating factor in the abatement. According to SoundScan, in the year 2000, 60 million top-ten albums were sold in the United States, in 2001, 40 million units, in 2002, 34 million units, and in 2003, sales were down to 33 million units.

Most successful artists receive advances on their royalties paid on the commencement or delivery of albums. However, as a result of the stagnation of CD sales over the past four years, the size of these advances has generally decreased. "The money is smaller now when you renegotiate," says artist attorney Danny Hayes, managing partner of Davis, Shapiro, Lewitt, Montone, and Hayes, and counsel to the superstar group Linkin Park. "It could be 30% to 50% less than it used to be."[20] "On renegotiations, we're just plain saying 'no'," one label attorney says.[21] For many artists, advances provide the financing to construct project studios thus enabling them to create music spontaneously in their own time and space. The reduction of this important source of income is not only discouraging to artists, it also interferes with their ability to design an environment which is conducive to creating and producing great music. While illegal downloading will never be entirely eliminated, it is hoped that the growth of sales of digital downloads will eventually offset its drastic impact on artists' ability to obtain advances that enable them to continue their creative work.

## Single Track Sales

Another factor affecting artists' income in the digital age is the consumer's transition from purchasing albums to purchasing digital single tracks. Over the past thirty-five years, successful recording artists have generated a large part of their income by receiving large recording funds from record companies to record albums. But in the emerging digital age, the sale of albums (physical and digital) may go the way of the eight-track tape: into extinction. Virgil Roberts, former President of Solar Records, the most successful African-American record company in the 1980s, notes how this change will affect the way record companies view recording funds. "We're really going back to the future because the record business started off as a singles business. What's happening with the internet consumers is, kids now want only what they want and it's almost unbundling what com-

panies have been doing because if you go back to selling singles, it doesn't make sense to have big recording funds."[22]

Legal digital download services offer consumers the option to purchase individual tracks, in essence allowing them to "unbundle" an album to suit their own needs and desires at a more affordable rate than purchasing the entire album. This feature is certainly one of the attractions of the internet download method of obtaining music and any loss in CD sales incurred by record companies may be deemed justified, considering their unconscionable (and at times, illegal) method of charging consumers inflated CD prices over the years. The unfortunate by-product of this new market system will be, at least, a short-term reduction in artist royalties as more singles and fewer albums are sold.

As the digital age matures, artists will become more dependent on royalties generated from sales of singles rather than large album advances. Therefore, it will be even more important for artists to argue for a fairer share of revenue generated from these sales as it may be the primary source of income artists receive from the exploitation of their recordings.

## Publishing

As a result of low album sales in recent years, recording artists who are also songwriters have suffered additional losses from a decline in mechanical royalty income. Large advances from publishing agreements with major and independent publishers, once a significant source of cash for the recording artist/songwriter, have also decreased over the past few years. University of Colorado at Denver Associate Professor Stan Soocher says, "Music publishing has long been idealized as the 'cash cow' of the industry, but with record sales down—and thus mechanical royalties income down—a big piece of hide is being skinned off the cow."[23] The latest international survey of music publishing revenues, published in 2001 by the National Music Publisher's Association, showed a twenty percent decline in domestic mechanical royalty revenue from the year 2000.[24] After polling several of his colleagues, L. Lee Phillips, attorney for The Eagles and Josh Groban, commented that he believed, in some instances, the downturn in advances for publishing deals could be as high as fifty percent.[25] In regard to the size of advances currently being given for publishing deals, David Renzer, Chairman and CEO of Universal Music Publishing Group says that, "it's half of what it was, if they get an offer at all."[26]

Most recording artists/songwriters who have become dependent on generating significant mechanical royalties from the sale of albums containing several of their compositions are receiving significantly lower royalties in the digital market as single track downloads dominate album sales. Considering the fact that during 2004 digital single tracks sold 140 million compared to 5.5 million digital album sales, it is likely that this trend will continue as the digital age progresses.

## Live Performance

While most recording artists still generate the bulk of their income from live performances, the road has not been a very artist-friendly place recently. Last year's concert market was flat.[27] Statistics provided by industry magazine *Pollstar* reveal that business dropped dramatically at the nation's amphitheaters, known in the industry as "sheds." In the summer of 2004, ticket sales at sheds decreased by 1.1 million, a 35% drop from the year before.[28] With most costs increasing and revenue decreasing, artists and their tour managers have to devise unique touring plans in order to maintain profitability. Artists involved with 2005's summer touring season will be subjected to tighter federal transportation regulations and higher gas prices.[29] Michael Rapino, CEO of CCE SpinCo, the live entertainment division of Clear Channel Entertainment (the largest live music entity that has ever existed), said his concentration in the 2005 tour season would be to take the focus off artists' guarantees (fees guaranteed for an act to perform) and instead offer artists 100% of the back end (total ticket receipts less expenses).[30] Even though the offer of 100% of the back end sounds appealing, some, including Artists Group International president Dennis Arfa, says that the back end of a shed, "still may not maximize revenue potential for an artist [...] I know from experience an act that can sell 17,000 tickets at an amphitheater with reduced lawn tickets can walk out with more money in an arena."[31] Ever-increasing tour costs coupled with the reduction of artists' guarantees makes the revenue most artists expect to earn on the road more difficult to achieve and leaves them in a position of looking for alternative revenue streams to offset their reduced income.

## Sponsorship

With touring income down and expenses increasing, artists are, more than ever, pursuing various forms of sponsorship to offset the rising costs of doing business. While a few of the most successful artists may obtain

large endorsements from companies anxious to make an impact on the elusive youth and young adult segments, most artists are not as fortunate. Deals range from McDonalds' multi-million dollar agreement with Destiny's Child to sponsor its 2005 72-concert world tour to the Grand Ole Opry and the Alison Krauss and Union Station's tour partnering with restaurant chain Cracker Barrel. Tour sponsorship is projected to increase almost nine percent this year. However, in an effort to make impressions on teens and young adults, companies are sponsoring tours of Hispanic artists, whose deals are less expensive than mass-market acts.[32] While the total amount of money allocated for sponsorships may be increasing, it appears that companies are doing more deals with artists who are willing to take less money so that the advertisers can expand their reach to a wider, more diverse market.

On a different and more troubling note, in the spring of 2005 a new and controversial form of sponsorship was offered by McDonald's when the fast food giant announced that it will pay rap artists one to five dollars every time one of their songs with lyrics that include the words "Big Mac" is played on the radio. Maven Strategies, a marketing company with a history of pairing hip-hop artists with advertisers, was retained by McDonald's to woo rappers to participate in this campaign which, unlike most sponsorship deals, offers no upfront payment to artists. Instead, artists are paid based on the amount of radio spins the songs receive, a move which drastically reduces the financial commitment McDonald's traditionally makes to launch an advertising campaign.[33] This effort has met resistance from a number of sources within the music community. Tim Burrowes, Editor of *Mediaweek* decries the promotion as being, "a good strategy for McDonald's, but what does it do for the credibility of the artist, when their fans discover they're being paid to talk about it?"[34] Others expressed dismay at the company's plan not to pay the artists upfront. "You're only going to get a certain amount of money depending on airplay. That's a total insult to artistic integrity," said 1Xtra DJ Semtex.[35]

This type of sponsorship may backfire on the artists who participate as well as on McDonald's. Not only does this plan insult the artists' level of business acumen, it also has the potential of negatively affecting the creative process. An advertising campaign of this nature reduces the value of artists' integrity to their fans as well as to their record companies in that their works may be considered nothing more than glorified jingles.

The emerging digital age is growing at a fast pace and before the end of this decade digital royalties will become a significant portion of an artist's income. In light of the challenges to the artist's non-royalty streams of income, it is of utmost importance for artists and their representatives to be aware of, and carefully negotiate, provisions that maximize compensation for digital uses of their recorded product.

## 3. Digital Royalty Provisions

The following are two areas of concern regarding digital royalty provisions to which artists and their representatives should give special consideration when artist contracts are negotiated or renegotiated.

### Digital Downloads

In typical recording agreements drafted in the late 1980s and early 1990s, CD, DAC (Digital Audio Cassettes), DVD audio, and any new software medium and transmission were defined as New Medium (NM) configurations for which the record company would pay a reduced royalty. Usually, the NM royalty rate was seventy-five percent of the artist's basic royalty rate (i.e., the rate paid for traditional vinyl and cassette configurations). Therefore, if an artist's basic royalty rate for vinyl and cassette albums was twelve percent, the NM rate would be nine percent. At that time record companies argued that the costs of research and development, and the investment in manufacturing plants required for the production of the new media products (particularly CDs), justified the paying of a lower royalty. However, by the onset of the new millennium, production costs had dropped dramatically and CD album sales experienced massive growth. This allowed record companies to generate substantial profits from CDs. While it took more than fifteen years for CD sales to dominate the market, the projected market-share growth of digital single tracks points to a more rapid transition from CD to digital single sales. Unfortunately, some form contracts from the late 1990s still define CDs and other new media (i.e., digital downloads) as new medium configurations, triggering the payment of lower royalties. The effect of these provisions lowering artist's digital royalties coupled with the aforementioned problems with other income streams may have a detrimental affect on an artist's ability and willingness

to create the innovative music that makes such a substantial contribution to our nation's economy.

In addition, because a record company's profit margin is smaller on the sale of singles as opposed to albums, recording artists have traditionally received a lower basic royalty rate for singles. For example, if the basic royalty rate is fifteen percent for albums, the singles rate may be only twelve percent. This will have a dramatic effect on artist royalties if the primary form of digital downloads is singles rather than albums. Royalties for digital downloads may be further reduced by the imposition of container and free goods deductions (usually twenty-five percent of the suggested retail list price and ten to fifteen percent of sales respectively). While these deductions are considered traditional for CD sales, they cannot be justified in the world of digital downloads. Nevertheless, some companies still insist on these deductions. Kendall Minter, artist attorney to the stars Kirk Franklin and Damien Marley, says, "Some [companies] are calculating single track downloads as single sales and still apply a packaging deduction, even though we know there's no packaging cost for downloads."[36] However, Randall McMillan, Senior Director of Legal and Business Affairs of Island Def Jam Records, maintains that at his company, "We don't take traditional deductions with respect to downloads […] We don't have container or freight deductions for downloads."[37]

It has been reported that artist royalties for sales through iTunes based on a single ninety-nine cent suggested retail list price will yield thirteen cents for an artist with a thirteen percent royalty rate depending on whether or not the company makes container or other deductions. Therefore, for an Island Def Jam artist who has a fifteen percent royalty rate for albums and a thirteen percent royalty rate for singles applied to the suggested retail price of the download without container or free good deductions, the resulting royalty will be $1.50 for albums and 13¢ for singles.[38]

Many industry leaders think that the next big distribution channel for music will be downloads to mobile phones. With a potential market of 1.4 billion people (a quarter of the world's population) who already have a mobile phone, this form of digital music distribution dwarfs Apple iPod's current ten million users[39] and has the promise to increase the digital sales market exponentially. As a result, in order for artists to maximize revenue from digital download royalties, clauses governing how artists are paid for these types of sales should be reexamined and renegotiated in existing contracts and completely redefined in new ones.[40]

## Ringtones and Master Tones

Ringtones, customized twenty-second snippets of songs used on cellular phones, is one of the fastest growing segments of the digital music business and have become a significant source of income for record companies and publishers. In 2004 the U.S. market for ringtones more than doubled to $315 million and is expected by many industry estimates to spike an additional twenty to thirty percent by the 2005 holiday season.[41] Strangely enough, it appears that many of the same teenagers who are willing to purchase several ringtones a month (at a cost of up to $2.99 each) balk at paying less than a dollar for a legal download of a full recording! The sheer volume of this new source of revenue has been very attractive to artists who also are songwriters.

The right to utilize a composition for a ringtone is licensed from the work's copyright owner (usually the publisher). Royalties can vary from a set amount (for example, ten cents per ringtone download) to a percentage of the revenue per ringtone sold (e.g., ten percent) or the greater of the two. Licensing agreements also allow the wireless company that aggregates, markets, and distributes the ringtones to deduct a one-time fixing fee, usually twenty-five dollars per song uploaded to a server.

Master tones are portions of master recordings of songs. Aggregators are required to obtain licenses from the record companies that own the sound recordings and the publishers who control the underlying musical compositions. This market is developing slowly as aggregators are resisting record companies' requests for royalties of 30%-75% of the retail sale price of the tone. In addition, publishers usually demand ten percent of the retail sale price or ten cents per sale, whichever is greater. Industry sources indicate that record companies put this type of sale in the same category as a traditional sale in regard to determining the type of royalty due the artist. The designation of this type of use as a traditional sale could be problematic to the artist.

## Economic Justification for Artists to Receive a Greater Share of Digital Download, Ringtone, and Master Tone Revenue

Major record labels have been slow to respond and adapt to the emerging digital age. This initial reluctance, along with their disregard for the consumer's desire to obtain music online, has resulted in internet software and hardware providers developing and maintaining the primary means of distribution of key digital products. Apple iTunes and several ringtone and

master tone aggregators dominate the legal digital download and ringtone/master tone market. These companies are content aggregators and distributors of digital product who negotiate what could be considered third-party licenses with record companies and publishers to provide musical products to consumers through either the internet or mobile phone providers. Most recording agreements provide for artists to receive fifty percent of the record company's net receipts from any third-party license of their master recordings. However, some record companies don't consider these transactions to be third-party licenses; instead they categorize them as sales through traditional channels as far as artist royalty rates are concerned. In other words, the artist will receive a ten to fifteen percent artist royalty on these sales, rather than the fifty percent allowable under the typical third-party license. The record companies maintain that their transactions with the digital providers are comparable to sales through their traditional channels. But a close examination of economic factors impacting the record company indicate a significant difference between the two and provides a justification for artists to receive a fairer share of the revenue derived from these sources.

In the typical third-party license transaction the licensee, for example, Razor & Tie Records (a company specializing in manufacturing, marketing, and selling compilation albums), bears the cost of manufacturing, marketing (via TV commercials or infomercials), and distributing (in the case of Razor & Tie, via direct sales). The record company provides the master recording for a fee and/or royalty and bears no other costs. However, in the traditional sales model, the record company does bear significant costs of manufacturing, distribution, and marketing of the recording. A review of certain economic tools typically used in cost analysis offers insight into the real differences between the traditional and third-party license scenario. In an economic analysis of the practice of recoupment, Professor Theo Papadopoulos of Victoria University offers the following formulas as part of a breakeven analysis illuminating the physical and intellectual property characteristics of the product and the risk assumed by the record company and artists:

$$TC = TFC + TVC \qquad (1)$$

$TC$ is the total cost, $TFC$ is the total fixed cost, and $TVC$ is the total variable cost. In the case of a record company, $TVC$ is comprised of several components, assumed to be:

$$TVC = MPC.Q + DIST.Q + R_A.Q + R_P.Q \qquad (2)$$

where *MPC* is the marginal physical cost (manufacturing or duplication cost), *DIST* is the distribution cost, $R_A$ is the artist royalty, $R_P$ is the publishing (or mechanical) royalty, and *Q* is the quantity of the sound recordings manufactured.[42]

In the traditional sales model, the total variable costs borne by the record company would include the marginal physical costs and distribution costs, which increase the company's total costs, thereby enhancing the company's risk. However, in the case of the third-party license to digital aggregators and providers (e.g., Apple iTunes and ringtone providers) the marginal physical and distribution costs are borne by the third party, not the record company, thereby reducing the record company's risk. As a result, the record company is in a better position to share more equitably the revenue derived from these digital sources. The third-party license model incorporated in most artist contracts provides a precedent for equally sharing revenue in this type of situation. Unfortunately, record companies are unlikely to concede on this point without some form of pressure from either artist representative groups or legislators. Attorney, author, and former Sony record executive Steve Gordon contends that the record companies should, but most likely will not, voluntarily agree to an equal sharing of digital revenue with artists. He proposes the enactment of a federal statute legalizing the sharing of music online that requires those companies directly profiting from file sharing to pay compulsory fees to a central administrator acting on behalf of record companies and artists. The fees would be shared equally among the companies and artists with a separate fund for payment of music publishing fees. The statutory royalties would override contractual provisions providing artists with only ten to fifteen percent in royalties and instead provide them with fifty percent of the revenue derived from the digital use of their recordings.[43]

## 4. Conclusion

Entertainment is the second leading export of the United States and music is perhaps the most global of all the entertainment businesses contributing to the U.S. economy. As developers of one of the nation's major exports, it is very important for music creators, recording artists, and songwriters to be protected and encouraged to continue to develop these valuable, world-respected products.

The increasing role of digital distribution presents enormous growth opportunities for artists and record companies. Digital music sales are anticipated to experience tremendous growth within the next few years. However, artists are currently confronted with problems affecting their income caused by the growth of digital sales as well as other concerns. The ability of recording artists and songwriters to make a decent living is crucial to the continued vitality and viability of a large sector of the U.S. economy.

Royalty provisions in most recording agreements discount payments to artists for digital uses of their product. As the digital age matures such terms may have a detrimental affect on the artist's ability to continue to create music that makes such a significant contribution to our culture. There is precedent for an equal sharing of record company receipts with artists in certain instances. The relationship between record companies and digital providers of music is similar to the relationship the companies have with third-party licensees of their product. Most recording agreements provide for the record company and artists to equally share net income received from third-party licenses of their recordings. A comparison of the traditional music sales model with the digital sales model reveals that record companies incur less risk with the digital model. Record companies should be willing to consider licenses to digital providers as third-party exchanges and pay artists an equal share accordingly.

Record companies historically have been reluctant to share royalties on a more equitable basis with artists. Therefore, it is unlikely that the situation will change without pressure from artist representative groups or by the enactment of legislation to override unfair contractual terms and provide a mechanism to administer an equal sharing of digital revenue.

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Licensed to practice in the states of New York and Ohio, Kellogg practices from his New York City offices. Since beginning his private law practice he has represented several successful recording artists including 2005 Rock and Roll Hall of Fame inductees The O'Jays, Gerald Levert, LSG, Stat Quo of Shady/Aftermath Records, and G-Dep of Bad Boy Records, as well as a number of music production companies and artist managers.

A former vocalist with the group Cameo, Kellogg now advocates for the rights of artists through his writings, which include his book, *Take Care of Your Music Business: The Legal and Business Aspects You Need to Know to Grow In the Music Business* (PJ's Publishing, 2000) , and articles "Adult R&B! Keep It Real," published September 18, 2004 in *Billboard* magazine, and "Livin' the Singles' Life" and "Royalty Audit Law Takes Effect in California," published December, 2003 and January, 2005, respectively, in *Entertainment Law and Finance Newsletter*.

Attorney Kellogg was recently elected to the board of the Music and Entertainment Industry Educators Association (MEIEA) and is a former board member of The Black Entertainment and Sports Lawyer's Association (BESLA), an organization in which he remains an active participant and exponent. He was inducted into the BESLA Hall of Fame at the organization's twenty-fifth annual conference in November, 2005.

The *MEIEA Journal* is published annually by the Music & Entertainment Industry Educators Association (MEIEA) in order to increase public awareness of the music industry and to foster music business education.

The *MEIEA Journal* provides a scholarly analysis of technological, legal, historical, educational, and business trends within the music industry and is designed as a resource for anyone currently involved or interested in the music industry. Topics include issues that affect music industry education and the music industry such as curriculum design, pedagogy, technological innovation, intellectual property matters, industry-related legislation, arts administration, industry analysis, and historical perspectives. The *MEIEA Journal* is distributed to members of MEIEA, universities, libraries, and individuals concerned with the music industry and music business education.

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