

Testimony of the Future of Music Coalition

on

**"Online Entertainment and Copyright Law:
Coming Soon to a Digital Device Near You."**

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Summary

The Future of Music Coalition is a not-for-profit think tank that advocates for new business models, technologies or policies that will advance the cause of artists. We firmly believe that the music industry as it exists today is, at a very basic level, anti-artist, and that any serious examination of a digital future must take into account the structures in place in our analog present. While the final solutions to the challenges in this space will be driven in many ways by technology and the market, there are a number of critical policy decisions in front of Congress that could make a significant difference in the lives of artists. These include:

1. Competition for collection and distribution of the digital royalty
2. Direct payment of the digital royalty to the artist
3. Fostering of non-commercial space on the radio and on the Internet
4. Ensuring artists have the right to keep their recordings in print

The Future of Music Coalition remains eager to work with any organization that shares our concern for improving the conditions for artists in these exciting times.

Introduction

More often than not, the debate over digital music distribution has left artists and their representatives sitting on the sidelines. Even today's hearing has omitted many of the organizations that have been driving the debate and have stood alone in proposing concrete and coherent solutions to the questions that the Senate is posing. The Future of Music Coalition (FMC), for example, took the unique step of bringing together more than 600 hundred music industry leaders, technologists, consumers, musicians, academics and composers (including Senator Hatch) to discuss these very issues this past January at Georgetown University. Unless the Senate and other governmental organizations include artist organizations, like the FMC, in public discussions about the future of digital music, the public cynicism that has made peer to peer a phenomenon will continue to grow.

Increasingly, the public believes that artists are not compensated fairly. This perspective is then used as a justification for file sharing of copyrighted materials. If the average teenager believes that their favorite artists will not receive compensation for their creations, it gives them the excuse to use peer to peer file-sharing services that have no mechanism in place to compensate the artist. This is the crux of an enormous problem.

The Recording Industry Association of America (RIAA) has a confusing track record. It has publicly stated that the organization does not represent the interests of artists, but rather the interests of the major record companies. It has also stated that it is trying to protect recording artists and their creations through litigation against Napster and MP3.com. Still there has been no public explanation as to how the recording artists will participate in the large sums that have been generated by the settlements and/or judgements from these cases.

The Senate must ask the difficult questions: how are the artists being paid now and how will they be paid in the future? In other words, each time that a settlement is reached or a new lawsuit is filed, the Senate must ask: how will the artists be compensated when there

is a final adjudication? Prospectively, the Senate should look at each of the digital music distribution issues and conflicts through this prism of artistic compensation.

The System is Broken

Any serious examination of the digital future of downloadable music needs to take into account the fact that the music industry in America is fundamentally broken. In 1999, less than 1 percent of the total number of albums released sold more than 10,000 copies.¹ Commercial radio airplay is often sold to the highest bidder through a shadowy network of "independent radio promoters,"² while attempts to create new non-commercial Low Power FM stations have been gutted by Congress.³ The dreams of stardom chased by many are met head on with the sad reality that an estimated 75 percent of releases from major labels are not even currently in print, leaving artists with a huge debt to the record companies that they have no means to pay back. Meanwhile, technology companies seem content to roll out new business models and technologies without giving serious thought to how these technologies will impact artists' traditional revenue streams.

Elevating the Artists

The Future of Music Coalition is a not-for-profit think tank whose sole mission is to elevate artists into the middle of this debate. The FMC aims to increase knowledge about the current industry and advocate in favor of specific solutions – including policy solutions and business models – that will improve artists' ability to succeed in a notoriously (if not artificially) constrained industry. We strongly believe that an artists' agenda and a consumers' agenda are one and the same.

¹ David Segal, "They Sell Songs the Whole World Sings: Mass Merchants Offer Convenience, Less Choice," *Washington Post*, February 21, 2001, Page A1.

² Eric Boehlert "Pay for Play," *Salon*, March 14, 2001.

³ Stephen Labaton, "Congress Curtails a Plan for Low-Power Radio Stations," *New York Times*, December 19, 2000, A1.

Ultimately, the new music industry will be defined in relation to innovations in technology and the marketplace. It is important to recognize that neither of these forces are neutral ones. There are a number of critical policy decisions that will determine how the market evolves and artists need to participate in those decisions. The FMC proposes four simple steps that will not only increase artist compensation but will also grow the size of the music market thereby creating new jobs and new sources of capital for investment. Each of these proposals will not only effectively create new opportunities in our industry but they will also enhance the shareholder value of each of the publicly traded major record labels. This is truly an opportunity to nurture and to grow the recording industry and the performing artists that make it all possible.

1. Competition in Collection of Digital Royalty

SoundExchange is the name of an organization created by the Recording Industry Association of America (RIAA) that is poised to become the sole mechanism by which all webcasting royalties will be collected and dispersed to all musicians. The Future of Music Coalition believes that artists must have the right to choose between competing collection agencies, similar to the robust competition between ASCAP, BMI and SESAC for analog performance royalties.

The Future of Music Coalition has stated a number of reasons why SoundExchange should not be the sole collector:

A. It is partisan.

It is clearly inappropriate to force independent musicians who have consciously worked outside of the major label system, and who compete with that system daily, to now go to an organization that was created by the major labels in order to collect their independently generated royalties.

B. The data is too valuable.

It is also our opinion that the transfer data (i.e. who is playing what songs, how many times, etc.) is valuable and should not be owned or controlled by the RIAA.

C. The RIAA cannot be trusted to represent artists' interests.

We believe that if the major labels are allowed any discretion in the manner by which webcasting royalties are collected, divided and paid out they will certainly exert influence in a way that benefits themselves and their constituents. Here it might be wise to remember the recent "work for hire" controversy which implicated the RIAA for requesting (and getting passed) a "technical amendment" which changed the substance of the Copyright Act to the detriment of recording artists. This change allowed record companies to claim ownership of sound recording copyrights FOREVER when previously these copyrights reverted to the creators after 35 years.

Thankfully the "work for hire" clause was identified, fought and ultimately repealed due to the efforts of a coalition of recording artists and musicians' rights groups. Still we think it would be unwise to allow such recently identified "foxes" as the RIAA or their agents at SoundExchange to be the sole guardian of the newly established "hen house" of digital royalties.

2. Direct Payment of Artists' 45 percent of Webcasting Royalties through the DMCA

The language of the Digital Millennium Copyright Act needs clarification to ensure artists are paid their royalties directly.

The Problem:

As it stands now, some parties believe the DMCA language states that the entire 100 percent of any webcasting royalty should be paid first to the copyright owner

(usually the label) who is then required to pay 45 percent to the performer and 5 percent to the unions.

Other parties suggest that ambiguity in the language of the DMCA implies that artists should be paid their 45 percent directly.

The Solution:

To eliminate further confusion and to guard the artists' right to their 45 percent share of the webcasting royalty, the FMC proposes an amendment to the Digital Millennium Copyright Act (DMCA). Modeled after the so-called writers' share paid by ASCAP, BMI and SESAC, the FMC amendment would establish that recording artists be paid directly their 45 percent share of all Digital Performance Royalties for Sound Recordings (DPRSR). The FMC believes that this is the first step in acknowledging recording artists as stakeholders in the use of music on the Internet.

Why should this be done?

As it stands the digital webcasting royalties are set to be administered exclusively by SoundExchange, a partisan collective created by the labels. Recently SoundExchange offered to pay the artists their 45 percent share directly – but only for the first year.

The FMC believes this is a smoke screen of false generosity. It is hardly a foregone conclusion that the money is currently controllable by the labels. If the law was meant to state that the artists get paid their 45 percent directly in perpetuity, who are SoundExchange to offer the same deal for a diminished period of only one year?

What is at stake?

A. Fear of Cross Collateralization.

If these royalties go first to the copyright owner, the labels may then attempt to cross collateralize this new money against any of the artists' accumulated label debt. If royalties are diverted in this manner, the overwhelming majority of major label artists would not see any webcasting royalties whatsoever.

B. Fear of Obfuscation.

As it stands very few artists who work through the major label system pay off their "expenses" and earn royalties. Oftentimes those artists that do recoup only learn of that fact after auditing the label. It would be dangerous to subject webcasting royalties to the same non-transparent formula that already underserves musicians in the terrestrial world.

C. The Future is Interactive - we should plan for that now.

FMC believes that it is critical that the stakeholders work together to attempt to make these statutory licenses apply to both interactive and non-interactive web uses. Impending technological advances (Tivo, etc.) already allow for interactive uses of non-interactive streams on the back end. Thus it is fair to suggest that the future of music and all "innovative" business models will be interactive.

If we do not address the issue of a fair statutory rate for interactivity now, we run the risk of a future where only non-interactive and dated business models pay the fair 45 percent statutory rate to creators. While all other interactive and forward-thinking business models pay artists in a manner that is subject to the same nebulous contractual rate that pays artists far less.

Here it is important to remember that artists' contract royalty rate is not statutory, transparent nor is it public. Traditional contract royalties begin at a much smaller "11 -13 percent" and allow for that royalty amount to be further

diminished through a process of unfair deductions that are standardized within the industry.

To understand this royalty reduction, multiply an 11 percent royalty rate by 85 percent for a “free goods” deduction. Then multiply it by 75 percent for a “packaging” deduction. Then multiply it again by 75 percent for a “new media” deduction. After this process of deduction, an 11 percent royalty is effectively reduced to less than 6 percent.

Non-interactive webcasting royalties pay artists 45 percent. Interactive webcasting royalties are subject to contracts. They pay artists 6 percent. At a difference of 39 percentage points, clearly, artists stand to fare far better under a statutory rate than one that is contractual. Therefore FMC suggests that it would greatly benefit the majority of artists if the statutory rate were applied to both interactive and non-interactive webcasting licenses.

3. Support for Non-Commercial Speech in Broadcasting and on the Internet

In general, music is programmed for one of two reasons: to aggregate the largest possible audience in hopes of charging larger rates to advertisers (the commercial model) or because a piece of music is important enough that a broadcaster thinks it should be shared with its audience (the non-commercial model). Obviously, artists and consumers benefit from the widest number of possible outlets for their music.

Therefore, beyond taking a look at potentially illegal “pay for play” practices in commercial radio, or creating new community-based platforms like Low Power FM, there needs to be a means by which less expensive (or graduated) licenses can be granted to community based webcasters in the same manner that the performing rights organizations – BMI, ASCAP, SESAC – license community based terrestrial stations at a less expensive rate.

While it is critical that webcasters compensate creators for the value of their music, we should recognize the important contribution that community based stations make in exposing music fans to a broader variety of music.

Why is this important?

In order to webcast legally, a majority of independent Internet radio programmers have signed the Statutory Licensing Agreement and agreed to back pay royalties at the “statutory rate” from the date of that signature, once the rate is established.

It has been over two years since some of these webcasters have signed the agreement yet the rate is still undecided! There are obvious and grave concerns among independent and community based webcasters that they will be forced out of business on the day that they are presented with a back-dated bill that is beyond their means.

If this happens the FMC fears we will soon find the infinite space of the World Wide Web dominated by the same hit-driven, bottom-line mentality that currently dominates the finite terrestrial bandwidth and underserves the majority of musicians and consumers.

Consolidation of the Terrestrial Bandwidth

The commercial radio bandwidth is no friend to the majority of musicians, nor, for that matter, the majority of consumers. In 2001, the overwhelming consolidation of the commercial radio ownership has concentrated control of terrestrial radio into very few dominant hands.⁴ The predominance of super-duopolies (more than 7 radio stations in a market owned by one company) and the resulting drive to create additional super-duopolies, has resulted in reductive, consolidated, market-driven programming and far less bandwidth space for niche

⁴Lydia Polgreen, “The Death of Local Radio”, *Washington Monthly*, April 1999.

or independent broadcasting on the radio dial. Both of these factors have had a grave impact on the ability for musicians to get their music in front of a listening audience.

Concentration of radio playlists

Commercial radio playlists seem dominated by a “once-removed” process of independent radio promotion that requires overwhelming investment to place songs on commercial radio. If this is true, then over 80 percent of musicians who do not choose to release records through the major label system are effectively locked out of the publicly owned but commercially licensed airwaves. It would be a disservice to artists and consumers to see this same unfair structure replicated on the web through a process of prohibitively expensive webcasting and licensing fees.

4. "Automatic" License for Out-of-Print Recordings

Major labels commonly acknowledge that a majority of their back catalog is currently out of print. This phenomenon harms both musicians, who lose potential record sales, and consumers who find their variety of musical choices artificially diminished.

In order to address this problem, record contracts in some countries contain “reversion clauses” which allow for the return the copyright to the creator (musician) if a title has remained out of print for an established period of time. Reversion clauses frame the relationship between artist and label as an equal one where both sides have responsibilities and accountability.

In the United States there is no such reversion clause and, therefore, very little recourse for musicians who have signed away their copyrights to a label that is unwilling to keep those records in print.

In order to address this problem FMC is advocating for the creation of a compulsory or “automatic” license to enable musician signatories (or their heirs) the unquestionable legal right to license their back catalog sound recordings (at a fair statutory rate) from labels that have allowed these recordings to go out of print.

Copyright as Ante

It is standard industry practice to require musicians to sign away the rights to their copyrights in order to participate in the major label system. This means that ultimately musicians will have little to no control over the availability of their records for sale. Since mechanical royalties paid to artists from record sales make up a large portion of musicians’ income, it seems wholly unfair that they would have no recourse when their records are purposefully allowed to remain out of print.

Artists and Recoupment

Danny Goldberg of Artemis Records recently indicated that most major label artists need to sell more than 200,000 copies in order to pay back their debt to the label.⁵ However, according to Soundscan data, only 1 percent of records released in 1999 sold more than 10,000 copies,⁶ a number far short of Mr. Goldberg’s projection. Using these statistics we can assume that the overwhelming majority of major label musicians are in debt to their labels. Understanding that major labels routinely let artists’ material fall out of print, as noted above, there are even fewer opportunities for artists to recoup.

Napster’s Newest Fans

In the physical world, record store and warehouse shelf-space is finite and valuable but the virtual marketplace does not have the same physical limitations.

⁵ Danny Goldberg, “The Ballad of the Mid-Level Artist,” *Inside*, 2000, http://www.tonos.com/app1/connect/commentary/jsp/danny_goldberg_1.jsp

⁶ Segal, “They Sell Songs.”

The fastest growing demographic segment using Napster are adults over the age of 24. Research reports have confirmed that one of the major reasons that they are doing so is to access commercial recordings that are no longer commercially available. The FMC believes that allowing recording artists to make all of their recordings available to the public will lessen the public dependence on Napster, stimulate new record sales, and help achieve our goal of putting more money into the pockets of both recording artists and record labels.

Conclusion

Clearly, the music technology space is a difficult area for policy makers to negotiate, with evolving technologies and market forces shifting constantly. That being said, the Future of Music Coalition has identified four specific areas of concern that Congress should address:

1. Competition for collection and distribution of the digital royalty
2. Direct payment of the digital royalty to the artist
3. Fostering of non-commercial space on the radio and on the Internet
4. Ensuring artists to have the right to keep their recordings in print

We firmly believe these four major items will make a tremendous difference to the lives of artists nationwide, and we look forward to collaborating with other interested parties to help build the structure that will sustain a middle class of musicians in America.