

# Understanding the Music Industry's Changing Economy and Wall Street's Interest in Song Catalogs

By Christopher J. Cabott



In view of the global economy's current turbulence, music publishing has caught the eye of the financial world as an opportunity to acquire relatively certain long-term assets. The reason is simple. In most cases, well-known songwriters and their catalogs generate substantial income streams.

Further, subject to a few exceptions, a songwriter will receive those royalties for his or her life and his or her heirs will continue to receive those income streams for 70 years after the writer's death. Most traditional business assets do not produce this type of long-term, consistent income. It should therefore come as no surprise that articles keep reappearing in a variety of financial journals about Wall Street heading to Music Row to acquire song catalogs, despite the substantial decline of recording revenue. A discussion of the legal and business aspects of music publishing and the declining record industry follows.

Copyright law governs the music business. According to the Copyright Act, one owns a copyright in the original expression of a work of authorship that is fixed in a tangible form. This means that there are two copyrights in music. There is one copyright in an underlying original musical composition (a song – music and lyrics) and a second in the original recording of that song. One actually owns a copyright in an original song when he or she reduces it to paper (tangible form) and owns a copyright in an original recording of that song when he or she records it onto a cassette, recording software, etc. (tangible forms). These rights are not enforceable, however, until they are registered with the U.S. Copyright Office. As mentioned above, one owns a copyright for his or her life plus 70 years, unless the creation of the particular work was created as a “work made for hire.” In that case, the employer or party commissioning the work is considered the author and copyright owner, for the lesser of 95 years from the date of the work's first “publication” (public performance, commercial sale, etc.) or 120 years from the date the work was created. If two people collaborate to create a song or recording and it is not a “work made for hire,” they (and their respective heirs) jointly own the applicable copyright for the longer of the life of the last surviving author plus 70 years after his or her death.

Music publishing royalties are generated from the exploitation of songs, not recordings of those songs. Recordings produce separate income streams, which are discussed later in this article. Recording artists do not receive publishing royalties, unless they actually write or co-write the songs that they record.

There are six primary forms of music publishing royalties: mechanical license royalties, public performance royalties, synchronization license fees, copy license fees, compulsory license royalties and new-media royalties.

In order to manufacture and sell copies of a recording, the owner must receive a license from the owner of the copyright in the underlying song to manufacture the copies of the recording. This is called a mechanical license. The current mechanical license royalty is 9.1 cents or 1.75 cents per minute if the song is over 5 minutes. This royalty is paid – or supposed to be paid – to the owner of the copyright in the underlying song every time a unit of that particular recording is sold, whether it is sold in the form of a download, cassette, CD, etc. This payment formula is known as the “statutory rate” because a “Copyright Tribunal” enacted pursuant to the Copyright Act determines the rate. These small payments might not seem like much, but they are substantial when multiplied by sales of 1 million units – the benchmark for a “platinum” download or album.

Songwriters receive public performance royalties anytime their song is performed publicly on any type of radio, in a restaurant, at an arena, on television, etc. The amount of public performance royalties paid is based on the length of time the recording of the song was played and how it was featured (e.g. background music, lead song, etc.) Performing Rights Organizations (PROs) collect public performance royalties. The PROs in the United States are the American Society of Composers, Authors and Publishers (ASCAP), Broadcast Music, Inc. (BMI) and Society of European



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Stage Authors and Composers (SESAC). These American affiliates work with foreign PROs, such as SOCAN (Canada) and JASRAC (Japan) to help collect public performance royalties in foreign countries as well. One-half of all public performance royalties are paid to the owner of the “writer share” and the other half is paid to the owner of the “publisher share.” If a songwriter is the sole author of a song and has not entered into an agreement with a music publisher, by default, he or she owns both shares in full.

In order to synchronize a recording to a visual picture (e.g. a film, television show, commercial, video game, etc.), the producer of the visual must receive permission from the owner of the copyright in the underlying song. The consideration for such permission (license) is a synchronization license fee, which is usually a one-time, flat-fee payment. Synchronization fees range from de minimus compensation to five- or six-figure payments, depending on the song’s popularity.

When copies of a song are manufactured as sheet music, the owners of the copyright in the song are entitled to a licensing fee. Copy license fees range from 7 cents to 15 cents per manufactured page of sheet music, depending on the demand for the song.

Compulsory license royalties are a form of mechanical royalties. According to the Copyright Act, once a song is published, the owners of the copyright in the song cannot prevent a recording artist from later performing a “cover version” of that same song, e.g. Alien Ant Farm’s version of “Smooth Criminal” of Michael Jackson fame. The Copyright Act requires that the recording artist or record label releasing the cover tune pay the owner of the copyright in the song the same 9.1 cents mechanical license royalty per unit embodied in the recording; however, this time the owner of the “cover” recording is required to pay the royalty per unit manufactured regardless of whether or not that unit sells. For example, if the record company wants to manufacture 10,000 CDs of the cover tune it has to pay the owner of the copyright in the song \$910 (10,000 x 9.1 cents) upfront. The Harry Fox Agency collects and administers compulsory license royalties for songwriters and music publishers.

New media licensing is the catchall for new forms of song exploitations such as ringtones, ringbacks, online lyric reprints, etc. The copyright owner in the song will negotiate a licensing fee arrangement directly with the cell phone company or Web site provider. The structures of these payments vary. Sometimes, they are one-time payments. Other times, they are paid as royalties for each use of the song. The Copyright Office recently enacted a mechanical royalty of 24 cents for “master tones.” A “master tone” is a portion of a pre-existing full-length recording of a song that plays on a cellular phone every time it rings. Practitioners should also note that there is a royalty rate of 10.5 percent of the revenues earned

from interactive audio streaming (e.g. on-demand music videos available for play online) and limited downloads (services where musical content is downloaded for use, view and/or listening for a limited period of time), less the applicable public performance royalties discussed above.

All of the above income streams are split between or among the owners of the copyrights in the applicable song(s), which are usually – but not always – the original songwriters. The Copyright Act does not govern the “split” percentages. The original co-writers determine them. Examples of “splits” between two co-writers might be 50-50, 60-40 or 90-10. These percentages hinge on how much each writer thinks he or she contributed to the overall song. Practitioners should encourage their clients to put the splits in writing before leaving a creative session to assure that they receive their appropriate percentage of publishing royalties. If splits are not recorded, the PROs, record companies paying the mechanical royalties, Harry Fox Agency and any other party with the responsibility of paying any of the above income streams can hold the applicable payments in an interest-bearing account until such time as the splits are determined. Split oversights happen more often than one might think, which is unfortunate because such errors prevent talented people from getting paid.

At first blush, one might wonder why the record industry and record labels have suffered substantial losses in the Internet downloading era if hit songs produce such long-term, substantial assets. This is a logical thought, but remember there are two copyrights in music; one in the underlying song and one in the recording of that song. Record companies make money by exploiting the copyright in the sound recording, i.e. selling records, CDs, downloads, etc. In the days of \$18.98 or \$15.99 CDs, profits soared on “platinum” albums. Things are much different today. Legal downloads at 99 cents do not produce the same returns even at the “platinum” level and the evil twin illegal downloads do not produce . . . well anything, except job loss.

A lesser-known truth about record labels and sound recording copyright owners is that they currently do not receive compensation when the recording that they own plays on terrestrial radio or television (although there is legislation before Congress to afford such a right). That is correct. Neither Madonna nor the record la-

bels who own her recordings receive a public performance royalty when her recordings play on terrestrial radio stations like 102.1, 93.7 or 95.7, or appear on NBC, ABC or CBS television. The recording copyright owners do receive a public performance royalty when the recordings play on satellite, digital and Internet radio, and Music Choice (the audio-only music channels at the end of the cable television dial), but that did not happen until recently courtesy of the Digital Performance Sound Recordings Act (1995) and Digital Millennium Copyright Act (1998). Further, play on these channels is not as prevalent as terrestrial play and, as a result, generates substantially less revenue.

The following is an illustration of how the dual copyrights generate income and why financial firms are now seeking to acquire song catalogs as a source of long-term assets.

Jan, age 30, writes a four-minute song titled “I Love Law” on a traditional (non-work for hire) basis for Jon, age 24, who is signed to Philly Lawyer Records (PLR), which owns the copyright to his recording of the song according to his record deal. PLR releases “I Love Law” digitally on iTunes so it does not incur packaging and manufacturing costs for CD pressings. “I Love Law” is a hit single and sells a total of 1 million downloads on iTunes during the first year after its release. The song also receives a great deal of terrestrial radio play and some play on satellite radio. Due to the success of the single, Best Buy also offers \$100,000 to be divided equally between Jan and PLR to clear the song and recording for use (synchronization) in an upcoming television commercial. Let’s examine the income breakdown.

Under the typical 99 cents iTunes scenario, PLR will receive roughly 70 cents after Apple receives its share. PLR then has to pay Jan the 9.1 cents mechanical royalty, leaving roughly 61 cents. If Jon and the producer of the recording receive a royalty of 11 cents between them for artist and producer royalties, with 8 cents going to Jan (totaling \$80,000 – 1,000,000 x 8 cents) and 3 cents going to the producer (totaling \$30,000 – 1,000,000 x 3 cents), which is a common split for beginning artists and producers, PLR is left with a profit of 50 cents per download. If the song reaches platinum status, the profit equals \$500,000 (1,000,000 x 50 cents). PLR does not receive any performance royalties from the terrestrial radio play, but the label does receive about \$10,000 from SoundExchange, which is the PRO for satellite, digital, Internet and

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cable public performance of sound recordings. The clearance of the recording for featured use in the Best Buy commercial (commonly known as a “master-use clearance”) generates \$50,000. Unfortunately, PLR does not receive any public performance income when the commercial airs on television. As the years go by “I Love Law” continues to play on “Hits of the 2000s” terrestrial radio stations, but not so much on the trendier digital, cable, satellite and Internet outlets. Like most recordings, the sales of “I Love Law” reduce drastically shortly after its release. Only 1,000 downloads of the recording sell in its second year, which generates a total of \$500 (1,000 x 50 cents), with no more sales thereafter. In total, PLR has earned about \$560,500 from “I Love Law.”

On Jan’s side – the sole owner of the copyright in the underlying song – she receives \$91,000 from the first year’s downloads of “I Love Law” (1,000,000 x 9.1 cents), \$50,000 from Best Buy for the synchronization license fee, \$135,000 from ASCAP – her PRO – for the public performance of the song (\$120,000 for all types of radio play, and \$15,000 for the television broadcast of the Best Buy commercial). Jan earns roughly \$276,000 during the first year after PRL releases “I Love Law.” In the second year, she earns \$91 in mechanical royalties (1,000 downloads x 9.1 cents), receives \$60,000 from ASCAP (\$60,000 from radio play and \$0 from television broadcasts, as the Best Buy commercial only ran for 13 weeks during the first year and has not run since). Jan earns \$60,091 for the second year. Her income for the two years totals about \$336,091. As mentioned earlier, in the years that follow, “I Love Law” plays on “Best of . . .” terrestrial radio stations. This decreased, but consistent airplay generates \$15,000 in public performance royalties annually.

Unfortunately, Jan died at the young age of 62 – 32 years after the release of “I Love Law.” During her final 30 years, when the song generated \$15,000 a year, she earned \$450,000. Her total income during life from “I Love Law” was \$786,091. If the song continues to do the same \$15,000 a year during the remaining 70 years of the copyright’s existence – which hit songs can do – her heirs will receive an additional \$1,050,000. Under the foregoing fact pattern, “I Love Law” – the song, not the recording – will earn approximately \$1,836,091 for the life of its copyright. During the same period, the copyright in the sound recording will earn only \$560,000.

In view of the above, it should come at no surprise as to why record labels have nose-dived and Wall Street is pacing on Music Row. The best advice you can offer your songwriter clients is to not give away their publishing ownership or income. They will thank you for this advice . . . and so will their heirs. The record labels will be envious and Wall Street will come “a knocking.” ■

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