REBUTTAL COMMENTS TO COPYRIGHT OFFICE MUSIC LICENSING STUDY

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I was a member of the Sound Recording Panel at the Copyright Office Music Licensing Study Public Roundtable, held in New York on June 23, 2014. These Rebuttal Comments are intended to supplement my comments on that roundtable.

Personal History

I am a Principal at RZO, LLC, a full-service business management firm that handles the business affairs of featured recording artists. My particular expertise is royalties, which is how featured recording artists get compensated from record companies. This entails, among other things, conducting royalty audits of record companies and music publishers on behalf of our clients, who are some of the most famous recording artists and songwriters in the world.

I am also an Artist Representative on the SoundExchange Board of Directors, which is comprised of 9 record company and 9 recording artist representatives. However, these comments are not intended to express the positions of SoundExchange, who have submitted their own comments to the Copyright Office. This submission is only intended to reflect the viewpoint of my clients, featured recording artists.

Since I have been at RZO, we have recovered over $50 Million in royalties for our clients, with approximately 80% recovered from the major record companies and 20% recovered from major music publishers. Our clients are only a tiny sliver of the industry, representing less than one-half of 1% of record industry revenues. This gives you an idea of just how much recording artist royalties are being underpaid by the major record companies. Extrapolating our royalty audit recoveries to all artists on major record labels would mean that featured recording artists were underpaid royalties well in excess of $8 Billion (with a "B") over the past 19 years. This comes to over $420 Million in royalty underpayments per year! I will get to how this is relevant to Section 114 in a minute.

Effectiveness of Section 112 & 114 statutory licenses

There is no practical reason that Section 112 license income should not be remitted to Sound Exchange so that recording artists receive 50% of this income directly. 100% of Section 112 income is paid to record companies, who are required to account a share to artists as "licensing income". However, this is not being done by the majority of the major record companies.

Distinction between interactive and non-interactive services

If you had to pick one item in Copyright Reform that is most important to recording artists, it would be to erase the arbitrary distinction between interactive and non-interactive services. The features found in interactive and non-interactive services run the length of the spectrum, and a true dividing line is impossible to discern.

If all digital licenses were statutory and came under Section 114, SoundExchange would administer all digital licensing income. This would be the most efficient and transparent way for featured recording artists to get paid their fair share of royalties. As detailed herein, payment of artist royalties via major label royalty systems is the least accurate and least transparent way for artists to receive their proper share of income from digital licensing.

I understand the need for higher rates being charged for interactive services, but this should be determined by the CRB rate-setting procedures, not by direct negotiation between the major record labels and licensees. This is extremely crucial to recording artists for the following reasons:

The major labels are only contractually required to pay artist royalties on income received for specific sound recordings. Royalties are generally not paid to artists on income that is not "attributable" to specific sound recordings.

Based on this premise, the major record companies have become experts at obtaining billions of dollars (again, with a "B") in non-attributable income from digital music companies, outside of the comparatively minor amounts of digital royalties paid by these companies for specific sound recordings. If a digital music company pays a record company $10 Million in non-recoupable fees, the royalties paid for actual sound recordings will necessarily be lower than if separate fees were not paid to the record company.

One of the reasons these separate payments are not well-known is because everything is done in secret. Digital music companies cannot obtain the necessary licenses from major record companies without signing strict confidentiality agreements. This prevents anyone but insiders from knowing the details of each deal. Making interactive licensing part of Section 114 is the only way to bring sorely needed transparency to the digital music industry, and ensure that recording artists receive their due.

Some details of these deals eventually do leak out and are reported in the press. The amount of income and equity obtained by the major record companies outside of the royalties paid for the use of specific sound recordings is staggering! It has been reported that the major labels have received, or are receiving:

- Minimum annual guarantees by year and by territory, far in excess of what is expected to be earned in royalties. Even if the advances are recouped in some countries and years, they are not likely to recoup in every territory, every year. This leads to windfalls for the major labels, as these excess payments are not shared with recording artists.
- Spotify alone is reported to have paid hundreds of millions in dollars in upfront and non-recoupable payments for the privilege of licensing major label catalogues...and there are dozens of other companies who are doing this on a smaller scale.
- Listener hour guarantees are paid to the major labels that are not attributable to any specific recordings.
- Many deals are not done unless the major labels receive a share of equity in the licensee, which also lowers the royalty rates paid for specific recordings, sometimes down to zero. One major label reportedly made over $40 million from its stake in Musicmaker, receiving a 50% share of the company in exchange for licensing its catalogue. The major record companies reportedly received equity stakes in YouTube literally hours before it was announced that Google was buying YouTube. This resulted in tens, if not hundreds, of millions of dollars in immediate gains. Artists received nothing from either of these deals, and there are dozens more like it.
- One deal had music pre-licensed for inclusion with the sale of mobile phones. When predetermined sales levels were not achieved, the major record company received several millions of dollars in additional guaranteed fees, but artists were only paid royalties on the actual mobile phone sales, not the subsequent payments received for guaranteed sales.
- Technical set-up fees are also received by major record companies for providing licensees with digital music files. These payments are directly attributable to specific sound recordings, but the payments are not shared with artists.

The major record companies have received billions of dollars in payments and equity from digital music providers in secret, and the vast majority of it is not shared with artists, whose works comprise the catalogues the major labels use to extract this value from licensees. Furthermore, digital royalty rates are artificially suppressed when consideration is received by the major record companies in other forms.

Under Section 114, 50% of non-interactive digital licensing income is paid directly to artists and 50% is paid to record companies. Including interactive digital licensing income within the mandates of Section 114 is the only way for artists to receive their fair share. The major labels argue that they would not be able sustain their business if they had to pay 50% of interactive licensing income to artists. However, Spotify pays 70% of revenues to rights owners for content. Pandora pays over 60% of their revenues to rights owners for content. Major record companies can surely afford to pay 50% of their revenues to recording artists for content that is essential to their business. They just do not want to, and directly licensing interactive digital rights is how they get around it.

The eventual winners and losers in the digital music industry should not be decided by who has the deepest pockets, and who is willing to give the most income and equity to major record companies to license their catalogues. Winners and losers in the digital music sphere should be decided by who best satisfies the consumers of digital music, not by who can satisfy the demands of rights owners.

Recording artists should directly receive 50% of the value received from the licensing of their recordings. Expanding Section 114 to include all digital licensing, interactive and non-interactive, is the only way that recording artists can be assured of receiving their fair share.

I audit major record companies on behalf of featured recording artists for a living, and even basic requests for supporting information on digital licensing income are routinely denied. There is absolutely no transparency in how the major record companies account to artists for interactive digital licensing income, and it is rife with abuse. The only way recording artists can be assured of a completely transparent accounting of digital licensing income is by Section 114 covering both interactive and non-interactive digital licenses.