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The Impact of Technology on Pre-Digital Recording Agreements: An Examination of F.B. T. Productions, LLC v. Aftermath Records

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THE IMPACT OF TECHNOLOGY ON PRE-DIGITAL RECORDING AGREEMENTS: AN EXAMINATION OF F.B.T. PRODUCTIONS, LLC v. AFTERMATH RECORDS

I. INTRODUCTION ................................................................. 347

II. A HISTORICAL VIEW OF THE MUSIC INDUSTRY ................... 350
    A. The Emergence of the Music Industry as We Conceive of It Today .............. 350
    B. The Nature of Recording Agreements ........................................ 350
    C. New Technology and the Traditional Business Model .......................... 351

III. CONTRACT INTERPRETATION AND THE RISE OF TECHNOLOGY ........ 354

IV. F.B.T. PRODUCTIONS, LLC v. AFTERMATH RECORDS .................. 355
    A. Background ............................................................... 355
    B. The Legal Dispute ..................................................... 357
    C. The Ninth Circuit's Analysis ........................................... 360
       1. Interpretation and Application of the Term "Notwithstanding" ................. 360
       2. Interpretation and Application of the Term "Licensed" .......................... 361
       3. Interpretation and Application of the Term "Masters" ........................... 362

V. THE MUSIC INDUSTRY AFTER F.B.T. PRODUCTIONS, LLC v. AFTERMATH RECORDS ......................................................... 362
    A. Similar Litigation Regarding Royalty Disputes .............................. 363
    B. Inadequacies of the Traditional Business Model as a Result of New Technology .......................................................... 366
       1. Manufacturing Costs ................................................. 367
       2. The Risks of Signing New Artists ..................................... 368
    C. The Sales vs. License Distinction ..................................... 369

VI. CONCLUSION ................................................................. 370

I. INTRODUCTION

In recent years, the best-selling CD in the United States has been a blank, recordable one.¹ Since 2000, revenue generated from CD sales has declined by over fifty percent.² While the music industry is thriving, record labels

are struggling to keep afloat. In 2010, digital music revenues grew by an estimated six percent globally to $4.6 billion, accounting for twenty-nine percent of record companies’ trade revenues. While there has been spectacular growth in digital revenues, up more than one thousand percent in seven years, the value of the entire recorded music industry has declined by thirty-one percent. For record labels that have long relied on record sales as a primary source of revenue, these trends have been devastating.

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3 See, e.g., Peter Kafka, Music Sales Still Going, Going . . . ., ALL THINGS DIGITAL (Feb. 8, 2011, 4:42 AM), http://mediamemo.allthingsd.com/20110208/music-sales-still-going-going/ ("More than a decade after the Napster era, the music business is still declining: Warner Music Group’s sales dropped 14 percent in the last three months of 2010. And digital revenue, via Apple’s iTunes and the mobile business, is sputtering too. It was up just 1.6 percent, and down 5 percent from the previous quarter.").


Record labels have resisted rather than embraced technological advancements, and, as a result, the role of record labels in the production, manufacturing, and distribution of albums has been minimized.\(^7\) Record labels and manufacturers no longer maintain control over the distribution of music.\(^8\) It has been taken out of the hands of record labels and placed into the hands of consumers.\(^9\) The ability to record and distribute music through the use of computers has fundamentally changed the business model and the relationships between artists and record labels.

Record labels are experiencing a "tectonic shift in the business model."\(^10\) Technological advancements have provided artists with an alternative to signing with the "major labels." Record labels are, therefore, making less profit from fewer bands, singers, and musicians than before.\(^11\) These alternatives, coupled with recent interpretations of pre-internet record contracts,\(^12\) signal the end of a music industry dominated by major record labels. While the recording industry as we know it is coming to an end, the future of the music industry is brighter than ever.\(^13\)

This Note examines the impact of digital technology on pre-digital recording agreements. Part II discusses the history of the music industry with an emphasis on the changes of intermediaries over time. Part II.B. and C. examine the impact of technology on the traditional business model as well the historical trends that occur as a result of the introduction of new technology. Part III discusses basic principles of contract interpretation. The recent Ninth Circuit case, *F.B.T. Productions, LLC v. Aftermath Records*, is discussed in Part IV. This case highlights the difficulties that arise when recording contracts do not contain language regarding new technology and the difficulties in determining which contract provisions control in those situations. Part V discusses the impact of the *Aftermath* decision with regards to other recording contracts entered into prior to the digital revolution. This Note concludes by noting the inadequacies of the

\(^7\) See Sara Karubian, 360° Deals: An Industry Reaction to the Devaluation of Recorded Music, 18 S. CAL. INTERDISC. L.J. 395, 398 (2006) ("The initial response of record labels to their deteriorating position . . . was to focus on maintaining the status quo in the traditional regime."); see also Gary Myers & George Howard, *The Future of Music: Reconfiguring Public Performance Rights*, 17 J. INTELL. PROP. L. 207, 218 (2010) (noting that the record labels "continue to cling to their old practices").


\(^10\) *Id. at* 10.


\(^12\) See F.B.T. Prods., LLC v. Aftermath Records, 621 F.3d 958 (9th Cir. 2010).

\(^13\) See KUSEK & LEONHARD, *supra* note 1, at 6.
traditional business model as a result of digital technology and suggests that the role of major record labels will be diminished as a result of market alternatives.

II. A HISTORICAL VIEW OF THE MUSIC INDUSTRY

A. The Emergence of the Music Industry as We Conceive of It Today

The early “music business was essentially [a] publishing business” whereby music publishers created and distributed sheet music.\(^{14}\) The widespread dissemination of music by radio broadcast changed the music industry and the role of music publishers.\(^{15}\) No longer was sheet music the product being sold. Instead, the focus shifted to finding individual performers “who could ‘sell’ the song.”\(^{16}\) The advent of piano rolls in 1911 signaled yet another change in the music industry. The music publishers no longer had exclusive control over the manufacture, distribution, and sale of music.\(^{17}\) Faced with being pushed out of the industry, music publishers turned to the courts.\(^{18}\) These developments in the early part of the twentieth century led to the emergence of the music industry as we conceive of it today.\(^{19}\)

B. The Nature of Recording Agreements

For many artists, securing a recording contract with a major record label is thought to be the first step to stardom.\(^{20}\) For this reason, artists are often eager to sign a recording contract, by which the artist transfers copyright ownership of his or her recordings to a record label.\(^{21}\) In exchange, the record label provides the artist with an advance payment in addition to a recording fund used to produce, manufacture, distribute, and market the album.\(^{22}\)

The recording agreement is the essential instrument of the recording industry.\(^{23}\) This instrument shapes the relationships between artists and record labels. The reality of the situation is that there are many more artists seeking

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\(^{14}\) Myers & Howard, supra note 7, at 210–11.
\(^{15}\) Id. at 211.
\(^{16}\) Id. at 212.
\(^{17}\) Id. at 214.
\(^{18}\) See White-Smith Music Publ’g Co. v. Apollo Co., 209 U.S. 1 (1908) (addressing the issue of whether a “mechanical reproduction” of a musical composition was an “unauthorized copy”).
\(^{19}\) Myers & Howard, supra note 7, at 210.
\(^{20}\) See generally Donald S. Passman, All You Need to Know About the Music Business (7th ed. 2009).
\(^{21}\) See id.
\(^{22}\) See id.
\(^{23}\) See id.
recording contracts than there are record labels seeking artists to sign. The unequal bargaining power between artists and record labels has enabled record labels to offer contracts on essentially a “take it or leave it” basis. These contracts often include harsh contract terms by which record companies maintained near-complete control while receiving a “lion’s share” of profits from record sales.

In recent years it has become well-known that “[r]ecord companies are not known for their benevolence to their signed recording artists.” The fact is that very few artists ever make it to superstardom and those who do rarely profit from their albums. New artists are often “surprised to learn that they will not ‘be living like a rockstar’” and that “[o]nly top-selling albums make money for recording artists.” While many artists believe that they will receive enough in royalties to sustain themselves for years, industry studies revealed that an estimated 99.6% of all recording artists are indebted to their record labels. Artists have long sued record labels out of discontent with their one-sided recording agreements; digital technology has only made these inequities more apparent.

**C. New Technology and the Traditional Business Model**

Technological advancements have precipitated many “power struggles” in the music industry in the past and continue to do so today.

Just about every new transformative technology was fought, tooth and nail, until it no longer could be contained, discredited, or sued out of existence, and only then it was reluctantly embraced, its providers acquired and controlled, then put to work to bring in the bacon.

...
Whether it was the radio in the 1920s, cassette recorders in the 1960s, or digital music in the 1990s, the industry reaction has always been the same—but the outcomes have almost always been the same, too.

... [P]ower shifts from the old technology towards the new transformative technologies ....

For the past fifty years, the "major labels" (currently Sony/BMG, Warner Music Group, EMI, and Universal) have generated the majority of their revenue from physical album sales. The business model has therefore been focused primarily on selling records through physical distribution. Under the traditional business model, "recorded music is placed onto a compact disc, tape, or vinyl record; the physical components, such as jewel cases and paper inserts, are manufactured; the record is distributed to retail and specialty stores; and finally, the major label advertises, promotes, and markets the album."35

Most recording agreements entered into prior to the year 2000 reflected the record labels' "presumption that a majority of their revenues would come from physical sales," thus "requiring only marginal royalty payments to artists[.]"36 The Internet has changed the cultural landscape in a way that is inconsistent with the traditional business model.37 The shift to a digital distribution system that "relies far more on licensing than sales—requiring higher royalty

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31 KUSEK & LEONHARD, supra note 1, at 140–41.
32 EMI was seized by Citigroup on February 1, 2011, restructuring EMI by reducing its debt sixty-five percent, to 1.2 billion pounds from 3.4 billion pounds. See Andrew Ross Sorkin, Citigroup Takes Over EMI, DEALBOOK (Feb. 1, 2011, 12:31 PM), http://dealbook.nytimes.com/2011/02/01/citigroup-takes-over-emi/.
33 Myers & Howard, supra note 7, at 217.
34 See generally Schott, supra note 8, at 74.
35 Id.
36 Brief Amicus Curiae of the Motown Alumni Association at 13, F.B.T. Prods., LLC v. Aftermath Records, 621 F.3d 958 (9th Cir. 2010).

Columbia is stuck in the dark ages. I have great confidence that we will have the best record company in the industry, but the reality is, in today's world, we might have the best dinosaur. Until a new model is agreed upon and rolling, we can be the best at the existing paradigm, but until the paradigm shifts, it's going to be a declining business. This model is done.

Id.
payments to artists under longstanding contracts,” left record labels “unprepared” and “undercapitalized.”

As seen throughout legal history, “[w]hen new music technologies and media emerge, content distributors, including record labels, have often sought to take advantage of these situations to use creators' works without additional compensation.” Every time a new technology hits the music industry, there are predictable patterns that take place:

[1] The record companies scramble to see what their contracts say about these devices. Since they didn’t exist when the deal was made, the contract either doesn’t deal with them at all, or if it does, it usually pays a royalty that proves to be wrong now that the fantasy is a reality. [2] Because the technology is so new, no one (including the record [labels]) really understands its economics. Also, when it’s first introduced, the thing is expensive, because it’s a small market. [3] The result is a grace period during which royalties on these newbies are not particularly favorable to the artist. This is to give the technology a chance to get off the ground, and to help the record [label] justify the financial risk. [4] Invariably, this grace period goes on far beyond its economic life, during which time the [labels] make disproportionate profits and the artist gets a smaller portion of them than he or she gets on the dominant technology. [5] As artist deals expire or are renegotiated, the rate goes up. [6] Finally, an industry pattern develops and royalty rates stabilize.

The response of record labels to digital downloading capabilities demonstrates that history has repeated itself once again. The story unfolded exactly as predicted. After strong resistance, Apple CEO, Steve Jobs, successfully negotiated a contract with the major record labels. Under the terms of the original iTunes agreement, iTunes was to receive thirty-five percent of revenue from each download. The remaining sixty-five percent would be paid to the record labels. Although it was assumed by the record labels that the economics of the

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38 Brief Amicus Curiae of the Motown Alumni Association, supra note 36.
39 Id. (citing N. Y. Times Co. v. Tasini, 533 U.S. 483 (2001)).
40 PASSMAN, supra note 20, at 162–63.
42 Id.
43 Id.
transaction was identical to that of the traditional distributor/retail licensee,\textsuperscript{44} artists soon began questioning this arrangement.\textsuperscript{45}

III. CONTRACT INTERPRETATION AND THE RISE OF TECHNOLOGY

Technological developments have presented difficulties in construing meaning of terms embodied in recording agreements. Courts have encountered new use problems in the past with the development of motion pictures,\textsuperscript{46} television,\textsuperscript{47} and videocassettes.\textsuperscript{48} In more recent years, new use issues have come to the forefront once again. Courts have been tasked with determining whether the provisions in older recording agreements include delivery by digital means that were not yet developed at the time the contract was entered into.

When deciding questions of contract interpretation, the primary function of courts is to ascertain the intention of the parties.\textsuperscript{49} In these disputes, courts traditionally have looked to see if there is "any indicia of a mutual general intent to apportion right to new uses."\textsuperscript{50} Such intent can be discerned from the language of the contract, the surrounding circumstances, industry custom, and subsequent conduct of the parties.\textsuperscript{51} If the recording agreement makes explicit reference to new uses, the plain language of the agreement controls.\textsuperscript{52} When the agreement does contain language regarding the ultimate issue, it is well-established that a contract will be found to be ambiguous only if it is reasonably and fairly susceptible of different constructions, not simply because two parties urge opposing interpretations.\textsuperscript{53}

\textsuperscript{44} Id.
\textsuperscript{45} See infra Part IV.A.
\textsuperscript{46} See Kirke La Shelle Co. v. Paul Armstrong Co., 188 N.E. 163 (N.Y. 1933) (noting that "talkie" (motion picture) rights were unknown at the time of the contract and were therefore not within the contemplation of the parties).
\textsuperscript{47} See Landon v. Twentieth Century-Fox Film Corp., 384 F. Supp. 450 (S.D.N.Y. 1974) (holding that television was a foreseeable "new use").
\textsuperscript{48} See Boosey & Hawkes Music Publishers, Ltd. v. Walt Disney Co., 145 F.3d 481 (2d Cir. 1998) (holding that "the right ‘to record [the composition] in any manner, medium or form’ for use ‘in [a] motion picture[ ]’" was broad enough to include the distribution of motion pictures in video format). But see Rey v. Lafferty, 990 F.2d 1379 (1st Cir. 1993) (holding that license for television viewing did not extend to videocassette release).
\textsuperscript{49} 6 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF CORPORATIONS § 2585.10 (2011).
\textsuperscript{51} Id.
\textsuperscript{52} FLETCHER, supra note 49.
\textsuperscript{53} Id.
IV. F.B.T. PRODUCTIONS, LLC v. AFTERMATH RECORDS

Under a standard recording agreement, artists “receive royalties from both [record] sales and licenses of recorded music.”54 This distinction is important because the royalty rate received by artists for record sales is generally between ten to twenty percent of the Standard Retail List Price (“SRLP”), whereas the royalty rate for licenses is typically fifty percent.55

A. Background

In 1995, F.B.T. Productions, LLC, signed American rapper, record producer, and actor, Eminem, to an exclusive recording deal.56 On March 9, 1998, F.B.T. Productions entered into an agreement (“1998 Agreement”) with Aftermath Records under which F.B.T. Productions transferred its exclusive rights in Eminem’s services to Aftermath Records in exchange for royalty payments.57 The 1998 Agreement contained two different royalty provisions.58 The first royalty provision of the 1998 Agreement, the “Records Sold” provision, provided that F.B.T. Productions is to receive between twelve percent and twenty percent of the adjusted retail price of all “full-price records sold in the United States” through normal retail channels.59 The second royalty provision of the 1998 Agreement, the “Masters Licensed” provision provided that “[o]n masters licensed by us . . . to others for their manufacture and sale of records or for any other uses, your royalty shall be an amount equal to fifty percent (50%) of our net receipts from the sale of those records or from other uses of the masters.”60

In 2000, the parties to the 1998 Agreement entered into a novation (“2000 Novation”) that established a direct contractual agreement between Eminem and Aftermath Records.61 Under the 2000 Novation, F.B.T. Productions became a “passive income participant.”62 In 2003, Aftermath Records and Eminem entered into a new recording contract (“2003 Agreement”) terminating

55 Id.
57 Id.
58 Id.
59 Id. (citing the 1998 Agreement).
60 Id.
61 A novation is defined as “[t]he act of substituting for an old obligation a new one that either replaces an existing obligation with a new obligation or replaces an original party with a new party.” BLACK’S LAW DICTIONARY 1168 (9th ed. 2009).
63 Id. (citing the 2000 Novation).
the 1998 Agreement.\textsuperscript{64} This agreement included an increased advance and higher royalty payments.\textsuperscript{65} The 2003 Agreement, like the 1998 Agreement, set forth two different royalty provisions.\textsuperscript{66}

In 2004, the parties entered into the 2004 Agreement ("2004 Agreement").\textsuperscript{67} This agreement altered the 2003 Agreement "to increase the advance for an upcoming LP, the fraction of [F.B.T. Production's] passive income participation, and certain royalty rates."\textsuperscript{68} The 2004 Agreement also was amended to provide that "Sales of Albums by way of permanent download shall be treated as [U.S. Normal Retail Channel] Net Sales for the purposes of escalations . . ."\textsuperscript{69}

Since approximately 2001, Aftermath Records has entered into third-party agreements by which third-party entities are granted the rights to distribute music to consumers over the Internet in various forms, including permanent downloads.\textsuperscript{70} A permanent download is a "digital cop[y] of [a] recording[] that, once downloaded over the Internet, remain[s] on an end-user’s computer or iPod indefinitely."\textsuperscript{71} In 2002, Aftermath Records, through its parent company, "concluded an agreement with Apple Computer, Inc., that enabled sound recordings, including the Eminem masters, to be sold through Apple’s iTunes store as permanent downloads."\textsuperscript{72}

In approximately 2003, Aftermath Records began entering into third-party agreements with cellular telephone network carriers such as Nextel, Sprint, T-Mobile, and Cingular to provide Eminem’s recordings for use on mobile phones as "mastertones."\textsuperscript{73} A "mastertone" refers to a short clip of a song downloaded on a purchaser’s cell phone that is used as a ringtone.\textsuperscript{74} A "mastertone" also can refer to the music a caller hears, in place of a traditional ring, when calling the cell phone of an individual who purchased a mastertone.\textsuperscript{75} When used in this manner, the mastertone is stored on a central server and "streamed" to the caller, in contrast to a permanent download.\textsuperscript{76}

\begin{thebibliography}{99}
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\bibitem{Id. at *2.}
\bibitem{Id.}
\bibitem{Id.}
\bibitem{Id.}
\bibitem{Aftermath, 2009 WL 137021, at *2.}
\bibitem{Id.}
\bibitem{Id.}
\bibitem{Id.}
\end{thebibliography}
B. The Legal Dispute

In 2005, Eminem and F.B.T. Productions hired an accounting firm to audit Aftermath Record's accounting records. The audit revealed that Aftermath Records was paying the "Records Sold" royalty rate for music downloads and mastertones instead of the "Masters Licensed" royalty rate.

In 2007, F.B.T. Productions brought suit against Aftermath Records for breach of contract and asked for a declaratory judgment based on the royalty rate used by Aftermath Records in calculating royalties owed to F.B.T. Productions. F.B.T. Productions asserted that it was entitled to fifty percent royalties under the "Masters Licensed" provision because the music downloads and mastertones were "masters licensed by [Aftermath Records] . . . to others for their manufacture and sale of records or for any other uses . . ." Aftermath Records disagreed with the position taken by F.B.T. Productions and argued that royalty payments for the music downloads and ringtones were to be calculated under the "Records Sold" provision of the agreements.

In *F.B.T. Productions, LLC v. Aftermath Records*, the court was confronted with the issue of "whether the contracts' 'Records Sold' provision or 'Masters Licensed' provision sets the royalty rate for sales of Eminem's records in the form of permanent downloads and mastertones." Prior to trial, F.B.T. Productions moved for summary judgment, asserting that "the Eminem Agreements unambiguously require[d] [Aftermath Records] to account for royalties on permanent downloads and mastertones under the 'Masters Licensed' provision." Aftermath Records cross-moved for summary judgment, arguing that the "'Records Sold' provision unambiguously applie[d] to permanent downloads and mastertones . . ."

In evaluating both parties' motions for summary judgment, the court noted the following:

Under California law, when the meaning of the words in a contract is disputed, the Court must provisionally consider all extrinsic evidence that is relevant to show whether the contractual language is reasonably susceptible to either of the competing in-

77 Id.
78 Id.
79 Id.
80 Id. at *4.
81 Id. at *7.
83 *Aftermath*, 2009 WL 137021, at *3.
84 Id. at *7.
interpretations advanced by the parties. This is the case even if the contract appears unambiguous on its face, because "the fact that the terms of an instrument appear clear to a judge does not preclude the possibility that the parties chose the language of the instrument to express different terms." "Extrinsic evidence can include the surrounding circumstances under which the parties negotiated or entered into the contract; the object, nature and subject matter of the contract; and the subsequent conduct of the parties." Whether a contract is ambiguous is a matter of law. If the Court determines that the contractual provision in question is ambiguous, summary judgment is inappropriate because the differing views of the parties' intent will raise genuine issues of material fact. Summary judgment is appropriate only if the contract is unambiguous. 85

Applying the correct legal standard, the court held that "[t]he Eminem Agreements do not expressly state whether royalties on permanent downloads and mastertones are to be calculated under the Records Sold provision or the Masters Licensed Provision." 86 The court further pointed out that "neither Plaintiffs nor Defendants have submitted evidence of the negotiating parties' discussions, drafts, or other contemporaneous expressions of intent as to how permanent downloads and mastertones were to be treated under the Agreements." 87 For this reason, the court found it necessary to "look to the nature of the contract and the surrounding circumstances to interpret the contractual language." 88 Because the parties' conflicting evidence created a triable issue of fact, the district court denied both motions and the case was submitted to the jury for determination. 89 The court instructed the jury as follows:

COURT'S INSTRUCTION NUMBER 28

... All of the recording agreements and amendments, which are part of the same transaction, must be interpreted together. If there are any provisions in one of these documents limiting, explaining, or otherwise affecting the provisions of another, all these provisions should be given consideration in determining the agreement of the parties.

COURT'S INSTRUCTION NUMBER 29

85 Id. at *4.
86 Id.
87 Id.
88 Id. (citations omitted).
89 Id. at *8.
You should assume that the parties intended the words in their recording agreements to have their usual and ordinary meaning unless you decide that the parties intended the words to have a special meaning.

COURT'S INSTRUCTION NUMBER 30

In interpreting the recording agreements, you should assume that the parties intended words used in a technical sense to have the meaning that is usually given to them by people who work in the recording industry, unless you decide that the parties clearly used the words in a different sense.

COURT'S INSTRUCTION NUMBER 31

In deciding what the words of the recording agreements meant to the parties, you should consider the whole agreement, not just isolated parts. You should use each part to help you interpret the others, so that all the parts make sense when taken together.

COURT'S INSTRUCTION NUMBER 32

In deciding what the words in a recording agreement meant to the parties, you may consider how the parties acted after the recording agreement was created but before any disagreement between the parties arose.

Interpretation of the parties' conduct is not limited to their joint conduct, but may include any unilateral conduct of one party without knowledge of the other party. However, the unilateral conduct of one party is not conclusive evidence as to the meaning of the recording agreement.

COURT'S INSTRUCTION NUMBER 33

A contract must be interpreted to give effect to the agreement of the parties at the time of contracting. You must determine what the parties agreed to by the words used in the written recording agreements. What the parties agreed to is based on the words and acts of the parties and not on their thoughts or unstated intentions.  

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After being read the above instructions, the jury returned a verdict in favor of Aftermath Records. The jury concluded that F.B.T. Productions was not entitled to royalties under the “Masters Licensed” provisions of the agreements and that Aftermath Records should pay royalties for permanent downloads and mastertones under the contractual provisions that applied to the “Records Sold” provision.91

On appeal, F.B.T. Productions reasserted that the “Masters Licensed” provision unambiguously applied to permanent downloads and ringtones.92 The Ninth Circuit Court of Appeals “agree[d] that the contracts [were] unambiguous and that the district court should have granted summary judgment to F.B.T.”93 For this reason, the Ninth Circuit reversed the judgment of the district court.94 Aftermath Records requested a rehearing, which the Ninth Circuit Court of Appeals denied on October 21, 2010.95 On December 8, 2010, Aftermath Records filed a petition for certiorari with the United States Supreme Court.96

C. The Ninth Circuit’s Analysis

The case primarily concerned questions of contract law. The court began its discussion by noting that “[u]nder California law, ‘[t]he language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity.’”97 The court was not persuaded by Aftermath’s argument “that the Records Sold provision applied because permanent downloads and mastertones [were] records, and because iTunes and other digital music providers are normal retail channels in the United States.”98 Its decision ultimately came down to the meaning of three terms: “notwithstanding,” “masters,” and “licensed.”

1. Interpretation and Application of the Term “Notwithstanding”

In response to Aftermath’s assertion, the court pointed out that the agreements provided that “‘notwithstanding’ the Records Sold provision, F.B.T.

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92 F.B.T. Prods., LLC v. Aftermath Records, 621 F.3d 958, 961 (9th Cir. 2010).
93 Id.
94 Id.
95 F.B.T. Prods., LLC v. Aftermath Records, 621 F.3d 958 (9th Cir. 2010) (Nos. 09-55817, 09-56069).
97 Aftermath Records, 621 F.3d at 963 (quoting CAL. CIV. CODE § 1638 (West 1872)).
98 Id. at 964.
was to receive a 50% royalty on 'masters licensed by [Aftermath] . . . to others for their manufacture and sale of records or for any other uses.' 99 Based on this language, the court concluded that "[t]he parties' use of the word 'notwithstanding' plainly indicate[d] that even if a transaction arguably [fell] within the scope of the Records Sold provision, F.B.T. [would be entitled] to receive a 50% royalty if Aftermath license[d] an Eminem master to a third party for 'any' use." 100 For this reason, the court ultimately concluded that "the Masters Licensed provision explicitly applies to (1) masters (2) that are licensed to third parties for the manufacture of records 'or for any other uses,' (3) 'notwithstanding' the Record Sold provision. This provision is admittedly broad, but it is not unclear or ambiguous." 101

2. Interpretation and Application of the Term "Licensed"

To determine whether the "Masters Licensed" provision was applicable, the court first needed to determine whether Aftermath licensed the Eminem masters to third parties. 102 Although Aftermath's argument that "there was no evidence that it or F.B.T. Productions used the term 'licensed' in a technical sense," was consistent with California law, 103 the court concluded that the third party agreements were licenses even in the "ordinary" use of the term. 104

The court found federal copyright law to be relevant in determining the meaning of the term "license." The court recognized that "the differences between [the terms "sale" and "license"] play an important role in the overall structures and policies that govern artistic rights." 105 The court concluded that Aftermath did not "sell" anything to Apple or other third party download distributors: "[t]he download distributors did not obtain title to the digital files. The ownership of those files remained with Aftermath, Aftermath reserved the right to regain possession of the files at any time, and Aftermath obtained recurring benefits in the form of payments based on the volume of downloads." 106

99 Id.
100 Id.
101 Id.
102 Id.
103 Id.
104 "The words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning; unless used by the parties in a technical sense, or unless a special meaning is given to them by usage . . . ." CAL. CIV. CODE § 1644 (West 1872).
105 The term license in its ordinary use is simply "permission to act." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE 1302 (2002).
106 Id. at 964–65.
107 Id. at 965.
Both case law interpreting and applying the Copyright Act establish that it is a settled principle that "where a copyright owner transfers a copy of copyrighted material, retains title, limits the uses to which the material may be put, and is compensated periodically based on the transferee’s exploitation of the material, the transaction is a license."\textsuperscript{108} Applying these principles, the court concluded that "Aftermath’s agreements permitting third parties to use its sound recordings to produce and sell permanent downloads and mastertones [were] licenses."\textsuperscript{109}

3. Interpretation and Application of the Term “Masters”

The terms of the Eminem Agreements defined a “master” as a “recording of sound ... which is used or useful in the recording, production, or manufacture of records.”\textsuperscript{110} The court concluded that the sound recordings were masters after noting that Aftermath admitted that permanent downloads are records and that the sound recordings supplied to third parties were "used or useful” in the production of permanent downloads and mastertones. After noting that Aftermath admitted that permanent downloads are records and that the sound recordings supplied to third parties were “used or useful” in the production of permanent downloads and mastertones, the court concluded that the sound recordings were masters.

In summary, the court held:

[T]he agreements unambiguously provide that “notwithstanding” the Records Sold provision, Aftermath owed F.B.T. a 50% royalty under the Masters Licensed provision for licensing the Eminem masters to third parties for any use. It was undisputed that Aftermath permitted third parties to use the Eminem masters to produce and sell permanent downloads and mastertones. . . . Because the agreements were unambiguous and were not reasonably susceptible to Aftermath’s interpretation, the district court erred in denying F.B.T. summary judgment.\textsuperscript{111}

V. THE MUSIC INDUSTRY AFTER F.B.T. PRODUCTIONS, LLC V. AFTERMATH RECORDS

Although Peter Lofrumento, a Universal Music Group spokesman, argues that the Ninth Circuit’s ruling "sets no legal precedent as it only concerns

\textsuperscript{108} Id.
\textsuperscript{109} Id. at 966.
\textsuperscript{110} Id. (quotations omitted).
\textsuperscript{111} Id. at 967.
the language of one specific recording agreement," the implications of its ruling are in fact far reaching. The Aftermath decision could provide copyright holders and artists with a legal basis to challenge royalties received for music downloads, ringtones/mastertones, and other digital formats. In fact, similar litigation regarding royalty disputes demonstrates the consequential effects of the Aftermath decision.

A. Similar Litigation Regarding Royalty Disputes

As noted by the Motown Alumni Association ("MAA"), "[t]he ‘Masters Licensed’ clause and the usage of standard terms [in the Aftermath case] parallel the terms in a great many recording agreements." In fact, "the relatively standard nature of many recording agreements of a particular vintage" is substantiated by the plethora of music industry treatises containing examples of "standard contract provisions." The fact that most recording agreements contain similar if not identical provisions is evidenced by recent litigation concerning the same issues as those in dispute in the Aftermath case.

Eminem is not the only artist challenging the record labels’ characterization of digital downloads for royalty calculations. In 2006, the Allman Brothers Band and Cheap Trick commenced a class action for breach of contract and declaratory judgment against Sony BMG Music Entertainment, Inc. ("BMG") for "failure to properly account . . . for royalties with respect to recordings of their musical performances or recordings produced by them which [were] sold by ‘Music Download Providers[,]’ . . . through digital distribution." These "[t]wo highly successful rock groups from the 1970s and '80s" alleged that

114 Brief Amicus Curiae of the Motown Alumni, supra note 36, at 11.
BMG was “paying them only a ‘miniscule percentage’ of royalties owed for licensing their songs to [ ] digital music providers.”

In their complaint, the Allman Brothers alleged that BMG’s “inappropriate treatment of revenue received from Music Download Providers, in violation of [the] Recording Agreements, result[ed] [in their receipt of] approximately $45.05 per one thousand Music Downloads instead of the $315.50 to which they [were] entitled (i.e., less than 15% of the compensation which they are due).” The following chart, which was included in the Allman Brothers complaint, is helpful in fully understanding the context of recent litigation concerning royalty disputes.

<table>
<thead>
<tr>
<th>[Royalty Calculation Under “Records Sold” Provision]</th>
</tr>
</thead>
<tbody>
<tr>
<td>1000 Units(^{121})</td>
</tr>
<tr>
<td>Less Net Sales Deduction(^{122}) (15%)</td>
</tr>
<tr>
<td>Total Units Credited to Plaintiffs</td>
</tr>
<tr>
<td>Total Wholesale Revenue Per Unit</td>
</tr>
<tr>
<td>Less Mechanical [Copyright] Royalty(^{123}) Payments to Publishers Per Unit</td>
</tr>
<tr>
<td>Net Wholesale Download Price Per Unit</td>
</tr>
<tr>
<td>Total Wholesale Download Price (850 Units x $0.631 Per Unit)</td>
</tr>
<tr>
<td>Less Container Charge(^{124}) (20%)</td>
</tr>
</tbody>
</table>

\(^{119}\) Cheap Trick, Allman Brothers Sue Sony for Unpaid Royalties, 18 NO. 5 ANDREWS ENT. INDUS. LITIG. REF. 12 (2006).

\(^{120}\) Amended Class Action Complaint and Demand for Jury Trial, supra note 117, at 17.

\(^{121}\) “Unit” refers to the total number of units shipped, not sold. This is not the same number of units that the artist will receive compensation for. This is because each recording agreement contains a “free goods” provision which is “[a] fixed percentage of units that are deducted from [the total number of units] shipped to account for the number of units given away as promotional gifts or sales incentives.” See AVALON, supra note 116, at 296.

\(^{122}\) See supra text accompanying note 121.

\(^{123}\) Mechanical royalties are “[t]he ‘royalty’ paid to the publishing company for use of a composition in their catalog when it is reproduced on any record ‘sold.’” See AVALON, supra note 116, at 297.

\(^{124}\) The container charge is “[a] percentage of the sticker price [usually] charged to the artist for the packaging of the record.” See id. at 295. In reality, the amount deducted for a container charge is much more than the actual cost of packaging the album.
### THE IMPACT OF TECHNOLOGY

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less [New Technologies] Deduction (50%)</td>
<td>$(268.75)</td>
</tr>
<tr>
<td>Royalty Base Price</td>
<td>$160.25</td>
</tr>
<tr>
<td>Royalty Rate (30%)</td>
<td>x .30</td>
</tr>
<tr>
<td>Net Royalty Payable</td>
<td>$45.05</td>
</tr>
</tbody>
</table>

### [Royalty Calculation Under “Masters Licensed” Provision]

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1000 Actual Units Downloaded</td>
<td>1000</td>
</tr>
<tr>
<td>Net Receipts remitted to Sony for 1000 Units sold (@ $0.70 Per Unit)</td>
<td>$700.00</td>
</tr>
<tr>
<td>Less Mechanical Royalty Payments to Publishers (approx. $0.069 Per Unit)</td>
<td>$(69.00)</td>
</tr>
<tr>
<td>Total Net Licensing Receipts</td>
<td>$631.00</td>
</tr>
<tr>
<td>Royalty Rate (@ 50% of Net Licensing Receipts)</td>
<td>x .50</td>
</tr>
<tr>
<td>Net Royalty Payable</td>
<td>$315.50</td>
</tr>
</tbody>
</table>

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125 Categorizing an album sale as a “new technology” is a method used by the record labels to pay an artist less for this type of configuration. “The concept behind the reduction comes from the idea that research and development costs for [the] new products should be passed on to the artist. . . .” See id. at 298.

126 The royalty base price is “[t]he amount of money that the royalty rate will be calculated upon. Usually, the royalty base price is calculated by deducting taxes and container charges from the sticker price of the record.” Id. at 300.

127 The royalty rate varies for each artist and is set out in the recording agreement.

128 See Amended Class Action Complaint and Demand for Jury Trial, supra note 117, at 17. Several treatises contain similar examples. For example, 

[If a single-song download sold on iTunes for 99 cents, 29 cents of this would go to iTunes, leaving 70 cents. . . . The record company then multiplies this amount by your net royalty rate of, say, 10 percent, arriving at your royalty per single digital download of approximately $0.07 cents ($0.70 x 0.10 = $0.070).]

BOBBY BORG, THE MUSICIAN'S HANDBOOK: A PRACTICAL GUIDE TO UNDERSTANDING THE MUSIC BUSINESS 189 (2008). This example does not “factor[ ] in other customary deductions like free goods and reserves.” Id.
In 2007, The Youngbloods commenced a similar breach of contract suit "on behalf of itself and all others similarly situated" for breach of contract and a declaratory judgment against BMG for failure to render to it and other artists accurate accounting statements and to account for and credit properly royalties for digital music download and mobile phone ringtone and ringback uses, during the period between January 1, 1962, through December 31, 2002, generated by BMG's licensing of the plaintiff's and other class members' master recordings to the third-party licensees.\textsuperscript{129}

The Youngbloods alleged that "of the 99 cents charged to consumers, by Apple, for each music download, [they] receive[d] approximately 4.7 cents, when they should [have] receive[d] in excess of 30 cents."\textsuperscript{130}

The claims of The Youngbloods, the Allman Brothers Band, and Cheap Trick are identical to those involved in the Aftermath case. Although final judgment has not been reached in these cases, the Aftermath case has been cited in recent court filings and likely will be a factor influencing their outcomes.\textsuperscript{131} These cases have the potential to have an enormous financial impact on the major record labels and thousands of artists.\textsuperscript{132}

\textbf{B. Inadequacies of the Traditional Business Model as a Result of New Technology}

Major record labels using the traditional business model capitalized on their dominance over both artists and smaller record labels. By financing the production of music, record labels were able to facilitate the sale of records through physical distribution. In order to maintain exclusive control, the major record labels expanded the scope of their business by staffing individuals in various departments including Artist and Repertoire ("A&R"), Sales,\textsuperscript{133} Marketing,\textsuperscript{134} and...
keting,135 Promotion,136 Product Management,137 New Media,138 Production,139 and Press.140 Record labels capitalized on the expenses of recording albums. Unlike their smaller counterparts,141 major record labels own their own distributors,142 and therefore they do not have to compete with the small record labels on a national level.

1. Manufacturing Costs

By expanding the scope of their business to include editing, printing, packaging, distribution, and promotion, record labels also have been able to profit from the industry’s dependence on physical distribution chains.143 The major record labels have controlled all aspects of distribution by owning and operating record and CD manufacturing plants and storage warehouses.144 These costs are borne not by the record labels, but by the individual artists, providing record labels with additional sources of revenue.

The decline in physical album sales has resulted in decreased revenue for major record labels in the manufacturing and distribution aspects as well. The reality now is that the record labels do not incur manufacturing costs to sell digital music.145 They do not manufacture, package, or warehouse any physical

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134 The sales department “[w]orks with the distribution companies and retailers to get records in stores, on sale, and in the right positioning on the shelves.” BORG, supra note 128, at 173.
135 The marketing department is responsible for “[a]dvertising, publicity, album-cover artwork, promotional videos, in-store displays, [and] promotional merchandise.” PASSMAN, supra note 20, at 62.
136 The promotion department focuses on getting music out to the public. This is often accomplished by getting songs played on radio stations and garnering airplay. BORG, supra note 128, at 173.
137 “Product managers are in charge of whipping up all the other departments (sales, marketing, promotion, etc.) and getting them to work together to push [the] records.” PASSMAN, supra note 20, at 62.
138 The new media department is responsible for developing websites for artists and marketing them by setting up online promotions with various retailers. BORG, supra note 128, at 173.
139 The production department is responsible for “[m]anufacturing, cover printing, assembling, and shipping physical product (CDs) to the distributors.” PASSMAN, supra note 20, at 62.
140 The press department generates exposure for artists by coordinating album reviews, interviews, and appearances. BORG, supra note 128, at 173.
141 These smaller and often independent record labels distribute their recordings through the wholesale distributors owned by the major record labels. Id. at 174.
142 “The major distributors include Sony/BMG (who distributes Columbia, RCA, and Epic), EMD (who distributes EMI recordings and Capital), UMG (who distributes Interscope, A&M, and Geffen), and Warner Music Group (who distributes Atlantic, Warner Bros., and Reprise).” Id.
143 See generally PASSMAN, supra note 20.
144 Id.
145 Id.
recordings. The record labels do not ship any product to stores or other distribution points. They do not bear the risk of breakage or the return of unsold recordings. These changes have reduced the revenue of major record labels drastically, especially in the United States, "the largest digital music market in the world." 

In 2010, revenues from digital channels accounted for almost half of record companies’ trade revenues in the United States. This has been “driven by a combination of increasing digital revenues and the sharp decline in CD sales caused in part by the closure of physical retail stores across the country.” Sony, for example, operated three CD-producing facilities in the United States. In 2003, that number dropped to two when it closed a CD plant in Springfield, Oregon. On March 31, 2011, this number dropped to one with the closing of a plant in Pitman, New Jersey. The remaining plant is located in Terre Haute, Indiana.

2. The Risks of Signing New Artists

Entry into the music industry has long been limited to those artists and bands that have been able to grab the attention of A&R executives. For decades, it has been the job of A&R executives to “scour the clubs for talent and listen to hundreds of [CDs] from hopeful musicians in an effort to discover the next chart-topping act.” While A&R executives still play an important role in the search for new talent, technology has expanded the channels for discovery. Recognition by A&R executives can launch an artist’s career, but such recognition is no longer the only avenue for entrance into the recording industry.

In the recording industry, “[i]t is nearly impossible to get discovered if no one ever sees the band [or artist] play live.” A&R executives know the importance of fans, which is one reason why “[b]ands [or artists] with large followings have an easier time getting signed by a label.” The internet has provided artists with the ability to independently develop a worldwide fan base,
THE IMPACT OF TECHNOLOGY

thereby increasing the likelihood of securing a recording contract with a record label. Instead of "project[ing] the listening and music buying tastes of the public,"158 A&R executives have the opportunity to project the success of an artist based on his or her current following. The ability to project the success of an artist prior to signing an artist to a record deal greatly reduces the risks involved.

C. The Sales vs. License Distinction

Compensating artists under the "Masters Licensed" provision is more consistent with current economic realities. The purpose of the "sale" versus "license" distinction "is to provide for a higher royalty rate when the record company licenses master recordings to third parties because in such situations the record company does not incur the expensive incremental costs associated with manufacturing, packaging and distributing the physical records associated with the release."159 This distinction also reflects the "understanding that where a record company is providing more services, [it] gets a bigger share" and when the record company "provides fewer services, it gets a lesser share."160

The contracts of many, if not most, recording artists who signed contracts beginning in the early 1960s and the early 2000s did not contemplate the sale of recordings in the form of digital downloads. At that time, record labels did contemplate that master recordings could be licensed to third parties who would then distribute the recordings to others. At the beginning of the digital music revolution in the early 2000s, many record labels, including Aftermath Records, sought renegotiation of existing recording agreements.161 These renegotiated agreements contained new, additional clarification language with respect to digital downloads. In 2002, Aftermath Records "amended their standard form agreements . . . to specify that digital downloads would be treated as record sales, . . . rather than under the Masters Licensed provision."162 Aftermath Records also "created a brand-new royalty rate for third party digital downloads not found in any [previous] recording agreements."163

Although the Aftermath decision likely will have no effect on recording agreements signed in the last decade, it will have an enormous impact on record labels' bottom lines. The major record labels collectively have sold thousands of legacy artists' recordings through digital sales and most legacy artists have similar contractual provisions to those in the Eminem Agreements.

158 Id. at 693.
160 Id. at 227.
162 Appellants' Reply Brief at *10, F.B.T. Prods., LLC v. Aftermath Records, 621 F.3d 958 (9th Cir. 2010).
163 Id.
VI. CONCLUSION

The music industry is larger than ever; however, the role of record labels in this industry is rapidly declining. As with any major industry transition, "the most successful businesses do not waste time negating the new; rather, they figure out how to embrace it before being outmoded by it." The recording industry at one time successfully anticipated and exploited trends, enabling the record labels to thrive economically. At a time when the recording industry had an opportunity to exploit digital technology, it chose to resist it, leaving room for more innovative entrepreneurs. Apple with its iTunes digital store has continued to grow, selling more than ten billion downloads since 2003.

Technological advancements have provided artists with an alternative to signing with a major record label, thereby changing the role of record labels in the industry. Better consumer technology provides affordable options for recording. Software programs such as Pro Tools allow artists to record music from virtually anywhere with the use of a computer. YouTube, Facebook, and other websites utilizing user-generated content ("UGC") have provided artists with access to promotion channels, making it possible for artists to distribute their music without the assistance of record companies.

In 2010, record industry leaders are recognizing the importance of innovation. As stated by Mark Piibe of EMI Music, "The record industry is more open to new models now than it has ever been. We are experimenting in ways that we wouldn't have considered three years ago, and we are also getting a lot more sophisticated about the differences between markets." However, it appears as though this is too little, too late.

The factors that have allowed record labels to exercise dominance over the industry are no longer present. The historical high barriers to entry into the music industry have been lowered as a result of technological advancements. Decreased transaction and production costs have allowed artists to become more independent. As a result of artists gaining more control over their music, consumers have gained bargaining power. Record labels have thus lost their role as "gatekeeper."

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164 KUSEK & LEONHARD, supra note 1, at 8.
165 See IFPI, supra note 5, at 7.
166 KUSEK & LEONHARD, supra note 1, at 143.
167 Id. at 144.
168 Examples include internet and satellite radio; streaming services such as Pandora; social networking sites such as MySpace, Twitter, and iLike; blogs; and other aggregators.
169 IFPI, supra note 5, at 7.
Society is moving away from a world of ownership and is focusing instead on the world of access. The *Aftermath* decision coupled with the changing demands of consumers and the inability of record labels to meet those demands ultimately has changed the role of record labels in the music industry. The music industry no longer needs intermediaries to deliver music to consumers, who can access music directly at a much lower cost. An industry once controlled by so few is now controlled by the masses.

Lauren K. Turner*

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171 Id.

172 See KUSEK & LEONHARD, supra note 1.

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