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Facing the Music on the Internet: Identifying Divergent Strategies for Different Segments of the Music Industry in Approaching Digital Distribution

Ryan S. Henriquez *

I. INTRODUCTION

Since Thomas Edison played “Mary had a Little Lamb” on the first gramophone in 1877,¹ technology has fixed and cemented recorded music into a cultural cornerstone of our society. The technological innovations that followed— phonograph, long-play album, eight-track, analog cassette, compact disc, and digital audiotape— have all brought advantages over their predecessors and have changed the way music infuses our lives. Now, in the age of the computer, technology is primed to jettison music into the new Millennium, and once again change the way we listen to music.

Prepare for the following scenario. You return to you home on Friday night after a long workweek, and begin contemplating the eve-

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¹ See PURNELL’S HISTORY OF THE 20TH CENTURY, (A.J. Purnell & Sons Limited, 1971).

ning's festivities. You turn on your computer and your music collection appears, song by song, there on the monitor. In the need of some nice ethereal relaxing jazz, you click your mouse once and the sounds of Ornette Coleman's saxophone fills the room. Eager to prepare the music list for the party you are hosting that evening, you connect to your favorite record label's website, and begin sampling free promotional 30-second sound clips the label has posted. You begin downloading the tracks that will provide the pulse of the party. Each song costs ninety-nine cents to download, and since your service provider already has your credit card number, so the transaction is over with the click of the mouse.

Once you have compiled a list of songs for the evening, you realize that you might need a short jog to clear your head before preparing for you guests' arrival. Curious what new underground rap music might have been released since last night, you connect to www.lycos.com, a search engine that lists every song available for digital download, which is updated daily. After shuffling through a few links, you find two brand new tracks by Public Enemy and one by The Anonymous, a new underground hip-hop group from Los Angeles that a friend recommended. You click on these selections, wait a minute for the songs to be downloaded to your business-card sized Yepp (a portable player of digitally downloaded music files), that you promptly place in your back pocket as you slip on your running shoes. Your run begins and the music never skips or weighs you down.

The preceding scenario is very close. While the compact disc remains the current dominant form of music dissemination, digital downloads of songs compressed into computer files called MP3's, are sweeping the nation.² Unlike compact discs, MP3 songs are often posted and disseminated on the Internet without the permission of and without compensating the musicians who own the copyrights to these songs. As MP3 increases in popularity and comes to supplement or displace the compact disc, the music industry's survival depends upon protecting its copyrights and receiving royalties from the exploitation

² “[MP3 is] the biggest things to happen in the business in about 40 years,” says Paul Vidich, senior vice-president of strategic planning for Warner Music Group. See Jeff Jensen, *Everything You Wanted to Know about MP3*, ENTERTAINMENT WEEKLY, Mar. 12, 1999, at 2.

of this presently unsecured medium.

The increased reliance on the personal computer in our society prime MP3's to become a premiere method of acquiring a music collection, as new technological innovations promise to ease access to consumers and increase consumption of online music. Forrester Research has predicted that, if the music industry can turn online music into a copyright-protecting, royalty-generating medium, digital music downloading could generate U.S. revenues of \$1.1 billion by 2003.³

Despite the allure of these substantial sums, a large segment of the music industry despises all of the uncertainties posited by the Internet. The Recording Industry Association of America ("RIAA") admits that it has not been able to keep up with consumers or their new jukebox, the personal computer. "There's no question the music fan beat the industry to music online. Now we're trying to catch up," says Hilary Rosen, president and CEO of the RIAA.⁴ Some have prophesized that online music will indeed cause the institutions of the music industry to crumble and fall.⁵ While the industry scrambles to obtain copyright protection and royalties for its songs floating free in cyberspace, consumers do what they do best: consume. Established websites, with new ones popping up daily, enable consumers to connect themselves to means by which they can receive the music they want without taking a jaunt to the record store. Some of these websites allow consumers to create custom-made CDs online, which the consumer can download himself onto CD format, if he has a recordable CD player as part of his computer system.⁶ Other websites act as on-line radio sta-

³ See Brett Atwood, *Study Predicts a Digital-Download Bonanza*, BILLBOARD, Apr. 24, 1999, at 80.

⁴ See Jensen, *supra* note 2, at 2.

⁵ Richard Valentin, lead vocalist for Poster Children, a band signed to spinART label, says, "The way the large corporations have controlled the music industry is by controlling distribution and the expensive process of making a record. Now, recording technology has gotten so cheap and of such good quality that people are . . . recording at home, spending very little money on the process. Now that the distribution end will be eliminated by the Web, there's not much a large corporation can offer a band." See Jonathan Vankin, *Downloading the Future: The MP3 Revolution—the End of the Industry as We Know It*, LA WEEKLY, Mar. 26, 1999, at 38.

⁶ MusicMaker.Com, specializes in made-to-order CD compilations. See *id.* at 36.

tions, posting songs to which users can listen.⁷ Other websites provide compressed versions of songs, called MP3 files ("MP3's"), which can be downloaded from the site to a computer user's hard drive. Alternatively, the MP3's can be downloaded to disc, which can be removed from the computer to be played on a walkman-style gizmo or in a car stereo after the user has left the computer terminal.⁸

The first of the walkman-style portable MP3 players is the Rio, by Diamond Multimedia, which is currently entangled in a lawsuit with the RIAA, in which the industry is seeking to enjoin the Rio's commercial release.⁹ Devices like the Rio exacerbate the danger posed to the music industry that MP3's have caused. Downloaded MP3's do not pay royalties to the music industry, but there was some consolation for the industry in that users could only enjoy them while confined to their computer terminal. With the Rio, however, MP3 files became portable, and thus more amenable to consumers as an alternative to CD. Such a threat could not be tolerated by the music industry, and the RIAA filed suit.¹⁰

The RIAA's initial attempt to enjoin the Rio's release failed (an appeal is pending), but it typifies the volatile relationship between technological companies and the music industry, the former trying to bring the music to the consumer, the latter trying to protect its copyrights and collect royalties from these consumers. To the dismay of the music industry institutions, the inventors of MP3 created a file format without copyright protection or a royalty streaming mecha-

⁷ The Internet Underground Music Archive offers a steady stream of online music in radio format on its "IUMA Radio" site. See <<http://www.iuma.com/IUMA-2.0/ftmp/IUMA-2.0/www/olas/subinfo/index/html>> (visited Mar. 10, 1999).

⁸ Diamond Multimedia's Rio was the first of the walkman-type portable players of digital downloads. The latest version of the Rio, the Special Edition Rio PMP300 carries 64 megabytes of memory, which is twice the original, which was released less than a year ago. Furthermore, the English technology company Empeg has begun to offer an MP3 car stereo with the capacity to play 476 hours of music. See Steve Morgenstern, *Web Music Players: The Next Wave*, ROLLING STONE, May 27, 1999, 75, at 77.

⁹ See *RIAA v. Diamond Multimedia Systems*, No. 98-8247 (C.D. Cal. Oct. 27, 1998) (Order Denying Plaintiff's Motion for Preliminary Injunction), <<http://208.240.92.66/press.htm>> (visited Mar. 10, 1999).

¹⁰ See *infra*, part III.B.1 for legal analysis of the Rio and its portable player progeny.

nism. Now that the industry has recognized that consumers desire music in digital download form, it is striving to provide an alternative format for online music, one that will protect copyrights and ensure royalties are collected when the songs are disseminated to consumers.

While MP3 music piracy grows, some websites have received all the proper licenses to post songs, and are hoping to base a lucrative business around the sale of digital downloads. As more legitimate websites arise and compensate record companies fully for the use of their songs, the music industry will realize catastrophic profits, absent the traditional diminution by packaging, manufacturing, and distribution expenses associated with the CD. Furthermore, artists can post their music on the Web themselves, without the traditional reliance on a record company to manufacture, package, and distribute his/her CD's.

Despite the allure of this Utopian model, where cyberspace music is always properly licensed, and the record company and the consumer hold hands and sing once again to the tunes sold by the duly authorized website, it is not likely to be realized soon. For every site that secures rights, there are numerous others that do not. On a single-day search, the RIAA uncovered some 80 websites containing over 20,000 MP3 songs, most of which had not been licensed.¹¹ While the music industry scrambles to sink these pirates and to develop a more secure alternative to MP3, the wave of digital music delivery continues to surge forward. As of March 1, 1999, over half a million songs had been distributed on the Internet, and that number grows daily.

This article will explore today's world of online music delivery of digitally downloaded music files. For a complete understanding, the reader must grasp the nature of the new technology, as well as the legal implications under U.S. Copyright Law. While the music industry has launched an industry-wide initiative to reign in online music piracy and ensure it is compensated for the exploitation of its songs, the pending success of its otherwise valiant efforts is circumspect. This article will offer strategies for approaching online music for different segments of the music industry who, despite their ultimate reliance on

¹¹ See Julian Dibbell, *The Record Industry's Digital Daze: Thanks to MP3, This Could Finally Be the End of the Music Business as We Know It*, ROLLING STONE, Nov. 26, 1998, at 104.

one another, should respond to online music in very different ways. Artists should capitalize on the increased exposure online music can provide, and enjoy the ability to reach fans more directly. Independent labels should lure artists by offering contracts that more accurately reflect the dynamics of digital downloads. Finally, the institutions of the record industry, who traditionally relied on the efficacy of the compact disc, will have to reinvent themselves and the manner in which they derive revenues while continuing to fight online music piracy.

II. THE TECHNOLOGY OF ONLINE MUSIC

A. *Thus Far, The MP3 File Format Has Been The Keystone To Internet Music Distribution.*

The rapid expansion of Internet music distribution has been fueled by the creation of new technologies that have made transferring songs in cyberspace easier and more rampant than ever. These technologies illuminate, or themselves engender, problems of applying current copyright law to the ever-expanding distribution music over the Internet. Leading the technologies is the MP3¹² file format¹³, which compresses music into a file that uses up only 1/12 the amount of space as that of uncompressed music files, which had been the norm until MP3 came along.¹⁴ Though there is a slight reduction in sound quality from the compact disc, MP3's compression capacity has helped the file

¹² MP3 is short for MPEG-1, Layer-3, and was developed between 1988-1992 by an international group of companies called the Moving Picture Coding Experts Group. See David Weiss, *MP3: The Real Deal*, *MUSICIAN*, Apr. 1999, at 40. The Moving Picture Coding Experts Group is an international group of computer technicians and scientists who meet several times annually to codify technological specifications for encoding and compressing digital audio and digital signals. The MPEG group pioneered the technologies that have led to such innovations as DVD and DirectTV. See Vankin, *supra* note 5, at 38.

¹³ The MP3 file format was developed starting in 1987 by the German research firm, Fraunhofer Gesellschaft. The project was a small portion of a larger ongoing effort, called EUREKA, to rejuvenate the European economy. Fraunhofer participated in the portion of the EUREKA project dedicated to digital audio broadcasting that ultimately spawned MP3. See *id.*

¹⁴ See James Coates, *PC Music Technology Puts Users in Tune*, *Industry Off-Key*, *CHICAGO TRIBUNE*, Nov. 15, 1998, at 5.

format spread rampantly across the Web.¹⁵ A single song that once might have filled forty megabytes of space on a hard drive now only takes up four megabytes, which drastically shortens the time it takes to download the song.¹⁶ With a T-1 connection to the Internet, like the one found in college dorms nationwide, one can download an entire CD's worth of MP3 files in just over 10 minutes.¹⁷

Adding to the glamour and rapid spread of the software is the fact that MP3 enabling software is free. If your computer is equipped with a Windows 98 operating system, then you already have the Microsoft Media Player, which is able to play MP3 files.¹⁸ For those without Windows 98, MP3 players can themselves be digitally downloaded, and at no charge. Competing online technology brokers such as Real Networks and Winamp offer consumers MP3 players free for the download.¹⁹

Music consumers have rampantly embraced MP3 as a costless way to retrieve the music they desire. Estimates show that over five million people are MP3 users,²⁰ and the International Federation of Phonographic Industries has estimated that over 3 million songs are downloaded daily,²¹ from over 30,000 music web sites.²² Furthermore, these numbers will likely increase when consumers begin using a new MP3 search engine developed by online company Lycos, which will find and list all sites across the Internet posting MP3 files, whether the postings are authorized or unauthorized.²³

¹⁵ See Vankin, *supra* note 5, at 40.

¹⁶ See *id.*

¹⁷ See *Ripoff Artists*, PC COMPUTING, Nov 1, 1998, at 85.

¹⁸ See *supra* note 2, at 32.

¹⁹ See <<http://www.real.com>>; <<http://www.winamp.com>> (visited Nov. 15, 1999).

²⁰ See Dibbell, *supra* note 11, at 106.

²¹ See *The Music Industry, A Note of Fear*, THE ECONOMIST, October 31, 1998, at 67.

²² See Steven V. Brull, *Net Nightmare for the Music Biz: Despite Piracy Woes, Web Distribution Seems Unstoppable*, BUS. WK., Mar. 2, at 89.

²³ See Bill Holland, *Lycos Cooperating With RIAA Over New MP3 Database*, BILLBOARD, Feb. 13, 1999, at 111.

B. MP3 Has Spawned Both Other Software Innovations And Electronic Devices That Further Facilitate The Transfer Of Music Over The Internet.

MP3 usage goes well beyond merely being able to download music files to one's hard drive and listening to them through headphones or computer speakers, while sitting in front of the computer screen. New software technologies called "ripper" software enable consumers to upload songs to the Internet from their own CD collections, so consumers may trade files with others. Furthermore, new electronic devices that free consumers from having to listen to MP3 files while confined to their computer terminal have begun to flood the market. These innovations will accelerate the appeal of Internet music distribution to mainstream consumers.

C. Ripper Software Turns Internet Music Distribution Into A Two-Way Street, And Exposes The Unsecured Nature Of Music On Compact Disc.

The Recording Industry's fear of Internet music piracy flourished with the genesis of encoder or "ripper" software, which lets consumers "rip" songs off of CD's they already own, upload the songs from the CD to the hard drive, where they can then be encoded into MP3 files, and distributed throughout cyberspace.²⁴

Increasing its anxiety is that, like MP3's and MP3 player software, ripper software can often be obtained for free or at a very small cost. One ripper software product, Music Match's Jukebox, is available on the company's website for \$30, but is up to eight times faster than other available encoders.²⁵ Slower encoders can often be downloaded for free at various sites across cyberspace.²⁶ Ripper software has enabled musicians to breathe new life into their older, out-of-print records by posting them online. It has also encouraged music fans to

²⁴ See Doug Reese, *Industry Grapples with MP3 Dilemma*, BILLBOARD, Jul. 18, 1998, at 1.

²⁵ See *id.*

²⁶ See Bruce Haring, *You Can't Stop the Music on the Net: Recording Industry Debates MP3 Privacy Issue*, USA TODAY, Nov. 4, 1998, at 106.

upload CD's they already own, in the hopes of converting some new fans or trading songs with others.

Such uses of ripper software, while seemingly benign to the musician or fan in these circumstances, begin to tread into the copyright infringement possibilities that MP3 and its progeny can create. The fan who uploads his CD collection for use by others and the musician signed to a record label who uploads his old out-of-print songs without the record company's permission, are both infringing on copyrights they do not own.

While a record company can monitor its artists for unlawful postings of songs and quickly remove past catalogs the company does not want floating about cyberspace, the uploading music fan is without constraint. The fan who uploads his CD collection is clearly infringing the copyright of whoever owns the songs,²⁷ even if his intentions are good. As RIAA vice-president Steven Marks explains, "There's a spirit on the Internet that lends itself to people thinking they can take everything for free. But it's hard to argue with the basic fact that if you're ripping music off a CD and putting it onto the Internet, it's theft. It's no different from walking into a store and taking something without paying for it."²⁸

D. New Electronic Devices That "Portablize" MP3 Files And Enable Consumers To Burn Their Own CD's From MP3 Files Have Helped Lure Consumers Into Receiving Their Music Over The Computer.

In addition to MP3 player and ripper software, new electronic devices free consumers from only enjoying MP3 songs when confined to their computer terminal. CD-Recordable devices (CD-R's) have infiltrated the marketplace, allowing consumers to actually burn their own custom-made CD's from MP3 files obtained over the Internet.²⁹ CD-R's essentially come in two forms: MiniDisc recorders, manufactured by companies such as Denon, Sony, and Sharp; or normal size CD-

²⁷ See *infra* Part III.

²⁸ See *supra* note 2, at 40.

²⁹ See Edward C. Baig, *Audio: Sweet Sounds on the Web*, BUS. WK., Feb. 16, 1998, at 121.

Recordables, from the likes of Phillips, Pioneer, and Yamaha.³⁰ The price of these devices range from \$200 to \$500, and blank compact discs can be purchased in bulk for less than a dollar each.³¹ CD-R sales are growing rapidly, and some predict they may eventually become standard in PC hardware packages in the not-too-distant future.³²

CD-R's entail an additional danger to the CD-centered music industry, since once the device has recorded MP3 files onto compact discs, the files can be disposed in any way the consumer sees fit, including, of course, selling the compiled CD's for a profit. Heightening the potential piracy concerns is the fact that, because MP3 files are so compressed, many more audio tracks can be recorded onto a single CD. Last year, law enforcement officials in Plainview, Texas, raided a online pirate operation and confiscated a single compact disc containing all 23 Beatles albums that had been constructed from piecing together MP3 files.³³

Though the CD-R's potential for piracy looms large, the RIAA has targeted a smaller, more inexpensive device recently developed that also allows consumers to portablize MP3 files, this time for Walkman-style use. Diamond Multimedia's Rio PMP300 ("Rio"), which is smaller than the standard Walkman and weighs a mere 2.4 ounces, can store MP3 files for playback after the consumer leaves the computer terminal.³⁴ Portable players could be the key to bringing MP3 into the mainstream of music consumption by freeing music fans from the confines of their computer terminals.³⁵ Portable MP3 devices like the Rio³⁶ may be more amenable to consumers than CD-R's, as they are

³⁰ *See id.*

³¹ *See* Doug Reece, *Sharp Jump Reported in CD-R Piracy*, BILLBOARD, Sept. 5, 1998, at 12.

³² *See id.*

³³ *See* Reese, *Industry Grapples*, *supra* note 24, at 1.

³⁴ *See* Weiss, *supra* note 12, at 42.

³⁵ Recall that English tech company Empeg has further expanded the portability of MP3 files by constructing an MP3-playing car stereo. *See* Morganstern, *supra* note 8, at 77.

³⁶ Samsung has announced its new line of Yepp players, to compete with the Rio. The Yepp will be about the same size as a business card, at 58 mm x 85 mm, and just 17 mm thick. The Yepp will each have 40 megabytes of memory which can

smaller and cheaper. Furthermore, MP3 portable players, unlike portable CD players, are more durable as they have no moving parts and are less likely to skip.³⁷

Because of the Rio's threat to integrate MP3 into the mainstream, the RIAA sued San-Jose based Diamond Multimedia in October 1998, claiming a violation of the 1992 Audio Home Recording Act (AHRA).³⁸ Diamond argued that the Rio cannot be covered by the AHRA, as it does not actually record music. Instead, Rio users must transport MP3 files from their hard drive into the Rio's memory using a cable connected to the computer's printer port.³⁹ Diamond's argument was bolstered by the fact that Rio's memory is finite, and once it is full, new files transported from the hard drive can be stored only by displacing already existing files.⁴⁰

The RIAA sought an injunction that would keep the Rio off store shelves entirely. U.S. District Court Judge Audrey Collins initially granted the injunction, but the decision was reversed days later.⁴¹ The decision remains on appeal.⁴² In the meantime, since the injunction was lifted, Diamond has shipped over 100,000 Rios, and competitors Siemens and Samsung have also begun to market portable MP3 devices.⁴³

store ten average pop songs and memory can be expanded through SmartMedia memory cards. Responding to consumers tests, the new Yepp will also incorporate an FM radio, voice recording, and a basic telephone book function. See Martyn Williams, *Samsung Debut's World's Smallest MP3 Player*, NEWSBYTES NEWS NETWORK, Apr. 27, 1999, available in 1999 WL 5121720.

³⁷ A recent statistical study by Forrester Research suggests that there will be 1 million users of portable downloadable music players by the end of 1999 and that the market for these players will explode once prices drop below \$100, an event Forrester predicts will take place in early 2001. See Atwood, *Study Predicts*, *supra* note 3, at 80.

³⁸ Recording Industry Ass'n of America, Inc. v. Diamond Multimedia Systems, Inc., 29 F.Supp. 2d 624 (C.D. Cal. 1998). See <<http://www.riaa.com>> (visited Nov. 15, 1999).

³⁹ See Vankin, *supra* note 5, at 40.

⁴⁰ See *id.*

⁴¹ For legal analysis of the RIAA's dispute with the Rio, see *infra*, Part III.B.1.

⁴² See *id.*

⁴³ See Williams, *supra* note 36, available in 1999 WL 5121720.

E. MP3 Has Spawned Numerous Online Entities, Who Offer MP3 Files To Consumers For Sale Or For Free.

In addition to Diamond's ingenious entry into portablizing Internet music files, and the progeny of competitors that followed, many entrepreneurs and website operators have demonstrated the ways Internet music can be turned into a business for profit. Internet companies, services, and sites have all endeavored to get a piece of the action by offering consumers a way of making computer-based copying a reality for them.

From the college student posting his favorite songs to the venture capital-funded public company whose website receives hundreds of thousands of MP3-hungry visitors daily, music distributed over the Internet certainly runs the gamut. Three distinct types of MP3-based online music distribution have emerged without the music industry's seal of approval: free and legal, paid and legal, and free and illegal.

Free and legal sites include the San Diego-based website MP3.com⁴⁴ and dozens of others who now offer free MP3's *with the permission of the bands*. Typically, most of the bands on these sites are unsigned or obscure.⁴⁵

MP3.com and its progeny allow artists to post their music, biographies, contact information, and links to the artist's own web site, all for free.⁴⁶ MP3.com bears heavy traffic; it often receives over 200,000 visitors daily, who can download the posted music, also for free.

The Internet Underground Music Archive ("IUMA") is another popular example of a site that is free and legal.⁴⁷ Like MP3.com, IUMA requires artists to waive their royalties in the sound recordings in order to post clips of their music onto IUMA's website where consumers can download them for free.⁴⁸

⁴⁴ See <<http://www.mp3.com>> (visited Nov. 15, 1999).

⁴⁵ See Vankin, *supra* note 5, at 36.

⁴⁶ See Weiss, *supra* note 12, at 40.

⁴⁷ See <<http://www.iuma.com>> (visited Nov. 15, 1999).

⁴⁸ See <<http://www.iuma.com/IUMA-2.0/ftmp/IUMA-2.0/www/olas/subinfo/index/html>> (visited Nov. 15, 1999). Some major labels are starting to use them as well. In 1994, Geffen Records placed a 30-second clip on one of its bands on IUMA's site. Major labels like Geffen are beginning to recognize,

GoodNoise⁴⁹ is the best-known of the “paid and legal” sites, which allow downloading of songs by better known artists for a price. GoodNoise sells full albums for \$8.99, and single songs for ninety-nine cents. GoodNoise catalog includes Frank Zappa, They Might Be Giants, Bruce Cockburn and many others. GoodNoise has also contracted with various independent labels to post music from their entire roster of artists for sale.⁵⁰

Finally, the “free and illegal” method of distribution, also known as “piracy,” involves ordinary people using ripper software to copy tracks off CD’s, convert them to MP3 files and upload them to the Net, where anyone in the world can copy them.⁵¹ As will be seen in the next section, this category of MP3 distribution is clearly subject to infringement lawsuits by various copyright holders.

III. CURRENT AND EXPANDING COPYRIGHT LEGISLATION RENDER MUCH OF TODAY’S INTERNET MUSIC DISTRIBUTION ILLEGAL.

Software and electronics innovations, such as MP3 and the Rio, have led to widespread unauthorized distribution of copyright-protected music files over the Internet. A musical work embodied in an MP3 file is inherently comprised of two copyrights. One is for the actual recording of the song, often called the sound recording (“SR”) copyright. Barring any assignments or transfers, the SR copyright belongs to the person who recorded the song, or his/her record com-

and utilize the advantage of having their acts music ripe for digital download without spending the time, money and effort to conventionally promote, press, and distribute recordings for promotional use. Artists can employ this alternative method of distribution at a fraction of the cost. Of course, unlike normal distribution channels, they are currently forsaking royalty streams for the sake of inexpensive exposure. Howard Siegel, *Digital Distribution of Music: How Current Trends Affect Industry*, MULTIMEDIA & WEB STRATEGIST, Oct. 1998, at 1.

⁴⁹ See <<http://www.goodnoise.com>> (visited Nov. 15, 1999).

⁵⁰ For instance, New-York based independent label, spinART sells downloadable versions of its CD releases, via a deal with GoodNoise. SpinART was the first label to offer its entire catalog in MP3 format (as well as on “physical” CD’s). See Vankin, *supra* note 5, at 36. Rykodisk is another independent label that has signed with GoodNoise. See *infra* p. 74.

⁵¹ See Vankin, *supra* note 5, at 36.

pany. The other is for the underlying song itself, i.e. the notes of music which when placed into the sequence created by the songwriter embodies a musical composition. This, logically, is called a musical composition ("MC") copyright. The MC copyright belongs to the composer of the song, or often the composer's music publishing company. Very often, the composer of the song and the person who records it will be one and the same. Bob Dylan composed the song, "Tangled Up in Blue," hence he (or his music publishing company) owns the musical composition copyright to the song. In addition to composing the song, Dylan also recorded the song for his *Blood on the Tracks* album. Thus, he (or his record company) also owns the sound recording copyright for *that version* of the song that appears on the album.

Often, however, the owner of the SR and MC copyrights will be different entities. Prince composed the song, "Nothing Compares 2 U", and hence he owns the MC copyright to the song.⁵² However, since Sinéad O'Connor recorded the song for her *I Do Not Want What I Haven't Got* album, she owns the sound recording copyright for *her version* of Prince's song. Anyone who wants to do anything with her version, e.g. compress it on a file for a consumer to download to his/her computer, had better contact both Prince and O'Connor (or more likely Prince's music publishing company and O'Connor's record company) for permission.

Posting a song in MP3 file format without permission, then, could violate two exclusive rights of both the MC and SR copyright holders under Section 106 of the Copyright Act, namely the right to copy and the right to publicly perform the work.⁵³

⁵² He was still called Prince when he wrote the song. Since then, he has assumed the name of an unpronounceable symbol, and the industry has dubbed him "The Artist Formerly Known as Prince," or "The Artist" for short.

⁵³ The right to copy MC and SR copyrights is embodied in 17 U.S.C. §106 (1), which grants the exclusive right "to reproduce the copyrighted work in copies and phonorecords." The right to publicly perform MC copyrights is embodied in 17 U.S.C. §106(4), which grants the exclusive right "in the case of . . . musical [compositions] . . . , to perform the copyrighted work publicly." The right to publicly perform SR copyrights is embodied in 17 U.S.C. §106(6), which grants the exclusive right "in the case of sound recordings, to perform the copyrighted work by means of a digital audio transmission." The limited right in public performance for sound re-

With this copyright scheme in place, posting a song on the Internet and transferring it to others has the potential to violate each of these rights of the copyright holders. First, merely creating a digital file of a song (e.g. in MP3 file format) with the help of compression and/or “ripper” software, infringes the MC and SR copyright holders’ exclusive right to make copies of their copyrighted material.⁵⁴ After creating the new copy in MP3 format, the act of posting the MP3 on the Internet violates the copyright holders’ right to publicly perform the work. Finally, when another user accesses the posted MP3 and downloads it to his personal library, he has also made a illicit copy in violation of Section 106(1).

A. To Post Or Copy MP3 Files Legally, One Must Acquire Various Licenses From The Sound Recording And Musical Composition Copyright Holders.

The seeming simplicity of this “dual copyright” in a song should not be overstated. While indeed there are two copyrights embodied in every song, the rights awarded to the MC copyright holder are broader than those awarded to the SR copyright holder. But substantively, the MP3 website provider will have to acquire four licenses, the (1) right to copy the musical composition, (2) the right to copy the sound recording, (3) the right to publicly perform the musical composition, and (4) the right to publicly perform the sound recording.⁵⁵ Acquiring some of these licenses may be more difficult to acquire than others.

1. Obtaining Licenses To Reproduce (Make Copies)

When a MP3 website creator wishes to compress a song into MP3 format for users to access, he must necessarily be making a copy of that song. The rights to make copies enures to both the SR copyright holder and the MC copyright holder. Furthermore, these rights, as

cordings set out in 17 U.S.C. §106(6) was added by the Digital Performance Rights in Sound Recordings Act of 1995. Prior to the Act, sound recording copyright holders had no exclusive right to publicly perform the work whatsoever.

⁵⁴ 17 U.S.C. § 106(1)

⁵⁵ See Bob Kohn, *A Primer on the Law of Webcasting and Digital Music Delivery*, ENTERTAINMENT LAW REPORTER, Vol. 20, No. 4, Sept. 1998, at 4.

with all other rights awarded to a copyright holder, are exclusive. Hence, the owner of a SR or MC copyright can prevent any unwanted duplication of their work.⁵⁶ Therefore, if you wish to make a copy of "Nothing Compares 2 U," you would need to secure a license from both Prince and O'Connor.

a. From the SR Copyright Holder

In order to legally make a copy of a sound recording, one must obtain a license, freely negotiable by the owner of the copyright. This means that for every song that you want to post in MP3 file form, you must negotiate with and get permission from the SR copyright holder, e.g., the recording artist or the record company. Record labels have begun issuing "blanket licenses," or licenses to all the song recordings it owns, to websites that portend to offer legally obtained MP3 songs.⁵⁷ For example, the New York-based independent label spinART has negotiated a license to legitimate MP3 provider, GoodNoise, whereby GoodNoise may copy and post all of the songs of spinART's roster of artists.⁵⁸

However, the record company is free to charge whatever license fee it wishes, or simply refuse permission to copy its sound recording. This alone creates a strong incentive for piracy. Presumably, when digital music transmission is eventually reigned in and regimented under the Copyright Act, record companies will become more lax as a system emerges by which it will receive steady revenues from sales of the MP3 files. If it is the recording industry's goal to discourage piracy and illegal sites, record companies would be wise to discourage piracy by liberally allowing MP3 website operators to use their sound recordings for a license fee. However, as the speed and use of MP3

⁵⁶ Incidentally, for those readers worried that all those mixtapes they have been making have constituted copyright infringement, fear no more. A portion of the Audio Home Recording Act of 1992 precluded infringement claims that may be brought by an MC or SR copyright holder, based on noncommercial copying by private consumers for their personal use. If one has been selling those mix tapes though, an action for copyright infringement can arise.

⁵⁷ See Vankin, *supra* note 5, at 36.

⁵⁸ See *id.* Note that SpinART was the first label to offer its entire catalog in MP3 format, as well as on physical CD's.

music spreads, and the potential for displacement of sales from record stores increases, expect to see these license fees increase.

b. From the MC Copyright Holder

Even if you have obtained O'Connor's permission (or more likely, her record company's permission) to compress her song into MP3 format, you still must receive analogous permission from Prince (or his publisher) to copy his musical composition. Fortunately, unless the song has never been released in any prior form, this permission will be easy to obtain.

An MC holder's exclusive right to copy his musical composition is subject to the "compulsory license provision" of Section 115 of the Copyright Act.⁵⁹ As long as records of a song have been released in the United States, Section 115 allows anyone else, including MP3 website operators, to compel the copyright owner of a song to license the song at a fee established by law.⁶⁰ The statutory rate, as of January 1998, was 7.1 cents per song, or 1.35 cents per minute of playing time (for longer songs). The statutory rate serves as a ceiling above which the MC copyright holders may not charge for issuing these licenses. An organization called the Harry Fox Agency ("HFA") issues these "mechanical licenses" on behalf of all MC copyright holders; the agency is a subsidiary of the National Music Publisher's Association.⁶¹ Again, these licenses are legally accessible to anyone.⁶²

⁵⁹ 17 U.S.C. § 115 (Supp. 1997).

⁶⁰ See Kohn, *supra* note 55.

⁶¹ See HFA (visited Nov. 16, 1999), <<http://www.nmpa.org/nfa.html>> (visited Nov. 15, 1999). Note that the Harry Fox Agency has arranged for blanket license agreements with America Online and GoodNoise, two service providers upon which artists can have their music posted in MP3 file form. See NMPA (visited Nov. 16, 1999), <<http://www.nmpa.org/pr/aol.html>>; see also Irv Lichtman, *1st MP3 Mechanical License Issued: GoodNoise Pacts with HFA to Pay Royalties For Downloaded Songs*, BILLBOARD, Feb. 13, 1999, at 9.

⁶² The HFA is currently negotiating an agreement with its foreign equivalents that would ensure the mechanical licenses are collected from the website offering MP3 files, regardless of where in the world the MP3 file is sent. See Kohn, *supra* note 55.

2. Obtaining Licenses To Publicly Perform The Song

Unlike MC copyrights which have always contained a public performance right, traditionally there has been no public performance right for SR copyright holders. Practically, this means that when O'Connor's version of "Nothing Compares 2 U," is publicly performed (i.e. on the radio), only Prince would be entitled to a royalty payment. Note, that the royalty payment would be made by the radio station, and not by the consumer listening. While this point seems obvious, we will see that this becomes less so when speaking about MP3 files.

The Recording Industry, on behalf of its SR copyright holders, successfully lobbied Congress to give them a limited public performance right in the exact context of an MP3 file transmission. The new law is embodied in the "Digital Performance Right in Sound Recordings Act of 1995."⁶³ The impetus for the law was that these MP3-type transmissions have the potential to eat away and even eradicate the entire market for sound recordings embodied on compact disc, tapes, or albums, which recording artists and record companies depend upon for their very existence. Hence, to deprive these SR copyright holders of the ability to have control over this particular performance of the songs would prove exceedingly onerous, and possibly even fatal to record companies.⁶⁴

a. *From the SR Copyright Holder*

With the Digital Performance Right in Sound Recordings Act in place, an MP3 website operator who wishes to transmit a work will have to get a license from the SR copyright holder. The DPRSRA also provides for compulsory licenses for the exploitation of sound recordings on the Internet.⁶⁵ As of June 1, 1998, the Act required digital pay radio stations to pay a statutory license fee of 6.5% of the gross revenues accrued from the transmission of the copyrighted sound recording.⁶⁶ While actual web broadcast in radio-like format obviously

⁶³ 17 U.S.C. § 114 (Supp. 1997).

⁶⁴ See Kohn, *supra* note 55.

⁶⁵ See Siegel, *supra* note 48, at 2.

⁶⁶ See *id.* The fee is collected by the RIAA, which then allocates the aggregate

constitutes a public performance, it is less clear with regards to website operators that simply offer MP3 files for download. As we will see below in reference to MC copyright holders, controversy is brewing over whether merely transferring a file, without actually allowing the recipient to hear the song as it is being transmitted, should constitute a “performance” of the song.⁶⁷

b. From the MC Copyright Holder

Just as the Harry Fox Agency issues and collects on mechanical licenses for the right to copy, separate organizations called performance rights societies issue and public performance licenses for MC copyright holders.⁶⁸ The two primary performance rights societies in the United States are Broadcast Music Inc. (“BMI”) and the American Society of Composers, Authors, and Publishers (“ASCAP”). Traditionally, MC copyright holders used these organizations to issue licenses and collect fees based on more traditional “performance” venues, such as nightclubs, restaurants, radio stations, and television stations. However, with the explosion of websites posting MP3’s, ASCAP and BMI have also now sought to collect performance monies derived from transmitting MP3 files via digital download.⁶⁹

It is easy for ASCAP and BMI to justify collecting license fees from websites that “stream” music in a radio station-like fashion. However, ASCAP and BMI have strained the definition of “performance” to include the act of simply allowing the download of an MP3 file. Despite the fact that the recipient cannot hear the song as it is

license fees among the record companies owning the sound recording copyrights to the digitally transmitted recordings.

⁶⁷ See Kohn, *supra* note 55. Some website operators offer “streaming” services, which most certainly constitute a public performance and would require a license from the SR copyright holder. Streaming websites act as online radio stations, in which a user may access a websites established playlist or choose which songs he/she would like to hear, and the songs are transmitted to the user’s PC for concurrent listening. Unlike MP3-providing websites, streaming sites do not generally result in the recipient actually possessing a copy of the song.

⁶⁸ See Donald S. Passman, *All You Need To Know About the Music Business*, Simon & Shuster, 1997 at 231.

⁶⁹ See Kohn, *supra* note 55.

downloaded to his/her PC, ASCAP and BMI still require an MP3-providing websites to pay a performance license fee.⁷⁰

A website operator that permits downloads of its posted MP3 files without allowing users to listen to the song has an argument against paying this performance license fee. He could argue that a song is never performed when an MP3 music files is sent to a recipient. Section 101 of the Copyright Act states that “to perform a work means to recite, render, play, dance, or act it, whether directly or by means of any device or process.”⁷¹ Throughout the course of transmitting an MP3 file to a recipient, the song is never “played” or “rendered” to anyone.⁷²

Despite this plausible argument, however, the performance rights societies also have a persuasive argument as to why the transmitting of an MP3 file should constitute a performance, and thus require a license.⁷³ While the Copyright Act’s definition of “perform” seems amenable to the MP3 website operator, the Copyright Act’s definition of “publicly . . . perform” seems equally amenable to ASCAP and BMI.⁷⁴ “To perform . . . a work publicly means . . . to transmit or otherwise communicate a performance . . . of the work to the public . . . whether the members of the public capable of receiving the performance . . . receive it in the same place or in separate places and *at the same time or at different times.*(emphasis)”⁷⁵ Such statutory language indicates that simultaneous listening by the recipient will not be controlling in determining whether a copyrighted work has indeed been performed.

The gravity of the dilemma increases since, unlike mechanical licenses, which are statutorily compelled by Section 115, performance right licenses are given solely at the discretion of the MC copyright holder. In other words, even despite the compulsory mechanical license for the right to copy, a MC copyright holder may stop a website operator from copying and transmitting its song unless the operator

⁷⁰ See *id.*

⁷¹ See 17 U.S.C. § 101 (1994).

⁷² See Kohn, *supra* note 55.

⁷³ See *id.*

⁷⁴ See 17 U.S.C. § 101(1), (2) (1994).

⁷⁵ See *id.*

pays the performance license fee as well. The current system, then, effectively allows MC copyright holders to force website operators into paying both license fees, or else not carry the song on its website.

The inequality of bargaining power between the copyright holder and the website operator highlights the fact that lawmakers, while making valiant attempts, still face unresolved issues. If ASCAP and BMI can negotiate with HFA to receive a portion of their revenues from mechanical licenses, perhaps the website operator will have this onerous double-payment situation lifted. However, neither organization will want to relinquish its right to collect for each downloaded file sent to a recipient, so the solution will likely have to result from more legislation. In the meantime, however, an MP3 website operator will be forced to pay (through ASCAP and BMI) the MC copyright holder whatever performance license fee it desires.⁷⁶

B. *Modern Statutory Response To The Digital Wave Of Music On The Internet*

The Copyright Act is clearly on the side of the music publishers and recording companies and makes infringement relatively easy to prove. On behalf of these organizations, the RIAA has sought out and sued operators of websites that provide unlicensed, illegal MP3 files, and has been triumphant in most of these suits. In January 1998, for instance, the RIAA settled three suits against MP3 sites. The RIAA recovered over one million dollars from each of these sites and forced them to quit posting unlawful MP3's.⁷⁷ Furthermore, the RIAA has not targeted only larger websites that traffic thousands of MP3 files, but rather has sought out smaller mom-and-pop web site operations. On May 5, 1998, RIAA sued a Arizona Internet-service provider that

⁷⁶ See Siegel, *supra* note 48, at 1. For ASCAP and BMI, license agreements with website operators are becoming standard procedure. BMI was the first performance rights society to issue blanket Internet music licenses to operators of websites that allow for the digital download of music files. ASCAP has followed suit. In contracting with ASCAP and BMI, website operators may tailor their license arrangement such that it is most amenable to their website. License fees can be based on the unlimited use of musical compositions, pay-per-use options, or linked to the number of visitors to the website.

⁷⁷ See Vankin, *supra* note 5, at 36. (Noting that the RIAA has agreed not to collect the judgments unless the site operators resume their infringing ways).

featured an MP3 “Song of the Week,” despite the fact the site only offered fifty songs in total.⁷⁸

However, such lawsuits only provide temporary relief to the disease of copyright infringement on the Internet. During the time a single suit is being litigated, the defendant pirate is usually forced by restraining order or injunction to cease his activities that so clearly constitute pirating. Yet, while the industry navigates its victory over one online music provider, numerous other pirates have already begun their infringing activities, and it is simply impossible for the music industry to locate and stamp out every instance of infringement.

In addition to the infringement of individual copyright holders’ rights, even more frightening is the potential loss of the royalty streams that piracy as an institution could facilitate, which the music industry depends upon to sustain itself. These institutional piracy and royalty collection issues have become more of a real danger with the recent technological developments in Internet music distribution.

Instead of being lax and hoping infringement suits will take care of piracy on the Internet, Congress has enacted legislation to address some of the concerns of the music industry and its copyright-holding constituents. In addition to the Digital Performance Right in Sound Recordings Act of 1995, which created a new public performance right for digitally transmitted sound recordings, Congress made other strides in the 1990’s to ensure that SR and MC copyright holders would not see their royalty streams from the exploitation of those copyrights diminish with new digital technological developments.

1. The Audio Home Recording Act of 1992 (“AHRA”)⁷⁹

The AHRA was initially enacted to regulate the emergence of new digital audio technology, including Digital Audio Tape (DAT), Digital Compact Cassette (DCC) and Sony’s MiniDisc.⁸⁰ With DAT, and MP3 for that matter, copies of songs can be made without any reduction in sound quality, and the music industry lobbied Congress to address the growing risk of record piracy from such devices. Specifi-

⁷⁸ See *id.* This lawsuit is still pending or in settlement negotiations.

⁷⁹ 17 U.S.C. §§ 1001-1010 (Supp. 1997)

⁸⁰ See Passman, *supra* note 68, at 245.

cally, the law mandates (1) a ban on copyright infringement suits based on personal, home copying,⁸¹ (2) incorporation of electronic copying controls called a Secure Copyright Management System ("SCMS") that prevent copies of copies,⁸² and (3) a royalty flow to the music industry based on a percentage of sales of digital recording equipment.⁸³

When enacted, the AHRA contemplated DAT, DCC, and MiniDiscs flooding the consumer market, and enabling pirates to make innumerable perfect copies from one master. Interestingly, only the Sony MiniDisc was actually a commercial success, and the music industry's panic that inspired the AHRA was overstated. However, the advent of Internet and computer based technologies have rekindled the music industry's fears, and it appears that the AHRA, in its current form, may be inadequate to address piracy and earnings concerns stemming from these technologies.

While the AHRA was designed to address future developments in digital audio recording, it has failed to address many of the new advancements in digital audio recording made in the last five years. Currently, with the help of only a personal computer, modem with Internet connection, and the right software, an increasingly large number of music files can be transmitted or downloaded. If one's computer has the increasingly popular CD-Recordable ("CD-R") drive, which allow

⁸¹ 17 U.S.C. § 1008 (1994) effectively exempts consumers from infringement suits based on home, personal, and non-commercial recording activities, for both digital and analog recording media.

⁸² 17 U.S.C. § 1002 (1994) prohibits importing, manufacturing, or distributing digital home audio recording devices that do not have SCMS. SCMS is a computer chip that, once installed, prevents recording devices from allowing consumers to use any perfect digital copy as a template to make more perfect digital copies. An unlimited amount of copies may be struck from the original CD, but none of those copies themselves can be used to strike more copies. The SCMS requirement ensures that the copyright owner is guaranteed that the home recording consumer has purchased at least one original version of the CD, thus contributing to the royalty streams to the copyright holders.

⁸³ 17 U.S.C. § 1004 (1994) helps to compensate the music industry for its inevitable loss of record sales stemming from home digital recording. Though the scheme varies for various recording media, an example is a 2% royalty levied against the sale of digital audio recording devices, with a floor of \$1 and a ceiling of \$8 per device.

consumers to make perfect digital copies of recorded music, one can set up an entire system for making cheap, digital audio recordings, stored on the computer's hard drive or on one's own personally crafted CD. Without further regulation or a more expansive interpretation of the AHRA, both CD-R's and Internet digital audio transmissions (i.e. illicit MP3 file downloads) have the potential to facilitate the concerns the music industry had when the law was drafted. Unfortunately, so far these technologies are not covered by the AHRA.

Under the AHRA, to qualify as a "digital audio recording device," a device must be "designed or marketed for the primary purpose of . . . making a digital audio copied recording for private use."⁸⁴ The components of the computer-driven recording system listed above generally do not qualify under the AHRA's definition. Unlike DAT and MiniDisc recorders, CD-R drives, computers, and modems all are not primarily designed for the purpose of recording music, and hence are exempt from the definition. Currently, then, CD-R's and computers need not have SCMS, which ensures no copies of copies may be generated, and that copyright holders are compensated at least by an initial purchase of an original CD. In addition, because the new devices are not currently covered by the AHRA, no royalties need be paid to the recording industry based on sales of CD-R's, computers, or modems.⁸⁵ Thus, consumers can create unauthorized, digital CD-quality home recordings, without the record industry receiving any piracy protection or compensation for lost sales guaranteed by the AHRA's royalty and SCMS provisions.

Though the danger of these new Internet-based recording systems is greater than previous devices, the RIAA recently recognized the difficulty in sweeping in new technologies to be covered by the AHRA. In its suit against Diamond Multimedia, the RIAA attempted to secure an injunction precluding the initial release of the portable Rio device by arguing it violated various provisions of the AHRA.⁸⁶ Specifically,

⁸⁴ 17 U.S.C. §1001(3).

⁸⁵ Recall the software needed to facilitate Internet music copying, ripper and MP3 player software, can be obtained for free and thus preclude the possibility of a percentage of sales being remitted to the recording industry.

⁸⁶ See *RIAA v. Diamond Multimedia Systems, Inc.*, No. 98-8247 (C.D. Cal. Oct. 26, 1998) (Order Denying Plaintiff's Motion for Preliminary Injunction), available at <http://www.riaa.com/piracy/pir_pr.htm> (visited Nov. 15, 1999).

the suit accuses Diamond of violating the AHRA, failing to pay royalties on each device sold, and failing to include SCMS within the device.⁸⁷

Judge Collins of the Central District of California initially entered a 10-day restraining order on the Rio's release, but reversed herself at the subsequent preliminary injunction hearing.

Despite the fact that Judge Collins agreed that the Rio was a recording device, within the parameters of the AHRA, she nevertheless refused to apply the law to the Rio, reasoning that the Rio had not violated AHRA's §1002, which outlaws making digital copies of copies.⁸⁸ "Incorporating SCMS into the Rio accomplishes nothing. The Rio could not 'act upon . . . copyright and generation status information' [as the AHRA requires] because the MP3 files on the computer's hard drive do not contain this information."⁸⁹ Therefore, the unsecured nature of MP3 files allowed the Rio to escape violating the AHRA, and Diamond was permitted to begin selling its device.⁹⁰

The lack of security of MP3 files, then, actually assists devices such as computers, modems, and CD-R's to escape the penumbra of the AHRA regulations.⁹¹ Furthermore, the statute's focus is not on unlawful infringement itself, but on devices that facilitate such in-

⁸⁷ *Judge Enters TRO Delaying Sale of New Internet Music Device*, ANDREWS COMPUTER & ONLINE INDUSTRY LITIGATION REPORTER, Oct. 20, 1998, at 3.

⁸⁸ *See* RIAA v. Diamond Multimedia Systems, Inc., No. 98-8247 (C.D. Cal. Oct. 26, 1998) (Order Denying Plaintiff's Motion for Preliminary Injunction), available at <http://www.riaa.com/piracy/pir_pr.htm> (visited Nov. 15, 1999), at 14.

⁸⁹ *See id.* at 16.

⁹⁰ Note that much of the industry and copyright concerns presented by the Rio may be drastically reduced in the future, as Diamond Multimedia announced on April 26, 1999 that it would be adopting copyright protection to incorporate into the Rio. Diamond has partnered with tech company Intertrust Technologies Corp. to secure audio files that are playable on the Rio. If Diamond can adequately demonstrate its Rio will not play pirated MP3 song files, presumably opposition from the music industry would dissipate. *See Diamond Multimedia Builds Copyright Protection into Rio*, NETWORK BRIEFING, Apr. 26, 1999, available at 1999 WL 17637619.

⁹¹ As we will see below, the industry is trying to convince consumers to adopt a more copyright-secure file format in place of the unsecured MP3 file format. If they are successful, and copyright information is embedded into the file, devices or systems that ignore or circumvent the copyright protection information will be easier to enjoy under the AHRA.

fringement. This will also help computers, modems, and CD-R's escape AHRA liability as these devices have primarily non-recording functions and thus do not fall under the AHRA. Finally, while MP3 player and ripper software certainly perform the primary function of facilitating copying, this software is available for free, and thus the music industry cannot collect royalties based on sales of such software.

Congress will have to amend the AHRA to ensure that new technological devices that facilitate pirating will not be permitted simply because their technological specifications may not fall within what was contemplated when the AHRA was originally drafted. The law should be changed to target infringement processes or systems, and not simply the isolated devices that, when used in conjunction, accomplish the infringement. Until legislators can implement these changes, the judicial system should be willing to recognize and implement the Congressional intent of the AHRA to outlaw not only non-complying devices, but systems that facilitate piracy and deplete the royalty streams of copyright holders.

2. The Digital Millennium Copyright Act of 1998 ("DMCA")⁹²

The most recent, and most effective, legislative addition to the fight against online music piracy is the Digital Millennium Copyright Act ("DMCA"), signed by President Clinton on October 28, 1998.⁹³ Like Judge Collins' opinion, which implicitly called for a more secure file format alternative to MP3, the DMCA anticipates the implementation of security measures for music transmitted over the Internet.⁹⁴

⁹² Pub. L. No. 105-304 (1998), 112 Stat. 2860 (1998).

⁹³ The DMCA implements the 1996 WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty. In addition, the law makes additional revisions to U.S. copyright law regarding digital delivery systems and technologies, such as music delivery over the Internet.

⁹⁴ Eric Schwartz and Steve Metalitz, *The Digital Millennium Act: Why It Is Important*, THE INTELLECTUAL PROPERTY STRATEGIST, Dec. 1998, at 1. (In addition to enhancing copyright protection for digitally distributed copyrighted materials in the U.S., the treaties forming the basis for the DMCA strive to protect and enforce the rights of copyrighted works in the global sphere. They stand to raise the minimum standards of copyright protection throughout the world, especially with regards to network-based delivery systems of copyrighted works.)

Furthermore, in light of these anticipated improvements, the DMCA ensures that copyright protection measures are not circumvented by software or technological devices, and supplies heavy penalties for noncompliance. Finally, the DMCA marks a substantial improvement in regulating not simply discrete devices, but actual systems, existing now and in the future, that might combine various devices and technologies.

Principally, the DMCA makes certain activities illegal, without tampering with existing copyright law. The new law makes it unlawful to manufacture, import, distribute, or provide services or products that are designed with the primary purpose of circumventing copyright protection technologies.⁹⁵ Trafficking in such products is also illegal.⁹⁶

The DMCA also prohibits tampering or otherwise reducing the integrity of copyright management information— data digitally embedded into the work that identifies its copyright owners.⁹⁷ The music industry is trying to develop technology that will encrypt or otherwise attach the copyright management information into a music file and travel with the file as it networked across the Internet. This will aid the industry in detecting pirates and ensuring proper payment of royalties.⁹⁸ The DMCA prescribes both civil and criminal penalties for manufacturing, supplying, or even trafficking in the proscribed disruptive technologies.⁹⁹

C. *Who To Sue?*

Industry players have utilized the copyright law and the license scheme aggressively to enjoin and collect judgements from pirate websites. ASCAP, BMI, and the RIAA have all instituted successful lawsuits against infringers on behalf of their recording industry con-

⁹⁵ See *id.* at 2. Protection technologies include serial copyright management systems, password protection, encryption, and digital watermarking. These systems will be discussed below.

⁹⁶ Pub. L. No 105-304 (1998), 112 stat. 2864 (1998).

⁹⁷ See Schwartz and Metalitz, *supra* note 94, at 2.

⁹⁸ See *id.*

⁹⁹ Pub. L. No 105-304 (1998).

stituents.¹⁰⁰ In 1997, the RIAA sent out hundreds of warning letters asking for compliance with the copyright laws, and sued some of those who resisted.¹⁰¹ That year they managed to shut down more than 250 infringing websites, the majority originating from university Internet service providers.¹⁰²

BMI, ASCAP, and the RIAA all have full-time staff members who utilize search engines to ferret out pirate websites which are often tremendously difficult to find.¹⁰³ Pirates often elude these policing organizations by communicating through code words and encrypted messages on transient Internet chat forums that signal to other privy pirates where free songs can be found on the Web.¹⁰⁴

While the rights holders or their representative organization may legally sue individual pirates and their websites, their efforts have been more wisely focused on the Internet service providers and bulletin board operators. These organizations are generally more solvent than the individual pirate, and have the ability to terminate the pirate subscribers' access to their services. Under the DMCA, these organizations can be held vicariously or contributorily liable if they refuse to terminate service to a pirate website they host once the copyright holder has given notice to the service provider that infringement is taking place.¹⁰⁵

¹⁰⁰ See *RIAA Releases Midyear AntiPiracy Statistics*, RIAA (Aug. 21, 1998) <http://www.riaa.com/piracy/pir_pr.htm> (visited Nov. 15, 1999); see also Colin Berry, *Robo(Music)Cop*, WIRE, Dec. 7, 1997, at 63.

¹⁰¹ See Janelle Brown, *Heat Turned Up on Digital Music Pirates*, WIRE.COM (Feb. 12, 1998), available at <<http://www.wired.com/news/culture/story/0,1284,10234,00.html>> (visited Nov. 15, 1999).

¹⁰² See *id.*

¹⁰³ See Jensen, *supra* note 2, at 33.

¹⁰⁴ See *id.*

¹⁰⁵ See Digital Millennium Copyright Act, Pub. L. No. 105-304, §202 (1998) (codified in 17 U.S.C. §1201). Note that the law also provides certain "safe harbor" limitations on liability for Internet Service Providers who adopt a policy of terminating infringing subscribers, designate an agent to receive notifications of infringement claims, and make contact information available to the Copyright Office. See *Senate Passes Digital Millennium Copyright Act*, SOFTWARE LAW BULLETIN, Sept. 1998, at 186.

D. *The Law Is Not Enough To Safeguard Copyrights And Royalty Streams In Online Music.*

While the law is clearly intolerant of online piracy and new Congressional responses such as the DMCA have made the law a more able weapon in the copyright holder's arsenal, the magnitude, proliferation, and elusiveness of online piracy grows. While the industry navigates its victory over one online music provider, numerous other pirates have already begun their infringing activities, and the music industry has found it impossible to detect and enjoin every instance of infringement. Furthermore, litigation victories are often enforceable in the United States only.¹⁰⁶ Pirate MP3 websites established abroad may be beyond the reach of U.S. record and publishing companies.¹⁰⁷ Even if a treaty or channel exists by which U.S. copyrights are protected abroad, very often the law of the home country would apply.¹⁰⁸ An entirely foreign copyright regime might not be as friendly to the music industry as the U.S. system.¹⁰⁹ Hence, suits brought against websites originating in foreign countries may not match results in U.S. suits. For these reasons, the courts will likely provide an ineffective, or at least incomplete, means by which the music industry can solve the massive copyright infringement occurring daily on the Internet.

If the recording and publishing industries want to realize full copy-

¹⁰⁶ With the pending implementation of the European Union's Copyright and E-Commerce Directives, rights holders will be better able to navigate victories over infringers in litigation disputes arising from unlawful digital transmissions in Europe. The Copyright Directive is designed to exempt companies from charges of piracy if they make "temporary" copies of music in their normal course of moving electronic signals around a digital network. The E-Commerce Directive is designed to give Internet companies the assurance they need to feel comfortable in permitting music to be sold via their web sites. The E-Commerce Directive is based closely on the U.S.'s Digital Millennium Copyright Act. Sanctions under national copyright laws in the European Union would be available to rights holders who prevail in lawsuits instituted in EU countries. See Jeff Clark-Meads, *EU E-Commerce Bill Faces Easy Passage*, BILLBOARD, Mar. 20, 1999, at 6.

¹⁰⁷ Trevor Cox, *Information and the Internet: Understanding the Emerging Legal Framework for Contract and Copyright Law and Problems with International Enforcement*, TRANSNAT'L. LAW., Spring 1998, 23, at 38.

¹⁰⁸ See *id.* at 39.

¹⁰⁹ See *id.*

right protection, they will have to take a more active stance themselves, rather than relying on the courts to do it for them. These industries must start planning now to ensure a system is in place by which it can turn the digital delivery of music into another reliable revenue-producing distribution channel.

The music industry has had difficulty adopting a universal specification for online music that would ease access to consumers as well as protect copyrights and royalty streams for copyright holders. Such a universal system, once in place, would be largely protected by the DMCA, and those who strive to circumvent it could be held to criminal and civil penalties.¹¹⁰ The system would have to combine various technological functions. It would have to be able to watermark the song files with the copyright information and track the watermarked song files as they move through cyberspace. It would have to assist remitting royalties to rights holders. It would have to incorporate a serial copying management system, to ensure copies of copies cannot be produced. Finally, it would have to render files unreadable to unauthorized users. While so far a universal system incorporating these three elements has been elusive, the music industry has launched an aggressive initiative to develop a universal specification for online music which would combine these attributes.

IV. THE SECURE DIGITAL MUSIC INITIATIVE: THE MUSIC INDUSTRY'S MESSIAH OR FALSE PROPHET?

Before 1999, the music industry balked at making a consolidated effort to develop a universal specification for online music that would protect copyrights, ensure the flow of royalty streams, and ease consumer access. As a result, unlicensed pirated MP3 works continued to spread. Software and technology companies tirelessly strived to find a way to capitalize, both by finding new ways to ease consumer access and by attempting to develop ways to protect the copyrights inherent in online music. These companies' technologies often vary significantly in function and design, and heavy competition has resulted from each striving to receive universal acceptance amongst the music industry and amongst consumers.

¹¹⁰ Pub. L. No 105-304 (1998).

Finally, in an effort to consolidate themselves against the ever-expanding scourge of online piracy, the music industry launched the Secure Digital Music Initiative ("SDMI") in December of 1998.¹¹¹ SDMI is a consortium sponsored by the RIAA and the International Federation of Phonographic Institutes (IFPI), and includes both record labels and technology companies.¹¹² SDMI's goal is simple—to find a universal way to secure the music available via Internet.

Indicating its need to address MP3 and digital delivery head-on, SDMI has partnered some of the biggest power brokers of the software industry with the "Big Five" conglomerates of the music industry, whose pooled affiliates and subsidiaries constitute over seventy-five percent of the record business.¹¹³ SDMI has chosen technological visionary Dr. Leonardo Chiariglione to serve as its executive director. Ironically, Chiariglione helped father the MPEG video and audio compression format, which ultimately spawned MP3.¹¹⁴ SDMI repre-

¹¹¹ "There's no question the music fan beat the industry to music online. Now we're trying to catch up," says Hilary Rosen, president and CEO of the Recording Industry Ass'n of America (RIAA). *See id.* at 33.

¹¹² Adam Sandler, *Securing the Future: SDMI Execs to Lead Search for Digital Copyright Protection*, BILLBOARD, March 1, 1999, at 8.

¹¹³ SDMI's software and technology constituents include representatives America Online, AT&T, IBM, Lucent, Microsoft, Matsushita, RealNetworks, Sony Corporation, and Toshiba. Record company constituents include the Big Five, with such industry luminaries as Strauss Zelnick, president and CEO of BMG Entertainment; Ken Berry, president of EMI Recorded Music; Tommy Mottola, chairman and CEO of Sony Music Entertainment; Doug Morris, chairman and CEO of the Universal Music Group; and Bob Daly, chairman and co-CEO of Warner Bros. and Warner Music America. Hillary Rosen (president and CEO of the RIAA) and Jason Berman (chairman-elect and chief executive of the IFPI, and representative for the Recording Industry Association of Japan) are also SDMI representatives. *See Worldwide Recording Industry Announces Precedent-Setting Initiative to Address New Digital Music Opportunities*, BUS. WIRE, Dec. 15, 1998. The men listed above indicates that the RIAA has involved all of the "Big Five" music companies of the world: Universal (owned by Canadian Seagram's Company), Sony (Japanese), Bertelsman / BMG (Germany), EMI (British), and Time-Warner (the sole U.S. representative). *See Vankin, supra* note 5, at 36.

¹¹⁴ Chiariglione is most noted for his work with MPEG, the Moving Picture Experts Group, who developed the standards for digitizing and compressing audio and video into such formats as the MP3 file and Advanced Audio Coding (AAC) formats. Currently, Chiariglione is a division head at CSELT, Telecom Italia's corpo-

sentatives insist that Chiariglione's appointment symbolizes their realization of a need for collaborative efforts among all industries that have a stake in digital and online music.¹¹⁵

SDMI has encouraged participating technology and software companies to present their approaches to digital music security and to collaborate with each other to establish an open architecture and universal specification for protecting online music. At its inaugural meeting on February 26, 1999, SDMI announced its goal and purpose of developing such a universal specification, that will "answer consumer demand for convenient accessibility to quality digital music, enable copyright protection for artists' works, and enable technology and music companies to build successful businesses."¹¹⁶

In an effort to meet its stated goals as soon as possible, SDMI has announced an aggressive timetable, and has established specialized work groups to address specific problems and issues. The first phase was the establishment of the Portable Device Working Group ("PDWG"), which includes technical experts from the technology and music industries who are striving to develop solutions for the implementation of a portable device architecture that would generate security standards for devices like the Rio.¹¹⁷ This phase is designed to respond to rapidly expanding market demands for these devices, and to establish a specification by June 30, 1999, to ensure portable devices would be equipped with the protection technology as early as the 1999 holiday season. As of March 31, 1999, over twenty-eight software

rate research center. *See Worldwide Recording Industry and Technology Companies Kick-Off Work of Secure Digital Music Initiative: Leonardo Chiariglione, Leader of MPEG Standards, Named SDMI Executive Director*, BUS. WIRE, Feb. 26, 1999.

¹¹⁵ Cary Sherman, senior executive vice-president and general counsel of the RIAA, stated "Dr. Chiariglione's vast experience, as well as the depth of his technical knowledge, will help SDMI to achieve its goal of promoting new generations of products and services for the delivery of music." *See Sandler, infra* note 112, at 8. But to some, "Chiariglione's enlistment by the RIAA was comparable to hiring Dr. Frankenstein to reign in the monster he created." *See Kipp Cheng, The Song Remains the Same*, ADWEEK (Eastern Edition), Mar. 8, 1999, at 42.

¹¹⁶ *See Secure Digital Music Initiative Continues Fast Path Toward Expanding Digital Music Marketplace; Hears Proposals for Portable Device Solutions; Forms Functional Requirements Working Group*, BUS. WIRE, Mar. 31, 1999.

¹¹⁷ *See id.*

and technology companies had submitted proposals to the PDWG, in the hopes that their specification will be the one which SDMI chooses to implement.¹¹⁸

The portable device specification anticipates the arrival of SDMI's long-term specification for securing all digital online music, which will include more encompassing standards that SDMI hopes to have in place by March 31, 2000. To this end, a Functional Requirements Work Group ("FRWG") has been established to address the needs of consumer access, and copyright protection for artists, record and music publishing companies.¹¹⁹ By March 31, 1999, one year before the anticipated launch of the universal specification, eighteen companies had presented proposals for meeting the FRWG's goals, including content providers, consumer electronics manufacturers, security technology vendors, and information technology companies.¹²⁰

- A. *Despite SDMI's utopian hope for universally protected digital online music, volatile relationships among its constituents, ever-expanding consumer demands, and impatient software and technology companies may undermine the initiative.*

With SDMI, the industry has finally assembled a strong army against the online music pirates, which will likely prove more effective than the judicial system alone. However, whether SDMI's battle marches will be launched on schedule or at all remains to be seen. SDMI faces numerous blockades it will have to surmount before its lofty, idealistic goals of universal protection of online music become reality.

¹¹⁸ See *id.*

¹¹⁹ See *id.* The FRWG includes chairman Niels Rump of the Fraunhofer Institute for Integrated Circuits in Germany, David Hughes of Sony Music Entertainment, Nick Kuroda of Victor Company of Japan, and Dan Sullivan of IBM.

¹²⁰ See *id.*

1. Too Little, Too Late: Consumers Have Already Embraced The Currently “Free” Music They Can Receive Online, And May Resist An SDMI-Forced Change By Remaining Underground.

Despite their aggressive timetable, SDMI and the music industry might already have missed their opportunity to quell the scourge of unprotected online music available in cyberspace. Consumers have already embraced MP3 in its current form. As of March 1, 1999, over half a million songs (both legal and illegal) had been distributed on the Internet, and that number grows daily.¹²¹

To the extent that SDMI claims that one of its primary goals is to ease access for consumers to legitimate song postings, the initiative may be responding to a complaint that has simply not been levied by consumers. SDMI executive director Chiariglione has stated “SDMI is an exciting endeavor because it will . . . create a new infrastructure for the secure delivery of music to consumers.”¹²² This will benefit everyone, from the artists who create the music to the consumers who enjoy it.”¹²³

With regard to benefiting consumers, the music industry must recognize that most consumers simply do not care about technological methods that can be used to facilitate a more equitable environment amongst artist, consumer and record company—rather; they simply want their music. Even certain members of SDMI have recognized the ingenuous claim that consumers are a primary beneficiary of the SDMI initiative. Larry Miller, CEO of SDMI-adherent a2b Music, has stated, “[a]t the end of the day the only thing music lovers care about is the music. They don’t care about technology.”¹²⁴

So far consumers have received their music in MP3 file format,

¹²¹ See Benny Evangelista, *Firms Jockeying to be First in MP3 Music Revolution*, S.F. CHRON., Mar. 1, 1999, at B2.

¹²² SDMI has insisted that consumers are the group at the heart of their efforts. Representatives have stated that the “ultimate goal if the initiative is to enable consumers to access and enjoy music in new ways, while ensuring interoperability among digital products and services so as to enhance the consumer’s listening experience.” See *supra* note 114.

¹²³ See Sandler, *supra* note 112, at 8.

¹²⁴ See Cheng, *supra* note 115, at 44.

and have downloaded ripper software and MP3 player software to assemble an online music collection with which they are proficient at using. SDMI's proposals would not only force consumers to forsake a method with which they are already familiar, but also ask them to now start paying. Currently, much of this music can be obtained for free; and SDMI cannot rationally conclude that consumers will willingly switch to an unfamiliar format for which they now have to pay.¹²⁵

Furthermore, search engines such as the one developed by Lycos, are constructed to find and list all MP3 files, both authorized and unauthorized, floating about the Web.¹²⁶ These search engines find only MP3 files, not any alternative file formats, such as the one SDMI may develop. The Lycos search engine will ease consumers' access to MP3 files by providing a ready resource consumers can reference to find the precise songs they desire. This eased access will also help perpetuate a consumer preference for MP3, as opposed to a newly developed alternative sponsored by SDMI.

Another obstacle SDMI must overcome with consumers is the attitude of Internet users that information and materials in cyberspace should be free to everyone. While record companies have been able to sell their CD's, tapes, and LPs in a traditional merchant-consumer setting at record stores, the Internet has its own traditions that may delay consumers' willingness to accept having to pay for material received over the Web.¹²⁷ As vice-president of corporate communications for GoodNoise, Steve Grady attests, "[t]hese encrypted solutions [of SDMI] don't satisfy the needs of consumers. If the music industry is going to come to the Internet, it has to play by the rules of the Inter-

¹²⁵ Many of the legitimate websites, such as GoodNoise, already charge 99 cents per song or \$8.99 per album. GoodNoise hopes that these prices will merely reflect a convenience fee for being able to find and quickly download desired tracks.

¹²⁶ See Holland, *supra* note 23, at 111.

¹²⁷ An illustrative example of Internet user's proclaimed resistance to corporate and governmental infiltration came from former Grateful Dead lyricist, John Perry Barlow: "Governments of the Industrial World, you weary giants of flesh and steel, I come from cyberspace, the new home of Mind. On behalf of the future, I ask you of the past to leave us alone. You are not welcome among us. You have no sovereignty where we gather." See Catherine Yang, *Law Creeps Onto the Lawless Net: Can Regulation and Liberty Coexist Online? Or Will Technology Outwit the Police?*, BUS. WK., May 6, 1996, at 58.

net.”¹²⁸

Even if SDMI is successful in implementing a specification that will force consumers to utilize a more copyright-protected and royalty-guaranteeing format for online music, consumers who still want their music for free will presumably find ways to obtain it. The MP3 format itself was not initially formulated to transmit music over the Web; rather, it was merely a better way to compress data. Ultimately consumers transmuted the format into something they could use. SDMI should be wary not to underestimate the ingenuity of consumers to manipulate technology specifications to match their own agenda.

While consumers may ultimately be forced (by law or an SDMI-induced market flood of its approved format) to change over to a more copyright-protective format than MP3 and even pay for the new format, the change may take longer than SDMI expects. Furthermore, as time passes without the SDMI specification in place, more unprotected MP3 song files will continue to flood the Internet. Even once the specification is in place, SDMI must acknowledge that trafficking of underground, unlicensed MP3 files will continue by Internet users who insist on obtaining their songs for free.¹²⁹ Hence, music industry faces large obstacles to overcome before their specification gains universal use.

2. Strange Bedfellows: Sponsors And Adherents To SDMI Have Divergent Interests That Will Delay SDMI's Goal Of Developing Any Universal Specification.

While SDMI constitutes commendable collaboration among music industry, software, and technology giants, the constituents have different interests and agendas that will certainly delay if not preclude SDMI's hope for universal specificity within online music distribution.

¹²⁸ See Jensen, *supra* note 2, at 37.

¹²⁹ See Robert Clarida, *Practice Pointers: New Rules for Webcasters*, THE INTELL. PROP. STRATEGIST, Dec. 1998, at 7 (stating that an SDMI universal specification may create the perverse incentive of continued underground trafficking of illicit MP3 song files; and the longer consumers strive to obtain what will then be black market music files, the longer it will take to develop a legitimate, royalty-paying means of delivering music to the online public).

Especially since the development of digital music, record conglomerates have historically had a contentious relationship with technology companies, despite the fact that the latter provide the method by which consumers get to hear the former's artists.¹³⁰ Software and technology companies are concerned with discerning and providing what the consumer wants, and seek to ease the consumer's access to their desired music. For them, SDMI represents a means by which their product or software can be mass marketed to consumers if (and only if) their technology is chosen to be incorporated into universal specification. Conversely, record and music publishing companies' primary concern is protecting their copyrights and ensuring they receive proper royalties when consumers acquire their songs. For them, SDMI represents the method by which they can achieve the copyright protection they desire in the newest form of music distribution, namely digital downloads.

In order for SDMI to accomplish its goals, the software companies must provide the technology that the music conglomerates desire. Certainly those technology companies that are selected by SDMI to serve this purpose will prosper, in the form of sales to consumers of products that have the SDMI-endorsement. But ultimately, the technology companies, especially those whose technologies go unselected, will continue to serve the interests of consumers, not music conglomerates. Hence, renegade technology companies may stall the universality SDMI contemplates by continuing to give consumers alternative methods of receiving online music, whether or not these methods have the SDMI endorsement.

¹³⁰ See *RIAA v. Diamond Multimedia Systems*, No. 98-8247 (C.D. Cal Oct. 27, 1998) (Order Denying Plaintiff's Motion for Preliminary Injunction), available at <<http://www.riaa.com/press.htm>> (visited Nov 27, 1999). See also, the Audio Home Recording Act of 1992, which was an initiated by lobbying from music industry representatives who were concerned that DAT and DAT Recorders whose perfect digital reproduction capabilities would reduce first-time record sales. Ultimately, the AHRA would force DAT and DAT recorder manufacturers to pay a royalty to the record industry, in the form of DART (Digital Audio Recording Trust) Monies. See Passman, *supra* note 68, at 245.

3. Vicious Competition Among Software Companies May Also Reduce SDMI's Hopes For Collaboration, And Companies Whose Technology Is Not Selected May Launch Renegade Efforts To Preclude The Universality SDMI Seeks.

The music industry can be sure that the specification SDMI ultimately endorses will benefit them in the form of increased copyright protection of their online music, no matter who is providing the technology. Conversely, only those software and tech companies whose products and services are incorporated into the SDMI-endorsed specification will guarantee the prosperity of their business. This has spawned heightened competition in an already fast-paced industry, with software companies vying for the brass ring of SDMI endorsement, at the expense of others. Even before SDMI, software and technology companies competed vigorously amongst one another to invent means of providing consumers with digitally downloadable music.¹³¹ With SDMI, these already competitive companies are forced to submit to a veritable SDMI-sponsored beauty pageant¹³² to discern which company will be crowned worthy of being used in SDMI's specification.¹³³

With regard to the slew of technological proposals SDMI will review, Chiariglione has attempted to frame the process in accordance with SDMI's spirit of collaboration. "It is an incredible experience to witness so many industry players contribute their ideas and share in

¹³¹ Referring to the harsh competition in an industry fueled by a rapidly changing business landscape, Steve Rennie, co-founder of ARTISTdirect and president of the Ultimate Band List, has stated, "I can't sleep at four in the morning for the fear that someone is going to pass me in the middle of the night." See *NARM 99: Facing the Future: Digital Delivery Debated*, BILLBOARD, March 20, 1999, 1, at 82.

¹³² "Everyone's trying to lay their cards on the table and jockey for position," said Rick Fleischman, senior marketing director for Liquid Audio. "This is now the prime time . . . to come out and show your stuff and get known." See Evangelista, *supra* note 121, at B2.

¹³³ To even receive SDMI consideration, companies must become "members" of SDMI, and must pay a \$10,000 membership fee to participate in future meetings and discussions. See Brett Atwood, *Online on Fast Track*, BILLBOARD, March 13, 1999, Vol. 1, at 106.

the development of this rapidly expanding field. The openness is unprecedented, and makes me confident that the collaborative effort that has characterized SDMI this far will result in a successful final specification."¹³⁴

This language hides the fierce competition being waged amongst the software and technology companies who hope their products will be chosen as an integral part of this final specification. Some companies have suspended production while SDMI makes their decision. The danger to SDMI, however, lies in the prospect of scorned companies becoming technological renegades who continue to compete with the SDMI-endorsed format.

The likelihood of renegade companies competing with an SDMI-endorsed specification is exacerbated by the fact that while striving for universality, SDMI is not striving for intercompatibility. "Expecting SDMI to come up with a solution for compatible system specifications 'is a common misconception,' warned an executive at a technology company, also an SDMI member, who asked for anonymity. 'SDMI is not about compatibility, its about creating platform for content owners [i.e. music publishing and record companies] to provide copyrighted music through a secure system and a secure channel.'"¹³⁵

For technology companies not selected to be a part of that platform, SDMI's failure to provide compatibility specifications will ultimately force them to become renegades that work outside of, and compete with, SDMI. If consumers accept the renegade's alternative to the SDMI-specification, SDMI will have failed in facilitating a universal specification and format.¹³⁶ Furthermore, if the renegade companies offer methods of obtaining online music for free (for instance, in the MP3 format), consumers may forsake the SDMI-endorsed system altogether.

¹³⁴ See *supra* note 116, available at <<http://www.businesswire.com>> (visited Nov 27, 1999).

¹³⁵ See Junko Yoshida, *Net-Music Players Hit Dissonant Notes*, ELECTRONIC ENGINEERING TIMES, May 3, 1999, 1; available at 1999 WL 2115731.

¹³⁶ Regarding SDMI's task to win consumers over from the often-pirated MP3 format, Liquid Audio's senior marketing director, Rick Fleishman said, "The challenge [for SDMI] is to come up with something as easy to use as MP3. If consumers don't like it, then the SDMI effort is all for naught." See Atwood, *supra* note 133, at 106.

4. Some Renegade Software And Technology Companies Have Already Declared Mutiny Against SDMI.

Instead of waiting for SDMI to develop their universal specification, some SDMI member companies have already starting marketing digital download processes outside the SDMI framework. Such activity indicates software and technology companies' unwillingness to wait for an SDMI specification that, even when it arrives, may not include their technologies. Leading the list of renegades is none other than Microsoft.¹³⁷

While SDMI scrambles to meet its pressing timetable, renegade software manufacturers race to establish a de facto digital-download standard. On April 13, 1999, Microsoft unveiled its Windows Media Technologies 4.0 ("WMT4") software, which "promises MP3-quality audio in about half the download time."¹³⁸ The player also incorporates a rights management system called Windows Media Rights Manager, which allows content providers and copyright holders to set parameters for the use of their copyrighted material. Microsoft will integrate Windows Media Technologies 4.0 into the latest versions of its Windows 98 operating system, as well as into the forthcoming Windows 2000.¹³⁹

Thus far, no major labels are supporting WMT4, since Microsoft is distributing its system outside of and without the approval of SDMI.¹⁴⁰ Despite the lack of support from the Big Five, some smaller but significant labels have signed on, including DreamWorks, TVT, Restless, Rykodisc, Hollywood, and Sub Pop. These labels have teamed with online distributor Launch Media, and plan to offer more than 50 unreleased free tracks on Launch's site, using the Microsoft technology.¹⁴¹

SDMI and the Big Five are also perturbed by RealNetworks, who

¹³⁷ See Brett Atwood, *Digital-Download Systems Spar for Dominance*, BILLBOARD, April 24, 1999, at 3.

¹³⁸ See *id.*

¹³⁹ See *id.*

¹⁴⁰ Another reason why majors have not supported WMT4 is because Microsoft refuses to remove the ongoing MP3 compatibility component in WMT4. See *id.*

¹⁴¹ See *id.* "Other companies planning to use the technology include broadcast.com, Tunes.com, ARTISTdirect, Liquid Audio, OnRadio, and amplified.com." See *id.*

recently spent \$75 million acquiring Xing Technology, a leading MP3 company that makes the ripper software AudioCatalyst.¹⁴² MP3 playback and Xing's ripper technology are soon expected to be fully integrated into RealNetwork's popular RealPlayer software, which reaches 57 million registered users. The digital downloading strategy will compete with Microsoft and any SDMI-approved specification.

Samsung Electronics has announced the development of a new line of portable MP3 "Yepp" players, to compete with the Diamond Multimedia's Rio.¹⁴³ The company previously said that the product will be launched only upon receiving approval from the RIAA. However, the RIAA will not approve anything until SDMI's Portable Device Working Group develops a universal specification for portable devices. Samsung is taking part in SDMI and has presented their technology as a suggestion for SDMI adoption. However, Samsung also expects to sell 500,000 units of the Yepp and anticipates cornering a 42% market share of the anticipated world market for portable players of digital downloads.¹⁴⁴ If the PDWG does not meet its self-imposed deadline by June 30, 1999, or if the PDWG accepts a competitor's specification for portable devices, Samsung will have to begin marketing the Yepp without SDMI approval if it hopes to meet expected projections. Here, again, technology companies are bypassing the anticipated SDMI approval and continue to provide consumers with methods of retrieving online music, whether or not it is copyright protected.¹⁴⁵

¹⁴² See *id.* at 88.

¹⁴³ See Williams, *supra* note 36, available at 1999 WL 5121720. The Yepp will be approximately the size as a business card, at 58 mm x 85 mm, and just 17 mm thick. The Yepp will each have 40 megabytes of memory, which can store ten average pop songs, and memory can be expanded through SmartMedia memory cards. Responding to consumers' tests, the new Yepp will also incorporate an FM radio, voice recording, and a basic telephone book function. See *id.*

¹⁴⁴ See *id.*

¹⁴⁵ In addition to Samsung, Creative Technology is another company working to market a competitor to the Rio. The new line of portable MP3 players will not be SDMI-compliant, as they plan to launch their Project NOMAD players before the SDMI announces its industry-approved portable device standard. See Brett Atwood, *Hardware Firms Ready Units With MP3 Compatibility*, BILLBOARD, March 20, 1999, Vol. 3 at 93.

B. SDMI May Be Reduced To Merely A Seal Of Approval, But The Ultimate Goal Of Obtaining Copyright Protection For Online Music Could Still Be Accomplished.

The combined reluctance of consumers and software and technology companies to wait for SDMI to develop a universal specification for digital downloading could drastically reduce SDMI's effectiveness even after such a specification is chosen. Scorned software companies will continue to offer consumers alternative methods of receiving music via the Internet, whether in an unsecured MP3 file format or another more protected format that went unselected by SDMI, such as Microsoft's. These SDMI-alternatives, if preferred by a sizeable segment of consumers, will spell the demise of SDMI's goal of universalizing a format for digital downloads. Worse yet, the flood of different methods of digital downloading will segment the consuming public even further, making a simple universal electronic method for collecting royalties almost impossible.

In addition, with the technology in this area constantly improving, any SDMI-endorsed universal specification may quickly become outmoded, likely by one of the technology companies whose product was not initially endorsed by SDMI. Though SDMI may falter in reaching its goal by the stated timetables, it has sparked the flame that will ultimately light the torch that leads the way to safe digital downloading. Even if its goals go unmet, SDMI will have forced software companies to speed the development of copyright-protected digital download formats, even more than one is ultimately used by consumers. With consumers choosing from fragmented methods of digital download, SDMI may become little more than an organization that grants its "stamp of approval" on any kind of digital download software or technology that complies with SDMI's stated objectives of protecting copyrights and collecting royalties. This is a diminished capacity from what SDMI initially set out to accomplish, but it will at least ensure that systems that meet its requirements will safeguard the rights of and compensate copyright holders.

V. DIFFERENT SEGMENTS OF THE MUSIC INDUSTRY SHOULD ADOPT DIVERGENT STRATEGIES FOR ADJUSTING TO LIFE IN THE BRAVE NEW WORLD OF DIGITAL DOWNLOADING.

As digital downloads augment and slowly usurp the market for traditional compact discs, we will see new changes in the relationships between artists and music companies, their agreements with one another, and their approaches to how they will prosper in the post-CD. Without the CD to stock store shelves and fill music companies' pockets with revenues, the music industry will witness a resurgence of the copyright as the primary device for bringing in revenues. Artists, independent labels, and the Big Five will all see online music redefine their roles and alter their traditional capabilities. New artists will bask in the inexpensive exposure online music can provide, and move one step closer to their fans. Independent labels, including those who function solely online, will provide the drawing board upon which the new artist-label relationship is defined. Finally, the Big Five music conglomerates face severe pressure to redefine themselves and develop new ways of raising revenue as their biggest cash cow, the compact disc, may get taken out to pasture.

A. *Artists: From Newly Emerging Bands To Certified Rock Stars, The Digital Download Regime Will Expand The Possibilities Of Reaching Fans Without The Traditional Reliance On A Record Label.*

1. To The Emerging Artist, Exposure Is Paramount And Can Be Achieved At A Drastically Reduced Cost.

The Internet, if properly utilized, could be an invaluable tool to the new or emerging artist. Once the new artist has made his self-produced record or demo tape, his most sought after, and oftentimes most elusive, asset is exposure. Before the Internet, for an artist to gain exposure, he would have to perform extensively at local venues, solicit recording companies, and drum up as much press as possible in radio and newsprint. To get the attention of these parties, the artist would at least have to print and send a CD or tape for their consideration, or secure the assistance of a manager or attorney to solicit for

them. To get his album circulated in record stores, the new artist would have to pay for art, printing, packaging, and distribution expenses. These can become some hefty expenditures. Moreover, even if a newspaper, concert venue, or radio station does agree to lend its services, resulting exposure is usually limited to the local geographic area.

The Internet, of course, reduces many of these costs and potentially leads to a wider exposure than any of these other media. Online music providers come in all shapes and sizes: from the college student "pirate" who posts his CD catalog collection merely to circulate his favorite music in search of common fans, to websites like MP3.com that offer hundreds of thousands of songs from known and unknown artists. No matter what size, all such online music providers can assist new artists in circulating their music.

Once a song is recorded, the new artist need only secure the use MP3 software and a high-speed modem to upload his song to the Internet. If the artist already has his music on compact disc, he can utilize ripper software to remove the tracks from the CD and upload them to the Internet as well. He may choose to upload the song to his own website, or find another MP3 website, perhaps an Independent Underground Music Archive¹⁴⁶ or MP3.com,¹⁴⁷ to carry the music for him.

The artist can choose whether he would like to allow the user to copy and download his song, or whether he wishes to have the song posted for transmission only on an online quasi-radio station. No matter which avenue he chooses, by getting his song on the Internet, he opens himself up to a new medium of exposure and to a potentially global audience.

a. *The Rap Model: Temporary Suspension Of Copyright Protection In Exchange For Increased Exposure.*

Of course, like the artists of the Big Five music companies who have their songs pirated, the new artist who allows a pirate to post his songs will have limited means of policing his copyright interests.

¹⁴⁶ Contact at <<http://www.iuma.com>> (visited Dec. 4, 1999).

¹⁴⁷ Contact at <<http://www.mp3.com>> (visited Dec. 4, 1999).

However, the new artist should be willing to suspend temporarily the security of his copyright in order to obtain exposure. New artists should heed the lesson of rap music, which has thrived despite limited resources. New rap artists incorporate novel methods of inexpensive promotion coupled with temporary suspension of their copyright interests to gain the exposure they need to break out of obscurity.

Rap artists attain their initial success and attract label attention through grassroots promotion in an urban area. Often, the rap artists have what is termed "street teams" of friends and fans who donate their time to fan out across cities distributing posters and stickers anywhere they can garner attention. Furthermore, new artist often leak advanced copies of an album to deejays who assemble mix tapes to be sold on street corners. These artists are willing to allow deejays, the street version of online music pirates, to copy, publicly perform, and distribute their copyrighted song without worrying about collecting royalties. These methods, though not the most secure for protecting copyrights, create a buzz sufficient to cause fans and eventually labels to take notice.

Uploading songs to the Internet is obviously different than setting up promotional street teams or leaking advanced CD's to deejays, but the underlying principles are the same. The new artist must be willing to temporarily sacrifice some of his copyright interests in those songs he chooses to post, hoping that exposure will provide a bigger payoff than a public performance royalty. Note that the copyright in a song is not lost when some of its rights are intentionally suspended. With the help of a newly updated and ever-expanding Copyright Act, any pirates posting unauthorized copies of a new artist's song in a manner undermining the artist's interests may be enjoined or sued.

b. Internet Exposure Can Also Attract The Attention Of Individuals Who Can Help Boost The Artist's Career, Such As A Label's Talent Scout Or A Prominent Artist.

Currently, bands create a buzz to court record companies by touring extensively, sending press kits that explain the band's accomplishments, or making cold-call solicitations to the Artist & Repertoire

staff.¹⁴⁸ These can become mounting expenses, which the Internet can reduce once a band posts its songs on the Web. Like the artists themselves, the record and music publishing companies will be able to monitor the buzz the band has created on the Web, and determine the response that the artist has received on sites carrying the artist's music. When the record company is deciding whether to sign an artist, they will not merely have to rely on their instinct or word-of-mouth to predict whether the artist will be successful, they will have numeric figures of how many and how frequently consumers have accessed the artist's music. Those that have visited the music sites are likely to be active consumers of music and part of a younger, more computer-literate demographic that is most likely to embrace new artists. In effect, the Internet will act as a testing sight the record company may employ to help predict whether a new act will be successful if signed.¹⁴⁹

In addition to attracting label attention, posting songs on the Web can also help new artists become an opening act for prominent national artists. Recently, pop superstars Tori Amos and Alanis Morissette announced that they will hand-pick their opening acts on their upcoming tour from the roster of bands who post music with MP3.com, which includes over 10,000 artists.¹⁵⁰ Furthermore, a full audio concert will be available on the MP3.com website upon the tour's conclusion, including the performances by the hand-picked openers.

¹⁴⁸ Artist & Repertoire ("A&R") Representatives are the individuals who scout and develop new talent for record labels and music publishing companies.

¹⁴⁹ The Independent Underground Music Archive tries to woo artists into employing their services by advertising that the online community they foster "includes a global audience of fans, radio station programmers, club promoters, and music industry A & R representatives who have already signed bands from IUMA to major labels." See <<http://www.iuma.com/IUMA-2.0/ftmp/IUMA-2.0/www/olas/subinfo/index.html>> (visited Nov 27, 1999).

¹⁵⁰ See Mike Drummond and Karla Peterson, *MP3.com, Superstars Bolster Ties*, THE SAN DIEGO UNION TRIBUNE, April 28, 1999, at C1; available at <1999 WL 4065456>. Note that the artists have chosen this method despite the fact that they are both signed to Time Warner record subsidiaries which are members of SDMI. MP3.com has announced it will also post concert photos, hold a chat forum with the artists and offer advance concert ticket sales. See <<http://www.mp3.com>> (visited Dec. 4, 1999).

2. The Internet Allows Established Artists To Remove The Barriers Of Record Labels And Radio To Instantly Access Fans And Consumers.

Artists who have achieved some notoriety have probably done so by signing with a major label and receiving significant amounts of air-play on the radio. Very often, labels will encourage their artists to record a certain way in an attempt to produce a sound that radio stations will play. While this goes a long way to establish an artist's fan base, it also compromises the artist's creative integrity in that the artist may be commercially releasing songs that the label and radio stations choose instead of the songs the artist wants to reach fans.

With the Internet, established artists are free to be as creative as they wish, for even if labels do not release or radio stations do not play a particular song, it will still be accessible to the artist's fans on the Internet. This will provide the benefit of bringing the artists one step closer to fans.¹⁵¹

Prominent band Soul Coughing, which is signed to the Warner Music subsidiary Slash Records, has been posting an "MP3 of the week" on its web site for nearly a year.¹⁵² These songs, which consist primarily of live and other unreleased tracks, are posted for free and cannot be found anywhere else. Whereas Warner Music may refuse to allow the band to release a certain song on any Warner album, now Soul Coughing has an outlet for that song that both they and their fans enjoy.

Artists can also use the Internet as a promotional tool for an upcoming release, to lure in potential consumers and start hyping their new music. Furthermore, receptivity towards the promotional track posted on a band's website can be an early indicator of how the record will do when it is finally released. "It helps in terms of publicity, letting people know your record is coming out," says Richard Valentin, vocalist for the group Poster Children, whose latest release is available

¹⁵¹ "Listeners are dominated and intimidated by the record stores and the radio into what they should listen to. So this is a wonderful way for artists and fans to bypass that," says country / blues recording artist K.D. Lang. See Jensen, *supra* note 2, at 37.

¹⁵² See <www.soulcoughing.com> (MP3 no longer available; Liquid Audio songs available on a monthly basis.).

in both CD and MP3 form, through GoodNoise.¹⁵³ Before the record was commercially released, the band posted one free song on the GoodNoise website which was downloaded over three thousand times in the first week.¹⁵⁴

3. Established Artists Can Receive Better Financial Deals By Going Straight To Large Online Distributors Instead Of Relying On Record Labels And Brick-And-Mortar Record Stores Which Take A Substantial Cut To Promote Their Albums.

Unlike artists and independent labels, the Big Five music conglomerates all have their own distribution system in place that can guarantee that its artists' albums are stocked in brick-and-mortar record stores across the country.¹⁵⁵ For many artists, this is the prime attraction of signing with a major label, as it ensures that the artist's songs will make their way to consumers who frequent such record store chains as Tower, Sam Goody, Camelot, Wherehouse, HMV, and others.

In the world of online, however, there are already a number of established "megastores" that offer consumers products they want, and such online megastores have not hesitated in providing compact discs as one of their wares for sale.¹⁵⁶ By dealing directly with these online megastores, established artists can bypass the need for major labels and their distribution systems, to sell their music directly to a massive consuming public.

Online giant retailers that carry or specialize in music, such as Amazon.com,¹⁵⁷ CDNow,¹⁵⁸ and Music Boulevard¹⁵⁹ can provide

¹⁵³ See Vankin, *supra* note 5, at 36.

¹⁵⁴ See *id.*

¹⁵⁵ See Passman, *supra* note 68, at 85.

¹⁵⁶ In addition to the online megastores, there are many smaller "mom-and-pop" online retail stores that can be accessed by music consumers. "Click on the the Yahoo! search engine, type in 'music online shopping, and you will get a directory of nearly 200 sites." See Dean Foust, *Click Here for Sinatra— And Savings*, BUS. WK., July 6, 1998, at 91.

¹⁵⁷ See <<http://www.amazon.com>> (visited Dec. 4, 1999).

¹⁵⁸ See <<http://www.cdnw.com>> (visited Dec. 4, 1999); "For sheer ease of use, CDNow stands out from the pack, with a clean design and the smartest search capa-

artists with direct access to consumers, without the need of a label or brick-and-mortar record store.¹⁶⁰ Online retailers' drastically reduced overhead also enables them to take a smaller percentage of sales than the record label - record store network would take.¹⁶¹ Indeed, by capitalizing on this unique aspect of their operation, online retailers have begun to turn the tables on traditional shopping centers. "By pioneering—and darn near perfecting—the art of selling online, it is forcing the titans of retail to scramble onto the Net. More than that, it's jolting them into rethinking whether their traditional advantages — physical size, mass media branding, and even the sensory appeal of shopping in stores— will be enough to thrive in the New Economy."¹⁶²

In addition to sheer volume and reduced overhead, which translate into a reduced cut for the retailer and thus more artist royalties, the dynamics of shopping online at one of these megastores can provide additional advantages for artists. First, they may be able to reach fans that would not otherwise venture to typical brick-and-mortar stores, especially consumers from the baby-boom generation. "A 45-year-old

bilities." See Foust, *supra* note 156, at 91.

¹⁵⁹ See <<http://www.musicblvd.com>> (visited Dec. 4, 1999); "Music Boulevard has a unique feature: the site automatically displays the cover art for many titles it has by an artist you select." See Foust, *supra* note 156, at 91.

¹⁶⁰ The operations of these giant online music retailers center around the consumer ordering the CD on their website with his/her credit card, and the retailer then sending the CD to the consumer a day or two later. Some online retailers have also begun carrying digital downloads that make the delivery of the purchased music almost instantaneous.

¹⁶¹ Amazon.com began as an online bookstore before it expanded into the sale of CD's online. Already it has shown its ability to outmode typical brick-and mortar bookstores, such as Barnes & Noble. Amazon.com carries over 3.1 million titles, which is fifteen times more than any bookstore on the planet and without the costly overhead of multi-million dollar buildings and armies of store clerks. "That paves the way for each of its 1,600 employees to generate, on average, \$375,000 in annual revenues— more than triple that of No.1 brick-and-mortar bookseller Barnes & Noble Inc.'s 27,000 employees." See Robert D. Hof, ET AL., *Amazon.com: The Wild World of E-Commerce— By Pioneering- and Damn Near Perfecting - the Art of Selling Online, Amazon Is Redefining Retailing*, BUS. WK., Dec. 14, 1998, at 106.

¹⁶² See *id.* Says Duke University marketing professor Martha Rogers: "Amazon is an example of how an upstart can redefine its whole industry."

guy doesn't want to hand his Frank Sinatra CD to a kid with a mo-hawk and a nose-ring,' said Jason Olim, CDNow's President."¹⁶³ In addition, fans of established but more obscure artists will be able to locate the albums they want online where they would otherwise be unable to find them in typical brick-and-mortar stores.¹⁶⁴ Established artists of yesteryear often find themselves getting bumped in traditional brick-and-mortar retailers to make room for newer releases from currently popular artists. The releases of these artists are often hard to locate, or if they are, it is often as a "used CD," which do not pay royalties to the artists.¹⁶⁵ Because they will not be taking up physical space, online music retailers can stock these otherwise neglected albums, sell them to fans on the Web, and ensure that artists are properly reimbursed when the online sale is consummated.¹⁶⁶

Finally, artists can benefit from online music retailers who can monitor individual consumers' tastes, and thereby recommend purchases that would suit a particular consumer's favorite artist, genre, musical period, or type of release. These retailers can "automatically analyze past purchases to make recommendations customized to each buyer—a trick that confounds 20th Century mass marketing."¹⁶⁷ Fur-

¹⁶³ See Roy Furchgott, *What Moves Mel Torme? The Web*, BUS. WK., May 26, 1997, at 8.

¹⁶⁴ "If you're a fan of obscure Chicago bluesman Washboard Sam but live in rural Vermont, your chances at finding the recording you want in a local records store may be next to nil. But thanks to the Internet, you don't have to drive hours to Boston to search. Instead, you can shop from a growing number of online stores offering everything from bebop to Beethoven at discounts of up to 40%." Foust, *supra* note 156, at 91.

¹⁶⁵ 17 U.S.C. § 109(a) (1999): First sale doctrine dictates that while copyright owners such as artists control the first sale of a copy of their product, and receive compensation from such sale in the form of royalty, they are no longer entitled to regulate or monetarily benefit from any future sale of that same copy. Used CD's paid royalties to the artists upon their initial sale. Once the customer lawfully owns a copy of the CD however, he may dispose of it as he wishes without concerning himself with the interests of the copyright owners. Hence, he may sell it back to a CD store, who in turn sells "used CD" to a second consumer at a reduced price, and pockets the entire profit without remitting any to the copyright owners.

¹⁶⁶ "[B]oomers probably won't find the complete recordings of favorites such as Grand Funk Railroad in a store, but they are likely to online," said Jason Olim, President of CDNow. See Furchgott, *supra* note 163, at 8.

¹⁶⁷ See Hof ET AL., *supra* note 161, at 106.

thermore, with a single mouse-click, consumers can place an order over the web site, which makes shopping a congenial, frictionless experience that can take less time than locating the record store in a shopping mall.¹⁶⁸ Such amenities of online shopping will help artists make sure that the fans will be able to purchase a copy of their album.

Better financial arrangements and more convenient access to fans have already prompted a number of established artists to sign deals with online retail megastores for the exclusive rights to distribute their albums.¹⁶⁹ Amazon.com has signed exclusive deals with well-known recording artists Sarah McLachlan and Cheap Trick.¹⁷⁰ Amazon, who had previously only sold and sent physical CD's to online buyers, is now offering a digital download service as well, which carries some free promotional songs off McLachlan's CD, *Mirrorball*.¹⁷¹

Amazon's exclusive arrangement with Cheap Trick covers only a sixty-day term and one album, a live compilation recorded last year while the band was on tour.¹⁷² These arrangements are helping both the band and Amazon. "Any retailer aspires to have an exclusive window, and here's a band that has a fan base that clearly wants a new record," said Amazon director of merchandising/music, Bob Douglas. "And we can get it to them without much effort."¹⁷³ Amazon is also providing a link to Cheap Trick and Sarah McLachlan's fan web sites, to help increase additional sales of these artists' back catalogs.¹⁷⁴

¹⁶⁸ *See id.*

¹⁶⁹ These deals with well-known artists benefit the online retailer as well by increasing traffic to their sites. *See id.*

¹⁷⁰ *See* Eileen Fitzpatrick, *Online Retailers, Artists Team for Exclusive Deals*, BILLBOARD, Apr. 24, 1999, 1, at 80.

¹⁷¹ *See id.*

¹⁷² *See id.*

¹⁷³ *See id.*

¹⁷⁴ Cheap Trick's exclusive deal with Amazon.com has not been without certain negative consequences. Trans World Entertainment, another distributor with both traditional (CD) and online (digital download) segments, has announced it is refusing to carry Cheap Trick's album on its e-commerce site after Amazon's 60-day window is up, in protest against the exclusivity with Amazon. *See id.*

4. Artists Can Start Their Own Online Label To Produce, Market, And Distribute Their Own And Like-Minded Artists' Music; But Skeptics Question Whether Emerging Artists Can Effectively Reach The Masses Without The Help Of A Label.

Artists can formulate their own web site utilizing digital download technology (whether MP3 or a more copyright protected alternative) to disseminate their music to consumers and fans. As explained above, online music makes starting one's own label all the more feasible as it removes the need for warehouses, trucks, and labor, as well as drastically reducing manufacturing and distribution costs. By distributing the music themselves, artists can remove all middlemen and reap any profit derived from the sale of CD's or digital downloads from their web site. Web sites can offer songs for sale, promotional songs for free download, advertisements of an artist's upcoming gigs, and other information and merchandising from the band that fans and consumers might desire.

Artists have already begun to do this, with moderate success. San Francisco band, Stru Tural, began their own label Ixchel Records, which is a label currently solely dedicated to disseminating Stru Tural's music.¹⁷⁵ The band offers both CD's for sale and MP3 clips of songs from their latest releases, and traffic to its site has nearly doubled since they added the MP3 offerings.¹⁷⁶

The concept of artist-as-label evolved long before online music became a reality, and artists who successfully ran their own labels realized significantly higher profit margins per sale than artists who signed with traditional record labels. Singer-songwriter Ani DiFranco started the label Righteous Babe Records in 1990, when larger record labels were not interested in her music. Since then, Righteous Babe has distributed all ten of DiFranco's releases, sales of which have produced profits that DiFranco splits with no one.¹⁷⁷

¹⁷⁵ See <<http://www.strutural.com>> (last modified Oct. 21, 1999).

¹⁷⁶ See *id.*

¹⁷⁷ It costs Righteous Babe \$1.85 to press a disc, and overhead to pay DiFranco's staff brings the total cost to \$3.85. She sells about two-thirds of her output to record stores at \$7.25 wholesale; the rest direct to consumers at \$15. Her average net per

Of course, the retention of profits does not accomplish much if the self-made label cannot push record sales. DiFranco's release in 1993 generated sales of \$75,000 while her expenses amounted to \$74,000.¹⁷⁸ While her latest releases have proven more successful, an artist-as-label can have difficulty developing a fan base matching that of an artist promoted by a major record label. Especially with the influx of artists racing to the Internet for exposure, representatives of the Big Five are skeptical whether artists will have the ability to market and promote their releases to the point where they actually get noticed and attract consumers to their web sites. "You'll see a rush of artists abandoning labels and releasing their music directly over the Net," says Ahmet Ertegun, co-chair and co-CEO of the Atlantic Group. "But then they'll come back when they realize they're not making any money."¹⁷⁹

Paul Vidich, Warner Music Group's senior vice-president of strategic planning elaborates. "There are many expenses that labels absorb so artists don't have to. You need inventory, people to distribute it, to maintain your site. It's time consuming and not particularly exciting."¹⁸⁰

While power players like the Big Five expect that artists will continue to rely on them to bankroll and administer their releases, there is a strong indication that they will be circumvented by a flurry of independent labels that can also infuse the Internet's capabilities with the traditional role of a record company.¹⁸¹

disc is \$4.25. Under traditional standards, rock musician of DiFranco's stature generally nets less than \$1.25 per album. See Joshua Levine, *Prince Speaks*, FORBES, Sept. 26, 1996, at 181.

¹⁷⁸ See *id.*

¹⁷⁹ See Jensen, *supra* note 2, at 37.

¹⁸⁰ See *id.*

¹⁸¹ Independent labels are those that are not owned by the Big Five, but are generally larger and handle more acts than an artist's self-started own label. Independent labels actually come in two primary forms. Some independents, called "major-distributed independents," have little or no staff and simply sign artists and contract with majors to perform all functions except recording records. These companies specialize in finding talent and to ensuring that the major with the distribution system actively promotes their product. The other type of independent label is the "true independent," which has no affiliation with a major but instead is financed by its own-

While still striving for profits, independent labels are much less rooted in traditional formulas of turning music into money than the Big Five. The Big Five are less inclined to allow artist's to "bully" them into altering their age-old contractual provisions simply because music can now be distributed online. Conversely, artists who sign with independents will be able to alter and manipulate their contractual agreements such that they more accurately reflect the artist's increased bargaining power and the artist's newfound potential of reaching consumers with the Internet as a primary tool. Independent labels should continue developing their own unique approaches to online music, and the recording agreement between artists and independent labels will come to reflect the material alteration online music has had on the artist-label relationship.

B. Independent Labels, And Their Contracts With Artists, Will Be Where The Music Business First Acknowledges The Internet As An Industry-Altering Phenomenon, And Will Reflect The Reduced Costs Associated With Distributing A Record Via Digital Download.

Artists have often signed with independent labels when the major labels ("majors") are not interested, or when they feel that an independent label ("independent") will provide a more hands-on and personal approach to their promotion and long-term development. Independent labels also appeal to artists who do not have a commercial sound or who appeal to a more sophisticated music listener, as this type of music does not generally sell well and therefore does not receive much support from the Big Five. Signing with an independent has always entailed sacrificing the huge bankrolls and international distribution channels that the Big Five can provide. Nevertheless, independents provide a good "minor league" for emerging artists to showcase their talent to attract major label attention, and afford artists more bargaining power in negotiating record contracts.

Certain independent labels, especially those who operate princi-

ers and investors. True independents traditionally distributed their records through independent distributors (i.e. not affiliated with a major label). See Passman, *supra* note 68, at 87-88.

pally online, have already begun to offer artists contracts that give artists the benefits of more ownership and control of their sound recording copyrights,¹⁸² and a better split of the profits. These benefits have been a direct result of the new online music environment. The traditional record contract used by the Big Five and its affiliated labels contains many arcane and outmoded provisions whose enforcement may seem grossly inappropriate in the context of digitally downloaded music. By recognizing this and altering their contracts, independent labels will be the fertile ground upon which the new artist-label relationship develops in the twenty-first century.

1. Outmoded Contract Provisions In The Big Five's Adhesive Record Contract Will Not Be Enforceable Once Artists Understand The Dynamics Of Online Music And Insist Their Contracts Reflect These Dynamics.

In exchange for the sound recording copyright and the majority of proceeds from album sales, the traditional record contract provides the artist with two principle sources of funds. The first is the advance, which is paid upfront, often before the artist even enters the studio. The advance is intended to cover the artist's living expenses, recording/producing expenses, promotion expenses, equipment expenses, and album artwork expenses.¹⁸³ Often artists do not even receive the entire advance because they spend up to 25% to pay his/her manager, attorney, accountant, and the government in the form of income taxes.¹⁸⁴ The second source of revenue is a royalty based on album sales, which for new artists is generally set at eight or ten percent of the suggested retail list price.¹⁸⁵

The advance is essentially a loan, however; because though the

¹⁸² Recall that the sound recording copyright is what recording artists (or their record company) owns, whereas the songwriter (or their music publishing designee) owns the musical composition copyright.

¹⁸³ See Sarah Luck Pearson, *The Suit: An Anonymous Executive Talks*, L.A. WEEKLY, Mar. 26, 1999, at 32.

¹⁸⁴ See *id.* at 32.

¹⁸⁵ See Passman, *supra* note 68, at 92. The suggested retail list price is an approximation of the price received by the *retailer*, not the price received by the record company from the wholesaler. The suggested retail list price tends to hover at a few dollars more than what the retailers ultimately charge the consumers.

artist gets to keep the advance money no matter what, he will not begin realizing profits from his record sales until he repays the advance to the label. The artist must repay his advance out of that eight or ten percent, before he/she sees any additional proceeds from his album. In the eight percent royalty scheme, if the suggested retail price of the CD is fifteen dollars, only \$1.20 of each CD sold can be used to recompense the label for the advance, which might have been many thousands of dollars. The pot of money remaining from each CD sold is divided between the record label, distributors, and retailers. Even after the record company had recouped its actual expenses (the advance plus distribution costs) from this pot, the traditional record contract does not pay the artist money from his CD sales until he has reimbursed the label the amount of his advance out of his paltry \$1.20 per CD sold.

The label will of course be willing to advance the artist more money, in exchange for a contract extension including more future album releases. Due to an industry device called cross-collateralization, even if future albums succeed, royalties from these albums, which would otherwise be payable to the artist, are instead used to eradicate artists' past debts from previously unrecouped advances.¹⁸⁶

Beneath the basic framework of the traditional recording contract lie certain contractual provisions that works to further reduce the artist's royalty. Each of these provisions will become completely irrelevant in the context of digital downloads; and independent labels can lure artists by acknowledging this in their revised record contracts.

a. Packaging Charge/Deduction

The royalty base of each compact disc sold, from which artists are paid, is not reached until a "packaging charge" is deducted from the

¹⁸⁶ Indeed, signing a traditional record contract in no way guarantees success or even a livelihood based on recording music. According to Pollstar, only 225 of the 4,500 to 6,000 artists being promoted and distributed each year will ever make money for their record companies—let alone for themselves. "No matter how much the record companies inflate their dreams, or how savory the \$250,000 advance sounds, the vast majority [of signed artists] will never rise above the poverty line." See Sarah Luck Pearson, *For the Record: The Life and Pre-Mature Death of Mary's Danish*, L.A. WEEKLY, Mar. 26, 1999, at 24.

suggested retail list price of the CD.¹⁸⁷ The packaging charge is generally 25% of the suggested retail list price.¹⁸⁸ Hence, if a compact disc's suggested retail list price is \$15.00, the packaging charge would be 25% of \$15.00, or \$3.75. Therefore, the artist gets paid his 8% royalty from sales of albums, not at their full suggested retail list price (\$15.00), but rather from said price reduced by the packaging charge (\$15.00 - \$3.75 = \$11.25).

The packaging charge already represents an inflated representation of what the packaging actually costs the record company. In addition, the packaging charge will be reduced to zero with digital downloads, as the download does not require packaging, it is simply transmitted to a paying online consumer's hard drive. Artists should recognize this discrepancy and ensure that the royalty base for digital download is not artificially diminished by the "packaging charge" which has no application in the realm of digitally downloaded albums.

b. "Free Goods"

In the traditional recording contract, royalties are paid for each record that is actually sold, not for each record that is made and distributed. Record companies developed a concept called "free goods," which is effectively a method of discounting the purchase price, and thus the artist's royalty.¹⁸⁹ Instead of selling a retailer one hundred records at 85 cents, they would sell eighty-five records at \$1.00 a piece and give the retailer fifteen more for free. Royalties from sales of the fifteen "free" CD's are not paid to the artist. By raising the price and giving away records for "free," record companies saved royalties on fifteen out of every 100 records while still earning the same money from retail.¹⁹⁰ Because the artist's royalty is based on retail, the artist gets no benefit from the inflated wholesale price. So even when 100

¹⁸⁷ "In theory, [the packaging charge represents] the cost of the package, and it's deducted because the artists should only get a royalty on the record, not the package. In reality, it's a charge of much more than any package actually costs, and is thus only an artificial way to reduce the artist's royalty." See Passman, *supra* note 68, at 92.

¹⁸⁸ See *id.*

¹⁸⁹ See *id.* at 93.

¹⁹⁰ See *id.* at 94-95.

records are sold, artists will only receive royalties on 85, because record companies figure they do not have to pay the artist royalties on the free records.¹⁹¹

There is no conceivable reason why free goods would be included in a recording agreement that anticipates distributing the record by digital download. Since record companies can provide online megastores and other online retailers with a single template file from which to copy and transmit requested songs, there would be no reason to provide such online retailers with any “free goods.” By negotiating the removal of this outmoded contractual provision with regards to digital downloads, artists can further guarantee their royalties accurately reflect the precise number of albums that are actually sold.

c. Promotional Copies

Traditionally, record companies have given away numerous free copies of newly released compact discs to radio stations for airplay and record stores for in-store listening stations.¹⁹² Though they are intended for deejays and listening posts, promotional CD's often end up being sold in record stores at reduced prices because whoever sold them to the store obtained them for free. Artists are not paid royalties on these units, but they are charged for their production and distribution.¹⁹³

With digital downloads, there are no real charges for “manufacturing” copies to be used as promos, and there is no distribution cost. Record companies will be able to issue promos without actually accruing costs to the artists that must be recouped.¹⁹⁴ While artists still

¹⁹¹ See *id.* at 95. Note that approximately half the record companies have discontinued utilizing the fiction of free goods to omit their obligation of paying royalties on all records sold to retailers. However, these companies simply contractually provide that they will only pay royalties on, for example 85% of the sales. So the result is precisely the same, whether the company utilizes the free goods scenario or simply pays on less than the full amount of records sold.

¹⁹² See *id.* at 96.

¹⁹³ See *id.* at 97. The production and distribution costs associated with these “promos” are added to the artist's account, which must be recouped out of the artist's royalties before artists begin profiting from their recording.

¹⁹⁴ Independent label Rykodisc has already been experimenting with issuing free promotional MP3's on GoodNoise's web site to advertise upcoming releases. See

will not be paid royalties on promotional downloads, they will at least be able to ensure costs associated with producing and distributing the promotional copies will not be used to balloon their unrecouped account with the record company.

d. "Reserves Against Returns"

Records, cassettes, and compact discs are sold on a 100% return privilege. Thus, if the retailer orders 100 compact discs from the company but cannot sell them, it can ship them back to the record company and receive full credit or a refund for the price it paid. Particularly with a new artist, companies cannot predict whether the records they ship will sell or be returned by the retailer some time in the future.¹⁹⁵ Because of this uncertainty, record companies traditionally contract to keep a portion of the royalties that would otherwise be payable to the artist until they are certain whether the sales to the retailer are final. This holdback is termed a "reserve against returns."¹⁹⁶

By selling directly to the consumer online, independent labels can reduce any chance that downloads sold will be returned. Furthermore, even if the independent decides to sell through an online megastore like Amazon.com, it can simply license a template to Amazon from which Amazon can make copies and digitally download the copies to purchasers when ordered. This means that the number of digital downloads will equal the number made, thus eliminating the need for reserves against returns.

e. "Breakage" Clause

Finally, the payments to the artists are also artificially reduced by

Catherine Applefeld Olson, *Ryko Licenses Songs for MP3*, 9 BILLBOARD, Feb. 13, 1999, at 111.

¹⁹⁵ See Passman, *supra* note 68, at 97.

¹⁹⁶ See *id.* A typical reserve for new artists is 35%, which drastically reduces the total amount of units from which the royalty is computed. This total amount of units is already less than the records that are actually sold because due to the "free goods" phenomenon. Here we see how the record company has used its contract to twice artificially reduce the total pool of records from which the artist's royalty is computed.

the contractual provisions that cover breakage during shipping. This type of arcane provision arose when records were made of vinyl and shellac, and were therefore highly prone to breakage. Companies, including Big Five constituents A & M and Atlantic Records, only pay royalties on 90% of the shipment, keeping the remaining 10% of the shipment to cover the breakage of compact discs, which rarely break. This deduction is in addition to the free goods, and a completely separate calculation. Music attorney Donald Passman explains that “there is no logical reason for this— it is a total rip-off that arbitrarily reduces [the artist’s] royalty by 10%.”¹⁹⁷ Therefore, when a company pays royalties on 90% of net sales under the breakage provision, the artist is being paid on 90% (for “breakage”) of 85% (for free goods), resulting in payment on only 76.5% of records sold.¹⁹⁸

Breakage provisions are arguably already outmoded in the age of the compact disc, but companies could argue that breakage of the plastic packaging can effectively preclude a unit from being sold. In the era of the digital download, however, record companies will not be able to sincerely argue that the downloads can be subject to a breakage deduction. Even farther removed from the shellac records, digital downloads are not “shipped” in a fashion that could result in breakage, they are digitally transmitted through modems and wires. While there is always a chance that a transmission may fail, the download can simply be recopied and sent from the template, without incurring any costs for breakage. In effect, “broken” digital downloads do not incur any costs to the record company; they can simply be discarded in the “trash can” of a consumer’s PC to make room for a new transmission. Here again, the traditional record contract is outmoded in the context of digital downloads.

f. “Records” Expansively Defined

In light of the incessant flow of technological innovations that have and will affect Internet music, the most troublesome clause of the traditional record contract is the expansive definition of the term “record.” In a typical recording agreement, the artist assigns either all or

¹⁹⁷ See *id.* at 99.

¹⁹⁸ See *id.*

half of the copyrights in his record to the label. Under virtually every recording agreement drafted since the 1960's, "record" is defined as both an audio-only and an audiovisual device.¹⁹⁹ Furthermore, the definition of "records" also includes any other device "now or hereafter known that is capable of transmitting sound alone, or sound with visual images."²⁰⁰

Effectively, this means that when the artist signs the contract, the record company owns the copyright to not only the record (audio-only) but also any manifestation of the record in visual form as well. Up until now, this has not been all that problematic, as the only manifestation that the record takes in visual form would be a music video. The outlet for videos has been restricted to cable television channels such as MTV, VH-1, and The Box. Only the top echelon of musicians, typically backed by major labels, have the budget and connections to make a video and have it played on MTV.

The Internet will expand the outlets for which music videos can be showcased. In 1999, online companies such as Sputnik7.com and Launch Media launched music video webcasting sites that will provide alternate avenues for showcasing videos.²⁰¹ Furthermore, just as the MP3 revolutionized audio-only compression, it will not be long before audio and video digital data will be compressed into a file format similar to the MP3 and available for use by musicians with high and low budgets. Already, the Moving Pictures Experts Group, who pioneered MP3, is preparing to launch MPEG-4 (MP4), which merges compression for audio, video, and computer graphics into one compact package.²⁰² Once a music video is compressed into MP4 file form, it

¹⁹⁹ See Passman, *supra* note 68, at 89. This is particularly remarkable, as audio-visual devices had not been invented yet in the 1960's; yet companies anticipated their development, despite the fact that no one knew exactly what form they would take.

²⁰⁰ See *id.*

²⁰¹ See Doug Reece, *New Ventures Anticipate Rise of Online Video*, BILLBOARD, February 13, 1999, at 110. Launch Media's site, Musicvideos.com, will offer users video-on-demand choices while Sputnik7.com will offer a steady pre-selected stream of music videos as well as user polls, quizzes, and a retail link to Amazon.com. See *id.*

²⁰² MP4 is being engineered with an Intellectual Property Management and Protection interface, MPEG's answer to copyright protection of creative content on the

can be easily submitted to Sputnik7.com or posted on an artist's own webpage and offered for sale, in the same way MP3 files are sold. MP4 can be also be employed to post actual concert footage on an artist's web page, again to be downloaded per song or per concert.²⁰³

Without a more narrow definition of "record" in their contracts, artists will forsake the copyrights to not just the sound recording of the song, but also all visual manifestations of the sound recording as well. Once MP4 and online videos enter the music scene and evolve into commercial items (like MP3), record companies will arguably be getting more than they bargained for under their current definition of "records". Each copyright they acquire will potentially be the source of various revenue-producing media— in both audio and audio/ visual forms. Artists must either negotiate to restrict the definition of "record" in their recording agreements to audio-only, or else demand higher advances and greater royalties to reflect the record companies newly acquired revenue sources.

2. The Independent Online Label Is Still Taking Shape: Both Traditional Independent Record Labels And Online Companies That Provide Digital Downloads Have Begun Experimenting With New Contractual Models That More Accurately Reflect The Dynamics Of Online Music.

Without the need for capital to physically manufacture, package, and distribute millions of units to record stores, independent labels can now compete with the Big Five to push their artist's music online. Still unresolved is who will become the dominant online independent: the traditional independent who now acquires the expertise to launch its artists online, or the online music company currently offering digital downloads that expands its role to become a label. Traditional in-

Internet and management of all associated rights. See Weiss, *supra* note 12, at 42.

²⁰³ The lengths to which compressed audio-video digital music may go is almost mind-boggling. One can anticipate artists even streaming live acoustic performances for visitors to their web site. Collections of live performance digital downloads, which enhance the listener's connection with the artist, may become as popular as audio-only collections. A portable player analogous to the Rio, but complete with audio and visual capabilities, cannot be far behind.

dependents are more familiar with the dynamics of the music industry, as well as traditional notions of how best to market and promote artists' new releases, than the dynamics of digital delivery of music. Conversely, online music companies that offer digital downloads are more familiar with the dynamics of turning digital downloads into revenue than the dynamics of the record business. Both are trying to learn each others' roles in the hopes luring artists into signing with them so they can share in the revenues stemming from digital downloads.

Since the MP3 file format became popular, companies such as GoodNoise, MP3.com, Twin/Tone, Music Previews, Internet Underground Music Archive, and N2K all sell digital downloads of independent artists' music over the Internet.²⁰⁴ Some of these companies have elected to form contracts and partnerships with artists to function as actual record labels, instead of mere bulletin boards or service providers for these artists. MP3.com, for example, started by simply providing artists a free web page to showcase their songs in MP3 file form.²⁰⁵ Artists could include songs, logos, album graphics, artist biographies, song lyrics, and links to artist websites.

While the above service is still provided for free, MP3.com has also ventured into the arena of becoming an online label for interested artists. The web site launched its Digital Automatic Music label (or "DAM"), and claims to "put the music business back in the hands of musicians."²⁰⁶ The DAM label pays a bona fide 50% royalty rate, and requires no signup fees, administration or accounting costs typically associated with traditional record deals. DAM will promote the artist's CD, and offer to sell the CD on the MP3.com website. Therefore, when a CD sells for \$7.99, the artist will receive approximately four dollars.²⁰⁷

In addition to a more artist-friendly royalty split, the DAM label has left the terms of the agreement completely in the hands of the art-

²⁰⁴ See Doug Reece, *Digital Distribution Making Inroads*, BILLBOARD, Aug. 22, 1998, at 43.

²⁰⁵ See <<http://www.mp3.com/newartist/learnmore.html>> (visited Nov. 4, 1999).

²⁰⁶ See *id.*

²⁰⁷ Presumably, as soon as the MP3 file format dons copyright protection or another protected file format replaces MP3, DAM will agree to sell digital downloads under the same royalty split.

ist. Where a traditional label usually asks for exclusivity for a period of years,²⁰⁸ the DAM label allows the artists who sign with them to break the deal whenever it suits them. The DAM agreement asks for no exclusive or future rights, and is terminable at will by both parties.²⁰⁹

The online company GoodNoise, while not calling itself a label, also provides fifty-fifty split to the artists or labels it distributes. GoodNoise sells digital downloads of songs for ninety-nine cents each and albums for \$7.99, and splits all profits with the artist.²¹⁰ Popular recording artists They Might Be Giants have signed a deal with GoodNoise to distribute their entire catalog and two new albums under this format.²¹¹

While online companies struggle to assume and understand their new role as label, other traditional independent labels struggle to assume and understand their role as online company. One independent who is off to a good start is the online label Atomic Pop. It has inked a deal with prominent rap group Public Enemy to release the band's first new album in five years, via digital download, in May 1999.²¹² The entire album will be sold for eight dollars. The deal is a combination of new and old record industry practices. For example, under the agreement Public Enemy is not expected or required to deliver a set number of albums and does not have to stay with the label for a specific time. The rap group contemplates a doubling of their royalties in comparison to what they received in the past from traditional labels.²¹³

In an effort to help themselves navigate the world of online music, many traditional independent labels have begun to partner with companies like MP3.com and GoodNoise, to begin to understand how their artists' music can be exploited via digital download. In March

²⁰⁸ "Exclusivity" generally means that an artist may not record albums for any other label for the duration of the contract. Recording contracts generally are tied to a term of years or a specified number of albums, with extension options available to the record label.

²⁰⁹ See <<http://www.mp3.com/newartist/learnmore.html>> (visited Dec. 4, 1999).

²¹⁰ See Jensen, *supra* note 2, at 37.

²¹¹ See *id.*

²¹² See Fitzpatrick, *supra* note 170, at 80.

²¹³ See *id.*

1999, the Seattle-based Sub Pop label (best known for discovering rock group Nirvana), partnered with MP3.com to make many of the songs by its artists available for free downloads.²¹⁴ In April 1999, Platinum Entertainment (the parent conglomerate of numerous mid-sized independent labels) signed a deal with MusicMaker.Com, which specializes in made-to-order CD compilations, to create the Web's largest commercial MP3 site, making available a reported 200,000 downloadable tracks from hundreds of artists.²¹⁵

The traditional independent label Rykodisc, has also recently licensed a sizable portion of its catalog to GoodNoise for both sale and promotion in MP3 file format.²¹⁶ GoodNoise will post an initial 200 songs from the Rykodisc catalog which consumers can download for ninety-nine cents each and pay royalties to Ryko's artists in alignment with GoodNoise's pact with the Harry Fox Agency.²¹⁷ A handful of songs from the Rykodisc catalog will also be offered for free as promotional items that will be posted before their commercial street date.²¹⁸

- a. *Online Independent Labels That Strive To Sign Artists Must Be Equipped To Handle Typical Artists' Needs As Well As The Digital Download Of Their Music.*

While online music companies such as MP3.com and GoodNoise

²¹⁴ See Vankin, *supra* note 5, at 36.

²¹⁵ See *id.*

²¹⁶ Rykodisc's artists whose music will be available on GoodNoise include Frank Zappa, Morphine, and Josh Rouse. In the music industry, Rykodisc is already considered a trailblazer in the field of embracing new technology—the label was founded as the first CD-only record company. GoodNoise President and CEO, Gene Hoffman says he expects many companies to follow Rykodisc's lead: “[Rykodisc executives] Don Rose and Chris Blackwell have always been trailblazers, and they are saying this is an interesting new medium to use as means of promotion and sales. Other people look up to those individuals to see what they are doing. See Olson, *supra* note 194, at 9.

²¹⁷ See Lichtman, *supra* note 61, at 9 (explaining that Harry Fox issued GoodNoise its first Digital Phonorecord Delivery License for delivering songs in MP3 format. GoodNoise will pay the publishers, who in turn pay the songwriters, the statutory rate of 7.1 cents per song downloaded.).

²¹⁸ See C.A. Olson, *supra* note 194, at 9.

have begun to sign artists to very artist-friendly record contracts, these companies will probably not evolve into the model of the online label. These companies are more concerned with selling a variety of MP3/digital download product than they are with artist development and personalized promotion. In fact, there is a strong chance that MP3.com and GoodNoise (and their progeny) will simply develop into the online record stores that sell product independent of artist or label.²¹⁹

Artists generally want a label that will help them develop and who will cultivate a hands-on, individualized approach to their promotion. Indeed, promotion and advertising will become more crucial than ever in the world of online music, and will likely become the hallmark of a respectable online independent. As musicians come to acknowledge the inexpensive nature of distributing music online, a flood of artists (and the labels to whom they are signed) will inundate online music providers with their music, and artists will have to compete for consumer's attention in the diluted online market. Online labels will have to increase their advertising budgets to promote upcoming releases with increased fervor in hopes of notifying and attracting consumers. This will likely necessitate signing deals with companies like GoodNoise and MP3.com, and advertising everywhere from music-related web pages to music magazines and trade periodicals.

MP3.com's DAM label, for instance, does not personalize its approach to marketing bands it signs, rather it relies on the already heavy traffic to its site to lure music consumers to check out the DAM artists.²²⁰ DAM and other companies-turned-label will not be willing to provide more extensive advertising and promotion budgets without obtaining an interest in the sound recording copyright, as traditional labels already do. These online music companies will thrive more by

²¹⁹ GoodNoise's deal with Rykodisc suggests that it would be more fruitful for these online MP3 companies to distribute labels' full roster, instead of isolated individual artists. *See id.* If and when the Ryko deal is replicated by other labels, GoodNoise indeed will start to resemble an online record store more than an actual record label.

²²⁰ In its promotional material for interested artists, DAM emphasizes that MP3.com has 200,000 visitors to its site daily. To promote their DAM artists, they rank songs by popularity and offer an "MP3.com Song of the Day" on their home page. Finally, they market MP3.com compilation discs that feature DAM artists.

providing an outlet for online independents to showcase their artists than by actually assuming the traditional responsibilities of a record label.

Furthermore, though digital downloads may be the future's preferred medium of music, the CD still reigns supreme today. Despite the rampant spread of digital downloads that will certainly continue, the CD continues to dominate commercial music sales. Artists should be wary of signing with label divisions of online music companies that cannot promote their music in traditional brick-and-mortar stores.

Over the course of the next several years, artists will begin pursuing independent labels that can provide the dual service of promoting their music in both CD and digital download form. Artists and labels should strive to draft agreements that address both CD and digital downloads, with royalty formulas calculated differently for each. As discussed above, many of the traditional record contract clauses that pertain to compact disc do not apply in the context of digital downloads, and artists must ensure that arcane record contract provisions do not artificially reduce their income. Certainly, these contracts will grant labels a larger stake in the artist's recordings than GoodNoise or DAM currently receive. But, in exchange, artists with modest bargaining power should try to remove the outdated contract provisions with regards to digital downloads, and narrow the definition of "records" to ensure they can exploit the recording in audio-visual form without the label's permission. If they cannot alter the contract in this fashion, artists should demand more advances and royalties from the independents, as the labels' traditional income from CD's will be supplemented by income from digital downloads (in both audio-only and audio/video form).²²¹

At least in the present and near future, artists will continue to sign deals with the institutional Big Five of the music industry, who specialize primarily in the marketing and promotion of the compact disc. So long as the compact disc remains the dominant music medium, many artists will see no choice but to sign with these large traditional record companies to avail themselves of superior promotion and dis-

²²¹ Forrester Research senior analyst Mark Hardie predicts that online download music sales will supplement, rather than cannibalize, sales of compact discs. See Atwood, *Study Predicts*, *supra* note 3, at 3.

tribution services. But artists must acknowledge that the Big Five, and their contracts, have always lagged behind in adapting to new technology. Even today, the Big Five are waiting for SDMI specifications before fully infiltrating the world of online distribution. Artists, who still choose to sign with the Big Five's labels, should ensure that their record deals carve out their ability to exploit their music online. Surely, the label will want a piece of the proceeds, but artists should negotiate for royalty schemes that more accurately reflect the respective mode of distribution. Should the Big Five refuse to alter their contracts to reflect the dual mode of distribution, artists should seek shelter with the independent labels, who will be more amenable to these two-tiered agreements.

C. *The Big Five: The Digital Download Revolution Poses The Greatest Challenge To The Institutional Music Conglomerates, Whose Very Survival Atop The Record Industry Hangs In The Balance.*

In addition to striving to maintain their dominance atop the music industry, the Big Five carry the responsibility of stifling the rampant piracy associated with digital transmission of music over the Internet. Their approach to online music should be two-tiered: attempt to debase the piracy while redefining themselves and their functions to fully avail themselves of the new dynamic of distributing music online.

1. Debasement Piracy

The Big Five, through their spokesperson, the RIAA, must continue staving off piracy as best they can. In addition to leading the SDMI process towards a universal and copyright-protected specification for posting and distributing online music, the Big Five must continue to ferret out wily music pirates that continue to trade in illegal music files. Indeed, especially while the unprotected MP3 format subsists as it likely will for some time in the future,²²² the institutions of

²²² See *supra* Part IV.A.1., for explanation why MP3 will likely subsist. Note also that an April 1999 report by senior analyst Mark Hardee of Forrester Research predicts that industry-approved technology will not begin to edge out MP3 until

the music industry must have a game plan as to how to shut down music pirates as quickly and completely as they can.

Just as the MP3 pirate can use the Lycos search engine to find new MP3 files postings,²²³ the music industry can reference new listings and determine whether they have been properly licensed. The Digital Millennium Copyright Act of 1998 gives copyright holders the power to give notice to Internet service providers when they discover a unlicensed MP3 on a web site. The Big Five can use a search engine such as Lycos to ferret out the pirated songs and then give notice to the infringing site's Internet service provider, who must then discontinue service to the pirate.²²⁴

- a. *More Than Just Sinking Pirates, The Big Five Must Adjust To A Reality Not Centered Around Their Traditional Cash Cow, The Compact Disc.*

The Big Five record labels and their affiliates and subsidiaries have been the primary moneymakers in the music business almost since its inception. The Big Five's current formula for success is based around the manufacture and distribution of small metal discs that spin. The compact disc costs approximately one dollar to make, and it sells for close to \$15.00.²²⁵ After paying overhead and royalties to the artists, which are often artificially diminished by contract,²²⁶ the record label pockets the majority of the profit. This formula has worked well since compact disc sales overtook cassette sales in

2002. See Atwood, *Study Predicts*, *supra* note 3, at 80.

²²³ See Holland, *supra* note 23, at 111 (noting that the Lycos search engine will not differentiate between authorized and unauthorized files).

²²⁴ In addition to Internet Service Providers which are expressly required by the Digital Millennium Copyright Act to discontinue service to pirate web sites, Lycos has indicated its intent to fulfill its obligations under the Act as well. As Lycos spokesperson Brian Payea stated, "We will show all these links, because all we know is that they are MP3 sites. But if somebody gives us the information that someone is violating copyright, then we will take those links down." See Holland, *supra* note 23, at 111.

²²⁵ See Pearson, *supra* note 183, at 32. Furthermore, the cost of manufacturing a compact disc continues to fall. See Passman, *supra* note 68, at 170.

²²⁶ See *supra* Part V.B.1.

1992.²²⁷

MP3 music files, or even a more secure alternative, are a different matter entirely. First, record companies will not be manufacturing an item that they can sell at an enormous profit. Digital download files are made and distributed all via a computer; no disc replicators, warehouses, or trucks are necessary. Furthermore, with no physical items to be sold over a counter, and no hard cash resulting from a highly profitable transaction, record companies must settle for getting paid royalties based on licensing the rights to copy and publicly perform their copyrighted sound recordings. This is a daunting prospect for the record industry.

b. Modeled After The Music Publishing Industry, The Recording Industry Must Develop A Surefire Method For Collecting Royalties Based On The Transmissions Of Its Songs Via Digital Download.

In order to legally replicate and send a music file, one must obtain the proper licenses from the holder of the musical composition copyright (the songwriter or music publisher) and the holder of the sound recording copyright (the recording artist or record company).²²⁸ Music publishers are already accustomed to collecting royalties for the exploitation of their songs; indeed, most of their income is derived from the collection of these royalties.²²⁹ The recording industry, conversely, has traditionally relied on sales of physical compact discs as its primary source of revenue, and it must become adept at collecting royalties based on licensing its sound recordings if it hopes to profit from the sale of digital downloads.

Music publishers utilize mechanical rights societies (Harry Fox Agency) and performance rights societies (ASCAP and BMI) to issue and collect royalties on mechanical and public performance licenses issued in the United States. To collect royalties for their songs in foreign countries, publishing companies either set up offices in different

²²⁷ See Pearson, *supra* note 183, 32.

²²⁸ See *supra*, Part III.A.

²²⁹ Publishers also receive income from the sale of sheet music (printed music of single songs) and folios (collections of the sheet music of various artists) that consumers purchase to learn how to play the notes of songs themselves.

counties, or hire what are called subpublishers, to collect mechanical and performance license fees internationally.²³⁰

Traditionally, record companies had no need for such organizations because their sound recording copyright, unlike the musical composition copyright, did not contain in its bundle of rights the exclusive right to publicly perform the sound recording. The recording industry obtained experience in collecting royalties when the Audio Home Recording Act of 1992 (“AHRA”) was passed. The AHRA required makers of digital audio tapes and digital audio tape recorders to pay a “tax” to the music publishing and recording industries based on sales of their devices. ASCAP and BMI collected the tax on behalf of the publishing industry, and RIAA formed the Alliance of Artists and Recording Companies (“AARC”) to collect on behalf of the recording industry. Sales of DAT’s and DAT recorders were both modest and easily traceable, making it rather easy for the AARC to collect the tax on behalf of the recording industry.

In 1995, Congress passed the Digital Performance Right in Sound Recordings Act, which provides the owner of a sound recording copyright, an exclusive right in the public performance when such performance is “by means of a digital audio transmission.”²³¹ This Act allows record companies to collect license fees based on the digital transmission of a music file containing one of their sound recordings. The record industry must enlist an organization such as the AARC to monitor transmissions of its sound recordings, and collect and remit the license fees to the sound recording copyright holders. Ideally, such an organization must become as thorough and efficient as ASCAP, BMI, and the Harry Fox Agency in properly remitting royalties to copyright holders. The recording industry must ensure such an organization is in place if it hopes to receive steady revenue streams from the sale of digital downloads.

c. Even As It Strives To Develop A Secure MP3 Alternative,

²³⁰ If publishing companies do not have their own affiliated office in a certain region of the world, they sign contracts with foreign subpublishers to collect license fees for them. The foreign subpublisher keeps a portion of the monies collected as its fee, and remits the remaining portion to the music publishing company. See Passman, *supra* note 68, at 239.

²³¹ See Kohn, *supra* note 55.

*The Big Five Can Still Utilize Existing Online Technology
For Promotional Purposes.*

Amidst their efforts to quell piracy and develop a royalty-paying model for online music, the Big Five can use existing technology, including MP3, to become accustomed to working with online music, and to experiment with different models of attracting consumer attention without onerously burdening copyright interests.

One such way the Big Five can delve into the field of digital music is by utilizing it as a promotional tool. Posting MP3 song files or at least clips of upcoming releases can create publicity that will entice record consumers and boost sales upon the album's release. What would normally be called piracy, the unfettered dissemination of the single across the Web, would actually be assisting the label's in creating a buzz to hype the release.

Some major labels have begun experimenting with this technique. Capitol Records' subsidiary Grand Royal Records released various MP3 remixes and live tracks from their latest "Hello Nasty" album that helped attract attention and boost sales of the album.²³² In 1994, Geffen Records placed a thirty-second clip on one of its bands on the Independent Underground Music Archive (IUMA).²³³ Major labels, like Geffen, are beginning to recognize the advantage of launching promotions online instead of spending the time, money and effort to conventionally promote, press, and distribute recordings for promotional use.

- d. *Because Songs Can Be Downloaded Individually, The Music Industry Should Push Sales From Its Back Catalogs, Which Will Become An Ever-Increasing Source Of Revenue.*

Once an MP3 alternative that pays royalties is in place, labels might want to solicit online digital download providers to sell both full albums and individual singles.²³⁴ In addition to new releases, the Big

²³² See Dibbell, *supra* note 11, at 106.

²³³ See Siegel, *supra* note 48, at 1.

²³⁴ Emusic.com sells its duly licensed individual songs for 99 cents per download, and full albums for \$8.99. See <<http://www.emusic.com>> (visited Nov. 23, 1999).

Five should also hand over the right to distribute their older catalog albums.²³⁵ Without digital downloads, a consumer wanting an older, obscure song from a relatively unknown artist, would have to purchase the entire album containing the desired song. Very often, consumers desire these songs for novelty purposes, but do not want to waste their money purchasing an entire album for just a single song.²³⁶ The ability to order singles only via digital download will help boost sales of older, back catalog songs, which consumers would otherwise not purchase.

3. The Big Five And Its Affiliated Labels Can Sustain Or Even Increase Current Revenues By Utilizing Online Technology To Sell Both CD's And Digital Downloads Direct To The Consumer.

Today's common scenario of purchasing a compact disc at a record store will fade once consumers begin to realize the cost savings they incur by purchasing an album online in digital download form.²³⁷ Consumers can then portablize the album by either burning the album to compact disc with a CD-R or simply playing the files on a Rio-type device.

The Big Five can help maintain consumer's current preference for the CD by making the price for compact discs competitive with the price of digital downloads. This will of course require record companies to realize less profit from CD's. By selling CD's online directly to the consumer and cutting out record store middlemen, the Big Five may be able to reduce the purchase price while still maintaining to-

²³⁵ "Catalog" is an industry term for albums or songs that have been released for more than eighteen months. Catalog yields higher profit margins than new releases because generally the marketing costs are less than those associated with new releases. See Don Jeffrey, *Music Biz Looks to Challenges Ahead*, BILLBOARD, Mar. 13, 1999, at 107.

²³⁶ As MP3 maven and freshman at USC Paul Smith states, "A lot of MP3s I have are one hit wonders like 'Come On Eileen' by Dexy's Midnight Runners! Heard of any songs by them? No. So why buy a CD for \$15 when I just want one song?" See Jensen, *supra* note 2, at 33.

²³⁷ Recall that authorized, full albums are already being sold by companies such as Emusic.com and MP3.com for a nine eight dollars, significantly less than the purchase of a CD in a record store. See *supra* note 234.

day's profit margins.

a. *Effectuating The Madison Project May Be The Key To The Big Five's Distributing The Music Themselves.*

In addition to the RIAA and the Big Five's Secure Digital Music Initiative, Warner Music has launched an additional initiative called the Madison Project (the "Project").²³⁸ While SDMI strives to develop universal copyright protective specifications for online music, the Project's goal is to create a secure mechanism for downloading an entire CD at once. The Project would allow consumers to buy albums, singles, and artwork online, and burn it onto a CD with an IBM home computer equipped with a CD-R.²³⁹ The Project promises to pay artists for each home-made unit sold, and will drastically reduce the purchase price of CD's by slashing manufacturing costs and the fees retained by distributor and record store middlemen.²⁴⁰ The Project is set to be tested in Southern California in 1999, using a Time-Warner owned cable/modem system.²⁴¹

The Project has received criticism from traditional record retail outlets with which it's progeny would compete. Tower Records vice-president George Scarlett says, "[t]he garden-variety music lover doesn't want to be at home rolling their own CD's. They want something pre-fabricated—and then make copies from it."²⁴²

Surprisingly, or perhaps in bluff, some Big Five record executives are not fully supporting the Madison Project either.²⁴³ They feel the

²³⁸ See Vankin, *supra* note 5, at 38.

²³⁹ See *id.*

²⁴⁰ See Jensen, *supra* note 2, at 38.

²⁴¹ See Vankin, *supra* note 5, at 38.

²⁴² See Jensen, *supra* note 2, at 37. Other representatives from brick-and-mortar establishments have begun to voice some anxiety over the Madison Project, and are pleading to be involved in the process. "I'm really surprised we haven't been working with labels on this," said Jason Fiber, VP of Internet services for Warehouse Entertainment. "[Labels] have been very hush-hush, and out of that came the Madison Project, which sounds like a really ugly, scary kind of project . . . [Labels and traditional record chains] really need to be working together on this." See *NARM '99*, *supra* note 131, at 82.

²⁴³ Val Azzoli, co-chairman/co-CEO of the Atlantic Group, stated "Atlantic doesn't want to be in retail. I think [retailers] are in a very difficult industry, and

Project does not acknowledge the social experience and intangible pleasure consumers derive from going to record stores, and they are seem convinced that direct visual sales plans conducted in-store are the best way to sell CD's. However, the Big Five are simply missing the point once again. As Internet use, online music, and Web audio/visual capabilities continue to grow, consumers will be more inclined to do their music shopping online. Furthermore, consumers will be willing to forgo the small pleasure they receive from shuffling through CD's at a brick-and-mortar record store for the cost savings and convenience and they will receive by ordering a CD directly to their home computer.

VI. CONCLUSION

Digital downloading of music over the Internet will change the face of the music industry for all time. Record stores, record contracts, record companies, and physical records themselves (including the descendant CD) all face extinction in their current forms in light of the fact that consumers can now retrieve the music they want with only a computer and a modem. Manufacturing and distribution costs all but disappear. Coupled with the potential of reaching a global audience with ease, artists and independent labels will be able to compete with the Big Five and challenge their largely outdated conventions stemming from a formula based on the compact disc that will no longer work when music goes completely intangible.

Artists should utilize the Internet to achieve wider exposure, and should look to independent record companies to be the revolutionaries who will challenge old industry conventions and offer agreements that properly reflect the new mode of music distribution. The greatest challenge, though, lies with the Big Five, to secure their position in the industry. In addition to decreased artist dependence, the Big Five must spearhead the fight against the rampant online music piracy that threaten to steal their once-dependable revenue and royalty streams. While the Copyright Act has become an able weapon with which to

frankly, I don't want to be in it." Polly Anthony, president of Epic / 550 Music, said "For [Epic corporate parent] Sony, there is nothing even remotely close to being in-store." See NARM 99, *supra* note 131, at 82.

fight piracy in court, the industry must take aim at the MP3 file format itself, and move swiftly to develop a more copyright protective alternative before MP3 is too popular with consumers.

Once the alternative system is in place, the industry should be poised to turn Internet music into a primary revenue source in the 21st Century. However, the Big Five will still have to adjust to a reality where their profits are not made by selling only physical CD's, but instead depend upon adequate collection of copyright royalties based on the exploitation of their sound recording copyright. The Big Five will have to be receptive to new, creative ways of exploiting the new on-line reality, such as selling CD's and digital downloads direct to the consumers. Technology has once again got the industry on the run, and the efficacy of the Big Five will be determined by the way they can evolve in the new era of online music.