

# NEW USES AND NEW PERCENTAGES: MUSIC CONTRACTS, ROYALTIES, AND DISTRIBUTION MODELS IN THE DIGITAL MILLENNIUM

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## I. THE MUSICIAN

From the musician's point of view, a composition or recorded performance begins its life under the statutory law of copyright,<sup>1</sup> and then generates income by the receipt of payment(s) or royalties determined by the common law of contract. This alchemy of turning music into money is accomplished within a complex United States music industry, whose multi-faceted business and licensing organizations have traditionally been in symbiosis with the copyright laws as evidenced by an industry structure that aligns with the categories of the "bundle of rights"<sup>2</sup> that comprise exclusive rights under copyright.

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<sup>1</sup> See 17 U.S.C. § 201(a) (1999). "Copyright in a work protected under this title vests initially in the author or authors of the work." See also Jane C. Ginsburg, *Authors and Users in Copyright*, 45 *J. Copyright Soc'y U.S.A.* 1, 20 (1997) (stating that "copyright is a law about creativity....").

<sup>2</sup> 17 U.S.C. §106 (1999). Exclusive rights in copyrighted works under § 106 include: (1) rights of reproduction; (2) to prepare derivative works; (3) to distribute;

Digital distribution of sound recordings is now reshaping this model by bringing about new alignments and overlap of traditionally separate functions both in copyright and in commerce. The roles for licensing organizations and manufacturing and retail enterprises are rapidly evolving as their traditionally separate functions converge in a single computer file containing a performance of a song and perhaps also its musical notation, transmitted via the Internet. This paper will examine some of these shifts in the commercial terrain that recent amendments to the copyright law<sup>3</sup> enable, and their effect on contractual relationships with performing artists. In the midst of this whirlwind of technological and legal changes, simple and low-tech proactive measures will be proposed to help ensure that no one, including the musician, is left behind.

## II. MARCHING IN STEP: THE OLD MEDIA WORLD

The separate rights in the “bundle of rights” of copyright ownership have traditionally marched in step with separate business functions and licensing organizations within the music industry. For example, the §106(1) right to reproduce copies or phonorecords; the §106(2) right to prepare derivative works, and the §106(3) right to distribute copies or phonorecords correspond to most of the activities of the print music industry, the recording industry, and the licensing organization The Harry Fox Agency Inc. (Harry Fox) which adminis-

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(4) to perform publicly; (5) to display publicly; (6) to perform sound recordings by means of a digital audio transmission. These rights may also be further divided by contract, for example carving out international territories for specific rights, or assigning them to different business entities within one territory.

<sup>3</sup> See the Digital Performance Right in Sound Recordings Act of 1995 (hereinafter “DPRSA”), Pub. L. No. 104-39, 109 Stat. 336 (1995) (adding §§ 106(6), 114(d)-(j), 115(c)(3) & (d) to the Copyright Act of 1976). See also The Digital Millennium Copyright Act of 1998 (hereinafter “DMCA”), Pub. L. No. 105-304, 112 Stat. 2860 (1998) (adding §§ 512 and 1201-05 to the Copyright Act of 1976). Technical amendments to Title 17 corrected a temporary duplication in numbering of § 512: the solution was that section 512 entitled “Determination of reasonable license fees for individual proprietors” was renumbered as section 513. The “other” section 512 under discussion here, “Limitations on Liability Relating to Material Online,” retains its numbering. 145 Cong. Rec. H6362-01 (1999).

ters licensees on behalf of copyright holders and collects the resultant “mechanical royalties” from record companies.<sup>4</sup> Similarly, the §106(4) right of public performance corresponds to the activities of performing rights organizations such as the American Society of Composers, Authors, and Publishers (ASCAP), Broadcast Music Inc. (BMI), and SESAC Inc., which license live, radio, television, and other performances on behalf of copyright owners.

In the age of the Internet, these business and licensing entities, and the musicians they represent, are discovering that formerly separate functions are overlapping and colliding together in new ways. To understand these shifts in industry practice brought about by the Internet, it is important to begin by understanding how copyright law itself has been molded into the image of a wired world.

### III. THE NEW MEDIA TUNE

Prior to 1995, while the United States copyright law did have an exclusive public performance right under §106(4) for the underlying copyrighted work (e.g. the song), there was no public performance right for sound recordings. If Singer X recorded a song composed by Irving Berlin and the record was played on the radio, Irving Berlin’s estate and his publisher each received a performing right royalty for the composition itself, while Singer X and her record company received nothing except the prospect of promotional air play generating sales in record stores.<sup>5</sup> Adding to the frustration for American record companies was the fact that in other countries, a performance right for sound recordings exists, and generates an estimated 150 million dollars per year worldwide excluding the United States.<sup>6</sup> Reciprocal copyright treaties will not allow American record companies to collect their estimated 35% share of this money so long as foreign record

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<sup>4</sup> See generally National Music Publishers’ Association & The Harry Fox Agency, Inc., *International Survey of Music Publishing Revenues Eighth Edition* (1999).

<sup>5</sup> See generally AL KOHN & BOB KOHN, *KOHN ON MUSIC LICENSING* (2d ed. Supp. 1999) at 91. (“Potential Forms of Uses Under the Copyright Law”). Assumed here is that the song is protected by copyright.

<sup>6</sup> Lionel S. Sobel, *A New Music Law for the Age of Digital Technology*. 17 ENT. L. REP. 3, 10 (1995).

companies could not collect performance rights for sound recordings under American law.<sup>7</sup>

With this background of the “old media” structure of the American music industry and the particular status of sound recording performance rights, we can better understand how the ability to make digitally perfect copies of sound recordings on computers, and to transmit them over the Internet, increasingly threatened the music industry:<sup>8</sup> 1) record companies and their retailers may lose sales through Internet piracy, already a \$5 billion dollar a year problem;<sup>9</sup> 2) music publishers and their administrative organization Harry Fox may lose the mechanical royalty they received for their songs on every copy of a recording distributed; 3) performing rights organizations may lose income collected on behalf of composers and publishers due to unlicensed Internet broadcast performances; 4) recording artists and representative organizations like the American Federation of Musicians might lose record sales and future recording opportunities; 5) record companies and performers did not want to miss an opportunity to “get in on the ground floor” by acquiring statutorily granted performing rights in sound recordings in the new digital transmission industry, a technology which began as a premium option available with cable television and satellite services, then quickly moved onto the Internet.<sup>10</sup>

In response to industry lobbying motivated by the above concerns, Congress passed the landmark amendments to the copyright act known as the Digital Performance Right in Sound Recordings Act of 1995 (DPRSRA)<sup>11</sup> and the closely related Digital Millennium Copyright Act of 1998 (DMCA).<sup>12</sup> While the new laws did not create a perform-

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<sup>7</sup> *Id.*

<sup>8</sup> For background of the legislation *see generally* H.R. Rep. No. 104-274, 104<sup>th</sup> Cong., 1<sup>st</sup> Sess. Testimony given included representatives of the National Music Publishers' Association, the American Federation of Musicians, and the Recording Industry Ass'n of America. *See also* Les Watkins, *The Digital Performance Right in Sound Recordings Act of 1995: Delicate Negotiations, Inadequate Protection*, 20 COLUM.-VLA J.L. & ARTS 323.

<sup>9</sup> *See* NMPA report, *supra* note 4.

<sup>10</sup> *See* H.R. Rep. No. 104-274 *supra* note 8.

<sup>11</sup> *See* DPRSRA *supra* note 3.

<sup>12</sup> *See* DMCA *supra* note 3.

ance right for sound recordings in traditional media like radio and television, success was achieved in the new media of digital music transmission via cable, satellite, and the Internet. The amendments police digital piracy of commercially produced recordings and facilitate exploitation of commercial opportunities for record companies through voluntary and compulsory licensing schemes.<sup>13</sup> New issues were then raised that go to the heart of the business and licensing structure of the music industry.

#### IV. MUDDY WATERS

From the perspective of the music industry and its interest in digital distribution of sound recordings via the Internet, the amendments to Title 17 known as the Digital Performance Right in Sound Recordings Act and the Digital Millennium Copyright Act can more easily be thought of as two parts of one historic amendment originally dating from 1995. The DPRSRA of 1995 granted a new right of public performance of sound recordings in the digital realm.<sup>14</sup> The 1998 DMCA dovetails with the earlier DPRSRA in several key areas including 1) fostering international data security under the World Intellectual Property Organization Copyright Treaty via prohibitions on circumvention of protection measures such as encryption of copyrighted data files and “digital watermarking” to identify copyright owners of data;<sup>15</sup> 2) “safe harbor” provisions regarding copyright infringement liability for various classes of on-line service providers whose Web sites may contain infringing recordings posted by third parties;<sup>16</sup> 3) bringing webcasters clearly into the fold of Internet entities who must license

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<sup>13</sup> See generally Jane C. Ginsburg, *Copyright Legislation for the “Digital Millennium”*, 23 COLUM.-VLA J.L. & ARTS 137 (1999). See also Legislative History in 1995 U.S.C.C.A.N. 356, 1995 WL 472241. See also Derek M. Kroeger, *Applicability of the Digital Performance Right in Sound Recordings Act of 1995*, 6 UCLA ENT. L. REV. 73 (1998).

<sup>14</sup> 17 U.S.C. §106 (6) (1999).

<sup>15</sup> See DMCA § 103, adding a new chapter 12 to Title 17 of the U.S. Code.

<sup>16</sup> See DMCA Title II, adding a new section 512 to Title 17 of the U.S. Code. See also Jennifer E. Markiewicz, *Seeking Shelter from the MP3 Storm: How Far does the Digital Millennium Copyright Act Online Service Provider Liability Limitation Reach?*, 7 COMM. LAW CONSPPECTUS 423 (1999) (examining the online service provider liability provisions in the DMCA).

their use of copyrights.<sup>17</sup> The DMCA's importance as an extension of the earlier DPRSRA lies in this third category and the narrowed definition it contains of what types of digital transmission webcasting services are exempt from compulsory licensing fees for the digital performance right in sound recordings.<sup>18</sup>

The passage of two amendments within three years reflected the rapid pace of change in technology and legal holdings, as well as the persistence and effectiveness of the music and Internet industry lobbying efforts.<sup>19</sup> As we have seen in subsequent litigation based on provisions in the DMCA, the complexity of the amendments as codified represents legislative drafting that, by leaving no stone in the pond unturned, inevitably muddied the waters.<sup>20</sup> For the music indus-

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<sup>17</sup> See DMCA §405.

<sup>18</sup> *Id.*

<sup>19</sup> See Ginsburg *Digital Millennium supra* note 13 (stating "copyright laws tend to be made by the affected industries; whoever is at the negotiating table will get a piece of the expanding pie . . .").

<sup>20</sup> As of this writing, litigation and other action arising from the "muddy waters" of the DMCA include a suit filed by record company members of the Recording Industry Association of America (RIAA) against the Internet site Napster.com. *A&M Records, Inc., et al v. Napster, Inc.*, No. C99-5183 MHP ADR (N.D. Cal., filed Dec. 1999). The issues include whether the online service provider liability limitations under § 512(a) provide a safe harbor against contributory and vicarious infringement claims against a Web site that provides indexing and links to, but does not store, infringing MP3 sound recording files.

A first-impression dispute over the scope of exemptions to compulsory licensing available to AM/FM broadcasters is being played out in the courts and under the administrative procedures of the Copyright Office: on March 1, 2000, the RIAA filed a petition for rulemaking urging "the Copyright Office to adopt a rule clarifying that a broadcaster's transmission of its AM or FM radio station over the Internet...is not exempt from the copyright liability under Section 114(d)(1)(A)." See U.S. Copyright Office, *RIAA Petition for Rulemaking on Definition of "Service"*, (visited Mar. 30, 2000) <<http://www.loc.gov/copyright/licensing/>>. In response, on March 16, 2000 the Copyright Office published in the Federal Register a Notice of Proposed Rulemaking regarding Digital Performance Right in sound Recordings (Docket No. RM 2000-3), with comment due by April 17, 2000. See 65 FR 14227. On March 27, 2000, the National Association of Broadcasters filed a civil action for declaratory relief against the RIAA in the U.S. District Court for the Southern District of New York, "...seeking statutory interpretation of sections 106(6) and 114 of the Copyright Act." The NAB further petitioned the Copyright Office to suspend the Proposed Rulemaking Proceedings pending outcome of the civil action. See U.S.

try, the essence of the amendments is that there is a new performance right in sound recordings when transmitted digitally on the Internet, and that infringers of this right are liable under United States copyright law. The amendments as codified under §114 of the Copyright Act enforce this new right by establishing three broad license categories for digital transmission of sound recordings:

1) Voluntary licensing at the sole discretion of the copyright holder: transmission services in this category create the greatest risk of avoiding purchase through the record company, so the amendment gives the record company maximum freedom to grant or refuse a license. Included are interactive digital transmissions (where the customer chooses what to hear, for example by clicking on an icon on a Web page), and subscription digital transmissions, historically a technology based on satellite and cable transmission where the customer can only receive the transmissions by paying a subscription fee, and receives advance information on the programming which would help the customer to make digital copies of desired repertoire.

2) Compulsory licensing: services in this category are perceived as a lesser threat to traditional recording purchases, because the listener cannot predict what music will be programmed. The copyright owner must grant a license at statutory rates to be determined by a Copyright Arbitration Royalty Panel.<sup>21</sup> Compulsory license payments for digital performance of sound recordings will be made to and administered by the Recording Industry Association of America (RIAA) on behalf of

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Copyright Office, *Motion to Suspend Rulemaking Proceeding*, (visited Apr. 6, 2000) <<http://www.loc.gov/copyright/licensing/>>.

<sup>21</sup> 17 U.S.C. § 114(f) (1999). The first-ever proceeding under §114(f) can be found in *Recording Industry Association of America v. Librarian of Congress*, 176 F.3d 528, 530 (1999), in which the DC Circuit Court of Appeals held that the determination of reasonable compulsory license rates for the digital performance of sound recordings would be based not on market rates, but on the test of Title 17 § 801(b)(1) wherein the purposes of the copyright royalty arbitration panels are:

to maximize the availability of creative works to the public; . . . to afford the copyright owner a fair return . . . and the copyright user a fair income . . . to reflect the relative roles of the copyright owner and the copyright user . . . with respect to . . . capital investment, cost, risk . . . [t]o minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

*Id.*

the copyright holders in the sound recording.<sup>22</sup> The RIAA thus becomes a new “new media” organization on the music licensing scene, collecting and distributing digital performance royalties on behalf of record companies in an analogous way to the National Music Publishers Association (NMPA), which through its affiliate the Harry Fox Agency collects and distributes mechanical and synchronization license fees on behalf of music publishers.

Compulsory licensing examples under § 114 include subscription digital transmissions where the customer pays a subscription fee, but does not receive advance information that facilitates copying. These have also historically included satellite and cable services, and may in the future include services such as transmission of music to specially equipped automobiles, cell phones, and other devices.<sup>23</sup> Other examples include non subscription digital transmissions where the customer does not pay a fee, does not receive advance program information, and the programming is presented so as to discourage planned duplication. This would cover an Internet generated webcasting channel, which usually offers distinct musical categories, for example all country music, or all oldies. Webcasters generate compulsorily licensed broadcasts by first filing notice of their intent with the U.S. Copyright Office,<sup>24</sup> then copying a recording onto a computer pursuant to the §112 statutory license for ephemeral recordings, which they qualify for under the compulsory licensing provisions of §114.<sup>25</sup> The transmission

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<sup>22</sup> See Copyright Office, Library of Congress, *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, 63 FR 25394, 25412 (stating that “the parties’ suggestion to designate a single entity to collect and to distribute the royalty fees creates an efficient administrative mechanism.”).

<sup>23</sup> See Webnoize News, *Internet: Not Just for PCs Anymore*, available at (visited Mar. 24, 2000) <<http://news.webnoize.com/item.rs?ID=7675>> (discussing digital delivery of music to cell phones, elevators, kitchen appliances, game consoles, etc.).

<sup>24</sup> “[A] ‘Service’ engaged in the digital transmission of sound recordings pursuant to section 114(f) shall file with the Licensing Division of the Copyright Office an *Initial Notice of Digital Transmission of Sound Recordings under Statutory License*. 37 C.F.R. §201.35 (1998). See Webnoize News, *Notice and Recordkeeping Requirements for Digital Transmissions of Sound Recordings Under Statutory License*, (visited Mar. 30, 2000) <<http://www.loc.gov/copyright/licensing/>>.

<sup>25</sup> The ephemeral recording limitations on exclusive rights granted to transmitting organizations such as webcasters under § 112(a) are subject to the organization qualifying under § 114(f) Licenses for Certain Nonexempt Transmissions.

then streams the music for listening to the recipient, a process that does not deposit a copy of the data on the listener's computer.

3) Exempt from licensing: the DMCA contains a third category of "Exempt transmissions and retransmissions" for which no license is required, which applies to "a nonsubscription broadcast transmission" or traditional terrestrial analog broadcast.<sup>26</sup> Whether traditional AM/FM radio stations retain this exemption when they transmit their signals onto the Internet through their own Web site, or via retransmission by a third party's Web site, is currently being litigated.<sup>27</sup> Pending resolution, these waters will remain muddy.

## V. PAYING THE PIPER

From the webcaster's point of view, depending on what types of service they offer, licensing requirements for sound recordings would flow from the following exclusive rights under copyright: 1) Performance rights in the underlying composition, licensed under §106(4) either directly by copyright holders, or by their authorized performing rights licensing organizations ASCAP; BMI, and SESAC. 2) Exclusive rights to reproduce and distribute copies of the underlying composition under § 106(1) and §106(3), the so-called "mechanical" right, which may be licensed directly from copyright holders, or through their authorized agent which in the United States is usually the Harry Fox Agency, Inc. 3) The digital performance right in sound recordings under § 106(6), which, depending on usage, will require either voluntary licensing at the discretion of the copyright holder or compulsory licensing administered by the RIAA on behalf of record companies.<sup>28</sup>

To understand the impact of these license fees for performance, distribution, and digital sound recordings on the Internet music economy, we should first acknowledge that the interactive nature of the Internet and the freedom to learn, communicate, experience, and connect without borders has proven to be a popular and innovative mix. It is also a hallmark of the Internet that it has been relatively unregulated

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<sup>26</sup> 17 U.S.C. § 114(d)(1)(A).

<sup>27</sup> See *supra* note 20.

<sup>28</sup> Recording Industry Association of America *Webcast Licensing Frequently Asked Questions*, available at (visited Nov. 26, 1999) <<http://www.riaa.com/weblic/wlwcst.htm>>.

by government and licensing entities. For example, there is currently no Internet-specific equivalent of the Federal Communications Commission or other Federal agencies that create complex regulatory compliance issues. The freedom of this model has already generated new and inventive types of Internet businesses, some of which may prove to have long-lasting commercial success.<sup>29</sup> This “wide open” philosophy is however in tension with the somewhat complex copyright licensing model discussed above, where performing, distribution, and sound recording rights are all administered by separate organizations, each of which has multiple layers of licensing rate plans, and each of which may apply in only certain international territories.<sup>30</sup>

To illustrate what these licensing obligations could mean in administrative and financial terms to an Internet company, let’s create a hypothetical Internet firm called Eli’s Internet Music LLC. Eli’s offers an array of music services including digital phonorecord deliveries, as well as randomly selected audio streaming of digital song files that promote sales of manufactured CDs available via mail order.<sup>31</sup>

To administer the digital performance rights, Eli’s will first have to negotiate dozens, if not hundreds, of voluntary negotiated licenses from each record company to cover the interactive digital phonorecord

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<sup>29</sup> Internet retailers Amazon.com (books and music) and MP3.com (music) offer Associates Programs, where a commission is paid to individuals or businesses who refer customers to the host site. On the Internet everyone can be a merchant and have a piece of the economic pie. See Amazon.com *Associates Program*, (visited Nov. 27, 1999) <<http://www.amazon.com/exec/olbidos/subst/associates/join/associat.../002-5742717-096025>>. See also MP3.com *Affiliate Network – Operating Agreement*, (visited December 12, 1999) <<http://www.mp3.com/affiliate/pages/operating.html>>. Other new business models include Web sites acting as virtual record companies where unknown bands vie for exposure and receive royalties up to 60% for any recordings sold: See Webnoize News, *The Musician’s Cut of Online Music: What’s the Deal?* (visited Dec. 1, 1999) <<http://news.webnoize.com/item.rs?ID=6152>>.

<sup>30</sup> See ASCAP *Internet Licensing: Frequently Asked Questions*, (visited Dec. 9, 1999) <<http://ascap.com/weblicense/webfaq.html>>. See also BMI *I Am A Webcaster FAQ Answers*, (visited Dec. 9, 1999) <<http://bmi.com/iama/webcaster/webans1.asp>>. See also SECAC’s *Internet/New Media License for Web Sites*, (visited Dec. 10, 1999) <<http://www.sesac.com/weblic.htm>>. See also RIAA *FAQ’s supra* note 28.

<sup>31</sup> See *supra* note 23.

deliveries, and pursuant to the DMCA will have to comply with any copy protection and digital watermarking requirements.<sup>32</sup> Next, we assume for this illustration that the separate service of randomly streamed music files will be covered by the new RIAA-administered compulsory license for digital performance of sound recordings. Eli's will duly file a notice of intent with the Copyright Office and contact the RIAA to administer the license payments.

As for performance rights to the underlying copyrights under §106(4), Eli's will have to arrange for Internet licenses from ASCAP, BMI, and SESAC. For the reproduction and distribution rights under §106(1) and §106(3), Eli's will contact the Harry Fox Agency. All of these organizations operate on a non-exclusive basis, which means that Eli's could, in theory, license from each separate copyright owner, if the copyright owner so desires. It's usually much easier to license through these organizations, in particular to take advantage of the blanket licenses offered by the performing rights societies which include all copyrights in their catalog.<sup>33</sup>

To estimate the financial impact of these multiple licenses, we can use as a model ASCAP's "RateCalc" software, which provides online calculation of performing rights fees for Internet companies using ASCAP repertoire.<sup>34</sup> To make the calculations, ASCAP's RateCalc uses a sliding scale of percentages, factoring in parameters including advertising ("sponsor") revenue; Web site user revenue from access or subscription fees; operating expenses; number of Web site visitors; percentage of visitors who access music files; and the Web site's ability to track music usage including whether a song is licensed by ASCAP. Income from actual sales of merchandise is not one of the factors used.

Eli's has one million dollars of sponsor revenue, \$500,000 in an-

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<sup>32</sup> See *supra* note 15. Many record companies are participating in the voluntary Secure Digital Music Initiative (SDMI) founded by RIAA and other organizations. The goal is to create a cross-platform standard for encryption that will prevent unauthorized use of digital music files. See SDMI FAQ, (visited Dec. 12, 1999) <[http://www.sdmi.org/public\\_doc/SDMI99070809-SDMI\\_FAQ.pdf](http://www.sdmi.org/public_doc/SDMI99070809-SDMI_FAQ.pdf)>.

<sup>33</sup> AL KOHN & BOB KOHN, KOHN ON MUSIC LICENSING 876 (2d ed. 1996) (discussing non-exclusive basis of performing rights societies).

<sup>34</sup> See *ASCAP's RateCalc*, (visited Dec. 12, 1999) <<http://ascap.com/license.html>>.

nual operating expenses, and through tracking of music usage knows that 75% of Web site sessions include music sessions. RateCalc therefore arrives at an annual performance license fee of \$18,150. Although BMI's Internet licensing may use different parameters and arrive at different fees, to simplify the hypothetical we will assume that BMI will also charge \$18,150 for a license. SESAC with its smaller performing rights repertory uses other criteria and has a maximum six-month Internet license fee of \$1,625, or \$3,250 annually.<sup>35</sup> The performing rights licenses would therefore total \$39,550. Detailed information on the RIAA compulsory fee schedule for digital performance of sound recordings, or on mechanical licensing for this Internet scenario is not yet available in a RateCalc-style online format,<sup>36</sup> but for the illustration we assume that these other categories of rights under copyright will be licensed for the same \$39,550 charged for performing rights. Our admittedly rough estimate of licensing obligations for Eli's is therefore \$118,650 or 11.87% of sponsor revenue.<sup>37</sup> Factoring in any other Eli's income makes the percentage shrink rapidly. For example if Eli's has a further three million dollars in income from merchandise sales, then the \$118,650 in licensing fees represents a mere 2.97% of gross revenues.<sup>38</sup>

Retail businesses, even on the Internet, are not accustomed to having worldwide licensing departments,<sup>39</sup> and the concept of infi-

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<sup>35</sup> See *Welcome to SESAC's Internet License FAQ "What is the Minimum Fee?"*, (visited December 10, 1999) <<http://www.sesac.com/faq8.htm>>.

<sup>36</sup> Note that mechanical royalties are paid on all copies distributed, regardless of whether they are sold or free distributions. See 17 U.S.C. § 115(c)(2). How this will affect the mechanical royalty rates for the millions of free song downloads taking place on the Internet is unknown. For statistics on download activity on the MP3.com Web site see *MP3.com Reports Key Metrics*, (visited Dec. 12, 1999) <<http://www.mp3.com/pr/991210keymetrics.html>> (reporting as of Nov. 30, 1999: 239,900 songs posted on the site, with 510,000 estimated average daily unique visitors, and 83,000,000 estimated page views per month). Note also that Web sites that offer exposure to unsigned musicians typically require the musicians to sign a waiver of mechanical license and other license fees.

<sup>37</sup> ASCAP \$18,150 + BMI \$18,150 + SESAC \$3,250 + RIAA \$39,550 + HARRY FOX \$39,550 = \$118,650.

<sup>38</sup>  $\$118,650 \div \$4,000,000 = 0.0296625$ .

<sup>39</sup> It should also be noted that the licenses taken in the United States may not be valid outside its borders for either transmission or reception. In response, some li-

nately divisible intellectual property rights under copyright can be difficult for a commercial entity to grasp. Traditionally, a radio station would only need to administer performance licenses, and a record company would only need to administer mechanical licenses. A Web site however needs to administer both of these, plus the digital performance license, all of which come in various flavors. While this has not slowed down the pace of new media venture announcements,<sup>40</sup> proposals for streamlining and consolidating the Internet licensing process have begun to appear,<sup>41</sup> as have predictions that there will be

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censing organizations have begun to implement international “packages” of performing rights. See Bennett M. Lincoff, *International Performing Rights: The Devil's in the Details*, BILLBOARD, Mar. 25, 2000 at 6 (commenting on a January, 2000 announcement at MIDEM that several international performing rights societies have agreed to offer Webcasters worldwide performance rights to their combined repertoires, including BMI (USA); PRS (UK); SACEM (France); GEMA (Germany); and BUMA (The Netherlands). Lincoff notes the possibility of webcasters engaging in international “license shopping” to take advantage of the country with the lowest rates and points out that because the United States, unlike European countries, has more than one performing rights society, webcasters who have licensed BMI repertoire in a package with international rights may try to exclude international revenues from the revenue calculations used by ASCAP to determine Internet licensing fees. Remember that the licensing obligations under discussion in the “Eli’s” hypothetical are in addition to normal commercial arrangements and costs of doing business relating to retail pricing, discounts, inventory, promotion, etc.

<sup>40</sup> See testimony before the House Commerce Committee Subcommittee on Telecommunications, Trade and Consumer Protection by Hilary Rosen, President and CEO of the RIAA (Oct. 28, 1999), (visited Mar. 16, 2000) <<http://www.riaa.com/musicleg/press/102899.htm>> (“Now, new technology deals are announced every day between our companies and different members of the technology industry.”).

<sup>41</sup> See Alan R. Kabat, *Proposal for a Worldwide Internet Collecting Society: Mark Twain and Samuel Johnson Licenses*, 45 J. COPYRIGHT SOC'Y U.S.A. 329 (1998). (“I believe that the current collecting societies are severely and needlessly restricted by their fragmentation in terms of the rights protected.”). *Id.* at 342. See also Don Biederman, *Copyright Trends: With Friends Like These . . .* 17 ENT. & SPORTS LAW. 3, 20 (1999) (“I believe that we need a third WIPO Treaty that would determine how worldwide licenses could be issued in split-rights situations and that would establish definitive jurisdictional rules in cases of international infringements...”).

ultimate legislative recognition that the “bundle of separate rights” concept of copyright will increasingly be a poor fit for new media where diverse rights of reproduction, distribution, performance, and digital performance for both underlying copyrights and the sound recording now overlap.<sup>42</sup> And perhaps some sort of commercial enterprise that handles these chores for Internet sites will emerge. As the debates go forward, the balancing act will be between the heightened responsibility of the copyright community to educate the public and business communities on the value of the rights of the creators of the music in the new media arena, while at the same time arriving at a financial model that continues to encourage the current rapid pace of commercial innovation and growth on the Internet.

## VI. NEW USES AND NEW PERCENTAGES

If uses of music on the Internet represent a new convergence of exclusive rights under copyright, then the same is true of commerce models. Instead of the usual sequential channels of manufacture, distribution, and retail, with attendant issues of promotion costs and difficulty in collecting from retail accounts, a record company could digitally distribute a song direct to the end user and receive immediate payment of the full retail price, either through a credit card or a pre-paid “music card” type account.<sup>43</sup> While many record companies al-

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<sup>42</sup> See Stephanie Haun, *Musical Works Performance and the Internet: A Discordance of Old and New Copyright Rules*, 6 RICH. J.L. & TECH. 3, 74 (1999) (“Because the Internet is truly unique, new licensing models are appropriate, and concomitant licensing fees, unbound by old rules and consent decrees would develop.”). See also Jessica Litman, *Reforming Information Law in Copyrights Image*, 22 U. Dayton L. Rev. 587 (1997) (“So, when we talk about making the current copyright rules the rules of the road for the information superhighway, we really may be talking about using these rules to govern the next century’s analogues of the telephone, telegram, fax, newspaper, mail, magazine, television, bookstore, record store, mail order catalog, travel agent, and town square. Our current copyright rules simply weren’t designed to do that.”) *Id.* at 610-611. See also AL KOHN & BOB KOHN, *KOHN ON MUSIC LICENSING* (2d ed. Supp. 1999) 101 (stating that “the issue[s] of . . . whether an entirely new exclusive right under copyright should be recognized, either in lieu of or in addition to existing rights.”)

<sup>43</sup> Ric Dube, *Can Micropayments Make a Macrodifference?* Webnoize News, (visited Dec. 1, 1999) <<http://news.webnoize.com/>> (discussing digital wallet Internet payment vehicles under development by Microsoft, IBM, and others).

ready sell physical merchandise direct to consumers through direct mail catalogs, the possibility of this direct distribution “cut out the middle man” model on the Internet has become a hotly debated topic in the music industry, both in digital distribution and mail order contexts.<sup>44</sup>

What has not been as widely discussed is the impact a direct-to-consumer digital distribution model might have on the performer and their contractual agreement with the record company. In a model where the record company receives 100% of the list price instead of a discounted wholesale price, and where there are no traditional manufacturing costs to produce a CD, the performing artist may be looking for an increased share in what may be perceived as an increased new use revenue stream for the record company. Conversely, record companies can point out that technology partners and in-house staff that provide digital software services such as encoding, encryption, payment systems and Web site maintenance may ultimately eat up a bigger slice of the revenue pie than the traditional CD and cassette manufacturers.<sup>45</sup>

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<sup>44</sup> The music industry magazine BILLBOARD has recently had several articles and letters to the editor concerning the tensions between record companies, online merchants, traditional “brick and mortar” retailers, and new combinations of the above. See Ed Christman, *Retailers Seek Level Playing Field With Net Sellers*, Billboard, Nov. 13, 1999 at 1. (Traditional retailers complain of preferential treatment for online merchants.) See also Don Jeffrey & Brian Garrity, *For Brick & Mortar Retail, Biz is Solid but Buzz is Silent*, BILLBOARD, Dec. 4, 1999. (“Amid all the noisy talk this year about companies selling music on the Internet, one quiet fact may have gotten lost: Brick-and-mortar music merchants are performing better than ever.”). See also Ed Christman, *Bowie Predicts End of Stores & Labels; Numbers Say Otherwise*, BILLBOARD, Nov. 13, 1999. (noting that an Internet exclusive release of David Bowie’s album “hours . . .” sold only 989 copies in two weeks before moving into traditional stores where it sold 56,000 copies in the following four weeks. Distinguishing consumers who are willing to pay for digital music from those who enjoy free downloads, Christman concludes “...the number of people willing to pay for music in the download format right now appears to be in the 1,000 – 2,000 range.”).

<sup>45</sup> See Webnoize News, *EMI Reports First Half Profit, Sales Growth*, (visited Nov. 29, 1999) <<http://news.webnoize.com/item.rs?ID=6455>> (detailing EMI Group PLC’s investments in Internet companies, including custom-CD producer Musicmaker.com; secure music delivery software company Liquid Audio; digital delivery company Digital On-Demand; and ecommerce technology company Preview Systems).

In addition to the direct-distribution issue, to examine the overall impact of digital distribution on performers' royalty expectations, we must also consider whether the digital distribution is offered to the consumer as a sale of the digital file, or as a restricted license to use the digital file. The advantages of offering digital phonorecord deliveries as a license instead of a sale include negating the first-sale doctrine which would otherwise apply in the case of a transfer of ownership, and which would allow the customer to transfer the file to others.<sup>46</sup> In the digital realm this is particularly important because digital files are not "transferred" as unique physical objects, but rather are distributed in the form of a never-ending succession of perfect copies. Other advantages of license over transfer include contractual reinforcement of use restrictions that may already be encrypted into the software, for example the ability to play a song a fixed number of times or the ability to print out the notation only once.

If a digital distribution is more akin to a license than a retail sale, the performing artist may claim that the royalty percentage for digital phonorecord deliveries should be based not on a physical merchandise model (where the performer's royalty may typically be in the range of ten to fifteen percent of list price, after deductions),<sup>47</sup> but on a licensing model where the performer and the record company divide the proceeds in a more equal percentage. Such licensing royalty percentage provisions may already exist in artist contracts, for example where master recordings are licensed to film and television media. Support for this position is in the DPRSRA itself, under §114(g) Proceeds From Licensing of Transmissions which provides that where the digital phonorecord delivery has been voluntary licensed by the record company (and thus where the income presumably is closest to traditional distribution models), the featured recording artist receives their

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<sup>46</sup> See generally David Nimmer, et al., *The Metamorphosis of Contract into Expand*, 87 CALIF. L. REV. 17. (Noting that while license instead of transfer "jumps past the chain of distribution and creates a direct link to the producer by the end user," rights under copyright cannot be expanded via contract). See also Keith Kupferschmid, *Lost in Cyberspace: The Digital Demise of the First-Sale Doctrine*, 16 J. MARSHALL J. COMPUTER & INFO. L. 825.

<sup>47</sup> See DONALD S. PASSMAN, *ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS* (1997) at 109.

contractually agreed upon royalty,<sup>48</sup> however where the digital phonorecord delivery has been compulsorily licensed under statute, the performing artists receive shares of income totaling fifty percent.<sup>49</sup>

For a comparison of how transfer of ownership versus licensing has affected contractual relations between copyright grantors and grantees, it is instructive to examine the book publishing industry's experience with authors, contracts, and electronic rights.

## VII. AUTHORS AND E-RIGHTS

In the book publishing world, the mid-1990's saw the "boom and bust" of the electronic book on CD-ROM as a digital substitute for traditionally printed books.<sup>50</sup> Because CD-ROM and online technologies for text-based copyrights pre-dated wide use of the Internet for digital distribution of sound recordings, authors were exposed to the legal issues of digital distribution ownership, licensing, and royalties several years before musicians. Although the book, magazine, and newspaper publishing industries operate on different assumptions of rights assigned or licensed by authors compared with the music industry, it is interesting to note that royalty issues were at the forefront of authors' demands for new contractual agreements for new technological uses of their efforts.

Issued in 1993, the Position Statement on Electronic Publishing Rights by the Authors Guild and the American Society of Journalists and Authors equated the publisher who licenses a book in digital format with an agent, and suggested that the publisher would receive ten or fifteen percent of the new electronic use license, leaving the writer with an eighty five or ninety percent share.<sup>51</sup> Authors further objected

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<sup>48</sup> 17 U.S.C. §114(g)(1)(A) (1999).

<sup>49</sup> *Id.* The 50 percent performing artist share is divided as follows: 45 percent to the featured performers; 2.5 percent to the backup musicians; 2.5 percent to the non-featured vocalists.

<sup>50</sup> See Herbert R. Lottman, *At Milia, a Search for New Web Business Models*, PUBLISHERS WEEKLY.COM, Mar. 1, 1999, (visited Nov. 24, 1999) <[http://www.publishersweekly.com/articles/19990301\\_70886.asp](http://www.publishersweekly.com/articles/19990301_70886.asp)> (discussing "the rise and fall of CD-ROM.").

<sup>51</sup> The Authors Guild & The American Society of Journalists and Authors, *Electronic Publishing Rights: A Position Statement*, Oct. 18, 1993 (visited Nov. 24, 1999) <<http://www.authorsguild.org/erightspositionstatement.html>>.

to the digital version of a physical product being subject to the same royalty provisions as a printed book, seeing digital delivery as “a license in everything but name” and calling for a fifty-fifty split “akin to a subsidiary rights or licensing deal.”<sup>52</sup>

A partial victory for book authors and journalists was obtained in *Tasini v. New York Times Co., Inc.*, a Second Circuit case in which a group of freelance authors claimed their articles were infringed when the New York Times re-sold the articles to an electronic data base.<sup>53</sup> On appeal, the holding in *Tasini* for the plaintiffs acknowledged that the digital use of the articles, when individually copyrighted, constitutes a separate right.<sup>54</sup> The publishing industry has begun to respond by including digital rights clauses in contracts, clarifying the percentages and terms for the additional use.<sup>55</sup>

#### VIII. IT'S 2000 A.D. DO YOU KNOW WHERE YOUR CONTRACTS ARE?

From the record company's perspective, a contract should now expressly include a grant of digital delivery rights as part of a package of complete assignment of all rights to the master recording, along with a standard “future technologies” clause including all technologies now known or hereafter discovered.<sup>56</sup> As for older agreements in the files,

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<sup>52</sup> Steven M. Zeitchik, *The Great Ether Grab*, PUBLISHERSWEELY.COM, June 14, 1999, (visited Nov. 24, 1999) <[http://www.publishersweekly.com/articles/19990614\\_71279.asp](http://www.publishersweekly.com/articles/19990614_71279.asp)> (quoting Author's Guild head Paul Aiken).

<sup>53</sup> 192 F.3d 356 (2d Cir. 1999).

<sup>54</sup> *Id.* at 360.

<sup>55</sup> *Id.* at 359.

<sup>56</sup> Although recording contracts may vary widely in their detailed terms and usually remain confidential, sample “standard” agreements and terms are available for study. See Jay L. Cooper, *Sample Recording Contract*, 1/99 Entertainment, Arts, and Sports Law, 1999 ABA Forum on the Entertainment and Sports Industries, ALI-ABA Course of Study Materials 53 (including provisions for a “New Record” defined as “a Phonograph Record in any software medium in which recorded music is not in general commercial distribution in the United States as of January 1, 1997, including, without limitation, the sale of Phonograph Records (or other exploitation of Masters) through the telephone, satellite, cable or other direct transmissions to the consumer over wire or through the a . . .”). *Id.* at 89. Royalty provisions for a “New Record” in the sample agreement include the lesser of “(A) Seventy-five percent (75%) of the otherwise applicable royalty rate applied to the Royalty Base Price of

proactive analysis will help to determine whether the scope of rights granted includes digital delivery, or whether the agreement was limited enough to now suggest a negotiated amendment to include the new use.<sup>57</sup>

In some cases, neither the recording artist or the record company will have any choice. Where a recording artist completely, totally, and absolutely assigned all rights in the master recording with no reservation of rights, there would be no reserved rights remaining to enable a cause of action under copyright law.<sup>58</sup> In that scenario, the plaintiff's only option would be a common law contract unconscionability or adhesion claim which is difficult to prove. Conversely, in rare circumstances a record company may find contracts with overseas artists signed under foreign laws which may statutorily prevent interpretation that grants rights to new technologies the grantor was unaware of at the time of signing.<sup>59</sup>

Between those extremes will be the agreements where something

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the New Record concerned; and (B) An amount equal to the product of (1) our Net Receipts from the exploitation of those New Records, and (2) the otherwise applicable royalty rate . . . ” *Id.* at 69. See also Passman, *supra* note 47.

<sup>57</sup> On the New Use Doctrine and new technology, see generally 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT (hereinafter NIMMER ON COPYRIGHT), §10.10, 10-86 – 10-94. See also Mark F. Radcliffe, *Repackaging the Past: Old Content in New Media Bottles*, 545 PLI/Pat 9 (1999). See also Mark F. Radcliffe, *Bringing Your Website into the 21<sup>st</sup> Century: Advanced Clearance and Licensing Issues*, 563 PLI/Pat 259 (1999). See also Sidney A. Rosenzweig, *Don't Put my Article Online!: Extending Copyright's New-use Doctrine to the Electronic Publishing Media and Beyond*, 143 U. PA. L. REV. 899 (1995). See also Gayley Rosen, *The Rights to Future Technologies: Should Bourne v. Disney Change the Rules?*, 24 FORDHAM URB. L.J. 617 (1997). See also Don E. Tomlinson & Timothy Nielander, *Unchained Melody: Music Licensing in the Digital Age*, 6 TEX. INTELL. PROP. L.J. 277, 293-295 (1998). See also Barbara D. Griff, *A New Use for an Old License: Who Owns the Right?*, 17 CARDOZO L. REV. 53 (1995).

<sup>58</sup> *Maljack Productions Inc. v. Goodtimes Home Video Corp.*, 30 U.S.P.Q. 2d 1959 (1994) (Plaintiff who transferred all rights has no standing under Copyright Act).

<sup>59</sup> Jane C. Ginsburg, *The Cyberian Captivity of Copyright: Territoriality and Authors' Rights in a Networked World*, 15 SANTA CLARA COMPUTER & HIGH TECH. L.J. 347, 357-358 (1999) (“In some jurisdictions, the copyright law prohibits grants of rights in modes of exploitation unknown at the time of contracting . . .”)

less than a full and complete assignment of rights was conveyed. As Nimmer points out, disputes over these types of agreements are usually settled by negotiation, and the cases in which rulings have been made have very different fact patterns so that it is difficult to identify a prevailing judicial doctrine in the case law.<sup>60</sup> Prominent in Nimmer's analysis is the fact that in new use cases, contract interpretation via determining the intent of the parties may be of little use. The parties could not have had intent regarding a technology which was not in existence at the time the contract was signed, and there is the practical difficulty of proving intent years or decades after the signing of the original agreement, when the original parties may no longer be living.<sup>61</sup>

Turning therefore to the language of the agreements, Nimmer proposes two broad approaches to contract construction. The first calls for unambiguous strict construction in which any rights not expressly granted are not included. The second, and preferred approach, allows for uses which "reasonably fall within the medium as described in the license."<sup>62</sup>

To illustrate the diverse interpretations of "reasonable," compare the following three cases involving new use rights in film, television and video cassettes spanning the period 1938 to 1998. In *Cohen v. Paramount Pictures Corp.* the Ninth Circuit Court of Appeals determined that the express grant of rights for exhibition on television in a 1969 synchronization license did not include the later invention of video cassettes, because a video cassette recorder could be operated with a monitor instead of a normal television receiver.<sup>63</sup> The case reportedly sent "shockwaves" through Hollywood and led to negotiated settlement of other new use cases involving video cassette release of motion pictures.<sup>64</sup> Contrast this with a Second Circuit Court of Appeals case, *Boosey & Hawkes Music Publishers Ltd. v. Walt Disney Co.* where a 1939 license between the composer Igor Stravinsky and

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<sup>60</sup> 3 NIMMER ON COPYRIGHT, §10.10[B] at 10-87.

<sup>61</sup> *Id.* at 10-90.

<sup>62</sup> *Id.* at 10-91.

<sup>63</sup> 845 F.2d 851 (9th Cir. 1988).

<sup>64</sup> THOMAS D. SELZ, ET AL., ENTERTAINMENT LAW, § 25.18 at 25-103 (2d ed. 1999).

Disney which included the right to “record [a motion picture] in any manner, medium, or form” was held 59 years later to include video cassette sales of the film *Fantasia*.<sup>65</sup> The court in *Boosey* held that the sophisticated negotiators of the 1939 agreement knew about the coming television technology or at least a “nascent market for home viewing of feature films,” which was held to reasonably include videocassettes.<sup>66</sup> Contrast this with *Ettore v. Philco Television Broad. Corp.*, a Third Circuit case where the court held that a license to film a prize fight in 1936 did not include new use rights to show the film on television in 1949 and 1950.<sup>67</sup> The court in *Ettore* found that as late as 1940 (one year after the *Fantasia* agreement in *Boosey*), the “social effect” of television was “nil,”<sup>68</sup> putting great weight on the fact that the plaintiff was “unsophisticated,” a prize fighter who received little or no legal assistance in negotiating the original film agreement.<sup>69</sup>

The conflict between the Ninth Circuit (new use reverting to licensor in *Cohen*) and Second Circuit (new use included in original license in *Boosey*) illustrates the importance that individual fact patterns and even perceived plaintiff sophistication (in *Ettore*) will play in any future new use cases, in addition to the impact of conflicting judicial decisions in different jurisdictions and venues.<sup>70</sup> It is also worth taking

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<sup>65</sup> 145 F.3d 481 (2d Cir. 1998).

<sup>66</sup> *Id.* at 486.

<sup>67</sup> 229 F.2d 481 (3d Cir. 1956) The plaintiff in *Ettore* was initially delighted to have the film of his five-round fight with the famous Joe Louis shown on local Philadelphia television in 1949, thirteen years after the bout. He informed his friends they should pay particular attention to the third round, which he considered to be his best. It was only after discovering that the film’s third round had been omitted from the television broadcast that an attorney was contacted. The plaintiff claimed the omission of the third round “caused his friends to deride him” (*Id.* at 483).

<sup>68</sup> *Id.* at 491.

<sup>69</sup> “Ettore, was not an experienced businessman but a prize fighter, and the Court relied heavily on his lack of sophistication in determining whether it was fair to charge him with knowledge of the new medium.” *Bartsch v. Metro-Goldwyn-Mayer, Inc.*, 391 F.2d 150 (2d Cir. 1968).

<sup>70</sup> See generally Michael Landau and Donald E. Biederman, *The Case for a Specialized Copyright Court: Eliminating the Jurisdictional Advantage*, 21 HASTINGS COMM. & ENT L.J. 717 (proposing a single specialized court of nationwide jurisdiction for the “highly technical legal doctrines which are so central to copyright law.”). *Id.* at 719.

note of the policy rationale articulated in *Boosey*: “By holding contracting parties accountable to the reasonable interpretation of their agreements, we encourage licensors and licensees to anticipate and bargain for the full value of potential future uses.”<sup>71</sup>

## IX. CODA

The only certainty in new technology is that it will continue to advance in surprising ways, and consumers will have the last word on which technology is commercially successful. No one can say for certain if the much-hyped potential of digital distribution will amount to a significant portion<sup>72</sup> of the currently 40 billion dollar per year worldwide sound-carrier market,<sup>73</sup> or even if the Internet will be replaced by something with more mass market commercial appeal, perhaps a telephone/television hybrid that will once again send copyright lawmakers back to the drawing board.

No matter what form new technology takes, the arrival of the digital millennium is the perfect time to look forward to continued change in copyright law stimulated by new technological ways of doing business, and to look back by ensuring that contractual partnerships in the digital millennium continue smoothly with those who create and perform the music.

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<sup>71</sup> *Boosey*, 145 F. 3d at 488.

<sup>72</sup> See Lucas Graves & Seamus Mcateer, *Media Distribution: Confronting the Threat of Music Piracy*, Jupiter Communications Web Technology Strategies, (May 1999) (visited November 23, 1999) <<http://www.jup.com/research/wts/excerpts/wt9905.html>> (“Despite its riveting hold on popular media and the recording industry, digital music distribution must overcome major obstacles before emerging as a mainstream consumer technology – just three percent of online consumers will purchase downloaded digital music by 2003.”).

<sup>73</sup> NMPA Report *supra* at 4.