The Statutory Overriding of Controlled Composition Clauses

Mario F. Gonzalez, Esq.*

I. INTRODUCTION

Now that the major record companies in the United States are finally starting to make their record catalogs available to the general public for digital downloading onto personal computers[1], those companies (and, in response, the artists' representatives and music publishers) need to take a new look at the controlled composition clauses in their recording contracts with their artists. By relying on the controlled composition clauses as historically drafted, record companies may be creating tremendous hidden future liabilities.

Most recording contracts use the term "controlled compositions" to refer to musical compositions written, owned or controlled by the recording artist who is being "signed" to the record label.[2] "Controlled composition clauses" refers generally to the provisions in a recording contract that set forth the terms for the licenses that are or will be granted to the record company for its use of controlled compositions, for the most part, in the United States and Canada. More specifically,

---

* B.A., UCLA, 1974; J.D., UCLA School of Law, 1977. Mr. Gonzalez practices as a music attorney in Los Angeles. He would like to thank Lionel S. Sobel and Milton E. Olin, Jr. for their valuable assistance in the preparation of this article.

[1] AOL Time Warner (which is the parent company for the record labels Warner Bros. Records, Elektra and Atlantic, among others), Bertelsmann (which is the parent company for the record labels RCA, Artista and J Records, among others) and EMI (which is the parent company for the record labels Capitol and Virgin among others) jointly own the Internet music provider MusicNet with RealNetworks, and Sony Music and Universal jointly own the Internet music provider Pressplay. The economic models for the digital download sale of recorded music seem to be either along the lines of a subscription model, where the consumer will have the right to download recorded music by paying a monthly fee, or a "pay-per-download" model so the consumer only pays for the individual titles that he or she is downloading.

[2] In addition, more recent recording contracts also include musical compositions written, owned or controlled, in whole or in part, directly or indirectly, by the applicable record producer within the definition of "controlled compositions."

the controlled composition clauses set forth the "mechanical" royalty rates that the record company will pay to the artist (usually through the artist's music publishing company) for the reproduction of controlled compositions on recordings featuring the applicable artist. These "mechanical" royalties are separate and apart from the "record royalties" payable to the artist for his or her performances on the sound recording embodied on a phonorecord.[3] Some controlled composition clauses are drafted as an actual license by the artist to the record company, and other controlled composition clauses set forth the terms to be contained in separate mechanical license agreements, which will be issued and executed each time an artist delivers a record.

It has been well-publicized in the music industry that the Digital Performance Right In Sound Recordings Act of 1995 (the "DPRA") accorded the copyright owners of sound recordings a limited exclusive right of public performance in their sound recordings by means of a digital audio transmission.[4] However, the DPRA also amended Section 115 of the Copyright Act. Section 115 provides for compulsory mechanical licenses, such that an owner of a musical composition can, in effect, be forced to grant a non-exclusive license for the reproduction of a nondramatic musical composition on phonorecords[5] following its initial authorized release. In the public discussion and debate regarding the DPRA and the more recent Digital Millennium Copyright Act, there has been little attention given to the impact the DPRA will have on the controlled composition clauses contained in recording contracts insofar as digital downloads are concerned.

II. BACKGROUND

Federal copyright protection grants a monopoly to the author or other owner of "a work of authorship" (a musical composition is an example of a "work of authorship"). In other words, the author or

[3] In other words, the record company is paying two types of royalties for each phonorecord, one to the artist for performing on the sound recording(s) contained on the phonorecord and the other to the music publisher(s) (which in the case of a controlled composition, is the artist's music publisher) for the right to reproduce the underlying musical composition(s) contained on the sound recording.

[4] A "digital transmission" is a transmission in whole or in part in a digital or other non-analog format. *See* 17 U.S.C. § 101.

[5] "Phonorecords" are material objects in which sounds, other than those accompanying a motion picture or other audiovisual work, are fixed by any method now known or later developed, and from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. The term "phonorecords" includes the material object in which the sounds are first fixed. 17 U.S.C. § 101. Phonograph records in the form of vinyl, tape cassette and compact discs are all examples of phonorecords.

other owner of the copyright has the exclusive right to determine when and how the work may be exploited or otherwise used (for convenience, references hereinafter to "owner" shall refer to the author or other owner of a copyright). However, in some cases, Congress felt it was necessary to make exceptions to this statutory monopoly in order to promote greater public access to certain kinds of works. One such exception to a copyright owner's monopoly is Section 115 of the Copyright Act. Under Section 115, once a phonorecord has been "distributed to the public in the United States under the authority of the copyright owner," the "nondramatic" musical composition contained on the phonorecord may be recorded and reproduced on another phonorecord pursuant to a compulsory license.[6] Congress has given the owner of a musical composition the exclusive right to determine who will be the licensee of the first phonorecord containing the composition to be released. Thereafter, the owner cannot prohibit anyone else from making a phonorecord of the composition so long as that person complies with the terms and procedures set forth in Section 115 and the regulations thereto as prescribed by the Copyright Office.[7]

A license to reproduce a musical composition on a phonorecord is commonly referred to as a "mechanical license." (A license for the first use of a composition on a phonorecord is commonly referred to as a "first use mechanical license.") The term "mechanical" originated with the reproduction of musical compositions on piano rolls; that is, a piano roll allowed the player piano to reproduce "mechanically" a musical composition. This terminology has continued over the years through the various technological recording advancements from piano rolls to vinyl phonograph records, audio tape 8-tracks and cassettes, compact discs, and now to the digital distribution of music over the Internet.

In practice, record companies very rarely need to avail themselves of a Section 115 compulsory license, because mechanical licenses in the United States are routinely granted either by the artist/songwriter in the controlled composition clauses of his or her recording contract, directly by the music publisher (i.e., the owner or administrator of the musical work), or by The Harry Fox Agency, Inc., as an agent of the music publisher. Therefore, the vast majority of mechanical licenses for non-controlled compositions are fairly standardized licenses voluntarily negotiated between the music publisher (or by The Harry Fox Agency on a publisher's behalf) and the record company. As noted above, with respect to controlled compositions, the terms of the mechanical licenses

[6] A similar compulsory license for musical compositions also existed in the 1909 Copyright Act, which was the predecessor to the current Copyright Act of 1976.

[7] 37 C.F.R. § 201.19.

are set forth in the controlled composition clauses in the artist's recording contract.

The compulsory mechanical royalty rate is commonly referred to as the "statutory rate." The 1909 Copyright Act provided for a statutory rate of 2¢ per copy.[8] Surprisingly,[9] this rate remained unchanged until the 1976 Copyright Act. The 1976 Copyright Act not only increased the minimum statutory rate to 2¾¢ per copy, it also added a potentially higher rate calculated at ½¢ per minute of playing time of the applicable sound recording. In order to continue to increase the statutory rate over time (although it could potentially also be decreased), the 1976 Copyright Act established a Copyright Royalty Tribunal that was responsible for changing the rate periodically. However, in 1993 the Copyright Royalty Tribunal was replaced by *ad hoc* Copyright Arbitration Royalty Panels ("CARPs"). As of the date of this writing, the current statutory rate is the greater of 8¢ or 1.55¢ per minute, for the two-year period beginning January 1, 2002 and ending December 31, 2003.[10]

In an effort to reduce the financial impact of the increase in the statutory rate, the record companies retaliated by greatly expanding the controlled composition clauses in their recording contracts. Prior to the 1976 Copyright Act, many recording contracts merely stated that controlled compositions would be available for mechanical licensing at the statutory rate and that the maximum rates would not be more than ten times the statutory rate for albums, two times the statutory rate for singles, etc. Since then, however, the controlled composition clauses have been expanded in a number of ways. For example[11]:

1. Most new artists and even some established artists agree to a mechanical rate that is less than the otherwise applicable statutory rate. Most commonly, the record company will want a rate that is 75% of the

[8] One seemingly anomalous result of the statutory rate as a "penny rate" is that the penny rate is the same per composition, regardless of the price of the phonorecord or the configuration of the phonorecord (i.e., the rate is the same whether the composition is contained on a single, an EP, or an album or whether the record is a vinyl record, a tape cassette or a compact disc). This is not the case outside of the United States and Canada. *See infra* note 12.

[9] Perhaps one reason the music publishers were willing to live with the same statutory rate for so long was the enormous increase in the number of phonorecords being reproduced over the years.

[10] 37 C.F.R. § 255(j). A quick and easy may to find out the historical, current and future statutory rates is to logon to http://www.nmpa.org/hfa/ratecurrent.html.

[11] In addition, controlled composition clauses may contain a variety of other provisions, such as music publishing royalties (or the lack thereof) for audiovisual reproductions of musical compositions on music videos, free licenses for the use of lyrics on record packages and websites, provisions related to non-controlled compositions, etc.

"minimum statutory rate" (i.e., the statutory rate without regard to the playing time of the recording). This is commonly referred to as a "¾ rate."[12] Whatever mechanical rate is agreed to in the recording agreement with respect to the controlled compositions is commonly referred to as the "controlled rate." Those artists, who have little choice but to accept a ¾ rate, may be able to negotiate escalations in the controlled rate based upon a particular album achieving certain sales levels or for future optional albums under the particular recording contract.

2. Even if the artist is of a significant enough stature to obtain in the artist's recording contract a so-called "full minimum rate" (i.e., the then-current statutory rate without regard to any potentially greater rate based on the playing time of the sound recording), the controlled composition clauses will still provide for mechanical rates that are less than the "full minimum rate" on sales of phonorecords other than top-line sales through "normal retail channels" (which is a term in the music industry used to denote records sold at a top-line price through "brick and mortar" retail outlets, such as conventional record retailers). In this regard, a reduced rate (usually a ¾ rate for those artists having a "full minimum rate") will apply to mid-line sales, budget sales, premium sales, so-called "new technology records" (which, at the current time, will almost always include digital downloads over the Internet), etc. Also, record clubs in the United States will not sell, or will discontinue the sale of, an album without having at least ¾ rates on the underlying compositions. Those artists who cannot avoid a ¾ rate with respect to top-line sales through normal retail channels face an even further reduction with respect to other sales. Often this rate is 75% of the ¾ rate. *In contrast, under a Section 115 compulsory license, there is only one full statutory rate per composition regardless of the price of the phonorecord or how or where the phonorecord is distributed.*

3. In order to escape the periodic increases in the statutory rate, the record companies want to fix (i.e., lock-in) the controlled rate at the earliest possible point in time. This would usually be the commence-

[12] In Canada, there currently is no statutory rate. There, the major record companies and the major music publishers have agreed to a "customary rate" that typically parallels the statutory rate in the United States, but, of course, is computed in Canadian currency. Outside of the United States and Canada, there are no statutory rates as the rates are determined by the performing/mechanical rights societies and the major record companies in the country where the phonorecords are manufactured. Also, outside the United States and Canada, the rates are akin to a record royalty, that is the mechanical royalty is a percentage of a constructed price of the phonorecord, rather than being a penny rate as is the case in the United States and Canada.

ment of the artist's recording of the composition under the recording contract (but no later than the date the artist is contractually required to deliver the applicable phonorecord to the record company). The artist will respond by requesting that the date for the fixing of the controlled rate be a later point in time, for example, the date of the initial release of the applicable phonorecord. Bear in mind that under almost all controlled composition clauses, the controlled rate with respect to a particular phonorecord (and probably with respect to the applicable sound recording even if it is later contained on another phonorecord) will remain fixed for the life of the copyright in the musical composition, regardless of any periodic increases in the statutory rate. In many cases, record companies are still paying mechanical rates of 2¢ or 2.75¢ per composition for albums released in the 1970s, even though the suggested retail price for the majority of those albums that have continued to sell has gone from $8.98 in the late 1970s to $17.98 today (with commensurate increases in the wholesale prices charged by the record companies). In some cases, however, the record company agrees to increase the controlled rate for greatest hits albums, such that the controlled rate will be calculated based on the statutory rate existing on the date the greatest hits album is released. *In contrast, under a Section 115 compulsory license, the statutory rate increases for phonorecords manufactured and sold after the increase in the statutory rate.*[13]

4. One type of controlled composition clause, which (as mentioned above) existed prior to the 1976 Copyright Act and continues today, sets maximums on the aggregate mechanical royalties that are payable for each record configuration. For example, the maximum rate is typically (a) ten times the controlled rate for albums (although many record companies agree to increase the maximum for albums to eleven or twelve times the controlled rate, especially with respect to compact discs), (b) two times the controlled rate for singles with one or two tracks, (c) three times the controlled rate for singles with more than two tracks (commonly referred to as 12" singles, long-play singles and maxi-singles), and (d) four or five times the controlled rate for extended-play records (commonly referred to as EPs). In addition to not being paid mechanical royalties on compositions over the maximums (which is typically effectuated by the record company proportionally reducing the mechanical royalties for all of the controlled compositions on the applicable record), there are two additional concerns for those

[13] Section 115 does not address what the statutory rate would be if a phonorecord were manufactured when the statutory rate was at one rate but distributed after a statutory increase.

artists who record any composition written by another songwriter: First, if the controlled composition clause does not have an allowance for non-controlled compositions (commonly referred to as "outside compositions" and "covers") and the music publisher of the non-controlled composition does not agree to the controlled rate, the artist will bear or be liable for the amount by which the statutory rate for the non-controlled composition(s) would otherwise result in aggregate mechanical royalties in excess of the maximum set forth in the controlled composition clauses.[14] Second, the foregoing liability of the artist is compounded over time if the mechanical rates for the non-controlled compositions increase each time the statutory rate increases. *In contrast, a Section 115 compulsory license would not be subject to any overall maximum on the aggregate amount of mechanical royalties payable for all of the compositions on a phonorecord.*

5. Unlike a Section 115 compulsory license, which requires that a mechanical royalty be paid for every phonorecord manufactured and distributed after the owner of the musical copyright is identified in the registration or other public records of the Copyright Office,[15] controlled composition clauses typically only require a royalty on records for which a record royalty is payable to the artist. There are a variety of record sales for which record royalties are not payable to the artist. In this regard, under the controlled composition clauses, mechanical royalties for controlled compositions typically are not payable for phonorecords identified as so-called "free goods," including "free goods" that are distributed to retailers for sale to the public. Most record companies, however, agree to pay mechanical royalties on 50% of "standard album free goods."[16] Also, controlled composition clauses will often allow the record company to make one royalty payment for each controlled composition on a phonorecord, and, in this regard, different mixes or versions of a controlled composition are deemed only one controlled composition for royalty purposes. *In contrast, under a Section 115 compulsory license, a mechanical royalty is payable for each phonorecord manufactured and distributed (note the absence of the word "sold") and for each version of a composition.* Even though the digital download market is in its relative infancy, most of the record

[14] An artist who records nothing but covers licensed at the statutory rate and who is subject to a ¾ rate would actually owe the record company a significant amount of pennies for every phonorecord sold.

[15] 17 U.S.C. § 115(c)(1).

[16] "Standard album free goods" are not really "free goods"; standard free goods are merely a way for a record company to avoid paying an artist on a percentage of records that are, in effect, sold by the record company's distributor.

companies and many websites have for some time offered for promotional purposes free "streaming" of excerpts from certain sound recordings. If "streaming" is a digital phonorecord delivery[17] within the meaning of Section 115, a mechanical license would be required and royalty would be payable for each "stream."[18]

6. Controlled composition clauses typically provide for semi-annual or quarterly accounting whereas Section 115(c)(5) requires monthly and annual accountings under a compulsory license, which

[17] As defined in 17 U.S.C. § 115(d): "A 'digital phonorecord delivery' is each individual delivery of a phonorecord by digital transmission of a sound recording which results in a specifically identifiable reproduction by or for any transmission recipient of a phonorecord of that sound recording, regardless of whether the digital transmission is also a public performance of the sound recording or any nondramatic musical work embodied therein. A digital phonorecord delivery does not result from a real-time, non-interactive subscription transmission of a sound recording where no reproduction of the sound recording or the musical work embodied therein is made from the inception of the transmission through to its receipt by the transmission recipient in order to make the sound recording audible."

[18] A recent ruling by Judge John S. Martin in the Southern District of New York raises the issue of whether a person or entity engaged only in "streaming" may even avail themselves of a compulsory license under Section 115. See Rodgers and Hammerstein Org. v. UMG Recordings, Inc., 2001 U.S. Dist. LEXIS 16111 (Sept. 25, 2001). In dicta, Judge Martin states that compulsory licenses under Section 115 are only available to potential licensees who engage in the distribution of phonorecords to the public for private use. In Judge Martin's opinion, a "stream" is not a "distribution" because the defendants who engaged in the "streaming" did not "sell copies of the records to their users." The implications of this view, i.e., that there must be a sale of a copy in order for there to be a distribution of the copy, reach beyond the subject matter of this article.

Also, the Copyright Office has taken the position that, although the creation of a "buffer" copy in a computer's RAM is a reproduction, the copy is subject to the fair use defense against a claim of infringement. *See* U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT 133–41 (2001), *available at* http://www.loc.gov/copyright/reports/studies/dmca/dmca_study.html.

The issue of whether a streamed "promotional excerpt" (i.e., the streaming of a composition for 30 seconds or less) gives rise to a mechanical royalty appears to have been tabled, at least until October 4, 2003, with respect to Internet subscription services and Internet services that provide for limited downloads (i.e., downloads that expire after a certain number of plays or period of time). On October 9, 2001, The National Music Publishers' Association and The Harry Fox Agency, Inc., on the one hand, and the Recording Industry Association of America, on the other, announced an agreement pending the determination of royalty rates for such services, either through negotiation or a CARP. In that agreement, "promotional excerpts" do not give rise to a mechanical royalty so long as the owner of the sound recording also allows the music publishers to stream a promotional excerpt of the sound recording "on-demand" without payment of a royalty to the owner of the sound recording. *See* Press Release, National Music Publishers Association, Songwriters and Music Publishers Reach Landmark Accord with Record Industry To License Music Subscription Services On the Internet (Oct. 9, 2001), *available at* http://www.nmpa.org/pr/subscription_10_09_01.html

must be sent by registered or certified mail in a specific certified format.[19]

III. AMENDMENTS TO SECTION 115 UNDER THE DPRA

In addition to according the copyright owner of a sound recording a limited exclusive right of public performance of sound recordings by means of a digital audio transmission, the DPRA made it clear that a musical composition contained on a phonorecord distributed by digital transmission (referred to in the DRPA as a "digital phonorecord delivery") is also subject to compulsory licensing under Section 115. However, the DRPA amendment to Section 115 went much further, in that, insofar as digital phonorecord deliveries are concerned, Congress intended for the statutory rates to override the controlled rates.[20]

In general, Section 115 provides that the music publisher and the record company are free to voluntarily negotiate a mechanical license that may contain a mechanical rate and other terms that vary from a Section 115 compulsory license. However, the second sentence of paragraph (c)(3)(E)(i) of Section 115 provides that the statutory rates will override any "contrary royalty rates specified in a contract pursuant to which a recording artist who is the author of a nondramatic musical work grants a license under that person's exclusive rights" in the musical work under the paragraphs of Section 106 that provide for the reproduction and distribution of phonorecords "or commits another person" (presumably, the artist's music publisher) to grant a license in that musical work. A recording contract would be such a contract, and

---

[19] 37 C.F.R. § 201.19.

[20] "There is a situation in which the provisions of voluntarily negotiated license agreements should not be given effect in lieu of any mechanical royalty rates determined by the Librarian of Congress. For some time, music publishers have expressed concerns about so-called "controlled composition" clauses in recording contracts. Generally speaking, controlled composition clauses are provisions whereby a recording artist who is the author of a nondramatic musical work agrees to reduce the mechanical royalty rate payable when a record company makes and distributes phonorecords which include recordings of such artist's compositions. Subject to the exceptions set forth in subparagraph (E)(ii), the second sentence of subparagraph (E)(i) is intended to make these controlled composition clauses inapplicable to digital phonorecord deliveries.. . . It should be emphasized that subparagraph (E) applies only to the making of digital phonorecord deliveries and not to the making and distribution of physical phonorecords. Nothing in the bill is intended to interfere with the application of controlled composition clauses to the making and distribution of physical phonorecords or to digital phonorecord deliveries where the agreements are not covered by the terms of subsection (c)(3)(E)." S. REP. No.104-128, at 41–42 (1995).However, a literal reading of paragraph (c)(3)(E)(i) does not limit the imposition of the statutory rates to digital phonorecord deliveries. If this is what is intended, as indicated by the Senate Report, it is surprising that this limitation was not expressly set forth in this paragraph.

the controlled composition clauses in a recording contract would be such a license.

Paragraph (c)(3)(E)(ii) of Section 115 contains two exceptions to the overriding of the controlled rates. The first exception grandfathers recording contracts entered into on or before the rather arbitrary date of June 22, 1995, such that the controlled rates, even with respect to phonorecord digital deliveries, will continue to apply to recording contracts entered into on or before June 22, 1995. However, the statutory rates will override the controlled rates if a pre-June 23, 1995 recording contract is amended (i.e., renegotiated) after June 22, 1995, provided the amendment (a) provides for controlled rates that are less than the statutory rates, *or* (b) increases the number of "musical works" subject to the controlled rates, provided, further, that the controlled rates will continue to apply to the number of musical works that would have been covered by the recording contract had the recording contract not been amended after June 22, 1995.

The second exception allows the record company to negotiate a controlled rate after the composition has been recorded by the artist for commercial release subject to the following qualification: *the artist must have retained the right to grant mechanical licenses in the controlled composition.*[21]

The qualification in the second exception warrants further analysis. On one hand, one could interpret the language in the second exception, which states "if at the time the contract is entered into, the recording artist retains the right to grant licenses," as merely stating the obvious. That is, if the recording artist has assigned his or her rights in the controlled composition to a third party prior to the recording of the composition for commercial release, the artist would no longer have any rights in the composition and would, therefore, not have the capacity to grant the record company a reduced rate. Under this view, there would seem to be no prohibition on a third party publisher (i.e., a music publisher other than a publishing company owned by the artist) at any time granting a reduced controlled rate to the record company.

On the other hand, one could interpret this qualification in the second exception as prohibiting a third party music publisher, who ob-

[21] "The second of the exceptions provided in subparagraph (E)(ii) is intended to allow a recording artist-author who chooses to act as his or her own music publisher to agree to accept mechanical royalties at less than the statutory rates, provided that the contract containing such lower rates is entered into after the sound recording has been fixed in a tangible medium of expression substantially in a form intended for commercial release." SENATE REPORT ON THE DIGITAL PERFORMANCE RIGHT IN SOUND RECORDINGS ACT OF 1995, S. REP. NO. 104-128, at 42.

tained administration rights from the artist in the controlled compositions after the execution of the recording agreement, from ever granting the artist's record company a reduced mechanical royalty rate for digital phonorecord delivery of a controlled composition contained on a sound recording subject to the recording contract (i.e., even after the controlled composition has been recorded by the artist for commercial release). If Congress intended to protect the artist/songwriter from being subjected to reduced controlled rates after the artist/songwriter had assigned his rights in the controlled composition to a third party, its seems odd that the statute seemingly does not allow an artist to voluntarily acquiesce in an agreement between a record company and a third party publisher for a reduced controlled rate once the controlled composition had been recorded for commercial release. In other words, why should the artist be prohibited from approving a third party publisher's grant of a reduced controlled rate when the artist would have had the right to grant the reduced controlled composition if the artist had only retained his or her rights in the controlled composition?

Nevertheless, the plain language of subsection (c)(3)(E)(i)(II) of Section 115 supports the latter view of the second exception to the overriding provisions of the controlled rates (the *plain language interpretation*). However, this view creates an even further anomaly: that is, if an artist/songwriter had assigned his compositions to a third party music publisher prior to signing his recording agreement, then the third party music publisher would seemingly be free to grant reduced controlled rates to the record company at any time. This is because the first sentence of paragraph (c)(3)(E)(i) of Section 115 states: "License agreements voluntarily negotiated at any time between one or more copyright owners of nondramatic musical works and one or more persons entitled to obtain a compulsory license under subsection (a)(1) shall be given effect in lieu of any determination by the Librarian of Congress." The only exception to the foregoing is in the second sentence of paragraph (c)(3)(E)(i) of Section 115, which states that the statutory rate "shall be given effect in lieu of any contrary royalty rates specified in" only a certain type of contract, i.e., a contract

> "pursuant to which a recording artist is the author of a nondramatic musical work grants a license under that person's exclusive rights in the musical work under paragraphs (1) and (3) of Section 106 [i.e., the reproduction right and the distribution right, respectively] or commits another person to grant a license in that musical work under paragraphs (1) and (3) of Section 106, to a person desiring to fix in a tangible medium of expression a sound recording embodying the musical work."

Accordingly, a "contract" between the record company and a person or entity who is not the artist/songwriter would not be subject to the second sentence of paragraph (c)(3)(E)(i) of Section 115. Therefore, that person or entity would be free to grant a controlled rate on controlled compositions contained on future sound recordings that is less than the statutory rate.[22]

If, however, the artist/songwriter assigns his musical copyrights to a third party music publisher *after* he or she signs the recording contract (assuming the recording contract contains controlled composition clauses for the digital phonorecord deliveries of future sound recordings), then, under *the plain language interpretation*, the third party music publisher would forever be prohibited from accepting a reduced controlled rate under the second view of subsection (c)(3)(E)(i)(II) of Section 115 noted above.

The better view is the one first noted above – a third party publisher should have the right, insofar as Section 115 is concerned, to grant a reduced controlled rate. One would assume that a third party publisher would only grant a reduced controlled rate if it was at least potentially advantageous for the publisher to do so. Moreover, at the time the artist/songwriter assigns his or her rights in the compositions to a third party publisher, the artist/songwriter could protect himself or herself by inserting a clause in the agreement with the third party publisher that prohibits the publisher from granting a reduced controlled rate for digital phonorecord delivery without the consent of the artist/songwriter.

The overriding provisions of paragraph (c)(3)(E)(i) of Section 115 result in the elimination of those aspects of the controlled composition clause discussed in paragraphs 1 through 5 in Section II above. Presumably, because the overriding provisions only address contrary rates in the controlled composition clauses, the artist and the record company are still free to contract for other controlled composition provisions, such as quarterly or semi-annual accounting.

Turning to how the statutory mechanical royalty rates for digital phonorecord delivery are to be determined under Section 115, those rates were to be determined in two stages: first, by the interested par-

[22] In light of the foregoing, the record company may very well insist that such a contract between the record company and a third party music publisher, granting the record company reduced controlled rates, be entered into concurrently with the execution of the recording contract. Worse yet, the record companies may start taking a stance that was long ago abandoned by all of the major record labels: that the artist must enter into a publishing agreement with a music publishing company affiliated with the record company as a condition of the record company offering the artist a recording contract.

ties negotiating the statutory rates, and, second, if the interested parties fail to agree upon the statutory rates, a CARP would be established to determine the rates through arbitration. Insofar as non-incidental digital phonorecord deliveries are concerned, the major interested parties were able to agree upon the statutory rates. As set forth in the announcement by the Copyright Office on February 9, 1999, the statutory rates for non-incidental digital phonorecord deliveries remained the same as for traditional physical phonorecords. However, the negotiating parties were unable to determine what an "incidental digital phonorecord delivery" was and what the statutory rates would be for incidental digital phonorecord deliveries.[23]

IV. Drafting Controlled Composition Clauses In Light of Section 115

As of the date of this writing, I am not aware of any major record company that has revised the controlled composition clauses in its form recording contracts to take into account the DPRA amendments to Section 115.

When I pointed out these amendments to one business affairs executive at a major record label, his response was that the label's recording contracts (like many contracts) include a provision that states that any invalid provision in the contract will be deemed deleted and will not affect the balance of the contract. Therefore, he reasoned that the controlled composition clause of the recording agreement will simply not apply to digital phonorecord deliveries.

This reasoning may be dangerous, because the "invalidity clause" to which he was referring is not a defense to copyright infringement. On one hand, the "invalidity clause" could be interpreted to mean that the controlled composition clauses in a particular recording contract do not, either in part or in their entirety, grant the record company a license to reproduce and distribute controlled compositions for digital phonorecord deliveries. Therefore, all distribution through digital phonorecord delivery without a mechanical license will be deemed acts of infringement, and may potentially be deemed intentional, thereby subjecting the record company to the possibility of statutory damages that are punitive in nature.[24] If the record company has already distributed or licensed the distribution of the phonorecord through digital phonorecord delivery, the record company will not have the right to avail itself of the compulsory licensing provisions of Section 115, as a notice

[23] *See* 37 C.F.R. § 255.6.

[24] *See* 17 U.S.C. § 504(c)(2).

of the record company's intent to obtain a compulsory license must be filed "before or within thirty days after making, and before distributing any phonorecords of the work."[25] On the other hand, the "invalidity" may only affect the determination of what is the correct mechanical royalty rate in light of paragraph (c)(3)(E) of Section 115. In this case, the plaintiff could only have a cause of action for additional mechanical royalties, not copyright infringement.

As set forth in paragraph (c)(3)(E)(ii)(II) of Section 115, the most obvious way for the record company to impose the controlled composition clauses on digital phonorecord deliveries is to have the artist/songwriter/publisher sign a new mechanical license containing the controlled composition clauses each time the artist delivers a new record. Very often, the artist needs the record company to make extra-contractual commitments whenever the artist delivers a new record. For example, an artist may want the record company to finance an expensive music video, provide tour support for the artist to perform in concert, buy independent promotion, marketing or promotion, etc., none of which may be required under the recording contract. A record company could use this as an opportunity to require the artist to sign a new mechanical license with the controlled composition provisions. Other contractual incentives to the artist, such as advances, non-recoupable payments or record royalty escalations, could also be tied to the record company obtaining new mechanical licenses in accordance with the controlled composition clauses with respect to the particular phonorecord.

However, this approach will not work if the artist does not view the trade-off to be worth the extra-contractual commitment from the record company. Moreover, as discussed above, under the *plain language interpretation*, paragraph (c)(3)(E)(ii)(II) of Section 115 may only allow this approach if the artist has retained the exclusive right to grant mechanical licenses.

Although I would not generally be in favor of record companies devising methods to get around the clear intent of Congress in amending Section 115 in this regard, the following are some additional ways the record companies may try to avoid the imposition of the statutory rates, in lieu of the controlled composition clauses:

1. The recording contract could state that an album (or other recording project) will not be deemed "delivered" (i.e., acceptable to the record company) until and unless new mechanical licenses in accordance with the controlled composition clauses

[25] 17 U.S.C. § 115(b)(1).

with respect to the particular phonorecord have been executed by the artist.

2. The recording contract could state that the record company will pay the then-current statutory rate for digital phonorecord deliveries of controlled compositions, but will have the right to offset the difference between the statutory rate and what would have been the controlled rate from any other monies payable to the artist. Obviously, from the record company's perspective, the problem with this approach is that there may not be any other monies available to offset the difference, especially in light of the fact that mechanical royalties are payable even though the artist's record royalty account may be unrecouped.
3. The recording contract could provide for a reduced record royalty[26] rate for digital phonorecord deliveries to offset the higher statutory mechanical rates. Bear in mind, however, that most recording contracts already treat digital phonorecord deliveries as "new technology records," which already bear a significantly reduced record royalty rate (for example, the royalties for new technology records may be 70% of the record royalty otherwise applicable to analog tape cassettes).
4. Similarly, the recording contract could provide for an "all-in" record royalty for digital phonorecord deliveries to offset the higher statutory rates. Record companies already do this for audiovisual records containing music videos: The record royalty for audiovisual records is usually a percentage of the wholesale related price, which is inclusive of whatever royalties the record company pays, if any, for the use of the underlying musical compositions in the audiovisual records.
5. A record company may take the position that Section 115, and in particular paragraph (c)(3)(E)(i) of Section 115, is not applicable to "first use" mechanical licenses. Under this theory, the record company and the artist would be free to negotiate a controlled rate with respect to unreleased controlled compositions that is less than the statutory rate. In this regard, the recording contract could require that the artist only record and deliver controlled compositions that have never been previously released on phonorecords distributed in the United States.

---

[26] *See supra* note 3.

6. A mechanical license grants two distinct rights: a license to reproduce the musical composition on a phonorecord (which, in the context of physical records, means the right to manufacture copies of the phonorecord) and a license to distribute phonorecords containing the licensed composition. These rights become somewhat blurred in the context of digital phonorecord deliveries; that is, a "reproduction" and a "distribution" may occur simultaneously. If the server where a consumer accesses a recorded song to be downloaded is located outside of the United States, the record companies may argue (although probably unsuccessfully) that the reproduction and the distribution occurs outside of the United States, even if the consumer is located in the United States. Under this theory, no mechanical license for the United States is necessary, because no reproduction or distribution is occurring within the United States. Accordingly, the second sentence of paragraph (c)(3)(E)(i), imposing the statutory rates in lieu of the controlled composition clauses, would not be applicable so long as the record company utilizes a server outside of the United States.

V. Conclusion

Although not initially the case, compact discs are now less expensive to manufacture and more profitable than tape cassettes. Similarly, it will likely be the case that selling records through digital transmission will become less expensive and more profitable for the record companies than the manufacture and distribution of physical records, especially in light of the fact that digital transmission eliminates the need to manufacture, ship and store physical records and gives the record companies the ability to charge a retail price when selling directly to the consumer, rather than a wholesale price when selling to a record retailer. In light of the foregoing, the record companies may "take the high road" and quietly accept the increased mechanical royalties caused by the DPRA's amendments to Section 115. More likely, the record companies will try to draft around those amendments. In that case, in the absence of clarifying legislation, it will be up to the courts, whether in the context of lawsuits by individual artists or music publishers or in the context of a class action, to determine whether any such attempts are enforceable. In the meantime, it is surprising that the record companies are not modifying their controlled composition provisions in some manner to address the amendments to Section 115 under the DPRA.