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CARDOZO LAW REVIEW
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CALCULATING ARTISTS' ROYALTIES: AN
ANALYSIS OF THE COURTS' DUALISTIC
INTERPRETATIONS OF RECORDING CONTRACTS
NEGOTIATED IN A PRE-DIGITAL AGE

Nina Aragon[†]

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INTRODUCTION

The business landscape of the recording industry has drastically changed with the quick evolution of digital technology. Record labels¹ fell behind the curve from the inception of music’s digitization by failing to embrace the new ways in which music was distributed and consumed.² Although more consumers were using the Internet to listen to and purchase music, for many years labels continued to rely on revenue generated from the sales of physical records.³ This is evidenced in the labels’ omission of digital distribution systems as a source of revenue in artists’ contracts.⁴ The record companies’ failure to include contractual provisions for digital distribution systems⁵ became problematic as sales of and profits from physical albums started to decline and digital music consumption rose.⁶ These tensions became evident as the artists and labels began to disagree over royalty

¹ A record label is defined as “[a] recording company, or a section of one, producing and releasing records under a distinctive name.” *Record label*, OXFORD ENGLISH DICTIONARY, <http://www.oxforddictionaries.com/definition/english/record-label?q=record+label> (last visited Feb. 8, 2016).

² See Bobby Owsinski, *How The Music Industry Created Its Own Worst Nightmares*, FORBES (Aug. 7, 2014, 11:00AM), <http://www.forbes.com/sites/bobbyowsinski/2014/08/07/how-the-music-industry-created-its-own-worst-nightmares>.

³ See Lauren K. Turner, Note, *The Impact of Technology on Pre-Digital Recording Agreements: An Examination of F.B.T. Productions, LLC v. Aftermath Records*, 114 W. VA. L. REV. 347, 351–54 (2011).

⁴ See, e.g., *F.B.T. Prods., L.L.C. v. Aftermath Records*, 621 F.3d 958 (9th Cir. 2010), *cert. denied*, 562 U.S. 1286 (2011); *Malmsteen v. Universal Music Grp., Inc.*, 940 F. Supp. 2d 123 (S.D.N.Y. 2014).

⁵ Specifically, royalty rate provisions that specified the percentage an artist would receive for a sale of music through an online retailer.

⁶ See, e.g., *F.B.T.*, 621 F.3d 958; *Malmsteen*, 940 F. Supp. 2d 123.

payments.⁷

Royalty payments from physical album sales were historically one of the main sources of revenue for record labels.⁸ Labels were successful in negotiating low royalty payments to artists for the sale of physical albums since album manufacturing and distribution costs were high. Major labels sought to retain a majority of the royalties as recoupment for their investment in the expensive physical distribution system.⁹

As labels struggled to remain profitable, they persisted on limiting royalty payments to artists. One strategy required a controversial interpretation of recording contracts that were negotiated in the pre-digital era.¹⁰ Since older recording contracts failed to specifically address royalty rates for music consumed through digital distribution methods, record labels argued that music purchased through a third party online retailer (e.g., Apple iTunes¹¹) constituted a “sale” under the traditional royalty structure, rendering a royalty rate between thirteen to twenty percent to artists.¹² In contrast, artists contended that online sales of albums were “licenses” and not sales, thus providing artists with the industry norm royalty of fifty percent.¹³ This point of contention—the company’s assertion that digital downloads were sales versus the artist’s insistence that they were licenses—has led record industry participants to turn to the courts for resolution.

Yet the courts themselves disagree about how these older contract terms should be interpreted and applied to digital distribution methods. In *Malmsteen v. Universal Music Group, Inc.*,¹⁴ the U.S. District Court for the Southern District of New York held that a digital download was considered a record sold, providing the artist with a lower royalty rate

⁷ See *infra* Part I.B (overview of the royalty structure).

⁸ See Turner, *supra* note 3, at 351–54; Zeb G. Schorr, Note, *The Future of Online Music: Balancing the Interests of Labels, Artists, and the Public*, 3 VA. SPORTS & ENT. L.J. 67, 83 (2003).

⁹ Brief for The Motown Alumni Ass’n as Amicus Curiae Supporting Appellants at 10–11, *F.B.T. Prods., L.L.C. v. Aftermath Records*, 621 F.3d 958 (9th Cir. 2010) (No. 09-55817), 2010 WL 2751584, at *10–11.

¹⁰ Brief for The Motown Alumni Ass’n as Amicus Curiae Supporting Appellants, *supra* note 9, at 10–11.

¹¹ *iTunes*, APPLE <https://www.apple.com/itunes> (last visited Oct. 8, 2017).

¹² Thirteen to twenty percent of the wholesale price is the current industry rate for royalties on U.S. album sales. DONALD S. PASSMAN, *ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS* 93–94 (9th ed. 2015).

¹³ Historically, the industry rate for royalties accrued for licensed records was 50%. *Id.* at 144. The percentage was based on the record company’s net receipts, meaning the costs paid by the purchaser, minus costs of duplication, shipping, etc. *Id.* Recently, however, labels have created new departments within their companies, normally referred to as “special markets” or “catalog” departments. *Id.* These departments are tasked with taking recordings and developing creative ways to make money off of them. *Id.* To cover the costs of these departments, labels charge a fee of fifteen to twenty-five percent of master license receipts, which is taken off the top, before an artist’s royalty is deducted. *Id.* at 144–45.

¹⁴ 940 F. Supp. 2d 123 (S.D.N.Y. 2014).

(i.e., eight to fifteen percent).¹⁵ This contradicts the court's finding in *F.B.T. Productions, L.L.C. v. Aftermath Records*,¹⁶ where the Ninth Circuit ruled that a purchase of a record through a third party online retailer was considered a master¹⁷ licensed, rendering a higher royalty percentage (i.e., fifty percent) to the artist for each digital download.¹⁸ One reason for the courts' conflicting rulings is likely because of their inconsistent interpretations of the contract terms in the parties' recording agreements.

This Note examines the disparity in the courts' rulings in the *Malmsteen* and *F.B.T.* cases, specifically the different ways in which each court interpreted the contractual language of the parties' pre-Internet recording agreements, and their application of royalty rates. Part I of this Note provides an overview of the royalty structure used to compute royalty rates for compact discs (CDs). Part I discusses on the economic effects of switching to a digital distribution system, the sales versus license distinction, and the principles relied on by the courts to interpret pre-Internet contracts. Part II of this Note examines the courts' rulings in *Malmsteen* and *F.B.T.* The *Malmsteen* court held that the "Records Sold" provision determined the artist's royalty rate for a digital download. Contrarily, in *F.B.T.* the court concluded that the royalty rate for a digital download is based on the royalty structure for "Masters Licensed." Part III explores the courts' failure to acknowledge a digital first-sale doctrine, which consequently frustrates the justifications for classifying digital music transactions as sales. Part IV serves as an analogy—discussing other types of agreements that are categorized as licenses, even though they are not labeled as such. Part V proposes reasons courts should follow the *F.B.T.* court's holding and apply the Masters Licensed provision for digital downloads. Specifically, labeling the transactions as licenses more accurately comports with the parties' intention when negotiating the agreements.

I. THE PRELUDE

A. *The Effects of Music's Digitization*

Based on the traditional business model, major labels depended heavily on the sales accrued from distribution of physical albums and

¹⁵ *See id.*

¹⁶ 621 F.3d 958 (9th Cir. 2010), *cert. denied*, 131 S. Ct. 1677 (2011).

¹⁷ In the music industry, there are two meanings for "master." PASSMAN, *supra* note 12, at 74–75. One definition of a master is an original recording created in the studio from which copies are made. *Id.* at 74. A master can also mean the recording of a particular song (e.g., one might say an album is comprised of "ten masters"). *Id.* at 74–75.

¹⁸ *See F.B.T.*, 621 F.3d 958.

they invested in the physical distribution system accordingly.¹⁹ Labels signed artists to expensive deals, financed the production of music, and acquired their own distributors.²⁰ By expanding their business to include editing, printing, packaging, distribution, and promotion, record labels were able to profit from the industry's dependence on the physical distribution system.²¹ Record labels controlled nearly every aspect of distribution through their ownership and operations of manufacturing plants and warehouses.²²

This vertical integration became meaningless as music consumption moved to a digital platform. As physical album sales declined, manufacturing and distribution costs simultaneously decreased as labels reduced their production of physical CDs.²³ Major record labels were discharged from the duties of manufacturing, packaging, and storing physical albums; they were no longer required to ship product to distribution outlets; nor did they have to bear the risk of breakage or unsold records.²⁴ Although their revenue decreased, labels benefited from the reduced distribution costs since digital distribution commanded exponentially less investment than physical distribution.²⁵

The migration to digital distribution and consumption dramatically changed the economics of the music business because labels no longer bore the costs associated with physical distribution (or, at the very minimum, these costs were drastically reduced).²⁶ Instead, the digital distribution system allowed record labels to license the music to third parties, who, in turn, distributed the music to consumers.²⁷

B. *The Royalty Scheme*

Although labels have converted to a simplified royalty structure in response to contemporary music consumption methods,²⁸ older

¹⁹ See Turner, *supra* note 3.

²⁰ See PASSMAN, *supra* note 12, at 65, 67–68 (A distributor “sells physical copies of . . . records to the stores and distributes . . . music digitally.” Major distributors “are gigantic distribution networks that coordinate digital distribution and move physical records from manufacturing plants into the stores [L]ike any other manufacturing business . . . it’s expensive to set up and maintain the warehousing, shipping, inventory controls, sales force, etc., necessary to move goods into a marketplace.” There are now only three major distributors left—Sony, Universal, and WEA.)

²¹ Turner, *supra* note 3, at 351–52, 366–67.

²² *Id.* at 367–68.

²³ See *id.* at 367–68.

²⁴ See *id.* at 369 (citing DONALD S. PASSMAN, ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS 89 (8th ed. 2013)).

²⁵ Brief for The Motown Alumni Ass’n as Amicus Curiae Supporting Appellants, *supra* note 9, at 10–11.

²⁶ See Turner, *supra* note 3, at 367–68.

²⁷ Brief for The Motown Alumni Ass’n as Amicus Curiae Supporting Appellants, *supra* note 9, at 11–12.

²⁸ See PASSMAN, *supra* note 12, at 76–77. In typical modern recording agreements, the

contracts were premised on a more complicated royalty computation system.²⁹ When an artist enters into a recording agreement with a label, the terms generally require the artist to transfer copyright ownership of her recordings to the record label.³⁰ In exchange for copyright ownership, the label agrees to pay the artist an advance and royalties based on several income participation sources, including artist royalties, mechanical royalties,³¹ synchronization fees,³² and master use fees,³³ subject to the terms specified in the recording agreement. A “royalty” is the percentage of revenue earned from the sale or other monetization of a sound recording that the record company pays to an artist.³⁴

Recording contracts contain royalty computation provisions that specify the means of determining the dollar amount an artist will be paid based on the royalty rates provided in the contract. Prior to the industry’s 2006 update of the royalty structure, various factors were taken into consideration to determine an artist’s royalty rate.³⁵ Historically, an artist’s royalty percentage for the sale of a record was calculated against the “base price.”³⁶ The base price was the *suggested* retail list price (SRLP), which was the estimated price for the sale of the record,³⁷ less the packaging charge.³⁸ The deduction of the packaging

royalty rate for physical recordings is a percentage of the wholesale price, also known as the Published Price to Dealers (PPD). *Id.* The royalty amount due to an artist is calculated by multiplying the royalty percentage times the wholesale price. *Id.* In older contracts, artists’ royalties were a percentage of the Suggested Retail List Price (SRLP). *Id.* at 80–81.

²⁹ *Id.* at 80–81.

³⁰ Brief for The Motown Alumni Ass’n as Amicus Curiae Supporting Appellants, *supra* note 9, at 4.

³¹ Section 115 of the Copyright Act of 1976 requires the payment of mechanical royalties. 17 U.S.C. § 115 (2012). Record labels are permitted to make and distribute sound recordings, so long as they pay a royalty to the artist. 17 U.S.C. § 115 (2012); *see also* Steven T. Lowe and Abhay Khosla, *Royal Treatment: While Many Legal Remedies May Exist to Collect Unpaid Music Royalties, Artists May Find Themselves Stymied in the Absence of a Fiduciary Relationship*, L.A. LAW. 24 (June 29, 2006). The mechanical royalty rate is fixed by the statute, but can be negotiated by the parties. *Id.*

³² Synchronization fees are fees obtained when a third party secures a synchronization license with the owner of the underlying composition to use the underlying composition in an audiovisual work, such as a movie. *See* Lowe and Khosla, *supra* note 31, at 26.

³³ A master use fee is a fee obtained when the owner of the sound recording licenses the right to use the sound recording in an audiovisual work. *Id.* A master use license is usually obtained in conjunction with a synchronization license. *Id.*

³⁴ *See id.*

³⁵ *See* PASSMAN, *supra* note 12, at 80–85.

³⁶ *Id.* at 80–81.

³⁷ *Id.* (emphasis added). The SRLP was provided by the label to the retailer. *See id.* at 80. *See also* RICHARD SCHULENBERG, LEGAL ASPECTS OF THE MUSIC INDUSTRY: AN INSIDER’S VIEW OF THE LEGAL AND PRACTICAL ASPECTS OF THE MUSIC BUSINESS 483 (1999) (defining SRLP as “[t]he suggested selling price to the public set by the manufacturer of the product, for example, \$15.95 for a CD”). The manufacturers were the record labels. PASSMAN, *supra* note 12, at 139. It is worth noting that the SRLP was not the price a purchaser *actually* paid for the compact disc. *Id.* at 80 (emphasis added).

³⁸ SCHULENBERG *supra* note 37, at 42. The packaging charge was the cost of the packaging, computed by the label. PASSMAN, *supra* note 12, at 80. In reality, the label most likely deducted a higher charge than the packaging actually cost. *Id.*

charge from the SRLP resulted in a decrease in the artist's royalty.³⁹

The royalty calculation for licenses was much easier to compute than royalties for sales of albums. Generally, an artist was entitled to fifty percent of the label's net receipts⁴⁰ received from licensing deals between the label and a third party.⁴¹ The divergence between the records sold and records licensed royalty rate created a noticeable financial difference depending on whether an artist's record was sold or licensed. It was important for labels and artists alike to distinguish between the meaning of sale and license within the recording agreement because an artist's royalty rate compensation was dependent upon which distinction is used.⁴²

1. Sales

Black's Law Dictionary defines a sale as transferring property or title for a price.⁴³ There are four elements to a sale: (1) competent parties that are able to contract; (2) mutual assent; (3) a thing capable of transference; and (4) a price in money that is either paid or promised.⁴⁴ The Uniform Commercial Code defines a sale as the passage of title from a seller to a buyer for a specific price.⁴⁵ For the purposes of this Note, it is also necessary to understand the meaning of sale as it is used within the music recording industry. Prior to the advent of the digital download, the sale of a physical record in the United States had to consist of the following criteria: (1) the record must be sold in the United States; and (2) the sale must be (a) made at full price; (b) through Normal Retail Channels; and (c) by normal distribution channels.⁴⁶

In the music industry, a sale made through a Normal Retail

³⁹ *Id.* Labels theorized that artists should receive royalties based solely on the record, not the packaging. *Id.* The packaging charge was calculated as a percentage of the SRLP. *Id.* The industry norm percentage for compact discs was 25% of the SRLP. *Id.* A royalty computation can be shown using simple numbers: CD retail price of \$10.00 less a packaging charge (i.e., 25% of \$10.00) of \$2.50, equals a base price of \$7.50. *Id.* at 81. If an artist had a royalty rate of ten percent, the she would receive \$0.75 for every album sold. *Id.*

⁴⁰ PASSMAN, *supra* note 12, at 144. As used in this sense, net receipts mean the flat fee or royalty received by the label that is directly attributable to the use of the sound recording, less any costs incurred by the label in connection with the exploitation, such as duplicating costs, union or guild payments, manufacturing costs, etc. SCHULENBERG, *supra* note 37, at 354.

⁴¹ SCHULENBERG, *supra* note 37, at 354.

⁴² *See supra* Introduction.

⁴³ *Sale*, BLACK'S LAW DICTIONARY (10th ed. 2014).

⁴⁴ *Id.*

⁴⁵ U.C.C. § 2-106 (AM. LAW INST. & UNIF. LAW COMM'N 1977).

⁴⁶ PASSMAN, *supra* note 12, at 141. Today, a full price record is about \$9.00–\$10.00 wholesale price (PPD) for a CD. *See id.* A "Normal Retail Channel" typically includes sales of records in brick-and-mortar record stores or other similar retail stores. *See* Rebecca J. Gremmel, Note, *New Use and the Music Licensing Agreement*, 22 T. JEFFERSON L. REV. 239, 246 (2000); PASSMAN, *supra* note 12, at 141.

Channel traditionally consisted of transactions in brick and mortar record or retail stores. The disadvantage of stocking these stores with physical records was that labels bore the high costs associated with manufacturing, packaging, and distributing physical records.⁴⁷ Music labels contend that royalty rates for sales under the physical distribution system should be limited to lower rates for the artist because the company incurs the high ancillary distribution costs.⁴⁸ Therefore, labels had more bargaining power when negotiating royalties with artists for physical record sales.⁴⁹

Much of the modern music consumption occurs through online retail stores, rather than the brick-and-mortar stores of the past.⁵⁰ Since music has become digital, consumers view online stores in the way previously associated with physical stores—which were once the most widely used sources for music consumption. Thus, labels argue that online retail stores or websites that sell records should be considered Normal Retail Channels as understood by the music industry’s standard definition of a sale.⁵¹ Music labels assert that selling a record through online stores comports with the elements required to qualify as a sale because online retail stores are now equated with physical stores.⁵²

2. Licenses

Black’s Law Dictionary defines a license as permission to act in a manner that would otherwise be considered unlawful.⁵³ Copyright licenses often possess similar elements: (1) an express limitation on the licensee’s use of the content; (2) licensee’s sublicensing ability; (3) a geographical or jurisdictional limitation on licensee’s rights; (4) a specification of whether the licensee has an exclusive or nonexclusive right to the content; (5) the term of the license (this includes licenses in perpetuity); and (6) the licensing fee or royalty.⁵⁴ Before the existence of online distributors, labels licensed artists’ recordings for movies, television shows, and commercials.⁵⁵ These licenses cost labels

⁴⁷ Brief for The Motown Alumni Ass’n as Amicus Curiae Supporting Appellants, *supra* note 9, at 10–11; *see supra* Part I.A.

⁴⁸ Brief for The Motown Alumni Ass’n as Amicus Curiae Supporting Appellants, *supra* note 9, at 10–11.

⁴⁹ *Id.*

⁵⁰ *See supra* Part I.A.

⁵¹ *See* *Boosey & Hawkes Music Publishers, Ltd. v. Walt Disney Co.*, 145 F.3d 481, 486 (2d Cir. 1998).

⁵² Brief for The Motown Alumni Ass’n as Amicus Curiae Supporting Appellants, *supra* note 9, at 10–11.

⁵³ *License*, BLACK’S LAW DICTIONARY (10th ed., 2014).

⁵⁴ Michael Seringhaus, *E-Book Transactions: Amazon “Kindles” the Copy Ownership Debate*, 12 YALE J.L. & TECH. 147, 162 (2009–2010).

⁵⁵ PASSMAN, *supra* note 12, at 144.

minimal, if any, distribution costs as the labels do not have to pay the additional costs associated with physical records.⁵⁶ Therefore, artists were able to negotiate higher royalty rates.⁵⁷

Artists argue that certain transactions with online third party music distributors should be classified as licenses, in light of the way labels contract with online retailers for music.⁵⁸ The transactions conducted over the Internet for digital music have conflated the meaning of license and sale, as used for music purchases. Oftentimes what consumers think are sales of records are really licenses.⁵⁹ Further, the decrease in manufacturing and distribution costs are reasonable justifications for why lower royalty rates for these types of transactions no longer comport with the way music is consumed. The labels reasoning for negotiating lower royalty rates for artists due to high manufacturing and distribution costs are less rational in the digital age. However, contracts that were negotiated prior to the early 2000s did not reflect the changes in music consumption associated with the inception of the Internet.⁶⁰

As noted above, the distinction between sales and licenses is important because the royalty rate for a record sale is about ten to twenty percent of the SRLP, and licenses are around fifty percent of the label's net receipts accrued from the license.⁶¹ Now that record companies and artists are earning revenue through digital listening platforms, such as iTunes, labels are trying to determine an adequate structure to pay out the royalty compensation. As a business model, the smaller the royalty rate a record label has to pay to the artist, the better for the company; therefore, labels interpret digital downloads as records sold, leaving artists with a lower royalty rate structure.⁶²

C. *Contract Interpretation*

The quick progression of technology burdens the courts with the responsibility of interpreting terms of recording agreements that were negotiated prior to the emergence of digital age and the advent of music downloading.⁶³ Courts are crucial in determining which royalty structures should be applied to certain provisions in older recording contracts that do not make reference to digital distribution.

⁵⁶ Brief for The Motown Alumni Ass'n as Amicus Curiae Supporting Appellants, *supra* note 9, at 10–11.

⁵⁷ *Id.*

⁵⁸ See *infra* Part II.

⁵⁹ See *infra* Part III.C.

⁶⁰ Brief for The Motown Alumni Ass'n as Amicus Curiae Supporting Appellants, *supra* note 9, at 13.

⁶¹ *Id.*

⁶² See Turner, *supra* note 3.

⁶³ See, e.g., F.B.T. Prods., L.L.C. v. Aftermath Records, 621 F.3d 958 (9th Cir. 2010); Malmsteen v. Universal Music Grp., Inc., 940 F. Supp. 2d 123 (S.D.N.Y. 2014).

When trying to interpret agreements, the courts are expected to determine the intention of the parties.⁶⁴ Traditionally, when adjudicating contract disputes regarding new technologies or uses between record companies and recording artists, courts look for any indication of a mutual general intent that can be applied and apportioned to the new uses.⁶⁵ This is achieved by taking a close look at the language used in the contract, surrounding circumstances, industry custom, purpose and subject matter of the agreement, and the conduct of the parties involved.⁶⁶ Since terms pertaining to digital distribution are absent from older recording contracts, this analysis must be read into the agreements by the courts.⁶⁷ However, the general intent of the parties is difficult to determine when it is applied to a new technological development that is adopted after the license has been granted.

If a contract is unambiguous then the terms must be interpreted by the judge as a matter of law, with the court applying the plain and commonly accepted meaning of the language to an ambiguous term.⁶⁸ Otherwise, the court must decide, as a matter of law, whether an ambiguity exists.⁶⁹ An ambiguous contract must be interpreted in light of the circumstances surrounding the parties at the time the contract was negotiated and signed.⁷⁰ An ambiguity cannot exist “unless and until the court’s application of the pertinent rules of interpretation leaves uncertain which of two or more possible meanings represent the true intention of the parties.”⁷¹ When a contract is silent on a certain point, the silence is considered ambiguous only if the matter is normally within the scope of the contract terms.⁷² However, a contract is not ambiguous merely because two or more parties disagree on its interpretation.⁷³ When a contract is equivocal, extrinsic evidence may be introduced by the parties to assist in determining the subjective intent of the parties.⁷⁴

⁶⁴ CAL. CIV. CODE § 1638 (West 2000); *F.B.T.*, 621 F.3d at 963; *Malmsteen*, 940 F. Supp. 2d at 130 (citing *Compagnie Financiere de CIC et de L’Union Europeenne v. Merrill Lynch*, 232 F.3d 153, 157 (2d Cir. 2000)).

⁶⁵ See Gremmel, *supra* note 46, at 246.

⁶⁶ 6 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS* § 2585.10 (2016 update); see also Gremmel, *supra* note 46.

⁶⁷ FLETCHER, *supra* note 66.

⁶⁸ *Id.*

⁶⁹ *Id.* (“While an ambiguous contractual term may create a fact issue for the jury to decide, the question of whether a contract is ambiguous is a question of law for the court to decide by looking at the contract in light of the circumstances existing at the time the contract was entered into.”).

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*; see also *F.B.T. Prods., L.L.C. v. Aftermath Records*, 621 F.3d 958, 963 (9th Cir. 2010) (“[p]arol evidence is properly admitted to construe a contract only when its language is ambiguous. The decision whether to admit parol evidence involves a two-step process. First, the court provisionally receives (without actually admitting) all credible evidence concerning the

When interpreting contracts in order to resolve issues regarding royalty rates, as seen in the cases of *Malmsteen* and *F.B.T.*, it is crucial for the courts to determine the meaning of sale and license, as expressed in the contracts.⁷⁵ If the contract does not explicitly define sale or license then the court uses the tools discussed above to make a determination on the meaning. In the *F.B.T.* case, the agreement did not explicitly define sale or license, so the court addressed and resolved the definitions accordingly.⁷⁶ In *Malmsteen*, however, the court did not determine the meaning of sale and license, even though these terms were not clearly defined within the contract.⁷⁷

D. *Copyright Law and the First-Sale Doctrine*

Aside from principles of contract interpretation, the courts also invoke copyright law in these cases because of the important role copyright plays in the music industry. In 1976, Congress enacted the Copyright Act of 1976 (Copyright Act or Act),⁷⁸ where sound recordings were considered a protected work, and copyright owners were provided the exclusive right to reproduce and distribute phonorecords⁷⁹ of their copyrighted work.⁸⁰ However, the copyright holder's exclusive reproduction and distribution rights are limited by the

parties' intentions to determine 'ambiguity,' i.e., whether the language is 'reasonably susceptible' to the interpretation urged by a party. If in light of the extrinsic evidence the court decides the language is 'reasonably susceptible' to the interpretation urged, the extrinsic evidence is then admitted to aid in the second step—interpreting the contract." (Citing *Winet v. Price*, 6 Cal. Rptr. 2d 554, 557 (1992)).

⁷⁵ This is important because the royalty rate will differ depending on whether the transaction is considered a sale or a license. *See supra* Part I.B.

⁷⁶ *See also infra* Part II.B.2; *see generally F.B.T.*, 621 F.3d 958.

⁷⁷ *See also infra* Part II.A.2; *see generally Malmsteen v. Universal Music Grp., Inc.*, 940 F. Supp. 2d 123 (S.D.N.Y. 2014).

⁷⁸ Copyright Act, 17 U.S.C. §§ 101–810 (2012); *see also* 17 U.S.C. § 102(a) (2012) (Copyrights protect "original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device."); 17 U.S.C. § 102(a)(7) (2012) (dividing "works of authorship" into categories, including "musical works" and "sound recordings").

⁷⁹ 17 U.S.C. § 101 ("[p]honorecords' 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." The further states that a copyrighted work is "'fixed' in a tangible medium of expression when its embodiment in a copy or phonorecord, by or under the authority of the author, is sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration.")

⁸⁰ 17 U.S.C. § 106(3) ("[T]he owner of copyright under this title has the exclusive rights . . . to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending.").

“first-sale” doctrine.⁸¹ In some cases, when a copyright holder sues for copyright infringement, the defendant can invoke the first-sale doctrine as a defense to the infringement claim.⁸² The first-sale doctrine permits the owner of a lawfully obtained phonorecord to sell or dispose of the phonorecord without infringing the rights of the copyright owner.⁸³

In *Malmsteen* and *F.B.T.*, the record labels argued that digital distribution of the artists’ music were sales not licenses.⁸⁴ Since the term sale was not defined in either contract, it would be useful for the courts to examine whether digital distribution transactions were susceptible to the first-sale doctrine. If they were, then it would make sense to classify these transactions as sales. As discussed later in this Note, this is one of the methods that the *F.B.T.* court used to help with its contract interpretation analysis.

II. THE CONFLICT

A. *Malmsteen v. Universal Music Group, Inc.*⁸⁵

1. Background

In *Malmsteen*, plaintiff Yngwie J. Malmsteen (Malmsteen), a professional musician and successor-in-interest to DeNovo Productions (DeNovo) and defendant, UMG Recordings, Inc. (UMG) (previously known as PolyGram Records, Inc. (PolyGram))⁸⁶ disputed the royalty rate that should apply to permanent downloads through digital distributors, such as iTunes.⁸⁷ PolyGram and DeNovo entered into an agreement on November 1, 1985 (the Agreement), which was at issue in this case.⁸⁸

In the Agreement between DeNovo and PolyGram, Malmsteen gave PolyGram the exclusive right to record “Master Recordings”⁸⁹

⁸¹ 17 U.S.C. § 109(a) (2012).

⁸² *Id.*

⁸³ *Id.*

⁸⁴ See generally *Malmsteen v. Universal Music Grp., Inc.*, 940 F. Supp. 2d 123 (S.D.N.Y. 2014); *F.B.T. Prods., L.L.C. v. Aftermath Records*, 621 F.3d 958, 963 (9th Cir. 2010).

⁸⁵ *Malmsteen*, 940 F. Supp. 2d 123.

⁸⁶ *Id.*

⁸⁷ *Id.* at 126.

⁸⁸ Presently, the agreement is between Malmsteen, as DeNovo’s successor-in-interest, and UMG, as the entity formerly known as PolyGram. *Id.* at 126.

⁸⁹ The agreement defines a “Master Recording” as “[a]ny recording of sound, whether or not coupled with a visual image, by any method and on any substance or material, whether now or hereafter known, intended for reproduction in the form of Phonograph Records, or otherwise, including Audio-Visual Recordings.” *Id.* The agreement further states that “these Master Recordings are “entirely the property of [UMG]” and that UMG “and its subsidiaries, affiliates, and licensees shall have the sole, exclusive and unlimited right . . . to manufacture

performed by Malmsteen during the Agreement term.⁹⁰ PolyGram also had the right to reproduce and sell the Master Recordings.⁹¹ UMG was expected to pay royalties on income derived from UMG's exploitation of the Master Recordings, in accordance with Article 7 of the Agreement.⁹² Malmsteen asserted that UMG breached the Agreement in three ways,⁹³ each breach relating to the calculation of royalty payments owed to him.⁹⁴

UMG sold records in various formats including digital downloads, which were sold through third party online retailers.⁹⁵ However, at the time the Agreement was negotiated and executed in 1985, third party online retailers were non-existent. Accordingly, the Agreement did not provide provisions specific to sales of records in this digital download format. Instead, UMG unilaterally decided to pay Malmsteen royalties for the sales of digital downloads at the same rates it paid out royalties on the sale of "Records" and "Phonograph Records"⁹⁶ through Normal Retail Channels,⁹⁷ as detailed in the Agreement.⁹⁸ The royalty rates for Records sold ranged from eight to fifteen percent, and depended on the sale's location, the aggregate number of albums sold, and whether an "Album" or a "Single" was sold.⁹⁹

Alternatively, a separate royalty rate of fifty percent is applied to the sale of records through methods of distribution that were outside of the Normal Retail Channels.¹⁰⁰ These methods included "direct mail,

Records . . . embodying . . . the performances embodied on Master Recordings,' and that UMG has the "exclusive right to publicly perform and otherwise utilize [Malmsteen's] performances in connection with Audio-Visual Recordings for promotional and commercial purposes." *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.* (Article 7 of the agreement species royalty rates for each revenue stream associated with the sale or license of the master recordings.).

⁹³ *Id.* at 131 (stating the Defendants (1) failed to pay the proper royalty rate for sales of digital downloads; (2) deducted improper video production costs from audio royalties; and (3) failed to account for royalties on sales of the Far Beyond the Sun DVD).

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.* (citing the Agreement § 13.02: "Records" and "Phonograph Records" are defined in the agreement as "[a]ny device now or hereafter known, on or by which sound may be recorded and reproduced, which is manufactured or distributed primarily for home and/or consumer and/or juke box use and/or use on or in means of transportation including 'sight and sound' devices or Audio-Visual Devices.").

⁹⁷ *Id.* (citing the Agreement § 13.16: A "Normal Retail Channel" is defined in the agreement as "[n]ormal retail distribution channels" with certain exclusions that are provided in the agreement.)

⁹⁸ *Id.* at 127 (defining "Records" and "Phonograph Records" as "[a]ny device now or hereafter known, on or by which sound may be recorded and reproduced, which is manufactured or distributed primarily for home and/or consumer and/or juke box use and/or use on or in means of transportation including "sight and sound" devices or Audio-Visual Devices; defining "Normal Retail Channels" as "[n]ormal retail distribution channels, excluding sales of Records described in [§§ 7.05–7.08], herein.").

⁹⁹ *Id.*

¹⁰⁰ *Id.* at 128.

mail order, or in conjunction with TV advertising, including through methods of distribution such as ‘key outlet marketing’ (distribution through retail fulfillment centers in conjunction with special advertisements on radio or television), or by any combination of the methods set forth above or other methods.”¹⁰¹ Malmsteen asserted that royalties for the sales of digital downloads were governed by the provision as applied to third party licenses, rather than the provision regarding sales through Normal Retail Channels.¹⁰²

2. Court’s Analysis

The parties disagreed on which royalty rate to apply to the sale of digital downloads, yet both parties contended that the contract was unambiguous, and that the issue could be resolved on the face of the contract, without relying on extrinsic evidence.¹⁰³ Accordingly, the court had to resolve the question as a matter of law.¹⁰⁴ First the court concluded that digital downloads constituted Records under the Agreement because the language in the Records provision stated that Records were, *inter alia*, “[a]ny device now or hereafter known” on which sound was recorded and reproduced.¹⁰⁵ The court identified this language as a clear intent by the parties to include future technologies as Records.¹⁰⁶

Next, the court addressed the question of whether the downloads are considered Records sold through Normal Retail Channels, or whether they were a specified distribution enumerated in § 7.06(a)(ii) of the agreement.¹⁰⁷ The court determined that, in modern times, the

¹⁰¹ *Id.* (citing Agreement § 7.06, which provides Malmsteen a royalty rate of 50% for Records sold by specific methods, including: “licenses of Master Recordings to Non-Affiliated Third Parties for sales of Records by such licenses through direct mail, mail order, or in conjunction with TV advertising, including through methods of distribution such as ‘key outlet marketing’ (distribution through retail fulfillment centers in conjunction with special advertisements on radio or television), or by any combination of the methods set forth above or other methods.”).

¹⁰² *Id.* at 127.

¹⁰³ *Id.* at 131.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 131–32 (“digital downloads are clearly Records, as defined in § 13.02 of the Agreement The phrase ‘[a]ny device now or hereafter known on or by which sound may be recorded and reproduced’ manifests the clear intent of the contracting parties that the definition of Record encompass as-yet-undeveloped technologies” (citing *Reinhardt v. Wal-Mart Stores, Inc.*, 547 F. Supp. 2d 346, 354–55 (S.D.N.Y. 2008))). In *Reinhardt*, the court ruled that the “phrase ‘now or hereafter known,’ when referring to forms of reproduction, reveals that future technologies are covered by the agreement It is not reasonable to construe the phrase ‘all forms’ ‘now or hereafter known’ to exclude Defendants’ alleged digital download form.” *Reinhardt*, 547 F. Supp. 2d at 354–55. See also *Greenfield v. Philes Records, Inc.*, 780 N.E.2d 166, 172 (N.Y. 2002); *Silvester v. Time Warner, Inc.*, 763 N.Y.S.2d 912, 917 (Sup. Ct. 2003), *aff’d*, 787 N.Y.S.2d 870 (App. Div. 2005).

¹⁰⁶ *Malmsteen*, 940 F. Supp. 2d at 131.

¹⁰⁷ *Id.* at 132.

phrase Normal Retail Channels included digital downloads sold through the iTunes store and similar online distribution retailers.¹⁰⁸ As brick and mortar record stores no longer existed, iTunes had comfortably taken their place and performed essentially the same function of selling music to consumers.¹⁰⁹ Accordingly, the royalty rate of eight to fifteen percent should be applied to these sales, rather than the fifty percent royalty rate that would be applied if the court found that digital downloads were licenses between UMG and third party retailers.¹¹⁰ The court reasoned that the term Records was defined broadly enough in the Agreement to include digital downloads sold through Normal Retail Channels and were thus, unambiguously governed by the applicable royalty rates.¹¹¹

The court further stated that Malmsteen's interpretation of the Agreement did not corroborate the intent of the parties because the sale of digital downloads did not resemble the methods expressed in § 7.06(a)(ii) of the Agreement.

Contrarily, Malmsteen argued that digital downloads fell into the residual clause following the list: "or by any combination of the methods set forth above *or other methods*."¹¹² However, the court countered Malmsteen's contention by turning to two basic principles of contractual interpretation: (1) *ejusdem generis* and (2) the reluctance by court to interpret contracts in a way to render certain provisions superfluous.¹¹³ The first principal that the court examined was *ejusdem generis*, which states that when a phrase such as "or other methods" follows a list of specific terms, the court is required to interpret the phrase to refer to items that are similar to the others specifically listed.¹¹⁴ The court reasoned that digital distribution was unlike the distribution means that were specified in § 7.06(a)(ii).¹¹⁵

The court also relied on the general principal that interpretations that create redundancy and render the contract provisions superfluous are disfavored.¹¹⁶ Malmsteen conceded that his interpretation of the clause "or other methods" was nearly limitless.¹¹⁷ Therefore, if new methods were to be construed under Malmsteen's interpretation, then

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* (citing *Allman v. Sony BMG Music Entm't*, No. 06 Civ. 3252(GBD), 2008 WL 2477465, at *2 (S.D.N.Y. June 18, 2008), *judgment vacated with leave to amend pleadings*, No. 06 Civ. 3252 (Dkt. 37)).

¹¹⁰ *Malmsteen*, 940 F. Supp. 2d at 132.

¹¹¹ *Id.*

¹¹² *Id.* (emphasis added).

¹¹³ *Id.* at 133.

¹¹⁴ *Id.* (citing *Travelers' Ins. Co. of Hartford v. Seaver*, 86 U.S. 531 (1873); *Haynes v. Kleinewefers & Lembo Corp.*, 921 F.2d 453, 457 (2d Cir. 1990); *Purchase Partners, L.L.C. v. Carver Fed. Sav. Bank*, 914 F. Supp. 2d 480, 491–92 (S.D.N.Y. 2012) (citing *BLACK'S LAW DICTIONARY* 594 (9th ed. 2009))).

¹¹⁵ *Malmsteen*, 940 F. Supp. 2d at 132.

¹¹⁶ *Id.* at 133.

¹¹⁷ *Id.* at 132.

they did not have to resemble the preceding distribution methods listed. If the court were to interpret the phrase according to Malmsteen's assertion, then the enumerated list in that section and in §7.06(i) would be rendered unnecessary.¹¹⁸

The court ultimately decided that UMG's interpretation of the contract was correct because § 7.06(a)(ii) could reasonably be interpreted to encompass the sales of digital downloads, especially considering the similarities between brick-and-mortar music retail stores and iTunes.¹¹⁹ Accordingly, the royalty rates of eight to fifteen percent, as expressed in §§ 7.01–7.02 of the Agreement, controlled these sales.¹²⁰

B. *F.B.T. Productions, L.L.C. v. Aftermath Records*¹²¹

1. Background

The parties in this case, plaintiffs F.B.T. Productions, L.L.C. and Em2M, L.L.C., (collectively F.B.T.), disputed the percentage of royalties due under their contract with defendant Aftermath Records (Aftermath), in connection with the recordings of their artist Marshal B. Mathers, III, professionally known as Eminem.¹²² F.B.T. acquired the exclusive rights to Eminem's recordings through an exclusive recording contract executed in 1995.¹²³ In 1998, F.B.T. transferred its rights to Aftermath in exchange for royalty payments.¹²⁴ The agreement between F.B.T. and Aftermath included two royalty provisions, a Records Sold provision¹²⁵ and a Masters Licensed provision.¹²⁶ The Records Sold

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *See id.*

¹²¹ *F.B.T. Prods., L.L.C. v. Aftermath Records*, 621 F.3d 958 (9th Cir. 2010).

¹²² *Id.* at 961

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *F.B.T. Prods., L.L.C. v. Aftermath Records*, No. CV 07-3314 PSG (MANx), 2009 WL 137021, at *1 (CD. Cal. Jan. 20, 2009), *rev'd*, 621 F.3d 958 (9th Cir. 2010) (Records are defined as "all forms of reproductions, whether embodying sound alone or sound together with visual images, manufactured or distributed primarily for home use."); *F.B.T.*, 621 F.3d at 961 (stating "[t]he 'Records Sold' provision of that agreement provides that F.B.T. is to receive between 12% and 20% of the adjusted retail price of all 'full price records sold in the United States . . . through normal retail channels The agreement does not contain a definition of . . . 'normal retail channels.'").

¹²⁶ *F.B.T.*, 2009 WL 137021, at *1 (A 'master' is defined as 'a recording of a sound, without or with visual images, which is used or useful in the recording, production or manufacture of records.');

F.B.T., 621 F.3d at 961 (citing that the "Masters Licensed" provision "provides that '[n]otwithstanding the foregoing,' F.B.T. is to receive 50% of Aftermath's net receipts '[o]n masters licensed by us . . . to others for their manufacture and sale of records or for any other uses.' The contract defines 'master' as a recording of a sound, without or with visual images, which is used or useful in the recording, production or manufacture of records.' The agreement

provision set a royalty rate in the range of twelve to twenty percent for records sold at full-price in the United States.” Alternatively, the Masters Licensed section stated that F.B.T. was entitled to fifty percent of the net receipts the label received for masters licensed to third parties for sale or “any other uses of the masters.”¹²⁷

In 2003, F.B.T. and Aftermath entered into a new agreement, which terminated the original agreement and increased various royalty rates, but maintained the provisions in the 1998 agreement regarding Records Sold and Masters Licensed.¹²⁸ In 2004, the parties amended the 2003 agreement to state that a sale of a permanently downloaded album will be treated as though it were a sale made through a Normal Retail Channel for purposes of royalty escalations.¹²⁹ This amendment was important to Aftermath’s argument because it linked permanent downloads, album sales, Normal Retail Channels, and royalty rates.

F.B.T. commenced this suit after an audit showed that Aftermath had applied the Records Sold provision (i.e., twelve and twenty percent rate) to calculate royalties for the sales received from these digital retail stores through permanent downloads.¹³⁰

The nature of the parties’ dispute originated from their disagreement over whether the royalty rate for sales of Eminem’s records in the form of permanent downloads through third party online retailers constituted Records Sold or Masters Licensed under the contract provisions.¹³¹ Prior to trial, F.B.T. moved for summary judgment, on the grounds that the Masters Licensed provision was unambiguous and applicable to permanent downloads.¹³² Aftermath cross-moved for summary judgment, arguing that the 2004 amendment was evidence that the parties intended the Records Sold provision to be applied to permanent downloads.¹³³ Both motions were denied by the district court, as the court concluded that the agreement language was susceptible to either interpretation.¹³⁴ In its appeal, F.B.T. reasserted that the Masters Licensed provision unambiguously applied to the sale of permanent downloads through online third party retailers.¹³⁵

does not contain a definition of . . . ‘licensed[.]’”).

¹²⁷ *F.B.T.*, 621 F.3d at 964.

¹²⁸ *Id.* at 962.

¹²⁹ *Id.* (The term “escalations” as used in the agreement means “increases in the royalty rate when total album sales surpass certain targets.” For example, an agreement might give an artist a one percent increase in her royalty rate if the album sells more than 500,000 units.). This amendment can be interpreted to show that the label was equating an online retail store to a brick-and-mortar record store.

¹³⁰ *Id.*

¹³¹ *Id.* at 961–62.

¹³² *Id.* at 961.

¹³³ *Id.* at 962.

¹³⁴ *F.B.T.*, 621 F.3d at 961.

¹³⁵ *Id.*

2. Court's Analysis

The Ninth Circuit was tasked with answering the question of whether the recordings downloaded through digital retail stores constituted Masters Licensed or Records Sold.¹³⁶ The district court denied F.B.T.'s motion for summary judgment, based on the fact that the contract language was ambiguous, and subject to either interpretation.¹³⁷ The Ninth Circuit, however, reversed the lower court's determination on the grounds that the Masters Licensed provision was unambiguous as applied to the contract between the parties.¹³⁸

As required by California Civil Code § 1638,¹³⁹ the court examined the language in the agreement as contracted by the parties. As discussed above, the Records Sold provision specifies the royalty rate for Records sold in the United States at full price and through Normal Retail Channels.¹⁴⁰ Here, Aftermath argued that the Records Sold provision controlled because permanent downloads should be considered Records, and iTunes and other digital music distribution retailers should be considered Normal Retail Channels.¹⁴¹

To determine whether Aftermath's assertion was correct, the court carefully examined the use of the word "notwithstanding," which was used in the Masters Licensed provision, following the Records Sold provision.¹⁴² Specifically, the agreement stated that "[n]otwithstanding" the Records Sold provision, F.B.T. is entitled to fifty percent of Aftermath's net receipts on "masters licensed by [Aftermath] . . . to others for their manufacture and sale of records of for any other uses."¹⁴³ The court concluded that the parties' use of "notwithstanding" indicated that a transaction could be considered a Record Sold, while simultaneously being a Master License, if Aftermath licensed an Eminem master recording to a third party for "any other uses."¹⁴⁴ The court explained that the broadness of a term does not make it ambiguous, and stated that, "the Masters Licensed provision explicitly applies to (1) masters (2) that are licensed to third parties for the manufacture of records 'or for any other uses,' (3) 'notwithstanding' the Record Sold provision."¹⁴⁵

¹³⁶ *Id.*

¹³⁷ F.B.T. Prods., L.L.C. v. Aftermath Records, No. CV 07-3314 PSG (MANx), 2009 WL 137021, at *7 (CD. Cal. Jan. 20, 2009).

¹³⁸ *F.B.T.*, 621 F.3d at 967.

¹³⁹ *Id.* at 963 ("The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity.").

¹⁴⁰ *Id.* at 964.

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.* at 961.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

To determine whether the Masters Licensed provision could apply in this context, the court first had to decide whether Aftermath's agreement with Apple was a third party license of Eminem's master.¹⁴⁶ To reach its conclusion, the court relied on California Civil Code § 1644.¹⁴⁷ When looking at the ordinary meaning of the word license, the dictionary defines it as "permission to act."¹⁴⁸ There was no dispute by Aftermath that the agreement it entered into with iTunes *permitted* iTunes to use the master recordings to produce and sell permanent downloads.¹⁴⁹ Accordingly, the court ruled that the agreement between Aftermath and Apple qualified as a license.¹⁵⁰

The court also looked to general principles of federal copyright law to ensure the court's ruling comported with the law—specifically the court looked at the meanings of license and sale as found in the Copyright Act.¹⁵¹ Under the Copyright Act and decisions of the Supreme Court, the sale of a work can "either be a transfer in title of an individual copy of a work, or a sale of all exclusive intellectual property rights in a work."¹⁵² At no point did Aftermath relinquish its ownership rights to Eminem's recordings in its agreements with Apple and other third parties.¹⁵³ According to the court, nothing had been "sold" to the online retailers as these distributors never acquired title to the digital files.¹⁵⁴

Although the first-sale doctrine¹⁵⁵ provides a definition for a sale, the court turned elsewhere in the Copyright Act for the meaning of license. Section 114(f) provides a statutory authorization, defined as a license, for the exercise of public performance rights that would otherwise be reserved as exclusive rights of the copyright holder.¹⁵⁶ Section 115 provides a statutory authorization, again defined as a license, for artists to make and distribute phonorecord "covers," a right

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* ("The words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning; unless used by the parties in a technical sense . . .").

¹⁴⁸ *Id.* (citing *License*, WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE (2002)).

¹⁴⁹ *F.B.T.*, 621 F.3d at 964.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.* at 965 (citing 17 U.S.C. § 109 (describing the "first sale" doctrine); *Quality King Distrib. v. Lanza Research Int'l, Inc.*, 523 U.S. 135, 145 (1998) (describing the transfer of an individual copy of a work as a sale); see also 3-10 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 10.02 (2017) [hereinafter NIMMER ON COPYRIGHT] (describing a transfer of all ownership in a copyright as a sale)).

¹⁵³ See *F.B.T.*, 621 F.3d at 965–66.

¹⁵⁴ *Id.* at 965.

¹⁵⁵ 17 U.S.C. § 109(a) (2012) ("[T]he owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.").

¹⁵⁶ 17 U.S.C. § 114(f). The court also cites to 17 U.S.C. §§ 111(a), 114(d)(2).

that would otherwise be reserved for the copyright holder.¹⁵⁷

The court also turned to cases that addressed the Copyright Act. The court stated that “it is well settled that where a copyright owner transfers a copy of copyrighted material, retains title, limits the uses to which the material may be put, and is compensated periodically based on the transferee’s exploitation of the material, the transaction is a license.”¹⁵⁸ The court determined that federal copyright law provided support for its conclusion that the agreements entered into with Apple iTunes and similar online retail distributors were licenses to distribute Eminem’s master recordings through permanent downloads, without transferring Aftermath’s title to the copyrights of the recordings.¹⁵⁹

The court addressed Aftermath’s contention that the 2004 amendment evidenced the parties’ intention to apply permanent downloads to the royalty structure of the Records Sold provision. The court responded by stating that the amendment clarified that the Records Sold provision was meant to be applied to permanent downloads only for royalty escalation purposes.¹⁶⁰ Looking at the plain language of the agreement, the court concluded that the amendment was meant to provide royalty escalation rates for sales of downloads, not the base royalty rate for the sales of downloads.¹⁶¹

The Ninth Circuit ruled to reverse the decision of the district court on the grounds that the agreements between F.B.T. and Aftermath were unambiguous.¹⁶² The agreements clearly stated that, “notwithstanding” the Records Sold provision, a fifty percent royalty rate was owed to F.B.T., under the Masters Licensed provision, for all masters licensed to third party online music distributors for “any” use. Aftermath had undisputedly given its express permission to third parties to produce and sell permanent downloads of Eminem’s master recordings.

¹⁵⁷ 17 U.S.C. § 115.

¹⁵⁸ *F.B.T.*, 621 F.3d at 965 (citing *Wall Data Inc. v. Los Angeles County Sheriff’s Dep’t*, 447 F.3d 769, 785 (9th Cir. 2006); *MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993); *United States v. Wise*, 550 F.2d 1180, 1190–91 (9th Cir. 1977); *Hampton v. Paramount Pictures Corp.*, 279 F.2d 100, 103 (9th Cir. 1960)).

¹⁵⁹ *F.B.T.*, 621 F.3d at 965 (The court stated that federal copyright law considered a license to be “an authorization by the copyright owner to enable another party to engage in behavior that would otherwise be the exclusive right of the copyright owner, but without transferring title in those rights.”).

¹⁶⁰ *Id.* at 966; *see also* PASSMAN, *supra* note 12, at 90 (“It’s common to escalate royalties based on sales. Typical escalations are .5% to 1% at some level between 500,000 and 1 million album sales, and another .5% to 1% at 500,000 to 1 million albums beyond that point.”).

¹⁶¹ *F.B.T.*, 621 F.3d at 966.

¹⁶² *Id.* at 967.

III. RECORD LABELS DO NOT WANT DIGITAL MUSIC DISTRIBUTION TO BE CONSIDERED SALES

A. *The Copyright Act and the First-Sale Doctrine*

The Copyright Act protects “original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device.”¹⁶³ A sound recording¹⁶⁴ is considered “fixed” in a tangible medium of expression when the author has embodied the work in a phonorecord¹⁶⁵ that is sufficiently permanent to be reproduced, *inter alia*, for a more than a temporary duration.¹⁶⁶ Although the Copyright Act does not define “material objects,” a Massachusetts federal district court and other authorities have held that electronic files are included in this category.¹⁶⁷

The Copyright Act grants an exclusive reproduction right of the protected work to the copyright holder.¹⁶⁸ This gives the copyright owner the right to reproduce her sound recordings in a phonorecord. Although “reproduction” is not defined in the Copyright Act,¹⁶⁹ it is inferred that a reproduction occurs when the copyrighted work is fixed

¹⁶³ 17 U.S.C. § 102(a) (2012). “Musical works” and “sound recordings” are categories included as “works of authorship.” *Id.*

¹⁶⁴ The Copyright Act defines sound recordings as “works that result from the fixation of a series of musical, spoken, or other sounds . . . regardless of the nature of the material objects, such as disks, tapes, or other phonorecords, in which they are embodied.” 17 U.S.C. § 101.

¹⁶⁵ The Copyright Act defines “phonorecords” as “material objects in which sounds . . . 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.” 17 U.S.C. § 101.

¹⁶⁶ *See* 17 U.S.C. § 101 (“A work is ‘fixed’ in a tangible medium of expression when its embodiment in a copy or phonorecord, by or under the authority of the author, is sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration.”).

¹⁶⁷ *London-Sire Records, Inc. v. Doe 1*, 542 F. Supp. 2d 153, 171 (D. Mass. 2008) (stating that, “[t]he Copyright Act . . . does not use materiality in its most obvious sense Rather, it refers to materiality as a medium in which a copyrighted work can be ‘fixed’ Thus, any object in which a sound recording can be fixed is a ‘material object.’ That includes the electronic files The electronic file (or, perhaps more accurately, the appropriate segment of the hard disk) is therefore a ‘phonorecord’ within the meaning of the statute.” (citations omitted)); *see also* *Matthew Bender & Co., Inc. v. West Pub. Co.*, 158 F.3d 693, 703 (2d Cir. 1998) (stating that “the definition of ‘copies’ is intended to expand the ‘fixation’ requirement to include material objects that embody works capable of being perceived with the aid of a machine, thereby ensuring that reproductions of copyrighted works contained on media such as floppy disks, hard drives, and magnetic tapes would meet the Copyright Act’s ‘fixation’ requirement.”); 2 WILLIAM F. PATRY, PATRY ON COPYRIGHT § 3:93 (2017) [hereinafter PATRY ON COPYRIGHT] (“Fixation now may be in ‘any tangible medium of expression,’ including tapes, LPs, compact discs, and MP3 files.” (footnote omitted)).

¹⁶⁸ 17 U.S.C. § 106(1).

¹⁶⁹ PATRY ON COPYRIGHT, *supra* note 167 § 9:63.

in a material object, including phonorecords.¹⁷⁰ The copyright holder's reproduction right is infringed when the protected work is embodied in a phonorecord without permission.¹⁷¹ Many courts have held that downloads of digital files infringe the reproduction right.¹⁷²

Copyright holders are also provided an exclusive distribution right. The Act does not define "distribution" but it is contended that distribution is a self-defining term because the statute enumerates the types of distribution covered.¹⁷³ Accordingly, "distribution" is seemingly defined as the sale or transfer of the copyrighted work.¹⁷⁴ Courts have held that sharing of digital files over the Internet constitutes infringement of a copyright owner's distribution right.¹⁷⁵ Accordingly, downloading and sharing digital files are considered violations of the reproduction and distribution rights, respectively.

The copyright holder's reproduction and distribution rights are limited by the first-sale doctrine, which provides a defense to a copyright holder's claim of infringement of her exclusive distribution right. The first-sale doctrine permits the owner of a lawfully obtained phonorecord to sell or dispose of the phonorecord without infringing the rights of the copyright owner.¹⁷⁶ This distinction can be explained by examining the ownership of a CD: the purchaser owns the copy of the CD, although the copyright holder owns the protected sound recordings on the CD.¹⁷⁷

¹⁷⁰ See NIMMER ON COPYRIGHT, *supra* note 152 § 8.02[A]; see also David Hamilton, *It's My Copy and I'll Sell it if I Want To: Capitol Records, LLC v. ReDigi Inc.*, 97 J. PAT. & TRADEMARK OFF. SOC'Y 232, 237–38 (2015).

¹⁷¹ NIMMER ON COPYRIGHT, *supra* note 152 § 8.02[B][1] (footnote omitted).

¹⁷² *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1014 (9th Cir. 2001) ("Napster uses who download files containing copyrighted music violate plaintiffs' reproduction rights."); *Capitol Records, L.L.C. v. ReDigi Inc.*, 934 F. Supp. 2d 640, 649 (S.D.N.Y. 2013) ("[W]hen a user downloads a digital music file or 'digital sequence' to his 'hard disk,' the file is 'reproduce[d]' on a new phonorecord within the meaning of the Copyright Act."); *Capitol Records, L.L.C. v. BlueBeat, Inc.*, 765 F. Supp. 2d 1198, 1202–03 (C.D. Cal. 2010) (holding that the exclusive reproduction right had been infringed due to a website's downloads and streaming transmissions of sound recordings).

¹⁷³ 17 U.S.C. § 106(3) ("[T]o distribute . . . by sale or other transfer of ownership, or by rental, lease, or lending[.]"); Hamilton, *supra* note 170 at 236.

¹⁷⁴ 17 U.S.C. § 106(3).

¹⁷⁵ *Napster*, 239 F.3d at 1014 (Napster users who upload file names to the search index for others to copy violate plaintiffs' distribution rights); *ReDigi*, 934 F. Supp. 2d at 651 (holding that, absent an affirmative defense, the sale of digital files on Defendant's website constituted infringement of the copyright holder's exclusive distribution right). *Cf.* *New York Times Co. v. Tasini*, 533 U.S. 483, 498 (2001) (holding that the sale of electronic copies of newspaper articles was a violation of the copyright owner's distribution right).

¹⁷⁶ 17 U.S.C. 109(a).

¹⁷⁷ *Cf.* *Krause v. Titleserve, Inc.*, 402 F.3d 119, 122 (2d Cir. 2005) ("[T]he author of a book, or her assignee, ordinarily owns the copyright in the book and thus the sole right to authorize copying; each purchaser of a copy of the book owns that copy, but is generally not entitled to make copies from it."); NIMMER ON COPYRIGHT *supra* note 152 § 2.03[C] ("As used in the Copyright Act, a 'literary work' is a work of authorship, but a 'book' is not. A 'book' is merely a material object that may embody, and hence constitute, a copy of a given literary work.").

1. Digital First-Sale Doctrine

In 2001, the U.S. Copyright Office released a report that stated that § 109 of the Copyright Act does not apply to digital transmissions of protected works.¹⁷⁸ The Copyright Office reasoned that digital transmissions result in a new person possessing a new copy of the protected work, and without human or technological intervention, the original owner retains the source copy.¹⁷⁹ Accordingly, the Copyright Office recommended that the Copyright Act should not be amended to include a digital first-sale.¹⁸⁰

Additionally, David Nimmer agrees that a digital first-sale doctrine is not practicable.¹⁸¹ According to Nimmer, the first-sale defense is comprised of four factors: (a) a lawful copy that was produced with the copyright owner's authority; (b) the particular copy was transferred with the copyright holder's permission; (c) the defendant qualifies as the lawful owner of that copy; and (d) the defendant simply distributed that particular copy.¹⁸² Nimmer reasoned that transferring a digital copy to another person breaches the "particular copy" element because the transmitted file must be reassembled while passing through cyberspace. Thus there is no longer a particular copy, rather there are two copies: (1) the copy on the original owner's hard drive and (2) the reassembled bits that are travelling to the other person's computer.

B. *Capitol Records, L.L.C. v. ReDigi Inc.*¹⁸³

About three weeks prior to its ruling in *Malmsteen*, the U.S. District Court for the Southern District of New York held that the first-sale doctrine did not apply to digital transfers of music files.¹⁸⁴ In *Capitol Records, L.L.C. v. ReDigi Inc.*, the court considered whether the first-sale doctrine permitted the owner of a lawfully purchased digital file to resell it through the ReDigi website.¹⁸⁵

ReDigi was a website that allowed its users to sell digital music files that had been legally acquired.¹⁸⁶ The user would upload her

¹⁷⁸ DMCA Section 104 Report, 79–80, U.S. COPYRIGHT OFFICE (2001), <http://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf>

¹⁷⁹ *Id.* at 79.

¹⁸⁰ *Id.* at 96.

¹⁸¹ NIMMER ON COPYRIGHT *supra* note 152 § 8.13[A].

¹⁸² *Id.*

¹⁸³ *Capitol Records, L.L.C. v. ReDigi Inc.*, 934 F. Supp. 2d 640 (S.D.N.Y. 2013).

¹⁸⁴ *Id.*

¹⁸⁵ *Id.* at 648. ReDigi argued that the resale of lawfully purchased digital music files on its service was protected by the first-sale doctrine. *Id.* at 655. The court disagreed and determined that the owner of the digital file could not resell it on the ReDigi website. *Id.* at 648.

¹⁸⁶ *Id.* at 645.

eligible files from her computer to the “Cloud Locker.”¹⁸⁷ Once a digital music file had been uploaded to the Cloud Locker, ReDigi’s “Media Manager”—which the user must download in order to use the service—automatically deleted the file from the user’s computer and connected devices.¹⁸⁸ The court held that the sale of a digital file on the ReDigi website constituted an infringement of the copyright holder’s exclusive right of reproduction and distribution,¹⁸⁹ thereby precluding ReDigi from asserting the first-sale defense.¹⁹⁰

1. The Reproduction and Distribution Rights

To determine the legality of resold music on ReDigi’s website, the court first examined whether Capitol’s reproduction right had been infringed.¹⁹¹ Judge Richard Sullivan reasoned that the embodiment of sound recordings on a phonorecord is distinguishable from the sound recording.¹⁹² The sound recording is the copyrightable subject matter, whereas the phonorecord is the material object on which the sound recordings are fixed.¹⁹³ Accordingly, the sound recording is the digital music file, and the phonorecord is the specific segment of the hard drive where the file is fixed.¹⁹⁴ ReDigi’s system infringed the copyright holder’s reproduction right because downloading a digital music file to another user’s hard drive caused the sound recording (i.e., the digital file) to be embodied on a new phonorecord (i.e., a new hard drive).¹⁹⁵

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 645–46.

¹⁸⁹ *Id.* at 651.

¹⁹⁰ *Id.* at 655.

¹⁹¹ As previously discussed, § 106(1) of the Copyright Act gives the owner of a copyright an exclusive reproduction right. The court noted that this was a case of first impression, where the court must address whether a duplication of digital music files over the Internet—where only one file remained after the transfer—constitutes an infringement of a copyright owner’s exclusive reproduction right. *ReDigi*, 934 F. Supp. 2d at 648. Courts had previously held that unauthorized transfers of digital music files over the Internet, where two files remained after the transfer, constituted an infringement of the reproduction right under the Copyright Act. *See, e.g., A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1011, 1014 (9th Cir. 2001).

¹⁹² *ReDigi*, 934 F. Supp. 2d at 649.

¹⁹³ *Id.*

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* at 649 (citing *London-Sire Records, Inc. v. Doe 1*, 542 F. Supp. 2d 153, 173 (D. Mass. 2008) (“It is simply impossible that the same ‘material object’ can be transferred over the Internet. . . . [t]he Internet transfer of a file results in a material object being ‘created elsewhere at its finish.’”)). To come to this conclusion, the court examines *London-Sire*, which states,

[w]hen a user on a [P2P] network downloads a song from another user, he receives into his computer a digital sequence representing the sound recording. That sequence is magnetically encoded on a segment of his hard disk (or likewise written on other media). With the right hardware and software, the downloader can use the magnetic sequence to reproduce the sound recording. The electronic file (or, perhaps more accurately, the appropriate segment of the hard disk) is therefore a “phonorecord” within the meaning of the statute.

The court also determined that a digital file transfer is protected under the copyright owner's distribution right.¹⁹⁶ The court followed previous courts' rulings that electronic file transfers constitute distribution of phonorecords within the meaning of the Copyright Act.¹⁹⁷ As there was no dispute that ReDigi distributed digital sound recordings on its website, Judge Sullivan found that ReDigi had violated the copyright owner's exclusive distribution right.¹⁹⁸

2. The First-Sale Defense

The court ruled that the first-sale doctrine could not be asserted by ReDigi to protect its distribution of the protected work.¹⁹⁹ The Copyright Act only allows distribution of a particular copy, but the users of ReDigi's services were not transferring their particular copy, rather they were producing a new phonorecord on ReDigi's servers.²⁰⁰ The court concluded that, since the users were not selling their "particular" phonorecord, ReDigi could not use the first-sale doctrine as a defense.²⁰¹

If a transaction that is categorized as a sale ordinarily allows the subsequent owner to invoke the first-sale doctrine, then it would follow that digital sales would be able to use the first-sale doctrine as a defense. If digital transactions cannot invoke the first-sale defense, then they begin to resemble a license, as opposed to a sale.

C. "Terms and Conditions" Are Licenses

Since the term license was not defined in *F.B.T.*, the court applied its ordinary meaning, which is "permission to act."²⁰² The court explained that Aftermath's agreement with iTunes gave iTunes permission to use its sound recordings to sell permanent downloads.²⁰³ Although the word "sell" is used to describe the transaction between iTunes and its subscribers, an examination of Apple's iTunes Store

London-Sire, 542 F. Supp. 2d at 166, n.16.

¹⁹⁶ *ReDigi*, 934 F. Supp. 2d at 651 (citing *London-Sire*, 542 F. Supp. 2d at 173–74); see also *Napster*, 239 F.3d at 1014. Cf. *New York Times Co., Inc. v. Tasini*, 533 U.S. 483, 498 (2001) (holding that an online news database infringed upon the copyright holder's distribution rights by selling digital copies of the author's articles for download).

¹⁹⁷ *ReDigi*, 934 F. Supp. 2d at 651 (citing *Arista Records, L.L.C. v. Greubel*, 453 F. Supp. 2d 961, 968 (N.D. Tex. 2006) (collecting cases)).

¹⁹⁸ *Id.*

¹⁹⁹ *Id.* at 655.

²⁰⁰ *Id.*

²⁰¹ *Id.*

²⁰² *F.B.T. Prods., L.L.C. v. Aftermath Records*, 621 F.3d 958, 964 (9th Cir. 2010).

²⁰³ *Id.*

Terms and Conditions shows that a user's music transactions are, in fact, licenses, not sales—further strengthening the court's reasoning in the *F.B.T.* case.

Apple's Terms and Conditions state that “Apple is the provider of the iTunes Service, which permits you to access, purchase or rent digital content.”²⁰⁴ Apple's use of the word access indicates that users may not own various purchases they make on iTunes. The agreement further states, “[w]hen you first acquire music, purchased (i.e., not rented) movie, TV show and music video iTunes Products . . . you may elect to automatically receive . . . copies of such [content] on additional compatible iOS devices.”²⁰⁵ Noticeably, the agreement does not list music as a purchased product, rather it has merely been acquired by the user. According to the Usage Rules, the user is only authorized to use the products for personal and noncommercial use.²⁰⁶ On the other hand, the Usage Rules allow iTunes Plus Products²⁰⁷ to be copied, stored or burned “as reasonably necessary for personal, noncommercial use.”²⁰⁸

Apple “reserve[s] the right to change, suspend, remove, or disable access to any iTunes Products, content, or other materials comprising a part of the iTunes Service at any time without notice.”²⁰⁹ Apple also reserves the right to discontinue its service.²¹⁰ Should Apple choose to do so, users may be unable to use or access the iTunes products they purchased, and in such case, Apple disclaims its liability.²¹¹ This constricting language found in the Terms and Conditions are licenses, especially when compared with the dictionary definition of license.²¹²

In *F.B.T.* as the court considered whether Eminem's masters were licensed to third parties, Aftermath argued that there was no evidence that it used the term license in the technical sense, rather license should be defined by its ordinary meaning—permission to act.²¹³ The court conjectured that, since Aftermath entered into agreements that permitted iTunes to produce and sell permanent downloads, the agreements were

²⁰⁴ APPLE, *Terms and Conditions* (Oct. 21, 2015), <http://web.archive.org/web/20151025153214/http://www.apple.com/legal/internet-services/itunes/us/terms.html>.

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ Music downloaded from the iTunes Store is considered an iTunes Plus Product and is no longer protected by security technology that limits its usage. About iTunes Plus, Apple (July 10, 2015), <https://support.apple.com/en-us/HT201616>.

²⁰⁸ Although this grant is arguably the right to “reproduce” within the meaning of the Copyright Act, Apple makes sure to limit this usage right by stating, “[a]ny burning or exporting capabilities are solely an accommodation to you and shall not constitute a grant, waiver, or other limitation of any rights of the copyright owners in any content embodied in any iTunes Product.” Terms and Conditions, *supra* note 204.

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *License*, BLACK'S LAW DICTIONARY (10th ed, 2014); *see also supra* Part I.B.2.

²¹³ *F.B.T. Prods., L.L.C. v. Aftermath Records*, 621 F.3d 958, 964 (9th Cir. 2010).

licenses.²¹⁴ Looking upstream, if online distributors, such as iTunes, are *licensing* the creative works to their users, and iTunes and the records labels are entering into *license* agreements, it must be asked, At what point are the works being *sold* in the digital distribution model?

IV. THE RECONCILIATION

When deciding the treatment of digital music downloads in the context of the royalty system, courts should consider the definitions of Record sold and Master License and their implications. Although the digital music download characterization will affect royalty rates, it will also have an effect on the copyright system. Copyright law attempts to balance the interests between the copyright holder and the user of a copyrighted work.²¹⁵ Arguably, a Record sold interpretation will unfairly favor copyright owners because not only will copyright holders benefit by paying lower royalties to artists, but they will also have full downstream control of the music. If a digital download is considered a Record sold then it would follow that the purchaser of a digital download possesses all the rights granted to her under the Copyright Act.

A. *Purchasers of Digital Music Files Are Licensees*

The purpose of the first-sale doctrine is to limit a copyright owner's exclusive statutory right to control the item's distribution once the item is put into the stream of commerce by the copyright owner.²¹⁶ Many of the arguments against categorizing digital music downloads as licenses are rooted in the fear that licenses give copyright holders too much control of the protected work.²¹⁷ In reality, without the ability to assert the first-sale defense, copyright holders essentially retain control of the digital music file anyways. If the first-sale doctrine does not apply to digital downloads, then purchasers of digital music are fundamentally considered licensees of their digital music catalog.

As evidenced by the *ReDigi* case, selling music through an online retailer is not truly a sale in the ordinary meaning of the word, because the rights a subsequent owner would normally gain from a sale, such as

²¹⁴ *Id.*

²¹⁵ *Stewart v. Abend*, 495 U.S. 207, 228 (1990) (“[T]he [Copyright] Act creates a balance between the artist’s right to control the work . . . and the public’s need for access to creative works. The copyright term is limited so that the public will not be permanently deprived of the fruits of an artist’s labor.”); *see also* *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417, 429 (1984); Brian Carver, *Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies*, 25 BERKELEY TECH. L.J. 1887, 1891 (2010).

²¹⁶ *Quality King Distribs. v. L’anza Research Int’l*, 523 U.S. 135, 152 (1998).

²¹⁷ *See* Carver, *supra* note 215, at 1891.

the right to resell the work, are voided.²¹⁸ Accordingly, these online sales are actually licenses—which is a beneficial categorization for the record labels because they retain control over the work. The labels’ intent when negotiating the artist contracts is to maintain as much control of the artist’s sound recordings, which is confirmed by the record label’s requirement that the artist assign the copyright to the sound recording to the label.²¹⁹ Thus, when courts are looking at the intent of the parties in negotiating the recording contract, the courts should consider that the label’s intent in retaining control of the copyright accords with categorizing digital downloads as licenses.

In the courts’ quest to interpret the pre-Internet recording contracts, they aim to give meaning to contract terms in a way that comports with the parties’ intent.²²⁰ Considering the copyright holders’—the labels—endeavor to retain their rights and power over sound recordings, and their subsequent agreements with online music distributors, it is likely that record labels would have intended digital distribution to be considered a license. As evidenced in cases such as *ReDigi*, record labels prefer online transactions to resemble licenses because it allows them to retain control the exclusive rights to the work.²²¹ Artists agree with this interpretation because licenses give them a higher royalty rate at fifty percent. Thus, there is a strong argument that the parties intend digital distribution to be considered a license under the existing agreements.

B. *The Ninth Circuit Got It Right*

The Ninth Circuit has maintained relatively consistent in the license versus sale debate. One week after its ruling in *F.B.T.*, the court held that the purchaser of computer software was a licensee rather than an owner, and thus, could not invoke the first-sale doctrine.²²² The court relied on a test, similar to the one used in *F.B.T.*, to determine whether the agreement between the parties was a license: (1) whether the parties classified the agreement as a license, and (2) whether the copyright holder retained title of the copy or disallowed its duplication, *inter alia*.²²³

Conversely, the U.S. District Court for the Southern District of New York has, on one hand, ruled that a sale has occurred when consumers purchase music through iTunes, or similar online retailer.²²⁴

²¹⁸ See *supra* Part III.B.

²¹⁹ See *supra* Part I.B.

²²⁰ See *supra* Part I.C.

²²¹ See *supra* Part III.A and B.

²²² *Vernor v. Autodesk, Inc.*, 621 F.3d 1102, 1111 (9th Cir. 2010).

²²³ *Id.* at 1109.

²²⁴ See *Malmsteen v. Universal Music Grp., Inc.*, 940 F. Supp. 2d 123 (S.D.N.Y. 2014).

Yet, the same court has ruled that the first-sale doctrine does not apply to digital downloads.²²⁵ Consequently, although the purchase is deemed a sale for an artist's royalty purposes, the sale is not privy to the first-sale doctrine and the purchaser cannot legally resell her digital music in the same way that she would be able to sell physical CDs. Characteristically, this provides record labels with two bites of the apple, because they dole out minimal royalty rates to the artists while benefitting from the absence of a secondary market for digital music. Such consequences need to be considered when the courts are choosing between the license versus sale distinction.

The Ninth Circuit performed a thorough interpretation of the parties' unambiguous recording contract.²²⁶ Unlike the New York court, the Ninth Circuit focused on providing an analysis of the meaning of the terms sale and license as used in the recording agreements. These two terms are crucial in determining royalty rates because the rates are directly related to whether the distribution method is classified as a sale or license. The New York district court focused its attention on the meaning of Records and Normal Retail Channels,²²⁷ and although these terms are important, the analysis is incomplete without a discussion of the terms sale and license. As courts begin to analyze the meaning of sale within the digital distribution system, they will encounter the dualism between the first-sale doctrine and the court and government's refusal to extend the doctrine to digital content. When addressing the term license within the digital distribution model, a court should take into consideration the ordinary meaning of license in this industry practice. Specifically, the way license is used in agreements between consumers and the online retail store; the online retail store and the record label; and, finally, the record label and the artist.

The Ninth Circuit's categorization of digital music downloads from third party online retailers as licenses should be followed by the courts. It is unlikely that, under the original contract, the parties intended for digital music downloads to be Records sold. One reason for this conjecture is because record labels do not want the music downloads to be considered sales, as this invokes the first-sale doctrine. The labels' are reluctant to allow users to resell the music in accordance with the first-sale doctrine; instead, the labels prefer to retain their control over the music.²²⁸ Additionally, it is obvious that artists did not intend for digital downloads to be considered sales because this would decrease their royalty rate.²²⁹ Therefore, when interpreting the contracts and looking to the intention of the parties, it is evident that the parties

²²⁵ See *ReDigi*, 934 F. Supp. 2d 640 (S.D.N.Y. 2013).

²²⁶ See *supra* Part II.B.2

²²⁷ See *supra* Part II.A.2

²²⁸ See *supra* Part IV.B.

²²⁹ See *supra* Introduction.

would not have originally intended for digital music downloads to be considered Records sold.

CONCLUSION

Record labels were ill-prepared under their longstanding contracts to transition to a new mainstream distribution system that relied heavily on licensing because of the higher royalty payments given to artists under the traditional licensing model.²³⁰ Wanting to preserve their business model, record labels interpreted digital downloads as sales, rather than licenses, in order to retain profits.²³¹ Unfortunately, the District Court for the Southern District of New York agrees with this interpretation. However, the court's reasoning causes disaccord with copyright law, specifically because of the court's refusal to assent to a digital first-sale doctrine. Further the court's ruling in *Malmsteen* disassociates digital music distribution usage terms with the nearly identical licensing terms found in software and e-book agreements.

The Ninth Circuit's classification of these transactions as licenses accords with the new music distribution model that has severely reduced the manufacturing and distribution costs previously incurred by labels. The court correctly recognized that a license was formed between users and online music retailers, because the terms did not conform with the necessary principles associated with a sale. This ruling created unity between the licensing terms of software, e-book, and digital music downloading platforms. The Ninth Circuit ruling also comports with courts' failure to recognize a digital first-sale doctrine. For these reasons, courts should use the Ninth Circuit's ruling as guidance in determining artists' royalty rates for downloads of music.

²³⁰ *Id.*

²³¹ *Id.*