The Ninth Circuit's Eminem License vs Sale Decision

September 9, 2010 by Bob Tarantino

When you're one of the biggest rap stars in the world, it shouldn't be surprising to find news of one of your recent court victories splashed all over the mainstream news; when that court victory prompts reactions like "staggering", no one should be shocked to see major news stories about the court decision being carried by major outlets all over the world (a sampling of coverage: the *Toronto Star*; the *Los Angeles Times*; the *Wall Street Journal*). And so it is with the US Ninth Circuit Court of Appeals decision in the case of *F.B.T. Productions et al v Aftermath Records et al* (full text of the decision is available here), a court case relating to the works of Marshal B. Mathers III, otherwise known as Eminem. (For ease of reference in the following discussion I'm going to use the term "artist" and "label" to refer to the plaintiffs (FBT et al) and the defendants (Aftermath, et al), respectively, even though, technically, the plaintiffs in this case weren't necessarily limited to the artist and the defendants weren't limited to the record labels.)

The background to the dispute between the parties is fairly simple. Most recording contracts between an artist and a record label provide that the artist is entitled to received royalties in at least two different situations: first, where there is a "sale" of a "record" (ie the physical object on which the music is embodied); second, where there is a "license" of the rights to duplicate or make another use of the record. A "sale" is pretty straightforward: someone goes into a record store and buys a CD (the "sale" which a record contract is usually concerned with is not *that* sale, but the sale by the record label to a wholesaler or distributor, but set that aside for now). A "license" is little more esoteric: historically it was limited to licensing the master recording for use in a compilation or for use in a film, television show or commercial. The distinction was important because two different royalty rates are applied: for a "sale", the artist received either a percentage of the sale price or the revenues received by the label (the percentage itself generally ranged from 10-25%, the upper end being rarely accorded and reserved largely for "superstar" acts); for a "license", convention was to provide a 50% royalty. All other things being equal, then, the artist would prefer to encounter many more licenses than sales.

Enter the internet and the downloading of digital versions of songs. Is that a "sale" or a "license"? Where a track came laden with digital rights management (DRM) protections, the issue was even fuzzier: if I give you something but make it subject to a bunch of restrictions on how you can make use of it, does that seem more like I've sold something to you or more like I've licensed something to you? In this case, with reference to the Eminen tracks, the label entered into contracts enabling providers like Apple's iTunes service to make the digital tracks available for download. The label took the position that such a contract involved a "sale" (and hence was subject to the lower royalty rate) - presumably their argument was something along the lines of "Consumers are purchasing a track which they can download to their computer and in meaningful sense they then 'own' that track - that looks like selling a single LP or CD, and so should be characterized as a 'sale'". The artist took a contrary position, arguing that the iTunes contract should be treated as a license - their argument presumably went something like this: "There hasn't been a 'sale' of anything, because there hasn't

been a physical object to which ownership has been transferred; all you've done is given iTunes the right to make digital copies of the song and to, in turn, authorize others, upon payment of a $0.99 fee, make their own digital copies - which looks an awful lot like a 'license'".

The US Ninth Circuit Court of Appeals has come down on the side of the plaintiffs:

[9] When the facts of this case are viewed through the lens of federal copyright law, it is all the more clear that Aftermath's agreements with the third-party download vendors are "licenses" to use the Eminem master recordings for specific purposes authorized thereby—i.e., to create and distribute permanent downloads and mastertones—in exchange for periodic payments based on the volume of downloads, without any transfer in title of Aftermath's copyrights to the recordings. Thus, federal copyright law supports and reinforces our conclusion that Aftermath's agreements permitting third parties to use its sound recordings to produce and sell permanent downloads and mastertones are licenses.

One of the reasons the decision is noteworthy is that it provides further evidence that seemingly novel issues arising at the interface of copyright and technology can be, in the forum of a litigation matter, be resolved with reference to relatively simple legal principles:

[7] There is no dispute that Aftermath was at all relevant times the owner of the copyrights to the Eminem recordings at issue in this case, having obtained those rights through the recording contracts in exchange for specified royalty payments. Pursuant to its agreements with Apple and other third parties, however, Aftermath did not "sell" anything to the download distributors. The download distributors did not obtain title to the digital files. The ownership of those files remained with Aftermath, Aftermath reserved the right to regain possession of the files at any time, and Aftermath obtained recurring benefits in the form of payments based on the volume of downloads. ...

[8] Under our case law interpreting and applying the Copyright Act, too, 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. See, e.g., Wall Data Inc. 13410 F.B.T. PRODUCTIONS v. AFTERMATH RECORDS Case: 09-56069 09/03/2010 Page: 11 of 15 ID: 7462343 DktEntry: 42-1 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). [emphasis added]

(As a side note, it strikes me that the Ninth Circuit's analysis of the distinction between a sale and a license of copyright is broadly consistent with how a Canadian court would approach the matter.)

What's the impact of this decision (noting that the defendants have indicated they will appeal)?

As the news report indicate, views on that question range from an artist's manager who calls the decision "staggering" and says "it affects everyone" (as recounted in the *Toronto Star*), to much more circumspect and conservative. Ethan Smith, writing the in the *WSJ*, probably has it correct when he says:

while Friday's ruling may be philosophically intriguing, in most cases, the song is likely to remain the same

In short, this decision is highly unlikely to result in a windfall for many artists. I think that's because of a few different factors: First, the decision enunciates not a principle of copyright law but a finding of contract interpretation - the contract under consideration in the Eminem case was particularly unclear as to whether, as between the parties, digital downloads should be treated as sales or licenses; such ambiguities are, for the most part, and particularly in the case of major label contracts, a thing of the past. Certainly any major label recording contract signed in the last five to eight years, which, to be clear, accounts for an awful lot of the songs which are being digitally downloaded on major commercial sites, will specifically set out that digital downloads are to be treated as sales and thus subject to the lower royalty rate.

Second, while the decision may have some bearing on older contracts, it appears (at least according to the *WSJ* report) that even in those cases many of the artists and record labels have amended or re-negotiated the terms of the contracts to more clearly address the treatment of digital downloads.

Finally, for contracts which don't fall into either of the foregoing categories (ie contracts which are so old that they are unclear on what royalty rate applies to digital downloads and which have not been amended or otherwise updated), those contracts are in many cases going to be for artists whose tracks don't see much activity on legitimate commercial download sites and, hence, won't have an obvious economic incentive to bring a court action seeking redress (if your song has been downloaded 300 times in the last five years, it's going to cost you a lot more just to describe the situation to your lawyer than you could possibly recover in a claim).
