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Author

Locke, Zac

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How to Save the Recording Industry?: Charge Less

Zac Locke*

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I. ONLINE MUSIC SALES ARE REPLACING TRADITIONAL CD SALES

“How much is music worth?” This is the question posed by University of Chicago Economist, and *Freakonomics* author, Steven Levy in a recent article in *Newsweek* magazine.¹ Levy posits that it has become painfully clear that the traditional fifteen dollars charged for a packaged CD can no longer be sustained under current market conditions. CD sales declined fourteen percent in 2008,² following years of similar erosion.³ Big-box retailers like Walmart, which account for two-

* Zac Locke is an Associate at Jeffer, Mangels, Butler and Marmaro in Los Angeles. He received his J.D. from the University of California, Los Angeles School of Law, where he was the Editor-in-Chief of the UCLA Entertainment Law Review and President of the Entertainment Law Association. He wishes to thank Natalie Skordilis for her support and always being a patient and wise sounding board.

¹ Steven Levy, *How Much is Music Worth?*, NEWSWEEK, Oct. 29, 2007, at 20.

² Phil Gallo, *Album Sales Continue to Slide in '08*, VARIETY, Jan. 2, 2009, at 1.

³ CD sales also declined 14% in 2007. See Brian Hiatt & Steve Knopper, *Big Chains Push CDs Off Shelves*, ROLLING STONE, Oct. 15, 2007, at 23. In 2006, CD sales declined 13%. See Frank Aherns, *Despite Drop in CD Sales, Music Industry Stays Upbeat*, WASHINGTON POST, April 17, 2007, at D1.

thirds of record sales,⁴ already demand cheaper CDs to use as loss leaders to generate foot traffic in their stores. As physical sales of music dwindle, these stores turn to DVDs and video games, with a corresponding loss of shelf space for CDs.⁵ With specialty chains like Tower Records going out of business in 2008, big-box retailers remain as the only place to buy CDs in many communities. Consequently a cutback on big-box retailers' commitment to stocking CDs could signal the final blow to a floundering industry.

In the author's opinion, the physical CD will stick around for the next decade or so, with \$10 becoming the price point necessary to compete with online services. But eventually, like vinyl, 8-tracks and cassettes before it, the CD will lose importance. Many new cars will come with an MP3-player dock, satellite radio, and even hard-drives to store the driver's music. Home stereos, an endangered species already, will become hard drives with speakers, as all music goes digital.

Consumer behavior indicates users still desire to have an ownership interest in their music, regardless of whether it consists merely of bits of data on a hard drive. Digital sales rose 27% in 2008.⁶ Subscription models have become slightly more popular amongst certain demographics,⁷ but rental subscribers must pay recurring fees. Once payment of the fee is terminated the consumer has no rights to previously downloaded music, and the songs are automatically deleted from their systems. But for many consumers, the music they listen to forms part of their identity. Also, a problem with current nascent subscription services such as the new Napster is that it is much more convenient to choose among the songs you know you own, rather than a catalogue of every song ever recorded. Thus, even if they own only the bits of data, consumers still want to own music. Therefore, online retailers who offer perpetual rights to music will become increasingly important as the CD goes the way of the pay phone.⁸

As online retail becomes the way of the future, record labels, music publishers and music e-tailers⁹ must find the ideal price point for their product. This Article defines the ideal price point as the price where profit is maximized while minimizing the economic obstacles that lead to music piracy. Bulk sales should be the goal because of the

⁴ *Id.*

⁵ Brian Hiatt & Steve Knopper, *Big Chains Push CDs Off Shelves*, ROLLING STONE, Oct. 15, 2007, at 23.

⁶ Phil Gallo, *Album Sales Continue to Slide in '08*, VARIETY, Jan. 2, 2009, at 1.

⁷ Only 2.5% of Americans were paid for music subscription services in 2007. Brian Hiatt, *Biz Bets on Subscriptions*, ROLLING STONE, Dec. 13, 2007, at 17.

⁸ Seventeen percent of Americans paid for downloaded music in 2007. *Id.*

⁹ An "e-tailer" sells digital music online.

low cost associated with selling songs online, as manufacturing, packaging, shipping, placement fees, returns, and inventory storage are not problems with digital files.

II. WHAT IS THE RIGHT PRICE FOR ONLINE MUSIC?

Over one billion digital tracks were sold in 2008 alone.¹⁰ However, digital music sales still only account for about 30% of music sales. Surprisingly, the growth rate of digital music sales has been tapering off of late.¹¹ While Apple's iTunes, the most popular music e-tailer, has sold hundreds of millions of songs at ninety-nine cents per unit, this ceiling on growth suggests that iTunes' famous ninety-nine cent price point may not be ideal.

Further proof of iTunes overpricing comes from an experiment undertaken by another music e-tailer, Rhapsody. For a limited time, the online music service offered songs for forty-nine cents, half of what iTunes charges.¹² Not surprisingly, more people bought music at forty-nine cents than at ninety-nine cents. What was surprising was how *much* more. In the Rhapsody experiment, sales went up *six-fold*.¹³ Thus, where Rhapsody could have sold, for example, one million songs for one million dollars, just by slashing the price they would have sold six million songs for three million dollars. Aside from costs required under the current royalty structure, as discussed below, digital sales do not require many of the significant costs associated with a CD. Therefore, the additional digital sales generated significant net revenue without the accompanying expense for the online retailer, which participates in a revenue sharing agreement with the record labels and publishers (about 70% goes to the label, and 10% to the publisher).¹⁴

This Article takes the position that the Rhapsody experiment should be pushed even further, and suggests that a lower price point should be the norm. In the author's opinion, if online retailers halved the price again, making it a mere George Washington quarter per song, sales would go up six-fold again. In other words, *thirty-six* times more music would be sold at quarter-each prices than is currently sold under the buck-a-song model. So, doing the math again, 25¢ times 36 million songs = \$9 million. This represents an extra eight million dollars in

¹⁰ Phil Gallo, *Digital Music Sales hit 1 Billion Mark*, VARIETY, Dec. 19, 2008.

¹¹ Nick Mokey, *Digital Sales Slipped 10% in 2007*, DIGITAL TRENDS NEWS, Jan. 24, 2008, http://news.digitaltrends.com/news/story/15521/music_sales_slipped_by_10_percent_in_2007.

¹² Steven Levy, *How Much is Music Worth?*, NEWSWEEK, Oct. 29, 2007, at 20.

¹³ *Id.*

¹⁴ Donald S. Passman, *All You Need to Know About the Music Business*, Sixth Edition, Free Press, 2006, at 159.

profit for the online retailers, labels and publishers to split than under the 99-cent model.

III. THERE IS A MARKET FOR CHEAP ONLINE MUSIC

People want music. Music is a unique media that can be consumed all day long, while partaking in other activities. In your car, at work, while cooking dinner, doing homework – think about what percentage of the day you are listening to music. Therefore, there is almost a limitless demand for music. And if the price is cheap enough, for example twenty-five cents, consumers will try new bands, or get the other four albums from a band they already like.

Recently, the Russian MP3 site, allofmp3.com, was forced to close up its business because of excessive litigation costs after pressure from record labels and publishers.¹⁵ However, instead of fighting to shut the site down, the record industry should have learned from it. The Russians charged from 10¢-30¢ per song, depending on quality. At those prices, consumers have less of an incentive to download songs illegally. Consumers could purchase some songs or albums on a whim, even if they had not heard the artist before. As memory on portable MP3 players increases, consumers need to fill them. At cheap, DRM-free¹⁶

¹⁵ Natali Del Conte, *Russia Agrees to U.S. Request to Shut Down AllofMp3.com*, TECH CRUNCH, Nov. 28, 2006, <http://www.techcrunch.com/2006/11/28/russia-agrees-to-us-request-to-shut-down-allofmp3com>.

¹⁶ “DRM” stands for “Digital Rights Management”. About.com explains:

Digital Rights Management is a technology that creates certain conditions about how some digital media files - such as audio and video - can be used and shared. Digital Rights Management terms are generally created by the owner of the piece of digital media (for instance, a record company when the piece of media is a song). DRM is encoded in the file in an attempt to make it irremovable. The DRM then governs how the file behaves on other computers. DRM is frequently used to prevent things like the sharing of MP3s on file-trading networks or to make sure that people buy the songs they download from the Internet. DRM is, in some areas, an extremely controversial technology, as some people argue that it takes away rights that consumers have in the physical world. Owners of media who employ DRM argue that it is necessary to ensure that they are paid for their property.

Sam Costello, *What is Digital Right Management?*, http://ipod.about.com/od/drmlicensesauthorizing/g/drm_definition.htm (last visited Feb. 9, 2009). However, recent efforts have been made to offer DRM-free songs to consumers. For example, iTunes used to install limited DRM in all the songs that it sold. The iTunes DRM allows users to install and play songs bought at iTunes on up to 5 computers or portable players. *Id.*

In 2007, iTunes agreed with record label EMI to offer non-protected songs for \$1.29 each. Now, over half the songs on iTunes are available DRM-free. Candace Lombardi, *iTunes Goes DRM-free with EMI*, CNET NEWS, May 30, 2007, http://news.cnet.com/iTunes-goes-DRM-free-with-EMI/2100-1027_3-6187457.html. Apple CEO, Steve Jobs, would like to abolish DRM entirely. In an open letter to the industry, he wrote:

Imagine a world where every online store sells DRM-free music. . . In such a world, any player can play music purchased from any store, and any store can sell music which is

prices, without the risk of computer viruses, faulty songs, and RIAA lawsuits,¹⁷ they will.¹⁸

Admittedly, cheap downloads do not have great traction presently. Apple's iTunes and Walmart are still the two biggest suppliers of music in the United States.¹⁹ However, 48% of teenagers did not buy a CD in 2007.²⁰ One fifth of Internet users download music illegally, and they are downloading more songs than ever before.²¹ In order to better understand how current and future generations of music consumers obtain their music and why, and to put these statistics into a street-level perspective, three music fans of three different ages were surveyed.²² They were asked how they listened to their music, where they obtained it, and their feelings about digital music and paying for downloads.

playable on all players. This is clearly the best alternative for consumers, and Apple would embrace it in a heartbeat. If the big four music companies would license Apple their music without the requirement that it be protected with a DRM, we would switch to selling only DRM-free music on our iTunes store. Every iPod ever made will play this DRM-free music.

Steve Jobs, Thoughts on Music (Feb 6, 2007), <http://www.apple.com/hotnews/thoughtsonmusic/>.

In fact, in an update just before press, Apple recently decided to abolish DRM entirely in its library, a positive step for digital music distribution. See Ethan Smith and Yukari Iwatani Kane, *Apple Changes Tune on Music Pricing*, WALL STREET JOURNAL, Jan. 6, 2009, at Marketplace 1. However, while Apple will reduce the prices on some songs to 69 cents, it is raising others to \$1.29, a step in the wrong direction in this author's opinion.

¹⁷ The "RIAA" stands for "Recording Industry Association of America", the powerful lobbying and trade group that represents the music industry. In 2003, the RIAA began a campaign of suing illegal downloaders. Today, the RIAA has sued, or threatened to sue, roughly 28,000 individuals for sharing music online. Electronic Frontier Foundation. RIAA v. The People, <http://www.eff.org/riaa-v-people> (last visited Feb. 9, 2009).

For an interesting look at the next steps the RIAA is taking against file-sharers, see Kristy Wiehe, *Dollars, Downloads, and Digital Distribution: Is "Making Available" Copyrighted Work a Violation of an Author's Distribution Right?* 15 UCLA ENT. L. REV. 117 (2008).

In another last-minute change just before press, the RIAA has decided to abandon its campaign against file-sharers, choosing instead to partner with the Internet Service Providers to slow down or cut service to illegal downloaders. See Sarah McBride and Ethan Smith, *Music Industry to Abandon Mass Suits*, WALL STREET JOURNAL, Dec. 19, 2008, at Marketplace 1.

¹⁸ This is not meant to suggest that illegal downloading would not still be a problem. According to a recent report by IFPI, an organization representing over a thousand record labels worldwide, broadband ISP expansion will continue to fuel the fire of illegal downloading as more and more people acquire fast access to digital files. According to its statistics, illegal downloads outpaced legal ones by a ratio of 20 to 1 in 2007. IFPI DIGITAL MUSIC REPORT (2008), available at http://www.ifpi.org/content/section_resources/dmr2008.html.

¹⁹ *The NPD Group: Consumers Acquired More Music in 2007, But Spent Less*, BUSINESS WIRE, Feb 26, 2008, available at http://findarticles.com/p/articles/mi_m0EIN/is_2008_Feb_26/ai_n24324810.

²⁰ *Id.*

²¹ *Id.*

²² Author interviews at the Boba Loca café in Los Angeles, CA. February 27, 2008.

The author's own music library, which contains 8,000 songs, reveals the following sources of songs:

Author -29 years old: 8,000 songs – iTunes:

Source of Song	Percentage
Imported from owned CDs	40%
Acquired from friends	35%
AllofMP3.com cheap DRM-free download	15%
Illegal downloads from the Napster era	9%
Purchased from iTunes	1%

However, the younger music purchasers of the future are even less likely to download music for a price. The informal surveys of a UCLA college student and a Los Angeles high-school student reveal the following sources of the songs they own:²³

College Student: 22 years old: 3,000 songs – iTunes:

Source of Song	Percentage
Imported from own CDs	20%
Acquired from friends	70%
Gomusic.ru cheap DRM-free download	1%
Illegal downloads from the Napster era	9%
Purchased from iTunes	0%

High School Student: 15 years old: 3,000 songs – Microsoft Zune player:

Source of Song	Percentage
Imported from own CDs	30%
Acquired from friends	50%
Cheap DRM-free download	0%
Illegal downloads from Limewire	20%
Purchased from iTunes	0%

When asked if he would pay twenty-five cents per song, and possibly two dollars an album from a streamlined and comprehensive service such as iTunes, the 22-year old college student said he probably would. He noted that the benefits over illegal downloading would be organization of his library and time-savings associated with finding the music.

²³ *Id.* Interview subjects were listening to music on portable players when asked to supply the above percentages and various follow-up questions.

He said the reason that he did not use the cheap, DRM-free Russian site, <http://www.gomusic.ru>, extensively was because the selection was not that good.²⁴ He also laughed at the idea of ever spending ninety-nine cents per song. For a buck, he said, it was worth his time to try to find the song for free. At two dollars per album, his seventy percent of songs acquired from friends (for free) might even go down, as he also noted that ripping a CD was a “pain.”

The high school student said he would probably not even buy music for a quarter, because he can get it for free. This mindset, common among younger music consumers, is obviously a problem for the music industry. But charging a dollar is not the answer. The lower the price, the more likely the younger generation will buy music as they start earning money from summer jobs, Bar Mitzvahs, or mowing the lawn.

Additionally, to back up the previous contention that CDs are on their way out, neither the college student nor the high school student could remember having bought a CD in the past few years.

IV. MUSIC INDUSTRY RESISTANCE

Labels and publishers should agree to a lower price with online retailers. As evident from this Article’s informal research and the industry numbers, iTunes’ buck-a-song model is not the answer and neither is selling physical CDs. The lower the price of music, the less likely consumers will spend time trying to find free illegal downloads or get it from their friends, and more likely they will be to buy music themselves.

The biggest online music retailer, Apple’s iTunes²⁵ has taken steps towards this price reduction.²⁶ Apple likes the money it makes from digital downloads, but its sale of music is primarily motivated by the desire to sell additional music players to hold that music. At lower prices, demand for music would increase, and so would the demand for its music players. Furthermore, as has been shown, iTunes would bring in even more revenue from its iTunes Store, which, although not that important to Apple, would not make it unhappy either.

However, the music industry continues to fight lower prices. There are at least three important reasons for this resistance: a) labels and

²⁴ Research seems to corroborate the college-students experience. The IFPI study referenced above found, in general, legitimate downloading sites such as iTunes had more selection than P2P sharing sites such as LimeWire. IFPI DIGITAL MUSIC REPORT (2008).

²⁵ In 2007, iTunes accounted for seventy-five percent of digital music sales in the US. Evan Serpick, *Amazon Takes Bite Out of Apple*, ROLLING STONE, Dec. 13, 2007, at 18.

²⁶ Ethan Smith and Yukari Iwatani Kane, *Apple Changes Tune on Music Pricing*, WALL STREET JOURNAL, Jan. 6, 2009, at Marketplace 1.

publishers cannot agree on sacrificing some of their royalty rates, b) labels are afraid of incurring the wrath of big box retailers, and c) the entire industry, including artists and retailers, is afraid of the devaluation of music.

A. *Publishers and Record Labels Want More than is Available*

The music publisher's right to receive a royalty for the distribution of their musical composition is codified in the United States Copyright Act (the "Act").²⁷ This right is extended to digital downloads as well.²⁸ The rates given to the publishers are contained in the Act and can be changed by a board of Copyright judges.²⁹ Currently, the statutory rate for publishers is 9.1 ¢ whenever their compositions are sold.³⁰

Additionally, record labels are used to getting seventy percent of the retail price on both physical CDs and digital downloads. Assuming e-tailers wanted to sell songs for a quarter, they would not be able to pay off both the publishers and labels.

Seventy percent of 25 ¢ is 17.5 ¢. With the publisher's share at 9.1¢ and the label's at 17.5¢, the online music retailer would owe third parties 26.6¢. However, the e-tailers will only be charging 25¢, so the master and composition holders would have to compromise. Instead of taking 9.1¢ per song, the publishers need to lower their fee in ratio with the lowered download price, taking about 2.5¢ per song. Thus, the online retailer would pay out 20¢ on each song and keep a twenty percent profit (which is what they get under the buck-a-song model as well). By not compromising, the publishers will be shooting themselves in the foot. However, it is very difficult to get the publishers to come to a consensus to allow the copyright laws to change, let alone get the thousands of viable publishers in the same room.

²⁷ The royalty under a compulsory license shall be payable for every phonorecord made and distributed in accordance with the license. 17 U.S.C. § 115(c)(2).

²⁸ A compulsory license under this section includes the right of the compulsory licensee to distribute or authorize the distribution of a phonorecord of a nondramatic musical work by means of a digital transmission which constitutes a digital phonorecord delivery, regardless of whether the digital transmission is also a public performance. 17 U.S.C. § 115(c)(3)(A).

²⁹ 17 U.S.C. § 801(b) et seq.

³⁰ This has been the rate for songs of five minutes or less since January 1, 2006. The Harry Fox Agency administers most of these licenses, and updates current rates at <http://www.harryfox.com/public/licenseeRateCurrent.jsp>. Mechanical licensing is the licensing of copyrighted musical compositions for use on CDs, records, tapes, and certain digital configurations. Harry Fox Agency, Mechanical Licensing, <http://www.harryfox.com/public/licenseeServicesMechanical.jsp> (last visited Feb, 9, 2009). The right to a mechanical rate is established in the 1978 United States Copyright Act, codified in 17 U.S.C. § 115(c)(2) (1978).

B. *Big Box Retailers Exert Pressure on the Industry to Not Undersell*

Second, big box retailers such as Walmart do not take kindly to labels agreeing to sell their product for two dollars per album online while Walmart tries to sell it for ten dollars in-store. Walmart does not make much profit from CDs, it uses them as a “loss leader” to get customers into their stores to buy bath towels and Fruit Loops. But why would a customer spend ten dollars in Walmart when she can spend two dollars online to get a legitimate product? For the most part she would not. Walmart would in response take away even more shelf space from CDs, probably only stocking the best sellers from the biggest, most mainstream artists, with an older, non-tech-savvy fanbase.³¹

This Article does not propose an answer to this dilemma. It simply poses another question – *so what?* With CDs sure to lose importance in the next decade,³² labels need to think about the future, not the present. As the Buddha writes, “in the future, only the future existence will be real.”³³ The music industry should not look at continued CD sales as the answer, and should develop a more viable, cheaper, online delivery system.

C. *The Danger of Devaluing a Commodity*

Lastly, there is always a danger that by making something extremely cheap, its intrinsic value is lessened in the minds of consumers. Film studios have done a great job fighting the devaluation of their films, railing against free giveaways with newspapers in Europe, and only begrudgingly joining subscription models like Netflix. But music is different because the cat is already out of the bag. Music is not only already devalued, for the younger generation it is *free!* Some industry insiders argue that if you can get people to pay for bottled water you can get them to pay for music. However, music used to be bottled; now it is on tap. It is too late to bottle it back up again, unless it is for prices that closely approximate your water bill, at much more convenience. That is what this Article suggests: cheap music in a convenient, high-quality online location.

³¹ Walmart was happy selling one million copies of the Eagles new album in 2007, even though they mounted a \$40 million advertising campaign to secure exclusive distribution of the album. They did not mind taking the loss because Eagles fans who came into the store to buy the album most likely walked out with an armful of other goods as well. Evan Serpick, *Eagles Go Back to Eden*, ROLLING STONE, Nov. 29, 2007, at 14.

³² This author also believes that long-play albums as we know them will continue to lose importance to consumers, and single-song downloads will dominate in the future. See Zac Locke, *The New (Record) Deal*, 15 UCLA ENT. L. REV. 105 (2008).

³³ DWIGHT GODDARD, A BUDDHIST BIBLE 36-9 (Kessinger Publishing Company 2006) (1932).

V. CONCLUSION

In his *Newsweek* article Steven Levy argues that it is irrelevant to argue what music is worth, because technology, through replacing the CD with subscription services, preloaded devices, and illegal downloads, wants to make it close to free. Technology has significantly lowered the price of music.³⁴ Instead of denying it or trying to stop it, the music industry needs to give music to consumers at a price – yes, close to free – that will increase demand and propensity to pay for it.

³⁴ Steven Levy, *How Much is Music Worth?*, NEWSWEEK, Oct. 29, 2007, at 20