F.B.T. v. Aftermath

Eminem Raps the Record Industry

BY EDWIN F. MCPHERSON

In typical modern recording agreements, an artist receives anywhere from 15 to 20 percent of the "Published Price to Dealers" ("PPD") for physical recordings (primarily compact discs) that are sold through "normal retail channels."[1] Previously, artist royalties were based on the "Suggested Retail List Price" ("SRLP"), with many deductions. However, with respect to music that is "licensed" to third parties, the artist typically has always received 50 percent of the net income that the label receives for that licensed music. There has been very little variance of these principles from recording agreement to recording agreement, or even from record label to record label.

For many years, these provisions remained virtually unchanged and unchallenged, and the labels paid the artists accordingly (though typically insufficiently). Since the advent of downloadable music, however, these provisions have been illuminated and have given music lawyers everywhere fodder for intense discussion. The main issue has been how to treat digital downloads; essentially, are they recordings sold through "normal retail channels" or are they licenses? The difference could be in excess of $2.00 per album. Quite obviously, for an A-list artist, the difference could be worth millions of dollars.

However, this discussion was just theoretical until the Ninth Circuit case of *F.B.T. Productions, LLC, et al. v. Aftermath Records, etc., et al.*,[2] in which the Ninth Circuit Court of Appeals held, as a matter of law, that digital downloads and mastertones are licenses, and that they are therefore subject to the 50 percent license fee rather than a much smaller percentage royalty.

F.B.T. Productions, LLC is a production company that is owned by Mark Bass, Jeff Bass, and their manager, Joel Martin. In 1995, F.B.T. signed an artist named Marshal B. Mathers III to an Exclusive Artist Recording Agreement. Mathers is professionally known as Eminem. According to Aftermath, F.B.T. was entirely unsuccessful in its attempts to market and package Eminem, with its first Eminem album selling only 30 copies.[3]

However, while F.B.T. was promoting Eminem across the country, a junior employee of Interscope Records saw his Los Angeles performance and brought a copy of his CD to Jimmy Iovine, the president of Interscope. Iovine gave the CD to Andre Young, who is professionally known as Dr. Dre. Dr. Dre, Interscope, and UMG Recordings, Inc. are co-owners of a record label called Aftermath Records. Dr. Dre loved the CD and immediately entered into a recording agreement on behalf of Aftermath with F.B.T. (the 1998 agreement), pursuant to which F.B.T. transferred the rights to Eminem's exclusive recording services to Aftermath.[4]

Eminem has since become a superstar and has sold tens of millions of records. F.B.T. has received millions of dollars in royalties, which they continue to receive today, based on Eminem's record sales.[5]

The 1998 agreement was based on a form contract that was drafted by A-list music attorney Peter Paterno.[6] Eminem's transactional attorney was another A-list music attorney, Gary Stiffelman.[7] In accordance with the *Records Sold* provision of the 1998 agreement, F.B.T. was to receive between 12 and 20 percent of the adjusted retail price of all "full price records sold in the United States . . . through normal retail channels." However, with respect to music that is *licensed*, the *Masters Licensed* provision of the agreement provided that "[n]otwithstanding the foregoing," F.B.T. was to receive 50 percent 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."[8] During the negotiation of the agreement, the parties had no discussion about either the *Records Sold* provision or the *Masters Licensed* provision.[9]

The agreement defined "master" as a "recording of sound, without or with visual images, which is used or useful in the recording, production or manufacture of records." However, there was no definition in the agreement of the terms "licensed" or "normal retail channels."[10]

In 2000, F.B.T., Eminem, and Aftermath entered into an amendment to the 1998 agreement (which Aftermath describes as a "novation"), which created a "direct relationship between Aftermath and Eminem" and made F.B.T. a "passive income participant," no longer "furnishing the services of" Eminem. In accordance with the 2000 agreement, F.B.T. received 40 percent of every dollar payable to Eminem.[11] Although the royalty rate under the *Records Sold* provision was increased, the substance of both provisions was unchanged.[12]

Commencing in 2001, Aftermath's parent company, UMG, started distributing its recordings in digital formats as permanent downloads through numerous companies, including Apple's iTunes store, its agreement with which was concluded in 2002. In addition, commencing in 2003, UMG began entering into agreements with major cellular telephone network carriers to sell downloads as mastertones (popularly known as "ringtones").[13]

Commencing in approximately 2002, UMG amended its form agreements to include an express provision dealing with digital downloads. Under the new agreements, digital downloads were to be paid to the artists as traditional record sales, and not as licenses, even if the agreements with the providers were actually licenses. However, for existing recording agreements, UMG came up with a new royalty structure for permanent downloads and mastertones, and offered to amend those existing recording agreements accordingly. Neither Eminem nor F.B.T. agreed to such an amendment.[14]

In 2003, Eminem and Aftermath entered into a new recording agreement that terminated the 1998 agreement. Although the 2003 agreement increased certain royalty rates and made a number of other changes (including a sizable advance[15]), it incorporated the wording of the *Records Sold* and *Masters Licensed* provisions from the earlier agreement (without the express digital royalty structure).[16]

However, in 2004, the agreement was amended specifically to address permanent downloads, as follows: "Sales of Albums by way of permanent download shall be treated as [U.S. Normal Retail Channel] Net Sales for the purposes of escalations" (increases in royalty rates when the artist exceeds certain album target sales). There were no other modifications to the 2003 agreement.[17]

In 2006, F.B.T. and Eminem conducted a royalty audit and discovered, among other deficiencies, that Aftermath had been paying F.B.T. for permanent downloads and mastertones in accordance with the *Records Sold* provision in the agreement

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(12–20 percent). F.B.T. and Eminem believed that they should have been paid in accordance with the *Masters Licensed* provision. F.B.T. commenced litigation against Aftermath and its distributors shortly thereafter.[18]

During the litigation, all parties agreed that, traditionally, the only transactions that had triggered the *Masters Licensed* provision were with third parties that were using Eminem master recordings in those third parties' products; in other words, Eminem masters that were used in a third party's soundtrack or on a compilation album that included other artists' master recordings.[19] However, F.B.T. insisted that the provision was not limited to these pre-download uses.

F.B.T. therefore filed a motion for summary judgment to establish that the *Masters Licensed* provision was unambiguous and that permanent downloads and mastertones were subject to that provision, as a matter of law. Aftermath filed a cross-motion, arguing that the 2004 amendment made it clear that the parties intended that permanent downloads and mastertones were subject to the *Records Sold* provision.[20]

In order to determine whether or not the recording agreements were ambiguous, the district court provisionally reviewed the undisputed extrinsic evidence that was offered by both parties and concluded that both parties' interpretations were reasonable.[21] The court determined that summary judgment was only appropriate if the agreements were unambiguous, and that, because the agreements were "reasonably susceptible to more than one interpretation, they were not unambiguous." The court therefore denied both motions.[22]

In its ruling, the district court noted that there was evidence that would support a finding that at least some of the agreements between the defendants and the third-party permanent download providers were licenses. However, the court declined to rule as a matter of law that the agreements before it were in fact licenses.[23]

The case ultimately went to trial, which commenced on February 20, 2009. Evidence was presented by both sides of the parties' supposed intentions in connection with the negotiation of the *Records Sold* and the *Masters Licensed* provisions. After the close of evidence, Aftermath moved for judgment as a matter of law, which motion was denied by the court.[24]

The jury found in favor of Aftermath on Count I (breach of contract) and in favor of F.B.T. on Count II (misallocation of expenses between F.B.T. and Eminem). Thereafter, the district court found in favor of Aftermath on Count III (declaratory relief on download issue) and entered final judgment on all three counts.[25] The court then awarded Aftermath attorney fees in excess of $2.4 million, notwithstanding that F.B.T. prevailed on the second count.[26]

The Ninth Circuit started by noting that it could review the denial of F.B.T.'s motion for summary judgment notwithstanding the subsequent jury trial, particularly when the lower court's ruling determined that an agreement was ambiguous. The court then reviewed California law, observing that, in California, "the language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity." Parol evidence is only considered when a contract is ambiguous.[27]

The court held first that the district court erred in determining that the recording agreement was ambiguous. Aftermath had argued on summary judgment that the *Records Sold* provision applied because permanent downloads and mastertones are "records" and that digital music providers are "normal retail channels" in the United States. However, the agreement provided that "notwithstanding" the *Records Sold* provision, F.B.T. was to receive a 50 percent royalty on "masters licensed by [Aftermath] . . . to others for their manufacture and sale of records for any other uses."[28]

The court noted that the parties' use of the word "notwithstanding" after the *Records Sold* provision "plainly indicates that even if a transaction arguably falls within the scope of the *Records Sold* provision, F.B.T. is to receive a 50 percent royalty if Aftermath licenses an Eminem master to a third party for 'any' use." The court then stated that, although the *Masters Licensed* provision is broad (because it applies to masters that are licensed to third parties for the manufacture of records "or for any other uses"), its breadth does not make it unclear or ambiguous.

The next step for the court in determining whether the *Masters Licensed* provision applied was to determine whether Aftermath licensed Eminem masters to third parties. Aftermath argued that the word "licensed" was never used "in a technical sense," and that, therefore, the ordinary sense of the word must control, which, according to Webster's, is simply "permission to act." The court ruled that, because Aftermath entered into agreements that permitted iTunes and others to "use its sound recordings to produce and sell permanent downloads and mastertones," the agreements therefore qualified as licenses.

The court went on to discuss various provisions of the Copyright Act and the Supreme Court's interpretations that illuminate the differences between a "sale" and a "license," which seem to focus on the temporary nature of a license, with title to the work remaining with the copyright owner. In fact, the court indicated that there is no question that, when a copyright owner transfers a copy of a work, retains title to that work, limits the copy's use, and is compensated periodically based on the transferee's exploitation, that transaction is a license.[29]

The court noted that, pursuant to the recording agreements, Aftermath owned the copyrights to the masters at issue in the case, and it did not "sell" anything to the download distributors, let alone title to the digital files, which remained with Aftermath. Aftermath reserved the right to regain possession of the files at any time and was paid based on the volume of downloads. The distributors were given permission to use the masters for specific purposes (to create and distribute permanent downloads and mastertones) in exchange for periodic payments based on the volume of downloads, without any transfer of title. Thus, according to the court, federal copyright law supports its conclusion that those transactions constitute licenses.[30]

Aftermath argued that the 2004 amendment clarified that the *Records Sold* provision sets a royalty rate for permanent downloads. However, the amendment states that albums sold as permanent downloads are to be counted "for purposes of escalations" under the *Records Sold* provision, and that "[e]xcept as modified herein, the Agreement shall be unaffected and remain in full force and effect."[31]

The court ruled that this provision merely means that the amount of permanent downloads sold is included in total sales of albums for purposes of determining the escalated royalty rate for nondigital albums sold. In other words, if there was an escalation of royalty rate from 16 to 18 percent when a million albums are sold, permanent downloads would be counted to get to that million. The provision, according to the court, does not state or even

imply that the royalty rate for permanent downloads by third parties is determined by the *Records Sold* provision.[32]

Aftermath's expert witness testified that the *Masters Licensed* provision previously had been applied "only to compilation records and incorporation into movies, TV shows, and commercials." However, the court ruled that this evidence was immaterial because permanent downloads and mastertones only came into existence from 2001 to 2003. As a result, "previous" application did not matter, particularly because the agreement contemplated advances in technology, providing that Aftermath had the right to exploit the "masters in any and all forms of media now known and hereinafter developed."[33]

Aftermath's final argument was that, by the time F.B.T. renewed its agreement with Aftermath, permanent downloads and mastertones were already in existence, and F.B.T. never objected to the payment of royalties under the *Records Sold* provision until 2006, when F.B.T.'s auditor raised the issue.[34]

However, the court found that there was no evidence that F.B.T. knowingly acquiesced to the payment under that provision. Although F.B.T. had received statements that included royalties for permanent downloads and mastertones, it did not audit these statements until 2006, immediately after which F.B.T. raised the issue with Aftermath. Because F.B.T. had no obligation to audit the statements any earlier than it did, the court would not construe F.B.T.'s lack of objection prior to 2006 as acquiescence. The court then found that "the undisputed extrinsic evidence provisionally reviewed by the district court therefore did not support Aftermath's interpretation that the Records Sold provision applies."[35]

The court therefore ruled that "the agreements unambiguously provide that 'notwithstanding'" the *Records Sold* provision, Aftermath owed F.B.T. a 50 percent royalty under the *Masters Licensed* provision for licensing the Eminem masters to third parties for any use. The court found that, because the agreements were unambiguous and were not susceptible to Aftermath's interpretation, the district court improperly denied F.B.T.'s summary judgment motion. The court reversed the judgment and the attorney fees award in favor of Aftermath and remanded the case to the district court.[36]

Aftermath has filed a Petition for Certiorari with the U.S. Supreme Court. It is difficult to predict whether the Supreme Court will grant the petition. Aftermath will have to argue that the case is of first impression and that the decision will affect other parties. At the same time, it (and other labels) will necessarily argue that this decision only applies to this particular case and these particular recording agreements.

However, this decision does not simply apply to these parties and to these agreements because many agreements by many artists with many labels have very similar if not identical language. The decision potentially applies to just about every label and just about every artist who has not let the statute of limitations run or who does not have an incontestability issue (unless, of course, he or she has already negotiated a side deal with his or her label for how to treat permanent downloads). Although this decision will not affect every artist, it is certainly much more far-reaching than just Eminem. ❖

Edwin F. McPherson is a partner at McPherson Rane LLP, a Century City–based entertainment litigation firm that specializes in the representation of recording artists.

ENDNOTES

1. Interview with Peter Paterno, Partner, King, Holmes, Paterno & Berliner.
2. 621 F.3d 958 (9th Cir. 2010). The full name of the case is *F.B.T. Productions, LLC; Em2M, LLC v. Aftermath Records, dba Aftermath Entertainment; Interscope Records; UMG Recording, Inc.; Ary, Inc.* Aftermath Records is a joint venture co-owned by UMG Recordings, Inc., Interscope Records, and ARY, Inc. (which is owned by Andre Young p/k/a Dr. Dre). UMG is an indirect subsidiary of Vivendi S.A., which is a publicly traded corporation. Interscope Records is an unincorporated division of UMG. Em2M, LLC is a limited liability corporation owned by Joel Martin.
3. Answering Brief at 16, F.B.T. Prods. v. Aftermath Records, 621 F.3d 958 (9th Cir. 2010) (Nos. 09-55817, 09-56069).
4. Opening Brief at 8, F.B.T. Prods. v. Aftermath Records, 621 F.3d 958 (9th Cir. 2010) (Nos. 09-55817, 09-56069).
5. Answering Brief, *supra* note 3, at 16.
6. Opening Brief, *supra* note 4, at 10. According to F.B.T., the form agreement used had only "very slight (and not pertinent) modifications from standard recording agreements used throughout the industry," and the distinction between Records Sold and Masters Licensed, along with the absence of any provision expressly dealing with digital downloads, were "common to recording agreements at the time." *Id.* at 11, n.5.
7. Answering Brief, *supra* note 3, at 18.
8. F.B.T. Prods. v. Aftermath Records, 621 F.3d 958, 961 (9th Cir. 2010).
9. Answering Brief, *supra* note 3, at 17.
10. *F.B.T. Prods.*, 621 F.3d at 961–62.
11. Answering Brief, *supra* note 3, at 17.
12. Opening Brief, *supra* note 4, at 11.
13. *F.B.T. Prods.*, 621 F.3d at 962.
14. Opening Brief, *supra* note 4, at 15.
15. Answering Brief, *supra* note 3, at 18.
16. Opening Brief, *supra* note 4, at 11.
17. *F.B.T. Prods.*, 621 F.3d at 962.
18. *Id.*
19. Answering Brief, *supra* note 3, at 4.
20. *F.B.T. Prods.*, 621 F.3d at 962.
21. *Id.*
22. Opening Brief, *supra* note 4, at 18.
23. *Id.* at 18.
24. *F.B.T. Prods.*, 621 F.3d at 962.
25. Opening Brief, *supra* note 4.
26. *F.B.T. Prods.*, 621 F.3d at 962. Aftermath's primary focus on appeal was a procedural issue, which was ultimately rejected by the court. Aftermath argued that, because F.B.T. did not, as Aftermath did, make a motion for judgment as a matter of law ("JMOL") at the conclusion of the evidence, F.B.T. could not then argue that the jury's verdict should be disregarded and all evidence reviewed de novo. F.B.T. argued, and the court was persuaded, that because the issue was a pure legal one, and never should have gone to the jury, the court could review the case de novo. In fact, F.B.T.'s appellate counsel argued that F.B.T. was essentially appealing the denial of its summary judgment motion, which is always reviewed de novo. F.B.T. did file a Rule 59 motion for new trial, on the ground that the jury's decision was against the weight of the evidence. However, that motion was denied by the district court, and, in order to overturn that decision, F.B.T. would have to have demonstrated that there is an "absolute absence of evidence" to support the jury's verdict. Answering Brief, *supra* note 3, at 5 (citing Merrick v. Paul Revere Ins. Co., 500 F.3d 1007, 1013 (9th Cir. 2007)).
27. *F.B.T. Prods.*, 621 F.3d at 963 (citing Cal. Civ. Code § 1638).
28. *Id.* at 964.
29. *Id.* at 965 (citing Wall Data 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)).
30. *Id.* at 965.
31. *Id.* at 966.
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.*
36. *Id.* at 967.

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