

BUSINESS

Where The Money Goes *A Breakdown Of The \$9.99 Digital Album*

by Pat Leyland

About 10 years ago in this column, entertainment lawyer Chris Taylor provided an approximate breakdown of the \$19.95 retail price of an average CD as follows:

Manufacturing	\$1.00	(5%)
Retailer	\$5.95	(29.8%)
Distributor	\$4.39	(22%)
Songwriters	\$0.69	(3.5%)
Artist	\$1.31	(6.6%)
Producer	\$0.44	(2.2%)
Record Label	\$6.17	(30.9%)
Total:	\$19.95	(100%)

Since 1998, the recording industry has been dramatically propelled by the original Napster and its P2P progeny into a new age marked by unprecedented levels of piracy and the challenge of establishing and developing a legitimate digital market for sound recordings. Let's take a general look at "where the money goes" today by breaking down the \$9.99 retail price of the average digital album sold through Apple's iTunes Music Store.

Retailer

In April 2008, the iTunes Music Store became the number one music retailer in the world. While the bulk of iTunes sales are in the form of \$0.99 individual track downloads, sales of digital albums are accounting for a growing portion of overall album sales in Canada.

So how much does iTunes make from the sale of a digital album priced at \$9.99? Roughly 30 per cent of the gross revenue: \$7.00 from each digital album sale is paid to the record company, with the remaining \$2.99 pocketed by iTunes. This amount offsets various expenses incurred by Apple, such as technology costs, credit card transaction fees, and, of course, advertising.

Distributor

Digital distributors fulfill a valuable function as an intermediary between online retailers and record companies. By way of compensation, distributors generally receive a fee in the range of 15-20 per cent. While some distributors offer a lower percentage, one should be cautious of additional fees that may be charged.

Choosing a mid-range fee of 17.5% for this example, the \$7.00 netted by the record company on a \$9.99 digital album sale results in a payment of \$1.22 to the distributor. The revenue is applied against expenses such as the cost of encoding and delivering music and related

metadata to online retailers, though the costs of digital distribution generally pale in comparison to the costs associated with physical distribution, such as manufacturing, warehousing, and shipping CDs.

Songwriters

The songwriters on an album are paid a mechanical royalty for each copy of the song sold or distributed. In Canada, mechanical royalties are generally paid at the industry standard rate of \$0.081 cents (where the song is five minutes or less), as negotiated between the Canadian Musical Reproduction Rights Agency on behalf of music publishers and the Canadian Recording Industry Association on behalf of record companies. In the case of permanent downloads, however, the mechanical royalty is set by a tariff requiring online music services to generally pay songwriters 7.9 per cent of the amount paid by a consumer for the download. On the sale of a digital album priced at \$9.99, a sum of \$0.79 cents would therefore be divided between the related songwriters.

Artist

Broadly speaking, a record company pays an artist a percentage of the revenue generated from the exploitation of the artist's sound recordings. In 1998 Taylor noted that an artist's royalty rate is usually subject to many contractual deductions and reductions, which have the effect of diminishing payments to the artist. He noted that an artist royalty of 12-14 per cent applied to the sale of a \$19.95 CD would likely result in a so-called "penny rate" of \$1.31, rather than the \$2.39 to \$2.79 one might expect based on the simple application of the royalty to the base price.

Sensibly, there has been a movement in recent years towards simpler and more transparent royalty provisions. While certain of the deductions and reductions applied to CD sales do not (or at least should not) apply to digital album sales (e.g., packaging deductions), others, such as amounts owing to producers, are subtracted from the artist's share. Assuming an average artist wholesale royalty rate of 17.5 per cent (including 3.5 per cent to be allocated to the producer of the recordings), a \$9.99 digital album sale might be expected to yield a payment to the artist in the amount of \$0.98, calculated as follows: \$7.00 (net wholesale price received by the record company) x 14 per cent (artist royalty less producer royalty) = \$0.98.



Producer

The producer of the \$9.99 digital album in this example is provided with a royalty of 3.5 per cent, which has the effect of reducing the artist's 17.5 per cent royalty to 14 per cent. A producer's royalty is customarily calculated and paid in the same manner as the artist's royalty. In this illustration, the sale of a \$9.99 digital album would therefore result in a payment to the producer in the amount of \$0.24.

Record Company

The record company will receive the \$3.77 remaining after the payments to the retailer, distributor, songwriters, artist, and producer. The record company will claim that its relatively large piece of the pie is reasonable based on the speculative nature of its business activity and the increased risk the company bears given the state of the industry. It also covers general operating expenses (which does not include as many sushi lunches these days).

Conclusion

In summary, the \$9.99 from the digital album sale breaks down as follows:

Retailer	\$2.99	(30%)
Distributor	\$1.22	(12.2%)
Songwriters	\$0.79	(7.9%)
Artist	\$0.98	(9.8%)
Producer	\$0.24	(2.4%)
Record Label	\$3.77	(37.7%)
Total:	\$9.99	(100%)

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