Record Labels Shot the Artists, But They Did Not Share the Equity

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Abstract

Spotify is planning an initial public offering. The three largest record labels in America own equity in Spotify. Recording artists are not being fairly compensated by the streaming service. The lack of fair compensation is likely caused by the record labels' partial ownership of Spotify. The relationship between recording artists and their record labels has changed in the digital era. This Note argues that the new relationship between artist and record label should be considered a partnership. Recognizing the artist–label relationship as a partnership gives rise to fiduciary duties. The recognition of a fiduciary duty would obligate record labels to pay artists a share of the profits from the sale of equity in Spotify's upcoming IPO.

Table of Contents

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INTRODUCTION

On March 17, 2017, Spotify announced that it had reached a deal with Universal Music Group, the largest record label in America.[1] The deal renews Spotify's licenses to stream sound recordings on demand, allowing Spotify to continue operating its enormous music library.[2] The deal also lowers the royalty rate to be paid per stream.[3] Royalty payments are how artists receive income from the interactive streaming of their recordings.[4] Further, the deal makes some sound recordings exclusive to Spotify Premium users and unavailable to users of the free service for certain periods of time.[5] The lower royalty rate decreases Spotify's operating costs, and the exclusive content increases its revenue by encouraging users to pay the subscription fee to join Spotify Premium.[6] Spotify has reached a similar deal with Sony Music Entertainment[7] and will soon reach a new agreement with Warner Music Group.[8]

1. Alex Hern, *Spotify to Host Top Stars' Albums for Premium Subscribers Only*, GUARDIAN (Apr. 4, 2017), https://www.theguardian.com/technology/2017/apr/04/spotify-universal-albums-premium-subscribers-only [https://perma.cc/UT4V-QEGN].
2. Nick Statt & Micah Singleton, *Spotify Will Restrict Some Albums to Its Paid Tier*, MSN (Mar. 16, 2017), http://www.msn.com/en-us/news/technology/spotify-will-restrict-some-albums-to-its-paid-tier/ar-BByeAhj?li=AA4Zoy&ocid=spartandhp [https://perma.cc/T8YE-2BCJ].
3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.*
7. Elias Leight, *Spotify Reaches Deal over Royalties with Sony Music*, ROLLING STONE (July 11, 2017), http://www.rollingstone.com/music/news/spotify-reaches-deal-over-royalties-with-sony-music-w491703 [https://perma.cc/7W7N-6B3W].
8. Sophie Sassard, *Exclusive: Spotify, Warner Hope to Clinch Royalty Deal by September*, REUTERS (July 24, 2017), https://www.reuters.com/article/us-spotify-warner-music/exclusive-spotify-warner-hope-to-clinch-royalty-deal-by-september-sources-idUSKBN1A91BL [https://perma.cc/VMP4-V7NF].

This is an elaborate deal that will increase Spotify's profitability, making it all the more attractive for an upcoming initial public offering (IPO).[9] The reason the three major record labels negotiated this deal—in which they will receive lower royalty payment—is likely because they own a significant portion of Spotify stock and stand to profit tremendously from the IPO.[10] The artists who created the music, however, will receive reduced benefits because their royalty rates are lower and their music is now being limited in its public dissemination. The artists entered into recording contracts on the assumption that the record labels had a common interest in obtaining the highest royalty rate and promoting the artists to the widest possible audience. Under the current law and absent specific contractual provisions, the recording artists have no legal recourse against the record labels and no legal right to the profit from equity obtained by leveraging their songs.

Part I of this paper will introduce the public performance right for sound recordings in interactive digital media, the basics of the music industry, and the success of Spotify as an interactive digital streaming platform. Part II will explain the current situation, including the advent of 360 record deals, the record labels' acquisition of Spotify stock, and the widespread belief that recording artists are not being fairly compensated. Part III will propose a potential solution by looking at three methods that an artist can use to establish a legal right to the profit from a record label's ownership of Spotify equity: good faith and fair dealing, fiduciary duty by special circumstance, and fiduciary duty by partnership. Part IV will then address the repercussions of recognizing a fiduciary duty, including the advantages and counterarguments, how to limit the fiduciary duty, and how to calculate the payout of the equity profit.

This paper concludes that the law should recognize that the artist–label relationship is a partnership triggering a limited fiduciary duty. This fiduciary duty should be limited to situations in which the label uses an artist's work to benefit the label in a way that decreases the benefit conferred upon the artist.

I. BACKGROUND

A complicated history led to the "Big Three" American record labels—Universal Music Group, Warner Music Group, and Sony Music—benefitting themselves at the expense of the artists they agreed to promote. Granting licenses to stream music on demand in exchange for equity in a company is a novel concept. To understand how it is possible, this paper will summarize: (A) the public performance right for sound recordings, (B) the basics of the music industry, and (C) the rise of Spotify.

9. *Id.*
10. *Id.*

A. *The Public Performance Right for Sound Recordings*

Sound recordings were not given federal copyright protection until 1972.[11] Sound recordings should not be confused with musical works, which constitute a separate copyrighted work.[12] A sound recording is the recorded sound, whereas a musical work is the authorship of a song.[13] Under the Copyright Act of 1976, sound recordings were not given the same scope of exclusive rights and protections as musical works.[14] Sound recordings were protected from reproduction and distribution of the copyrighted work, such as selling pirated CDs.[15] Congress initially rejected granting a public performance[16] right to sound recordings on the grounds that, among other things, enforcing the right would be too difficult and the publicity from unrestricted airplay actually benefitted the rights holders.[17]

In 1995, the Copyright Act was amended in anticipation of the impending digital revolution and its potential effect on album sales.[18] Congress passed the Digital Performance Right in Sound Recordings Act of 1995, giving sound recordings a limited public performance right in digital media.[19] The Digital Performance Right in Sound Recordings Act separated interactive digital services from non-interactive digital services.[20] In 1998, Congress passed the Digital Millennium Copyright Act, amending the scope of the public performance right to include sound recordings in certain digital media.[21] Despite these new provisions, digital music piracy has continued to plague the music industry

11. Act of Oct. 15, 1971, Pub. L. No. 92-140, 85 Stat. 391 (1971); Stasha Loeza, *Out of Tune: How Public Performance Rights Are Failing to Hit the Right Notes*, 31 BERKELEY TECH. L.J. 725, 735 (2016). The sound recordings were protected by state laws. Loeza, *supra*, at 735 n.96.

12. *See* JULIE E. COHEN ET AL., COPYRIGHT IN A GLOBAL INFORMATION ECONOMY 410 (4th ed. 2015).

13. Stephen E. Demos, *The Fair Pay Fair Play Act of 2015: Does Congress Spot-Ify a Solution for the Music Market?*, 12 J. BUS. & TECH. L. 73, 79 (2016). For example, Jimi Hendrix originally owned the sound recording copyright to "All Along the Watchtower," but Bob Dylan owned the musical works copyright. Justin Jacobson, *Breaking Down Copyrights in Music*, TUNECORE (Dec. 8, 2016), http://www.tunecore.com/blog/2016/12/breaking-copyrights-music.html [https://perma.cc/6VG7-BXVA].

14. Loeza, *supra* note 11, at 735.

15. Demos, *supra* note 13, at 78.

16. 17 U.S.C. § 101 (2010) ("To perform or display a work 'publicly' means—(1) to perform or display it at a place open to the public or at any place where a substantial number of persons outside of a normal circle of a family and its social acquaintances is gathered; or (2) to transmit or otherwise communicate a performance or display of the work to a place specified by clause (1) or to the public, by means of any device or process, whether the members of the public capable of receiving the performance or display receive it in the same place or in separate places and at the same time or at different times."). For example, playing a song on the radio would be a public performance. Jeffrey S. Becker et. al., *The Fair Play, Fair Pay Act of 2015: What's at Stake and for Whom?*, 32 ENT. & SPORTS LAW. 5, 5–6 (2015).

17. Loeza, *supra* note 11, at 735 (citing *Arista Records, LLC v. Launch Media, Inc.*, 578 F.3d 148, 152 (2d Cir. 2009)).

18. *Id*. at 737.

19. *Id*. at 737; *see* Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat 336.

20. Loeza, *supra* note 11, at 737; *see also* 17 U.S.C. § 114(j)(7).

21. Loeza, *supra* note 11, at 739; *see also* Digital Millennium Copyright Act, Pub. L. No. 105-304, 112 Stat 2860 § 405 (1998).

since the mid-1990s.[22]

Under the current law, there are three tiers of digital transmissions. The first tier, non-interactive non-subscription broadcast transmissions, is exempt from the public performance right, so the broadcasters do not owe a copyright owner any royalty as long as the broadcaster is offering a free, over-the-air digital broadcast by FCC licensed broadcasters.[23] The second tier, non-interactive digital streaming services, has a statutory license scheme and establishes the Copyright Royalty Board that is empowered to set the royalty rate, although the parties are free to negotiate a different rate.[24] Pandora is an example of a non-interactive digital streaming service.[25] The third tier, "interactive services,"[26] provides an exclusive right to public performance of a sound recording, and the only way to obtain a license for this use is through a freely negotiated agreement between the digital streaming service and the copyright owner.[27] Copyright holders are given special protection from interactive digital streaming services because the services are considered a substitute for album sales.[28]

B. The Basics of the Music Industry

There are now three major American record labels: Universal Music Group, Warner Music Group, and Sony Music Entertainment.[29] Together they made up 62.4% of global music revenue in 2016.[30] Many musicians dream of being

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22. Loeza, *supra* note 11, at 736 (citing Peter S. Menell, *This American Copyright Life: Reflections on Re-Equilibrating Copyright for the Internet Age*, 61 J. COPYRIGHT SOC'Y U.S.A. 235, 252–54 (2013-2014)).

23. 17 U.S.C. § 114(d)(1) (2010); COHEN ET AL., *supra* note 12, at 432.

24. 17 U.S.C. § 114(d)(2) (2010); This payment goes to Soundexchange who then divvies up the payment with 45% of the royalty going to the featured artist, 50% going to the copyright owner, and 5% to a fund for session musicians, non-featured artists, and background singers. COHEN ET AL., *supra* note 12, at 435.

25. In re Pandora Media, Inc., 6 F. Supp. 3d 317, 332 (S.D.N.Y. 2014), *aff'd sub nom.* Pandora Media, Inc. v. Am. Soc. of Composers, Authors & Publishers, 785 F.3d 73 (2d Cir. 2015).

26. An "interactive service" is one that enables a member of the public to receive a transmission of a program specially created for the recipient, or on request, a transmission of a particular sound recording, whether or not as part of a program, which is selected by or on behalf of the recipient. The ability of individuals to request that particular sound recordings be performed for reception by the public at large, or in the case of a subscription service, by all subscribers of the service, does not make a service interactive, if the programming on each channel of the service does not substantially consist of sound recordings that are performed within one hour of the request or at a time designated by either the transmitting entity or the individual making such request. If an entity offers both interactive and non-interactive services (either concurrently or at different times), the non-interactive component shall not be treated as part of an interactive service. 17 U.S.C. § 114(j)(7) (2010).

27. 17 U.S.C. § 114(d)(3) (2010); COHEN ET AL., *supra* note 12, at 432.

28. COHEN ET AL., *supra* note 12, at 432.

29. Paul Resnikoff, *Two-Thirds of All Music Sold Comes from Just 3 Companies*, DIGITAL MUSIC NEWS (Aug. 3, 2016), http://www.digitalmusicnews.com/2016/08/03/two-thirds-music-sales-come-three-major-labels/ [https://perma.cc/YNN3-6KKN].

30. *Id*.

offered a record contract from a major label.[31] Being signed to a major label increases an artist's chance of success due to increased prestige, exposure, and financial support.[32]

Under a traditional recording contract, the record label pays for the recording and promotion process.[33] Once there is a record contract, the record label will either be the sole owner, co-owner, or licensee of the copyrighted sound recording, depending on the contract's terms.[34] The record label will then have the authority to license the sound recording for profit.[35] This authority includes the right to distribute both physical and digital albums.[36] Upon signing a recording contract, the label pays the artist an advance payment against future royalties, which can be used for recording expenses, such as fees to producers and arrangers, studio and equipment rentals, and living expenses.[37] Recording an album costs about $150,000 to $500,000.[38] The record company then retains the royalties from the album sales to recoup its upfront payments to the artist.[39] When combined with promotional and other costs, these contracts are often a money-losing endeavor for record labels.[40] Occasionally an artist becomes popular enough to pay for the financial losses of all the other artists.[41] Even those artists that become popular enough to generate a profit for the record labels often remain indebted to the record company and rarely receive any royalty payment.[42]

C. The Rise of Spotify

Spotify is an on-demand digital streaming service founded in 2006 by CEO Daniel Ek and Martin Lorentzon.[43] Spotify launched in the European Union in 2008 and in the United States in 2011.[44] Spotify then partnered with Facebook,

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31. *How Record Labels Invest*, INTERNATIONAL FEDERATION OF THE PHONOGRAPHIC INDUSTRY, http://www.ifpi.org/how-record-labels-invest.php [https://perma.cc/LF6Z-PM4Y].

32. *Id.*

33. *See* DONALD S. PASSMAN, ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS 68 (7th ed. 2009).

34. *See* Estate of Brown v. Arc Music Grp., 830 F. Supp. 2d 501, 513 (N.D. Ill. 2011).

35. *See* E. Jordan Teague, *Saving the Spotify Revolution: Recalibrating the Power Imbalance in Digital Copyright*, 4 CASE W. RESERVE J.L. TECH. & INTERNET 207, 218 (2012).

36. *See* Molly Hogan, *The Upstream Effects of the Streaming Revolution: A Look into the Law and Economics of a Spotify-Dominated Music Industry*, 14 COLO. TECH. L.J. 131, 145 (2015).

37. Douglas Okorocha, *A Full 360: How the 360 Deal Challenges the Historical Resistance to Establishing a Fiduciary Duty Between Artist and Label*, 18 UCLA ENT. L. REV. 1, 12 (2011).

38. *How Record Labels Invest*, *supra* note 31.

39. *Id.*

40. *Id.*

41. *Id*.

42. *Id.*

43. The Spotify Team, *We've Only Just Begun!*, SPOTIFY (Oct. 10, 2008), https://news.spotify.com/us/2008/10/07/weve-only-just-begun/ [https://perma.cc/57VK-5DGL]; Burt Helm, *Inside Spotify's U.S. Invasion*, INC. (July 2, 2012), https://www.inc.com/30under30/burt-helm/daniel-ek-founder-of-spotify.html [https://perma.cc/2LPM-G3WM].

44. Helm, *supra* note 43. Spotify was significantly easier to launch in the EU than in the US because of the differences in copyright law. *See* John Seabrook, *Revenue Streams: Is Spotify the Music*

increasing the social aspect of the music streaming experience.[45] Among other successful ventures, Ek had previously served as the CEO of μTorrent, a major peer-to-peer file-sharing program often used for internet piracy..[46] His goal in founding Spotify was to turn Napster into a viable business.[47] Ek believed that piracy could be beaten because it has significant downsides—including potential for viruses, slow downloading, and lack of user friendliness in piracy services—and because people just do not like being pirates.[48]

Spotify exploded onto the U.S. market with the help of Napster-founder Sean Parker and Facebook-founder Mark Zuckerberg.[49] By 2014, Spotify had over ten million paying subscribers and over forty million active users.[50] By mid-2017, the number of paid subscribers was over sixty million and the number of active users was over 140 million.[51]

Spotify uses a "freemium" business model with two tiers of users: one tier that allows free use of the product with ads, and another tier that provides access to an ad-free service with a paid subscription.[52] Spotify has two primary sources of revenue: advertising and subscriptions.[53] The goal is often to bring in users with the free mode, then push them into becoming a premium member with additional features.[54] Spotify Premium, unlike free Spotify, allows users to select individual songs and can be used offline.[55]

II. THE SITUATION: SELF-DEALING RECORD LABELS

Technology caused the recording industry to form the way it did, with radio play promoting album sales.[56] When the technology changed, the industry

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Industry's Friend or Foe?, NEW YORKER (Nov. 24, 2014), http://www.newyorker.com/magazine/2014/11/24/revenue-streams [https://perma.cc/WPE4-8JN2].

45. Candice Katz, *Share the Music*, SPOTIFY (Aug. 8, 2011), https://news.spotify.com/us/2011/08/08/share-the-music/ [https://perma.cc/9BRD-X3RE].

46. Seabrook, *supra* note 44.

47. *Id*.

48. *Id*. The rise of Spotify has led to a significant decline in digital music piracy. *See* James Titcomb, *Internet Piracy Falls to Record Lows Amid Rise of Spotify and Netflix*, TELEGRAPH (July 5, 2016), http://www.telegraph.co.uk/technology/2016/07/04/internet-piracy-falls-to-record-lows-amid-rise-of-spotify-and-ne/ [https://perma.cc/W489-H5V6].

49. Seabrook, *supra* note 44.

50. *Spotify Hits 10 Million Global Subscribers*, SPOTIFY (May 21, 2014), https://press.spotify.com/us/2014/05/21/spotify-hits-10-million-global-subscribers/ [https://perma.cc/5Q8L-DEUJ].

51. *About Spotify*, SPOTIFY, https://press.spotify.com/us/about/ [https://perma.cc/XHX9-646F] (last visited Nov. 26, 2017).

52. *Go Premium. Be Happy*, SPOTIFY, https://www.spotify.com/us/premium/?checkout=false [https://perma.cc/JV6V-CARQ] (last visited Nov. 26, 2017).

53. *See* Teague, *supra* note 35, at 222.

54. *Id.* at 214.

55. *Go Premium. Be Happy*, SPOTIFY, https://www.spotify.com/us/premium/?checkout=false, (last visited May 14, 2017). Prices range from $ 4.99 per month for students and $ 9.99 per month standard. *Id.*

56. Christopher Knab, *How Record Labels and Radio Stations Work Together*, MUSIC BIZ ACAD. (Mar. 2010), http://www.musicbizacademy.com/knab/articles/radiostations.htm [https://perma.cc/EJ5Z-E5JG].

changed with it. The old industry involved record labels promoting artists' albums.[57] This was a limited relationship with aligned interests; both artist and label benefitted from selling the most albums at the highest price.[58] Now, record labels use 360 deals that involve the label in nearly all aspects of the recording artist's business, yet the label and artist interests are not fully aligned: record labels are profiting at the expense of the artists by offering reduced royalty rates to streaming services in exchange for equity in the streaming companies.[59] Courts have declined to rectify this situation because the parties' rights are governed by the label-artist contract, which gives the label the right to use its discretion in determining how to exploit the sound recordings.[60]

After the advent of the internet and the rise of internet piracy, record labels searched for new revenue sources.[61] This led to three major consequences in the current music industry: (A) the development of the 360 deal; (B) the acquisition of equity in Spotify; and (C) a widespread belief that artists are not being fairly compensated. The combination of these three factors suggests that a change in the legal relationship between artist and label would be justified because the label's role in the artist's business has increased yet the label is benefitting itself at the expense of the artist.

A. The Development of the 360 Deal

The internet changed the music industry.[62] Traditional recording agreements only gave labels the right to share in the income derived from the sale of an artist's recordings.[63] In the first decade of the twenty-first century, music sales were cut in half.[64] The decline in album sales forced labels to find other sources of income to remain viable.[65] "As the drop in album sales deepened, artists' ancillary ventures—such as publishing, touring, and merchandising—proved more valuable to the fiscally distressed labels than the decaying record-selling business."[66] Thus, the 360 deal was born.

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57. *See id.*

58. *See id*.

59. Zack O'Malley Greenburg & Nick Messitte, *Revenge of the Record Labels*, FORBES (Apr. 15, 2015), https://www.forbes.com/sites/zackomalleygreenburg/2015/04/15/revenge-of-the-record-labels-how-the-majors-renewed-their-grip-on-music/#7e6366312fba [https://perma.cc/CQY6-73TQ].

60. *See* 19 Recordings Ltd. v. Sony Music Entm't, 165 F. Supp. 3d 156, 164–65 (S.D.N.Y. 2016).

61. Loeza, *supra* note 11, at 736.

62. *See* Peter S. Menell, *This American Copyright Life: Reflections on Re-Equilibrating Copyright for the Internet Age*, 61 J. COPYRIGHT SOC'Y U.S.A. 201, 235, 237 (2014).

63. Okorocha, *supra* note 37, at 9.

64. David Goldman, *Music's Lost Decade: Sales Cut in Half*, CNN (Feb. 3, 2010), http://money.cnn.com/2010/02/02/news/companies/napster_music_industry/ [https://perma.cc/9HN4-VHA5]. (noting the music business was worth half of what it was ten years ago).

65. *See* Jeff Leeds, *The New Deal: Band as Brand*, N.Y. TIMES (Nov. 11, 2007), http://www.nytimes.com/2007/11/11/arts/music/11leed.html?pagewanted=1&_ r=1&emc=eta1 [https://perma.cc/5HD2-5DVS].

66. Okorocha, *supra* note 37, at 9.

A 360 deal, or a multiple rights agreement, grants labels a right to share in all the revenue generated by an artist, from merchandise and ticket sales to motion picture acting.[67] Most labels take between 10% and 35% of their artists' net income from these non-record sale sources.[68] The 360 deals have become standard in both major and independent labels.[69] As profits from the sale of recorded music dropped, labels conceived of a music industry driven by artist branding rather than music sales.[70]

The relationship between artists and labels changed in other ways too. As the brand of the artist became the valuable asset, artists gained more power over their own success.[71] Artists are now able to use social media to promote their brands,[72] diminishing the role of the record labels.[73] So, record labels are becoming less crucial to success, yet they are increasing their control over revenue sources.[74]

B. The Acquisition of Equity in Spotify

In their search for new revenue sources, record labels also sought to integrate vertically into music streaming services.[75] The three major music labels have acquired equity in several interactive streaming services, including Spotify, Rdio, and Soundcloud.[76]

The success of Spotify as a digital streaming platform comes largely from its successful negotiations in securing licenses for sound recordings.[77] Having a one-stop shop where users can listen to just about every song their hearts' desire is essential to maintaining a user base.[78] In Sweden and the European Union, where Spotify began, obtaining copyright licenses does not require the free market negotiation process that takes place in the United States.[79] Ek and the

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67. *Id.*

68. *Id.*

69. The CEO of Warner Music requires all new acts to sign 360 deals. *Id.* at 10.

70. *See* Cherie Hu, *The Record Labels of the Future are Already Here*, FORBES (Oct. 15, 2016), https://www.forbes.com/sites/cheriehu/2016/10/15/the-record-labels-of-the-future-are-already-here/#26079181872a [https://perma.cc/L52S-6VRG].

71. *See id.*

72. *Id.*

73. *See id.*

74. Chance the rapper recently became the first artist to win a Grammy without a record label. Jason Guerrasio, *A 23-Year-Old Rapper Who Has no Label Just Made History with His Grammy Win*, BUS. INSIDER (Feb. 12, 2017), http://www.businessinsider.com/chance-the-rapper-grammy-win-2017-2 [https://perma.cc/W47X-Q4RD].

75. Greenburg & Messitte, *supra* note 59.

76. *Id.*

77. *See* Seabrook, *supra* note 44.

78. *See* Ethan Wolff-Mann, *Which Music Streaming Service Is Best for You?*, MONEY (July 20, 2016), http://time.com/money/4391632/best-music-streaming-service-spotify-apple-tidal/ [https://perma.cc/42L5-SHRC].

79. *See* Richard Smirke, *Europe and Copyright: A Comprehensive Look at the Continent's Digital Plans*, BILLBOARD (Apr. 26, 2016), http://www.billboard.com/articles/business/7349853/digital-single-market-music-business-european-union [https://perma.cc/FC6H-R5H2].

Spotify team enlisted the help of Sean Parker to negotiate with the United States' major music labels for the rights to U.S. airplay.[80] Getting the major record labels to allow music to be streamed for free throughout the country, potentially cannibalizing record sales,[81] was no easy feat.

Labels received partial ownership in Spotify in exchange for licenses to their sound recordings.[82] The three major labels combined own an estimated 18% of Spotify stock.[83] Sony owns an estimated 6% of the equity, and Merlin, an aggregation of indie labels, owns about 1%.[84]

The transfer of this equity was negotiated as part of the same deal that granted Spotify a license to stream the music and set the royalty rates to be paid to artists.[85] This might be the reason royalty rates are as low as they are.[86] The record labels have the potential to receive income from Spotify in two ways, through the portion of the royalty that the labels share with the artists, and from the sale of equity.[87] It is likely that the record labels structured the deal with Spotify to receive equity in exchange for a lower royalty rate.[88]

Spotify has been flirting with going public through an initial public offering.[89] The most conservative estimates value the company, with its forty million paying subscribers, at $8 billion.[90] The most extreme evaluation, expecting to reach 100 million paying subscribers by 2020, values the company at $53 billion.[91] One investor has estimated that a more reasonable value would be $32 billion.[92]

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80. Ingrid Lunden, *Sean Parker Has Left Spotify's Board; Padmasree Warrior, Thomas Staggs Join in Lead up to IPO*, (June 22, 2017), https://techcrunch.com/2017/06/22/sean-parker-has-left-spotifys-board-padmasree-warrior-thomas-staggs-join-in-lead-up-to-ipo/ [https://perma.cc/4UP3-NU8Y].

81. *See* Ben Richmond, *Taylor Swift Versus Spotify: How the Music Industry Is Still Fighting Streaming*, (Nov. 3, 2014), https://motherboard.vice.com/en_us/article/nzeqvd/taylor-swift-shows-streaming-isnt-a-solution-to-the-music-industrys-woes [https://perma.cc/8BDT-3SKF].

82. Helienne Lindvall, *Behind the Music: The Real Reason Why the Major Labels Love Spotify*, GUARDIAN (Aug. 17, 2009), https://www.theguardian.com/music/musicblog/2009/aug/17/major-labels-spotify [https://perma.cc/H9NJ-2D5B].

83. *Id.*

84. *Id.*

85. Tim Ingham, *Warner Will Pay Artists Spotify IPO Money When It Sells Its Shares*, MUSIC BUS. WORLDWIDE (Feb. 4, 2016), http://www.musicbusinessworldwide.com/warner-will-pay-artists-spotify-ipo-money-when-streaming-service-floats/ [https://perma.cc/4Z4V-Y5ZT]. *See also* Josh Constine, *How Spotify Is Finally Gaining Leverage over Record Labels*, TECHCRUNCH (Mar. 18, 2017), https://techcrunch.com/2017/03/18/dictate-top-40/ [https://perma.cc/NKQ6-2E6W].

86. Seabrook, *supra* note 44 ("'You might want to take a discount in a business you have equity in,' one label head told me.").

87. Teague, *supra* note 35, at 220–21.

88. *Id.* at 221.

89. Robin Wauterd, *Spotify Could Reach 100 Million Users and a $53 Billion Valuation by 2020*, BUS. INSIDER (Sept. 16, 2016), http://www.businessinsider.com/spotify-could-reach-100-million-users-and-a-53-billion-valuation-by-2020-2016-9 [https://perma.cc/FQ5D-TBL9].

90. *Id.*

91. *Id.*

92. *Id.*

Given that record labels' acquisition of equity in Spotify in exchange for lower royalty rates reduces artist earnings from Spotify, it would make sense for the record companies to share any profits from the equity with the artists.[93] Stephen Cooper, the CEO of Warner Music Group, once said that "in the event we . . . receive cash proceeds from the sale of these equity stakes, we will share this revenue with artists."[94] Warner's shares in Spotify are estimated to be worth at least $200 million.[95] If the aforementioned investor's estimates are correct, Warner's profit from equity sales after an IPO would be worth $800 million.[96] Sony made a similar statement.[97] Universal has not made a statement on this matter.[98] Despite these messages about compensating artists, it is unclear how the compensation will take place.[99] Without a legal right to some portion, artists' compensation will be subject to the goodwill of the record labels.

C. Widespread Belief That Artists Are Not Being Fairly Compensated

The world took notice when Taylor Swift withdrew her music from Spotify because she believed she was not being fairly compensated.[100] Many other artists, including Gwen Stefani, Kanye West, and Radiohead, have since also withdrawn their music from Spotify due to perceived unfair compensation.[101]

93. Ingham, *supra* note 85.

94. *Id.*

95. *Id.*

96. *See* Wauterd, *supra* note 89.

97. Tim Ingham, *Sony: We Will Also Pay Artists Profits from the Sale of Our Spotify Stake*, MUSIC BUS. WORLDWIDE (Feb. 4, 2016), http://www.musicbusinessworldwide.com/sony-we-will-also-pay-artists-profits-from-the-sale-of-our-spotify-stake/ [https://perma.cc/EY82-TBLP] ("Net proceeds realized by Sony Music from the monetization of equity interests . . . will be shared with our artists on a basis consistent with our breakage policy.").

98. *Id.*

99. Chris Cooke & Andy Malt, *Free Money All Round, Say Warner and Sony on Spotify IPO Payouts*, COMPLETE MUSIC UPDATE (Feb. 5, 2016), http://www.completemusicupdate.com/article/free-money-all-round-say-warner-and-sony-on-spotify-ipo-payouts/ [https://perma.cc/ZG2H-DXLE]. The claims that Warner and Sony will pay artists portions of the equity sale proceeds is probably just a public-relations move, some of the big three are publicly traded and might not be able to follow through. *Id.*

100. Iris Lee, *Are Musicians Really Making Less Money Now?*, IMONEY.MY (Dec. 4, 2014), https://www.imoney.my/articles/are-musicians-really-making-less-money-now [https://perma.cc/T5UE-NN9J]; *see also* Lisa France, *Taylor Swift to Spotify: You Belong with Me*, CNN (June 9, 2017), http://money.cnn.com/2017/06/09/media/taylor-swift-streaming-spotify-tidal-amazon/index.html [https://perma.cc/55U9-SQC2] (Taylor Swift said, "I'm not willing to contribute my life's work to an experiment that I don't feel fairly compensates the writers, producers, artists and creators of this music.").

101. Victor Luckerson, *11 Wildly Popular Albums You Can't Get on Spotify*, TIME (Mar. 29, 2016), http://time.com/4274430/spotify-albums/ [https://perma.cc/EP3J-XG8A]. Many of these artists have since returned to Spotify. *See* France, *supra* note 100; Lucy Clarke-Billings, *Radiohead's Burn the Witch: Has Thom Yorke Made Up With Spotify?*, NEWSWEEK (May 4, 2016), http://www.newsweek.com/thom-yorke-launches-new-single-burn-witch-spotify-despite-criticism-455398 [https://perma.cc/M7BH-GCVE].

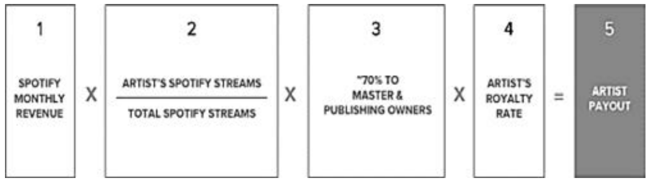

Figure 1[104]

Spotify's payout system is complicated and not publicly disclosed.[102] Spotify has reported a general payment scheme in which it takes its monthly revenue (from advertising and subscriptions) and multiplies it by the artist's total streams that month. Then it divides that number by the total number of Spotify streams. Then, 70% of the computed result goes to the master recording and publishing rights holders. After that, the portion gets multiplied by the artist's royalty rate in the record contract.[103]

Through this general model, Spotify claims to keep 30% of revenue and to pay out 70% to rights holders.[105] That 70% payout is being divided up between the publisher and songwriter as well as the record label and artist.[106] The amount that goes to record labels and is then shared with recording artists is only about 52%.[107] Spotify has claimed that it pays out \$0.006 to \$0.0084 per stream.[108] These estimates simplify a process in which the free tier is paid on a different rate than the subscription tier[109] and more popular artists are paid a different rate than less popular artists.[110] A signed artist earns closer to an estimated \$0.0011 per stream.[111] An independent artist with over a million

102. Teague, *supra* note 35, at 222.

103. Jack Linshi, *Here's Why Taylor Swift Pulled Her Music from Spotify*, TIME (Nov. 3, 2014), http://time.com/3554468/why-taylor-swift-spotify/ [https://perma.cc/FT86-E2A6]. This rate varies from contract to contract; for non-interactive streaming services, this number is set at about 50% to artists and 50% to record labels. *See* COHEN ET AL., *supra* note 12, at 435.

104. Linshi, *supra* note 103.

105. Mike King, *Spotify's D.A. Wallach Explains How Spotify Pays Artists*, HYPEBOT (Sept. 6, 2012), http://www.hypebot.com/hypebot/2012/09/spotifys-da-wallach-explains-how-spotify-pays-artists.html [https://perma.cc/TAN7-7NUZ]. D.A. Wallach is the artist in residence at Spotify and leads their artist outreach team. *Id.*

106. *Id.*

107. Leight, *supra* note 7.

108. Stuart Dredge, *How Much Do Musicians Really Make on Spotify, iTunes and YouTube?*, GUARDIAN (Apr. 3, 2015), https://www.theguardian.com/technology/2015/apr/03/how-much-musicians-make-spotify-itunes-youtube [https://perma.cc/MKG8-T9ZS].

109. Claire Zillman, *Here's How Much Artists Really Make on Spotify*, FORTUNE (June 4, 2015), http://fortune.com/2015/06/04/heres-how-much-artists-really-make-on-spotify/ [https://perma.cc/4C9K-24LS].

110. *See* Seabrook, *supra* note 44.

111. Dredge, *supra* note 108 (assuming under standard contract that artist only keeps about 20% of royalty).

streams claims the average payout is $0.004891 per stream.[112]

In 2013, the average top ten most streamed albums on Spotify earned $145,000 per month.[113] Spotify reported that it paid out two million dollars to Taylor Swift in the year leading up to her withdrawal from the service, yet her record label reported that she received only $496,044.[114]

The Spotify payout system should be compared to other revenue sources. For a $0.99 song sold on iTunes, an artist gets about $0.23, Apple keeps $0.30, and the record label gets about $0.47.[115] It has been argued that musicians were never making money from their recordings,[116] yet music sales generally make up about 10–20% of a musician's income.[117]

Once the three major record labels have agreed to a lower royalty rate, it depresses the market and forces other labels and independent artists to agree to lower rates.[118] For instance, if Drake and Nicki Minaj have already agreed to stream their songs at a certain rate, it makes it impossible for a less popular artist like Car Seat Headrest to argue that their songs are worth more per stream.[119]

In summary, the relationship between the artists and record labels fundamentally changed with the advent of 360 deals and the further integration of labels' and artists' businesses. The record labels have become partial owners of Spotify, functionally serving as both buyer and seller of sound recording copyrights. The growth of 360 deals and the acquisition of equity in streaming services have led

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112. Paul Resnikoff, *My Band Has 1,000,000 Spotify Streams. Want to See Our Royalties?*, DIGITAL MUSIC NEWS (May 26, 2016), http://www.digitalmusicnews.com/2016/05/26/band-1-million-spotify-streams-royalties/ [https://perma.cc/NAZ9-EW2K].

113. Gabriela Tully Claymore, *Spotify Explains Royalty Payments*, STEREOGUM (Dec. 3, 2013), http://www.stereogum.com/1587932/spotify-explains-royalty-payments/news/ [https://perma.cc/G3H3-P7YT].

114. David Johnson, *See How Much Every Top Artist Makes on Spotify*, TIME (Nov. 18, 2014), http://time.com/3590670/spotify-calculator/ [https://perma.cc/9H4F-PGUM]. The number discrepancy could involve separate payments from songwriting.

115. Dredge, *supra* note 108. It would take about 200 streams on Spotify to equal the $0.23 the artist receives from iTunes if the artist's cut per stream is $0.0011. *See supra* text accompanying note 111.

116. Mike Masnick, *RIAA Accounting: Why Even Major Label Musicians Rarely Make Money from Album Sales*, TECHDIRT (July 13, 2010), https://www.techdirt.com/articles/20100712/23482610186.shtml [https://perma.cc/CN3U-S44F].

117. Jordan Weissmann, *Think Artists Don't Make Anything Off Music Sales? These Graphs Prove You Wrong*, ATLANTIC (Feb. 27, 2013), https://www.theatlantic.com/business/archive/2013/02/think-artists-dont-make-anything-off-music-sales-these-graphs-prove-you-wrong/273571/ [https://perma.cc/6EBK-7CQX] (analyzing a survey by Northwestern Law Professor Peter DiCola).

118. *See* Daniel Sanchez, *Why Does Spotify Pay Out Such a Terrible Per-Stream Rate? The Answer Is More Complicated Than You Think*, DIGITAL MUSIC NEWS (Aug. 18, 2016), http://www.digitalmusicnews.com/2016/08/18/kill-rock-stars-president-explains-why-spotify-pays-out-terrible-streaming-rates/ [https://perma.cc/6C5C-YLFP].

119. Another proposal that has been suggested to help artists receive the full fair market value of their works in the streaming context is to extend the statutory licensing system used for non-interactive streaming services. *See* Teague, *supra* note 35. This proposal has several problems. It would make it more difficult for streaming startups to succeed because the reduced royalty combined with equity exchange allows the streaming service to defer costs until it is better established, and because a government-mandated royalty rate would hinder the free market.

many recording artists to believe that they are not being fairly compensated for their contribution to digital streaming services.

III. THE SOLUTION: A FIDUCIARY DUTY

Recognizing the modern relationship between artists and record labels as a partnership that imposes a limited fiduciary duty upon the labels would enable the artists to recover a portion of the profit from the sale of Spotify stock.

A fiduciary duty is a product of public policy, designed to regulate opportunism and abuses of trust or confidence.[120] A fiduciary duty need not be formalized in writing.[121] Ongoing business between two parties could be sufficient to recognize a fiduciary duty.[122] A fiduciary duty would give artists increased leverage, obligating record labels beyond what is expressly required of them by the recording contract.[123]

Generally, there are two types of fiduciary relationships: those that arise from legal relations such as attorney and client, broker and client, partners, principal and agent, and trustee and *cestui que* trust; and those that exist as fact, in which there is confidence reposed on one side and the resulting superiority and influence on the other.[124] No fiduciary relationship currently exists between a recording artist and a record label in the absence of special circumstances.[125]

A fiduciary duty can take several forms in different contexts.[126] Band members can owe fiduciary duties to one another.[127] Companies contracted to promote and sell intellectual property can owe a fiduciary duty to the creator.[128] Managers, and often their companies, can owe a fiduciary duty to the artists they have agreed to promote.[129]

There are three legal theories an artist can use to establish a legal right to the profit of equity stakes in streaming services: (A) good faith and fair dealing; (B) fiduciary duty by special circumstance; and (C) fiduciary duty by partnership. The cases suggest that good faith and fair dealing and fiduciary duty by

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120. Wendy V. Bartholomew, *Fiduciary Duty: Can It Help Calm the Fears of Underpaid Artists?*, 6 VAND. J. ENT. L. & PRAC. 246, 253 (2004).

121. *Id.* (citing 37 AM. JUR. 2D *Fraud and Deceit* § 32 (2002)).

122. 37 AM. JUR. 2D *Fraud and Deceit* § 34 (2017).

123. *See* Bartholomew, *supra* note 120, at 252.

124. 37 AM. JUR. 2d *Fraud and Deceit* § 37 (2002); 37 C.J.S. *Fraud* § 8 (1996).

125. *See, e.g.*, Cooper v. Sony Records Int'l, 2001 WL 1223492, at *5 (S.D.N.Y. Oct. 15, 2001); Cafferty v. Scotti Bros. Records, Inc., 969 F. Supp. 193, 205–06 (S.D.N.Y. 1997); Carter v. Goodman Group Music Publishers, 848 F. Supp. 438, 445 (S.D.N.Y. 1994); Rodgers v. Roulette Records, Inc., 677 F. Supp. 731, 739 (S.D.N.Y. 1988).

126. Eugene Temchenko, *Fiduciary Duty*, CORNELL U. L. SCH. (2016), https://www.law.cornell.edu/wex/fiduciary_duty [https://perma.cc/TZX3-3GE5] (discussing the corporate, charitable, and confidential fiduciary relationships).

127. Dead Kennedys v. Biafra, 2003 WL 21399983, at *10 (Cal. Ct. App. June 18, 2003).

128. Stevens v. Marco, 305 P.2d 669, 681 (Cal. 1956) (patents).

129. Hal I. Gilenson, *Badlands: Artist-Personal Manager Conflicts of Interest in the Music Industry*, 9 CARDOZO ARTS & ENT. L.J. 501, 519 (1991); Joel v. Weber, 602 N.Y.S.2d 383 (N.Y. App. Div. 1993) (Billy Joel's manager owed him a fiduciary duty).

special circumstance are both unlikely to succeed. The advent of 360 deals and the acquisition of equity by record labels have made the artist–label relationship ripe for recognition as a partnership.[130] Given the location of Spotify headquarters and the stated jurisdiction of many record contracts, the following Section will focus on New York state law.[131]

A. Good Faith and Fair Dealing

Good faith is defined as honesty in fact in the conduct or transaction concerned.[132] Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party.[133] The duty of good faith and fair dealing applies to all contracts and does not require a fiduciary duty.[134] Claiming a violation of good faith to receive a legal right to a portion of the equity profit is unlikely to be successful for artists because few contracts provide for this situation.

The covenant of good faith and fair dealing is breached where a party has complied with the contract's literal terms, but has done so in a way that undermines the contract's purpose and deprives the other party of the benefit of the bargain.[135] In New York, the covenant of good faith and fair dealing does not prohibit a party from acting in its own interests in a way that may incidentally lessen the other party's expected benefit.[136] Although a duty of good faith and fair dealing is implicit in every contract, it cannot be used to create independent obligations beyond those agreed to and stated in the contract's express language.[137]

In *19 Recordings v. Sony*,[138] the court found that Sony did not breach the duty of good faith and fair dealing by agreeing to accept equity in its deal with Spotify.[139] 19 Recordings is a music label representing Carrie Underwood and several other American Idol stars that licensed its sound recordings to Sony for distribution.[140] The complaint alleged that Sony deprived it of the benefit of the bargain by not seeking the highest royalty rate possible in Sony's negotiations with Spotify.[141] Instead, Sony accepted nearly 6% in Spotify equity and advertis-

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130. For a more thorough discussion of an artist-label partnership see Okorocha, *supra* note 37. This Note is different from Okorocha because his paper focuses on a right to an accounting, but this Note focuses on a right to equity profit.

131. *See* Tritt v. Category 5 Records, LLC, 570 F. Supp. 2d 977, 980 (M.D. Tenn. 2008).

132. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

133. *Id*.

134. Okorocha, *supra* note 37, at 16.

135. In re HSBC Bank, USA, N.A., Debit Card Overdraft Fee Litig., 1 F. Supp. 3d 34, 51 (E.D.N.Y. 2014).

136. Sec. Plans, Inc. v. CUNA Mut. Ins. Soc'y, 769 F.3d 807, 817 (2d Cir. 2014).

137. Sutton Assocs. v. Lexis-Nexis, 761 N.Y.S.2d 800, 804 (N.Y. Sup. Ct. 2003).

138. 19 Recordings Ltd. v. Sony Music Entm't, 165 F. Supp. 3d 156 (S.D.N.Y. 2016).

139. *Id*. at 165.

140. *Id.*

141. *Id*. at 163–164.

ing slots, which Sony could use for its own products or sell to other companies.[142] The equity and the advertising slots are revenue streams that directly benefit Sony, are not shared with the artists, and were acquired by leveraging the sound recordings.[143] Sony responded to the complaint by saying that there was no stipulation in its contracts with 19 Recordings that prohibit it from acting in its own interests even if it "may incidentally lessen the other party's anticipated fruits from the contract."[144]

The court found that Sony was acting in its own self-interest within the rights granted to the company by the licensing contract given Sony's sole and absolute discretion to license the sound recordings.[145] Further, the court noted that it had to dismiss the complaint because 19 Recordings failed to establish the fair market value for a stream in the absence of the equity or advertising slots.[146] For these same reasons, any suit that is based solely on contractual duties of good faith and fair dealing is unlikely to succeed.

B. Fiduciary Duty by Special Circumstance

The defining characteristic of a fiduciary relationship is the confidence or trust reposed in one party to act primarily for the entrusting party's benefit.[147] The duty extends to "all relations in which confidence is rested, and in which dominion and influence resulting from this confidence can be exercised by one person over another."[148] A fiduciary relationship generally arises when there is an unequal relationship between the parties—the party entrusting the confidence must be in a position of inequality, dependence, weakness, or lack of knowledge.[149] Yet, to avoid extra-contractual duties, courts do not lightly impose an informal fiduciary duty.[150] Artists are unlikely to succeed in establishing a right to the equity profit under this theory because courts defer to contracts and precedent limits recognizing a fiduciary duty by special circumstance.

1. Legal Standard

It is futile to identify a comprehensive set of factors that necessarily give rise to a fiduciary relationship.[151] When determining whether an informal fiduciary relationship exists between contracting parties, courts may examine several factors, generally including: the trust or confidence existing between the parties;

142. *Id.* at 164.
143. *Id*.
144. Ingham, *supra* note 85 (quoting Sony's response to 19 Entertainment's complaint).
145. *19 Recordings*, 165 F. Supp. 3d at 165.
146. *Id*.
147. 37 C.J.S. *Fraud* § 8 (1996) (citing Kent v. United of Omaha Life Ins. Co., 484 F.3d 988 (8th Cir. 2007)).
148. Bartholomew, *supra* note 120, at 253 (citing 37 AM. JUR. 2D *Fraud and Deceit* § 32 (2002)).
149. *Id*. (citing 37 AM. JUR. 2D *Fraud and Deceit* § 32 (2002)).
150. 37 AM. JUR. 2D *Fraud and Deceit* § 34 (2002).
151. City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 181 P.3d 142, 151 (Cal. 2008) (citing RAPHAEL CHODOS, THE LAW OF FIDUCIARY DUTIES 44 (2000)).

superiority, influence, or control by one party over another as a result of the relationship; and other special facts indicating a need for special duties.[152]A fiduciary relationship, even an informal one, is "founded upon trust or confidence reposed by one person in the integrity and fidelity of another."[153] A fiduciary obligation exists whenever one person places special trust and confidence in another person, relying upon them to exercise discretion and expertise with the utmost honesty, and the fiduciary knowingly accepts that special trust and confidence, undertaking to act on the client's behalf.[154]

The extent of superiority, influence, or control by one party and the reliance of another weigh heavily in favor of establishing a fiduciary relationship.[155] The essence of a fiduciary or confidential relationship is that the parties do not deal on equal terms because the person in whom trust and confidence is reposed and who accepts that trust and confidence is in a superior position to exert unique influence over the dependent party.[156] This is why lawyers, stockbrokers, and trustees have fiduciary duties; they have control and influence over a person who is reliant on them.[157]

It is unclear what courts look for when establishing a fiduciary duty, but a special fact or circumstance beyond the first two factors is necessary to establish a fiduciary duty. It could be that the parties were close friends,[158] or that the parties had a prior course of dealing.[159] Public policy encourages imposing further duties based on special circumstances.[160] The special circumstance must be something that establishes a special entrustment which justifies the imposition of obligations beyond the contractual obligations.[161]

2. Application to the Artist–Label Relationship

Many artists have attempted to establish a fiduciary duty under this theory and almost none have succeeded.[162] One successful case was *CBS v. Ahern*,[163] in which the contract gave the record label the authority to retain the artist's

152. Bartholomew, *supra* note 120, at 255; for other articulations of the factors see, e.g., 37 C.J.S. *Fraud* § 8 (1996); Reuben H. Donnelley Corp. v. Mark I Mktg. Corp., 893 F. Supp. 285, 289 (S.D.N.Y. 1995).

153. Apple Records, Inc. v. Capitol Records, Inc., 529 N.Y.S.2d 279, 283 (N.Y. Sup. Ct. 1988).

154. United States v. Milovanovic, 678 F.3d 713, 723 n.9 (9th Cir. 2012).

155. Bartholomew, *supra* note 120, at 256.

156. Brown v. Wells Fargo Bank, NA, 85 Cal. Rptr. 3d 817, 835 (Cal. Ct. App. 2008).

157. *Id*.

158. Cody v. Gallow, 214 N.Y.S.2d 127, 128 (N.Y. Sup. Ct. 1961).

159. Levine v. Chussid, 221 N.Y.S.2d 311, 312 (N.Y. Sup. Ct. 1961).

160. Tamar Frankel, *Fiduciary Duties*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 127 (Peter Newman ed., 1998).

161. Mellencamp v. Riva Music Ltd., 698 F. Supp. 1154, 1156 (S.D.N.Y. 1988).

162. *See, e.g.*, Reuben H. Donnelley Corp. v. Mark I Mktg. Corp., 893 F. Supp. 285, 289 (S.D.N.Y. 1995); Sony Music Entm't, Inc. v. Robison, 2002 WL 272406 (S.D.N.Y. Feb. 26, 2002); Silvester v. Time Warner, Inc., 763 N.Y.S.2d 912, 918 (N.Y. Sup. Ct. 2003).

163. CBS, Inc. v. Ahern, 108 F.R.D. 14 (S.D.N.Y. 1985).

royalties for the purpose of investing.[164] The maintenance of this special account by the record label for the benefit of the artist was sufficient to establish a fiduciary duty.[165] However, this special accounting and investment arrangement is unusual; most artist–label contracts do not include this type of investing arrangement.

Another notable instance was *Apple Records v. Capitol Records*,[166] in which Capitol Records owed a fiduciary duty to The Beatles.[167] The court reasoned "that from such a long enduring relationship was borne a special relationship of trust and confidence, one which existed independent of the contractual duties."[168] The "long enduring relationship" was about twenty-six years.[169] These circumstances were sufficient to establish a fiduciary duty, and the record company violated that duty by claiming the recordings were destroyed when they were actually sold for profit.[170]

Other artists have not fared as well as The Beatles in establishing the requisite trust to form a fiduciary relationship.[171] The Dixie Chicks' six years of trust and confidence in Sony was not sufficient to establish a fiduciary relationship.[172] A simple contract to collect royalty fees and pass them along is not sufficient trust to create a fiduciary relationship.[173] The Beatles' case is an outlier that might partially be explained by the 26-year relationship between The Beatles' and Capitol.[174]

Modern 360 recording contracts give the labels control over all rights granted, which typically includes final approval over tour schedules, salaries of certain employees, and the vendors the artist uses for publishing and merchandising.[175] It could also include using the label-owned management company to manage the artist.[176] Further, the recording labels' venture into equity ownership of music streaming platforms like Spotify forces artists to rely even more on record companies. Spotify enables the artists to be heard and develop a wider

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164. *Id*. at 25.
165. *Id*.
166. Apple Records, Inc. v. Capitol Records, Inc., 529 N.Y.S.2d 279 (N.Y. App. Div. 1988).
167. *Id*. at 283.
168. *Id*.
169. *Id*. at 279.
170. *Id*. at 283.
171. *See, e.g.*, Sony Music Entertainment, Inc. v. Robison, 2002 WL 272406, at *3 (S.D.N.Y.2002); Savage Records v. Jones, 667 N.Y.S.2d 906 (N.Y. App. Div.1998); Rodgers v. Roulette Records, Inc., 677 F. Supp. 731, 739 (S.D.N.Y. 1988); Mellencamp v. Riva Music Ltd., 698 F. Supp. 1154, 1156 (S.D.N.Y. 1988); Carter v. Goodman Group Music Publishers, 848 F. Supp. 438, 445 (S.D.N.Y. 1994); Silvester v. Time Warner, Inc., 763 N.Y.S.2d 912, 918 (N.Y. Sup. Ct. 2003).
172. *Sony Music Entm't Inc.*, 2002 WL 272406, at *3.
173. *Rodgers*, 677 F. Supp. at 739.
174. Cooper v. Sony Records Int'l, 2001 WL 1223492, at *5 (S.D.N.Y. Oct. 15, 2001).
175. Okorocha, *supra* note 37, at 13.
176. Bob Donnelly, *Buyer Beware: Why Artists Should Do A 180 On "360" Deals*, BILLBOARD (Mar. 22, 2010, 12:00 AM), https://www.billboard.com/biz/articles/news/1209534/buyer-beware-why-artists-should-do-a-180-on-360-deals [https://perma.cc/S6Q3-HBTK]. The manager would likely have a fiduciary duty to the artist. *See* Joel v. Weber, 197 A.D.2d 396, 602 N.Y.S.2d 383 (N.Y. App. Div. 1993).

fan base, allowing them to sell more concert tickets and t-shirts. Now that the record companies partially own the streaming services, they can greatly affect the exposure artists get on that platform.[177] This vertical integration increases the trust placed in the record company and is a special fact that could indicate a need for heightened duty. However, given the strong precedent against recognizing a fiduciary duty from special circumstance, it is unlikely to succeed.[178]

C. Fiduciary Duty by Partnership

The modern artist–label relationship should be considered a legal partnership. This should successfully enable recording artists to recover a portion of the profit from the Spotify equity. A partnership is defined as a contractual relationship or a voluntary association of two or more competent persons to place their money, effects, labor, and skill in lawful commerce or business and to divide the profits and bear the losses in certain proportions.[179] Partners owe a limited fiduciary duty to one another.[180]

1. Legal Standard

There is some variation in the factors that lead to recognition of a partnership.[181] A version of the Uniform Partnership Act has been adopted by forty-nine states, including New York.[182] Under the Uniform Partnership Act, proving the formation of a partnership requires a showing of: (1) the parties' sharing of profits and losses; (2) the parties' joint control and management of the business; (3) each party's contribution of property, financial resources, effort, skill, or knowledge to the business; and (4) the parties' intention to be partners.[183] No one factor is dispositive, it is necessary to address the parties' relationship as a whole.[184]

An important element of a contract of partnership or joint venture, both under common law and statutory law, is a mutual promise or undertaking by the parties to share in the profits of the business and accept liability for its debts.[185] Agreement to share losses may be inferred where all of the other elements of a partnership are present.[186] Losses do not have to be monetary, but may include

177. Seabrook, *supra* note 44. Lorde's meteoric success was based on being listed in the right Spotify playlist. *Id.*

178. Okorocha, *supra* note 37, at 16.

179. 68 C.J.S. *Partnership* § 1 (2017).

180. 106 AM. JUR. 3D *Proof of Facts* § 7 (2009).

181. *Id*.

182. Okorocha, *supra* note 37, at 4; N.Y. PARTNERSHIP LAW § 11 (McKinney 1994).

183. 106 AM. JUR. 3D *Proof of Facts* § 8 (2009); Anwar v. Fairfield Greenwich Ltd., 728 F. Supp. 2d 372, 403–04 (S.D. N.Y. 2010) (applying New York law). Sacramento E.D.M., Inc. v. Hynes Aviation Industries, Inc., 965 F. Supp. 2d 1141, 1150 (E.D. Cal. 2013) (applying California law).

184. *In re* Cross Media Mktg. Corp., 367 B.R. 435, 455 (Bkrtcy. S.D.N.Y. 2007) (applying New York Law).

185. Dinaco, Inc. v. Time Warner, Inc., 346 F.3d 64, 68 (2d Cir. 2003) (applying New York law).

186. Anderson v. Nat'l Producing Co., 253 F.2d 834, 838 (2d Cir. 1958).

"sweat equity"—the loss of time and effort.[187] Further, the element is always necessary because a partnership could exist without the sharing of losses.[188]

Co-ownership of any sort, including the management and control of the business, is evidence of a partnership.[189] A partnership can exist as long as the parties have the right to manage the business even though in practice one partner relinquishes the day-to-day management of the business to the other partner.[190]

Some contribution to the enterprise of property, financial resources, effort, skill, or knowledge to the business is necessary to be a partner.[191] Contribution of labor, capital, or promotion of the business is sufficient.[192] Sweat equity is also sufficient as contribution to the enterprise.[193]

To demonstrate the existence of a partnership, the parties must enter into the relationship with the intent to share in the profits and losses, have joint control or management, and contribute to the enterprise, regardless of the parties' expressed purpose.[194] Even if the contract includes a statement that "no partnership is intended," the contract could establish a partnership if the contract directs the association of two or more persons to carry on a for-profit business as co-owners.[195] To determine whether a partnership exists, the focus is whether the contract's *objective* terms demonstrate an intention to jointly carry on a for-profit business, not whether the individuals *subjectively* intended to form a partnership. [196]

In *Godoy v. Restaurant Opportunity Center*, former restaurant workers helped form a not-for-profit restaurant, but they were denied employment or back pay upon completion of the project.[197] The plaintiffs argued that they were merely employees, but the court found that they had actually formed a partnership because they had assumed a risk of loss and stood to benefit from potential gains, despite the lack of formal agreement. This is because they were members of the board of directors of the cooperative committee that constituted joint control and management, their sweat equity constituted a contribution to the enterprise, and all of this was done intentionally.[198]

187. Godoy v. Rest. Opportunity Ctr. of New York, Inc., 615 F. Supp. 2d 186, 195 (S.D.N.Y. 2009); Sacco v. Paxton, 133 So. 3d 213, 218 (La. Ct. App. 2014).

188. *See Anderson*, 253 F.2d at 838 (explaining the owner and the operator of a circus were partners despite the operator not being liable for losses under the contract).

189. *In re* Tsurukawa, 287 B.R. 515, 521 (B.A.P. 9th Cir. 2002).

190. *Id*.

191. VIDIVIXI, LLC v. Grattan, 155 F. Supp. 3d 476, 481 (S.D.N.Y. 2016).

192. *Id*.

193. Godoy v. Rest. Opportunity Ctr. of New York, Inc., 615 F. Supp. 2d 186, 195 (S.D.N.Y. 2009).

194. 106 AM. JUR. 3D *Proof of Facts* § 9 (2009).

195. Union Carbide Corp. v. Montell N.V., 944 F. Supp. 1119, 1132 (S.D.N.Y. 1996).

196. 106 AM. JUR. 3D *Proof of Facts* § 9 (2009).

197. *Godoy*, 615 F. Supp. 2d at 187.

198. *Id.* at 195.

In *Rivkin v. Coleman*, a medical assistant who helped a physician develop a medical device had not established a partnership.[199] No partnership existed because Dr. Coleman bore the sole risk of loss; Ms. Rivkin's claim for loss of sweat equity was insufficient because she would not be personally liable in the same way as Dr. Coleman and because her sweat equity was already compensated in the form of salary.[200] Further, Ms. Rivkin never had joint management or control over the business.[201]

2. Application to the Artist–label Relationship

The artist–label relationship should be considered a partnership. The record label and the artist both share in the profits and losses from their venture. This sharing of profits is furthered by 360 deals, which entitle record labels to a portion of profits from touring and merchandise that was traditionally reserved for the artists. It may seem as though the record label bears the risk of losses because it pays the advance and then attempts to recoup that expenditure through album sales, but the artists bear the risk of loss in two ways. First, the artists lose sweat equity by losing their time and effort on a speculative endeavor.[202]

Second, the artists also bear the risk of loss of revenue from accepting reduced royalties. The royalty rates are reduced, and this increases the viability of the streaming service. In exchange for reduced royalties, the record labels received equity which, if the streaming service succeeds, will yield profit in the amount commensurate with the difference between the reduced royalty and the royalty's fair market value. The artists have already shared the loss of a reduced royalty, the question remains whether they should be entitled to the profits if the venture succeeds.

The risk of loss being shared by the artists are more similar to the workers in *Godoy* than the medical assistant in *Rivkin* because both the record label and the artist bear the same type of risk of loss; time and effort as well as financial.

Under a 360 deal, both the record label and the artist have a right to management and control over the business. The degree of creative control varies, but both parties have control over business decisions regarding touring locations and dates, merchandising, and advertising.[203]

Both the record label and the artist contribute to the enterprise. Under a 360 deal, the record label puts up the initial capital investment and promotes the artist. The artist then spends time and effort and likely out-of-pocket expenses

199. Rivkin v. Coleman, 978 F. Supp. 539, 541 (S.D.N.Y. 1997).
200. *Id.* at 543.
201. *Id.*
202. *Godoy*, 615 F. Supp. 2d at 195.
203. Okorocha, *supra* note 37, at 13.

to create the sound recordings and to promote themselves through touring.[204] While touring, the artist often must pay for a vehicle and other travel expenses out of pocket.[205] The musical instruments and their maintenance are usually purchased by the musicians with their personal funds.[206] Under many 360 deals, the record label helps pay for t-shirts and merchandise, but the artist often bears a majority of those costs.[207]

Both the record label and the artist entered this relationship with the intent to have joint control and management over this for-profit business. Whether they intended or agreed to be partners in this endeavor is irrelevant. All the factors are present in the artist–label relationship; the modern artist–label relationship is ripe for recognition as a partnership.

IV. REPERCUSSIONS OF RECOGNIZING A FIDUCIARY DUTY

If the artists and record labels are found to be partners, they will owe a fiduciary duty of care and loyalty to one another as a matter of law.[208] The exact contours and repercussions of this duty would have to be decided by the courts on an ad hoc basis. If the fiduciary duty is recognized, courts will have to consider the: (A) advantages; (B) counterarguments; (C) limits to the fiduciary duty; and (D) the method to calculate the payout from the equity profit.

A. Advantages of Recognizing a Fiduciary Duty

If a fiduciary duty is recognized, then some artists would have a claim for constructive trust to the profits from the equity sales.[209] To establish the equitable doctrine of constructive trust there must be: (1) a confidential or fiduciary relation; (2) an express or implied promise; (3) a transfer made in reliance on that promise; and (4) unjust enrichment.[210] Before 360 deals became commonplace, artists attempted to sue record companies under this constructive trust theory, but they failed due to a lack of fiduciary duty.[211]

Record labels impliedly promised to maximize royalty revenues because that was the business model that benefitted both contracting parties. The artists transferred ownership or license of their sound recordings to the record labels in reliance on that promise to maximize royalties. Instead of maximizing royalties, the record companies were unjustly enriched by accepting equity in exchange for a lower royalty rate without sharing the equity with the artists. If the

204. Mike Errico, *Touring Can't Save Musicians in the Age of Spotify*, N.Y. TIMES (Jan. 25, 2016), https://www.nytimes.com/2016/01/25/magazine/touring-cant-save-musicians-in-the-age-of-spotify.html?mcubz=0 [https://perma.cc/5H5M-46T6].

205. *Id.*

206. *Id.*

207. *Id.*

208. 106 AM. JUR. 3D *Proof of Facts* § 7 (2009).

209. Bartholomew, *supra* note 120, at 257.

210. Bankers Sec. Life Ins. Soc. v. Shakerdge, 406 N.E.2d 440, 440 (N.Y. 1980).

211. Rodgers v. Roulette Records, Inc., 677 F. Supp. 731, 739 (S.D.N.Y. 1988).

artist–label relationship is found to be a partnership with fiduciary obligations, this would establish all of the elements necessary to support a successful claim for a constructive trust.[212]

Recognizing a fiduciary duty would also give artists the power necessary to obtain fair compensation for their work and the leverage they need to negotiate in future situations.[213]

B. Counterarguments to Recognizing a Fiduciary Duty

Courts' recognizing a fiduciary duty between record labels and recording artists will need to handle some associated challenges. The major record labels argue that it is impossible to maintain a fiduciary duty without violating the duty of loyalty to any single artist because of artist priorities, conflicts with release dates, and competition within the label for resources.[214] Further, recognizing a fiduciary duty in such situations could open the floodgates of litigation for other contractual obligations that are morphed into fiduciary obligations.[215]

The record labels also claim a right to the whole equity profit.[216] The labels believe that the equity was obtained in consideration of the label's entire library, not any individual artist.[217] The labels argue that they took the risk that any of these start up tech companies could fail, so they deserve the profit from the few that succeed. The record labels should be free to use their business judgment in a way that maximizes profit. It is better for the artist to get paid something for their recordings rather than nothing, which is what would happen if the streaming services failed and internet piracy returned to Napster-level highs. The record labels take stakes in these music streaming startups and give the streaming services generous royalty agreements to help the streaming services succeed.[218] Forcing the record labels to seek higher royalties could bankrupt the streaming services, leaving illegal downloading through peer-to-peer (P2P) networks as the dominant form of access to music.

C. Limiting the Duty

To counter these difficulties, courts should limit the fiduciary duty. The fiduciary duty owed by partners to one another is not the same obligation that a trustee owes to a beneficiary of a trust.[219] The partnership fiduciary duty is

212. *See* Simonds v. Simonds, 380 N.E.2d 189, 194 (N.Y. 1978).

213. *See* Bartholomew, *supra* note 120, at 252.

214. Corrina Cree Clover, *Accounting Accountability: Should Record Labels Have a Fiduciary Duty to Report Accurate Royalties to Recording Artists?*, 23 LOY. L.A. ENT. L. REV. 395, 428 (2003).

215. *See* Elmira Teachers' Ass'n v. Elmira City Sch. Dist., 2006 WL 240552, at *6 (W.D.N.Y. Jan. 27, 2006).

216. *See* 19 Recordings Ltd. v. Sony Music Entm't, 165 F. Supp. 3d 156, 165 (S.D.N.Y. 2016).

217. *See* Eriq Gardner, *Sony's Equity Stake in Spotify Challenged in Lawsuit Claiming Artists Are Robbed*, HOLLYWOOD REP. (June 24, 2015), http://www.hollywoodreporter.com/thr-esq/sonys-equity-stake-spotify-challenged-802758 [https://perma.cc/NB99-PRJT].

218. Seabrook, *supra* note 44.

219. *See* UNIFORM PARTNERSHIP ACT § 409(e) (2013); UNIFORM PARTNERSHIP ACT § 404 cmt. 5 (1997).

limited in ways that allow the partner to still act in self-interest, even if it harms the partnership.[220] The artist–label fiduciary duty should only apply to instances in which the record label uses a work created by an artist for the label's benefit in a way that reduces the benefits conferred upon that artist.[221] This articulation of a limited duty is consistent with the fiduciary duty partners owe to one another because it only applies when the partnership property is in use by one of the partners.[222] The conflicts of interest which the record labels worry about would not be a problem if the duty were limited in this way.

Under a full fiduciary duty, "neither party may exert influence or pressure upon the other, take selfish advantage of his trust or deal with the subject-matter of the trust in such a way as to benefit himself or prejudice the other except in the exercise of utmost good faith."[223] Unlike a trustee's fiduciary duty, a partner can undertake a profit-seeking activity for self-benefit even if it might harm the partnership.[224] At common law, a partner could even engage in a competitive enterprise with the partnership under certain circumstances.[225] What the partner cannot do without violating the duty is use the partnership to benefit himself at the expense of the other partner.[226] For example, if two partners own a grocery store, one partner can open another grocery store down the street, which would harm the initial store owned by the partnership. But, the partner cannot use his ownership of the first store as leverage against a supplier to benefit the second store because, in that case, the other partner would have a right to any benefit obtained by use of the partnership assets.[227]

Further, the artist–label contract can alter the limits and obligations under the duty of loyalty.[228] This includes exempting an entire category of activity from the duty of loyalty.[229] So record labels would still be free to represent a variety of artists without violating the duty of loyalty.

In the artist–label partnership, the partnership is the artist's brand. For example, the brand "Lady Gaga" would be a partnership asset between Stefani Joanne Angelina Germanotta and Interscope Records, which is owned by

220. *See* UNIFORM PARTNERSHIP ACT § 404 cmt. 5 (1997).

221. This might include instances in which a record label does not give full royalty payments collected to an artist. *See* Bartholomew, *supra* note 120; Clover, *supra* note 214; and Okorocha, *supra* note 37 (giving artists a right to audit the accounting by record label in royalty payments).

222. UNIFORM PARTNERSHIP ACT § 409(b)(1)(B) (2013).

223. CBS, Inc. v. Ahern, 108 F.R.D. 14, 25 (S.D.N.Y. 1985).

224. *See* UNIFORM PARTNERSHIP ACT § 409(e) (2013).

225. *See* Meinhard v. Salmon, 249 N.Y. 458, 468, 164 N.E. 545, 548 (1928) (J. Cardozo) (had the real estate opportunity been a certain distance from the property owned by the partnership, no violation of fiduciary duty would have occurred).

226. *See* UNIFORM PARTNERSHIP ACT § 409(b)(1), (b)(3) (2013).

227. *See* NCAS Realty Mgmt. Corp. v. Nat'l Corp. for Hous. Partnerships, 143 F.3d 38, 43 (2d Cir. 1998) (citing N.Y. PARTNERSHIP LAW § 43(1) (McKinney 1988)). A fiduciary duty is breached if a partner benefits from "any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property." *Id.*

228. UNIFORM PARTNERSHIP ACT § 105(d)(3)(A) (2013).

229. UNIFORM PARTNERSHIP ACT § 105(d)(3)(B) (2013).

Universal Music Group. If Universal were to release a Katy Perry song in mid-May with the expectation that it would be the hit song of the summer, that may harm Lady Gaga, but it would not violate the fiduciary duty because the label did not use any assets of the Lady Gaga partnership. Whereas if Universal were to grant a license to publicly perform "Poker Face" by Lady Gaga as part of a deal that would reduce the amount of money going to Germanotta while increasing the amount of money going to Universal, that would violate the duty. In one instance, the partner is competing against the partnership with a separate enterprise, in the other instance, the partner is using partnership assets to benefit himself at the expense of his partner. The actual use of a partnership asset would be needed to constitute a violation of the fiduciary duty.[230]

D. How to Pay Out the Equity Profit

Calculating the payout to the artists from any equity profit will not be an easy task. This paper suggests that the Spotify equity was not obtained in consideration of the labels' whole catalogues; rather, it was obtained in lieu of a higher royalty rate. This means that a portion of the equity profit rightfully belongs to the artists as recoupment of the reduced royalty rate. So, the payout should be tied to the idea that if the equity had not been obtained the artists would have received a higher royalty from Spotify.[231]

The payout should be pro-rata based on the number of streams each artist has received since the inception of Spotify. The total number of streams that an artist has received on Spotify should be divided by the total number of streams on Spotify. Then that number should be multiplied by the ratio of each royalty payment the artist is contractually owed. Finally, that number should be multiplied by the total profit the record label received from the equity sale.[232]

CONCLUSION

Technology changed the music industry, and the law must adapt to achieve equitable results in light of new circumstances. Internet piracy decimated the music industry, so the major record labels searched for new revenue sources. They developed 360 record deals and made them the industry standard for new artists, thereby extending their control over the artists by entitling themselves to all revenue sources generated from the success of the artist's brand. In an effort to defeat internet piracy, the record labels turned to music streaming services like Spotify and gave them reduced royalty rates in exchange for equity in the

230. *See* Sriraman v. Patel, 761 F. Supp. 2d 7, 19 (E.D.N.Y.), amended, 761 F. Supp. 2d 23 (E.D.N.Y. 2011) (a medical partner did not violate fiduciary duty by acting as chief of medicine).

231. It is unclear if artists who do not have 360 deals will be entitled to this remedy. They would not be owed a fiduciary duty, but, once some artists become entitled to this remedy, equitable considerations might enable other artists to recover a portion of the equity profit.

232. (Number of streams the artist has received / Total number of streams) * (royalty ratio in contract)) * (record label's profit from equity sale).

company. This reduced the benefits conferred on the artists that the labels had agreed to promote, including Taylor Swift. The record labels now stand to gain tremendously from Spotify's upcoming initial public offering.

Given the change in circumstance, including the advent of the 360 deal and the acquisition of equity, the artist–label relationship should be recognized as a partnership. Doing so would create a limited fiduciary duty which would only be violated if the record label used the artist's work in a way that benefits the label at the expense of the artist. Recognizing the artist–label relationship as a partnership would entitle artists to a portion of the profit from the sale of Spotify stock through a constructive trust.