The Deal Pipeline

The row over Duke Ellington's royalties

By Matt Miller | June 27, 2013

The strains of Duke Ellington, who three-quarters-of-a-century ago swung jazz into the American mainstream and inked some of the most popular tunes in history, have been reverberating recently through one of the music business's more esoteric corners–foreign subpublishing.

A battle over royalties due to Ellington's estate is casting a light on the subpublishing business and led New York courts indirectly to bless the wholesale consolidation of the music publishing business. Since Ellington's heyday, that consolidation has brought what were once thousands of independent companies under a single corporate umbrella with global reach.

A decision in May by a New York State appellate court reaffirmed the validity of a contract Ellington signed in December 1961 with his publishers: Mills Music Inc., the American Academy of Music Inc. and Gotham Music Service Inc. That contract included provisions for royalties collected outside the U.S. by agents of the publishers, which then remitted the money back, minus a percentage. In the trade, they are known as subpublishers. They are music publishers themselves who operate in a particular country and act, in effect, as collection agencies for publishers and songwriters based in other countries.

A New York class action lawsuit by Paul Ellington, Duke's grandson and an heir, challenged the structure of that royalty agreement on behalf of himself and his four siblings, charging fraudulent concealment and breach of contract. The suit argued that what were once independent agents are now all subsidiaries of EMI's publishing empire and that those once arms-length arrangements became collusive, allowing the foreign subpublishers to charge nonmarket rates, assisting a common owner. The suit accused EMI Music Publishing of "double-dipping."

A lower court judge, Bernard J. Fried, in October 2011 dismissed those arguments along with the suit itself, and at an early stage. He threw out the case at the prediscovery phase. Last month, the state's appellate division, first department, concurred, nixing the demand by the Ellington estate lawyers that they be allowed discovery.

"'Foreign publication' has one unmistakable meaning regardless of whether it is performed by independent or affiliated subpublishers," a five-judge panel wrote.

Donald Zakarin, a New York-based partner at Pryor Cashman LLP who represented EMI Music Publishing, says that while similar cases have wound through lower courts, he believes it is the first time an appellate level court has ruled on this issue.

Richard Scarola, who represents Paul Ellington, declined to comment on the decision beyond saying that "we are looking at the possibility of seeking permission to be heard in the [full] court of appeals."

This is one case whose news value can be calculated in what didn't happen. "It could have had a major impact on acquisitions had it gone the other way," says lawyer Bob Kohn, whose definitive book on the subject, "Kohn on Music Licensing," was cited by the Ellington estate in the case. "It provides certainty, particularly for those buying up publishing assets."

In the trade, acquirers typically base purchase price on a multiple of net publisher's share, or NPS. That equals revenue generated from a song or catalogue of songs, minus expenses and any co-publishing deals. If the terms of the catalogue are changed retroactively, those numbers become meaningless.

Lawyers for the heirs maintained that they have lost hundreds of thousands of dollars in revenue because of the arrangement. In that 1961 agreement, a foreign subpublisher is entitled to retain 50% of revenues it collects from its particular territory. It remits the remaining 50% to the American publisher, which, in turn, splits the money 50-50 with the songwriter.

According to Zakarin, two of the biggest subpublishing contracts predate the 1961 agreement by several decades. In 1928, Ellington assigned foreign subpublishing rights in Great Britain, Ireland and the British colonies to Lawrence Wright Music Co. Eight years later, Éditions Salabert in France obtained the rights to most of ContinentalEurope. The terms of both called for a 50-50 revenue split for the life of the copyright, which in those days in Europe usually translated into the life of the author plus 70 years.

That the foreign subpublisher retained such a large percentage is unusual, although not unprecedented, say industry experts.

The suit focuses on two contrasting methods of garnering royalties from overseas. Ellington properties were stuck in what is termed "net publishing receipts," which allow publishers to deduct foreign agency fees before splitting royalties with the songwriter. For a songwriter, a far more advantageous method is what's called "at source." This means a foreign subpublisher gets agreed-on fees and remits the rest directly to the songwriter, without the American intermediary, or any others for that matter.

Ellington estate lawyers argued that the contracts with EMI should be changed to the more equitable at-source collection. Their focus on this business arrangement resonates far beyond the Duke's sophisticated jazz stylings.

In the music business, subpublishing "is always a bone of contention," says Corey Field, a Los Angeles-based intellectual property and entertainment lawyer with Ballard Spahr LLP and past-president of the Copyright Society of the USA.

The Ellington songbook represents some of the foundations of jazz. "Caravan," "Take the A Train" and "It Don't Mean a Thing (If It Ain't Got that Swing)" are just three of the better-known titles. Performed and recorded repeatedly for decades, these standards have produced millions of dollars in revenue over the years. Ellington's heirs, however, sold their American rights to Famous Music Co., in the 1980s. At various junctures owned byParamount Picturesand Viacom, Famous Music was eventually acquired by Sony/ATV Music Publishing in 2007.

As Famous Music demonstrates, the business of music publishing represents an almost constant wave of mergers and acquisitions, a Darwinian chain of small fish being gobbled by bigger fish being gobbled by still bigger fish. Along the way, catalogues of songs penned by a particular songwriter may follow a similar path: They start life as an independent standalone, many times owned by the writer. The catalogue is acquired by one publishing house and then bought and sold up the chain. A song could have five or six different owners over the years, say those in the industry.

Other times, publishing houses don't own the catalogues outright, but administer their rights and keep a percentage. Or, a songwriter may own a percentage alongside a publishing house.

The value of these properties, of course, varies widely. However, the potential revenue streams have grown ever more complicated — and vital — with advances in technology, the decrease in recorded music sales and the global reach of music. A song used in a film or television series in, say, France may garner tens of thousands of dollars for an American composer and represent a far more valuable income source than CD sales on the composer's home turf.

EMI Music Publishing is a prime example of how music publishing consolidated over the years. EMI Music Publishing lists roughly 1,600 discreet entities. Many, if not most of these are small catalogues, often times representing a single songwriter.

But there also are dozens of what were once prominent independent publishers. The EMI Music Publishing empire truly is global. Over the years EMI acquired many of its foreign subpublishers as part of the acquisition juggernaut. So, for example, EMI bought Mills Music Inc., an old-line New York publisher in 1990, and, four years later, Mills Music Ltd., based in London and the original publishing home of Elton John and Bernie Taupin. EMI acquired Lawrence Wright Music in 1987. According to its Web site, Éditions Salabert is now part of theUniversal Music Publishing group.

EMI Music Publishing itself was acquired a year back for $2.2 billion by investors led by Sony Corp. Its catalogue is now administered bySony/ATV, a joint venture between Sony Corp. and the estate of Michael Jackson.

EMI Music Publishing readily acknowledged that it now owns many former independent subpublishers. The Ellington estate failed, however, to demonstrate a causal relationship — that the giant has used its web of companies purposely to water down royalty payments. Nor did Paul Ellington's lawyers demonstrate that these subpublishers were acquired somehow to take advantage of the publishing-subpublishing relationship.
Scarola and his colleagues argued that discovery was necessary to flesh out the arrangement.

Each country has its own collection society, with an often-confusing tangle of rules, regulations and idiosyncrasies. So, say industry experts, the original motivation behind a network of subpublishers was sound. "To the extent there's real activity, real money [overseas], you [as an artist] are going to be paid faster, better if there's someone there, that's the concept of subpublishing," Ballard Spahr's Field says. "Arguably, they deserve some compensation for the work involved."

Over the years, however, the publisher-subpublisher relationship evolved and that's where some of the tension lies. How much of a motivating factor those subpublishing agreements were in the acquisition process is left unexplained in the Ellington case.

At issue is whether EMI somehow recrafted the relationship between various publishers and subpublishers to benefit common ownership. The estate was hard-pressed to offer proof. The appeals court noted that the Ellington estate lawyers didn't allege "any change in the basis for payment of royalties" in their filings.

In its appellate brief, Ellington estate lawyers argued that they needed discovery to substantiate a belief that this, in fact, happened, that "the music publishing agreement at issue initially entailed the music publisher dealing at arms' length with unaffiliated foreign subpublishers that collected market-rate subpublishing percentages of 15%-25% and only later, as time went on, found the music publisher buying up those previously independent foreign entities and then switching to a non-market 50% foreign subpublishing percentage."

"That's a complete fabrication," Zakarin snaps back. "There's absolutely no evidence to support it." Zakarin points out the subpublishing contracts from the onset established a 50-50 split. "Not a thing was changed."

Zakarin adds that Paul Ellington and the other heirs have received a detailed royalties statement twice yearly since 1990 that showed this split.
In a memorandum filed to oppose dismissal of the case, the Ellington estate lawyers accused EMI of double-dipping "in the royalties due to plaintiff and other artists," numbering those composers in the thousands.

This wording was undoubtedly aimed at supporting the case's class-action status. It tapped into a rich vein of distrust of many music publishers, who for decades crafted contracts that unfairly decreased revenue due songwriters.

There has been long-held suspicions in the trade that some unscrupulous publishers used foreign subpublishing as a deliberate way to cut royalty payments. In a daisy-chain of jurisdictions, a publisher in, say, Germany could claim to be a subpublisher of an entity in France, which claimed to be a subpublisher of a London-based publisher, which claimed to be a subpublisher of an American company. The result: German revenue shrunk to practically nothing by the time it reached American shores.

That's the belief. However, the practice was never proved in court. Authorities such as Kohn argue that if the practice existed in the past, it's no longer a concern and certainly not something major publishers undertake. Even Ellington estate lawyers didn't allege EMI entities engaged in this round-trip accounting.

The best way to prevent publishers from taking their cut from the subpublishing layering is through at-source accounting. This gained acceptance beginning in the 1980s and is now common practice. Tamera Bennett, a Dallas-based music lawyer who writes a blog on music law, says she always insists on at-source accounting for her clients. "We just don't do a deal unless it's at-source," she says, adding that subpublishing itself remains a necessary evil in many overseas territories. "You have to have them to get your money out of a jurisdiction," she says.

According to Bennett, net receipts accounting not only offers publishers a bigger piece of the royalty pie, it delays payment to the songwriter. "It can easily be more than one year," she says. At-source can "cut out one accounting period."

Not that at-source accounting has completely substituted the old method. Net receipts accounting "is still out there," says Kohn. "Many music publishers use the older form of net receipts language if a [songwriter's] attorney doesn't insist on substituting at-source."

"It's not that easy to get at-source accounting, especially if you're not established," adds Field.

Field likens this case to another recent decision, but related to book publishing. Technical writer Bob Cordell sued McGraw-Hill Cos., challenging the publisher's net receipts accounting for foreign sales of his book on audio amplifier design. Cordell alleged that McGraw-Hill sold his book to McGraw-Hill divisions outside the US for below-market prices in self-serving deals. The divisions, in turn, sold the books to independent third parties at market prices. Cordell argued that because of the arrangement, he collected less royalties than he was entitled to.

Andrew Carter Jr. of the U.S. District Court, Southern District of New York, didn't buy the argument and dismissed the case in October 2012. The judge wrote that Cordell entered into a contract knowing full well that McGraw-Hill would be selling his books to its overseas divisions.

"Cordell's contention that McGraw-Hill had the implicit obligation to sell the works at fair market value — irrespective of what McGraw-Hill deemed suitable — would imply a term inconsistent with the express terms of the agreement," the judge wrote.

In other words, if you knowingly enter into a disadvantageous contract, tough luck. Duke Ellington may have done just that. In this case, he signed a contract that because of the percentage of the split and duration of a subpublishing agreement saddled his heirs with less revenue than they might have otherwise expected. "It doesn't matter if it's fair or not, it's the deal you did," explains Field.

These decisions underscore that lack of fairness isn't enough for the courts to intervene. "The court can't rewrite the contract," says Bennett. — Matt Miller

New York Law Journal

DAILY REPORT An ALM Website

Court Rejects Royalty Suit by Duke Ellington's Grandson

New York Law Journal / Daily Report (Atlanta)

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A unanimous New York appeals panel on May 2 affirmed the dismissal of a lawsuit by Duke Ellington's grandson, Paul Ellington, accusing EMI Music of unfairly depriving him of royalties from overseas sales of his grandfather's records.

Duke Ellington signed a contract with EMI in 1961 under which he would get 50 percent of the revenues received by EMI from foreign sales. At the time, Ellington's records were sold abroad by independent companies, which paid royalties to EMI. Since then, EMI, like most music publishers, has acquired ownership of the foreign companies that sold its recordings. Paul Ellington alleged that this has allowed EMI to skim off part of the royalties intended for his grandfather's estate by paying commissions to its foreign affiliates before paying half the remaining proceeds to the estate.

Manhattan Supreme Court Justice Bernard Fried dismissed the case, ruling that he could not disregard the plain meaning of the contract even though industry practices had changed since it was drafted. The First Department, Appellate Division agreed in *Ellington v. EMI Music*, 651558/10. "'Foreign publication' has one unmistakable meaning regardless of whether it is performed by independent or affiliated subpublishers," the panel concluded in an unsigned opinion. "Given the plain meaning of the agreement's language, plaintiff's argument that foreign subpublishers were generally unaffiliated in 1961, when the agreement was executed, is immaterial."

Justices Angela Mazzarelli, Richard Andrias, Leland DeGrasse, Rosalyn Richter and Darcel Clark sat on the panel.

Richard Scarola of Scarola Malone & Zubatov represents Ellington. Donald Zakarin of Pryor Cashman represents EMI.

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EMI Wins Dispute Over Duke Ellington 'Net Revenue'

By Eriq Gardner, The Hollywood Reporter | May 06, 2013 5:23 PM EDT

The decision is a defeat for Paul Ellington, the grandson of the great jazz pianist, who sued EMI for hundreds of thousands of dollars. He alleged that EMI had breached a 1961 songwriter royalty agreement with Ellington by deducting fees for foreign affiliates before accounting to Ellington's 50 percent share of net revenue.

In 2011, EMI prevailed at a New York State court by arguing that it was allowed to do so by the terms of the 1961 contract. On Thursday, an appellate division in New York agreed with the assessment that the contract is not ambiguous.

During his lifetime, Duke Ellington composed dozens of famous tunes including "It Don't Mean a Thing (If It Ain't Got That Swing)" and "Mood Indigo."

In the mid-20th century, when Ellington was creating his hit songs, the music industry was quite different. Unlike today, there were quite a few big song publishers out there. His publishing deal was with a company owned by Irving Mills.

Slowly, the music publishing industry consolidated. EMI acquired Mills Music to its stable.

The issue in this case was what to do about the foreign music publishers. When Ellington signed his deal in 1961, the foreign publishers connected to his music handed over money to Mills, which then split the money with the jazz legend. At that time, these foreign publishers were unaffiliated with Mills, but over time, EMI began purchasing stakes in those foreign companies too.

After seeing a royalty statement where certain divisions of EMI were essentially deducting money from another division, Ellington's heir sued.

But just because the music industry has changed doesn't mean that the contract will be read in a different light.

"We find no ambiguity in the agreement which, by its terms, requires EMI Mills to pay Ellington's heirs 50% of the net revenue actually received from foreign publication of Ellington's compositions," writes the appeals court in the ruling. " 'Foreign publication' has one unmistakable meaning regardless of whether it is performed by independent or affiliated subpublishers. Given the plain meaning of the agreement's language, plaintiff's argument that foreign subpublishers were generally unaffiliated in 1961, when the agreement was executed, is immaterial."

Foreign receipts has been at issue in many other accounting battles in the entertainment industry.

Donald Zakarin, a partner at Pryor Cashman who represented EMI, believes the decision will set precedent that under net receipts agreements, affiliated foreign publishers are entitled to deduct fees and be compensated like unaffiliated publishers. He says, "We believe that this decision will provide support across a broad spectrum of businesses in which royalties are payable based on 'net receipts' contracts, including record companies and traditional publishers."

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EMI Prevails In Duke Ellington Foreign Royalty Appeal

By Matthew Heller

Law360, New York (May 03, 2013, 3:52 PM ET) -- EMI Music Inc. has not improperly deprived heirs of Duke Ellington of "hundreds of thousands" of dollars in royalties from foreign sales of the jazz legend's recordings, a New York appeals court ruled Thursday, finding a 1961 "net receipts" contract was not ambiguous.

The Appellate Division of the New York Supreme Court affirmed a trial judge's dismissal of a breach-of-contract suit alleging "net receipts" agreements are now recognized as scams and the one Elllington signed with Mills Music Inc., now an affiliate of EMI, has allowed the music giant to "double dip" from foreign publication income, while reducing the heirs' share of royalties.

Under the 1961 deal, Mills was required to pay Ellington 50 percent of net revenue from foreign publication. His grandson, Paul Ellington, alleged in a suit filed in September 2010 that EMI has been keeping 75 percent of the royalties by "funneling [them] through EMI-affiliated foreign subpublishers."

"'Foreign publication' has one unmistakable meaning regardless of whether it is performed by independent or affiliated subpublishers," the appeals court said. "Given the plain meaning of the agreement's language, plaintiff's argument that foreign subpublishers were generally unaffiliated in 1961, when the agreement was executed, is immaterial."

"Net receipts" agreements have been replaced as the music industry standard by "at source" agreements, under which royalties are based on the grand total of earned music publishing revenue with all costs of collection absorbed by the publisher.

But in throwing out Paul Ellington's suit in October 2011, New York Supreme Court Justice Bernard J. Fried said that, "The mere fact that [net receipts] agreements are no longer common is simply not a valid reason to rewrite a clear and unambiguous contract."

Duke Ellington, who wrote more than 1,000 compositions, reached his agreement with Mills Music 13 years before his death in 1974. The deal covered foreign royalties on songs going back to 1927, when Ellington launched his career with agent-publisher Irving Mills.

At the time of the agreement, commissions on foreign sales were being charged by independent foreign subpublishers that were typically unaffiliated with domestic publishers such as Mills Music. But EMI Music, like other publishers, has taken over foreign subpublishers.

According to Paul Ellington, this has enabled EMI to skim his share of royalties by paying commissions to its affiliated foreign subpublishers before remitting royalty payments. Paul Ellington said he was entitled to 40 percent of the money and his three siblings to 20 percent each.

But the appeals court said Justice Fried was correct in "declin[ing] to read into the royalty payment terms any distinction between affiliated and unaffiliated foreign subpublishers inasmuch as the contracting parties themselves chose not to make such a distinction."

"[T]he complaint sets forth no basis for plaintiff's apparent premise that subpublishers owned by EMI Mills should render their services for free although independent subpublishers were presumably compensated for rendering identical services," the opinion said.

Paul Ellington filed the suit as a putative class action but a class was never certified.

Ellington is represented by Richard J. J. Scarola of Scarola Malone & Zubatov LLP.

EMI Music is represented by Donald S. Zakarin of Pryor Cashman LLP.

The case is Ellington v. EMI Music Inc., case number 651558/10, in the Appellate Division of New York Supreme Court.

--Editing by Rebecca Flanagan.