Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In the Matter of	)	
ADJUSTMENT OF RATES AND TERMS FOR PREEXISTING SUBSCRIPTION SERVICES AND SATELLITE DIGITAL AUDIO RADIO SERVICES	)	Docket No. 2006-1 CRB DSTRA

TESTIMONY OF

EDWARD CHMELEWSKI

Co-Founder and President of Blind Pig Records

PUBLIC VERSION

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DECLARATION OF EDWARD CHMELEWSKI

I. Background and Qualifications

I am a co-founder and President of Blind Pig Records, one of the premier Blues and American roots music labels in the world. Blind Pig Records traces its roots to the basement of the Blind Pig Café, in Ann Arbor, Michigan in the 1970's. At the time, Jerry Del Giudice, who co-owned the cafe and was a college friend of mine, decided to make some extra money by opening up a club for live Blues performances in the basement, and it quickly became a stage for some great performances. The incredible performances and the enthusiasm of the audiences led to the notion of recording this music and presenting it to fans beyond the confines of the club. In 1977, Jerry began Blind Pig Records in earnest, and asked me to join him. We remain partners in the business to this day.

Blind Pig was hardly a commercial success overnight. The first several albums we released did not sell particularly well, and Jerry and I both worked other jobs to make a living. I taught English as a Second Language for many years, until I eventually took a job working for a music distribution company, as did Jerry, so that we could learn more about the music business. To the best of my recollection, one of the first Blind Pig albums that turned a profit was a recording we licensed of Bill Wyman (the bassist for the Rolling Stones) playing with Blues greats Buddy Guy and Junior Wells at the Montreux Jazz Festival in the early 1980's. I didn't receive a paycheck from Blind Pig for the first ten or so years of our existence, and it wasn't until the late 1980's that I was able to quit teaching and take a modest full-time salary at Blind Pig.

From those humble beginnings, Blind Pig has grown into a leading Blues label with some of the world's greatest Blues artists, releasing about eight to ten albums a year. Blind Pig has a catalog of approximately 150 titles from over 70 artists, including Buddy Guy, James Cotton, Muddy Waters, Junior Wells and Mighty Joe Young, to name just a few. We believe that the creative abilities of our artists takes precedence over a strict adherence to any narrowly defined musical idiom. As a result, Blind Pig releases albums not only in Blues, but also in the fields of Roots Rock, Zydeco, Rhythm & Blues, and Soul Gospel. This philosophy has earned Blind Pig a reputation for excellence both through releases of some of the all-time greats and through recordings of the new generation of artists who are bringing these uniquely American art forms into the 21st century.

We are proud that our musicians have been recognized for their artistic achievements. In 2006, for example, Blind Pig artists scored multiple nominations for Blues Music Awards (the Blues community's highest honor) -- Rod Piazza & the Mighty Flyers won "Band of the Year" for the fourth time, Magic Slim received five nominations, and Tommy Castro, Elvin Bishop and Otis Clay received nominations, as well.

II. The Perspective of an Independent Record Label

I am testifying in this proceeding to provide the Copyright Royalty Judges with the perspective of an independent record label. I understand that the purpose of this proceeding is to set the rates that the satellite radio services (XM and Sirius) and services that stream digital music over satellite and cable television must pay copyright owners and artists for the use of their copyrighted sound recordings.

Despite the artistic successes mentioned above, we remain a small business and struggle to generate enough revenue to cover our costs and pay ourselves, our artists and our employees.

We are determined to succeed because we are committed to Blind Pig and our artists, and to preserving and expanding the musical traditions that we and our fans love. In order for us to continue to achieve these goals and to make Blues music available to the public, we must be compensated fairly when our sound recordings are purchased or licensed. Our sound recordings are our intellectual property. They are the "product" that we create. We expend significant resources and face considerable risks in creating them, and we cannot afford to license them at a discounted rate.

A. The Market for Independent Record Labels

Since I got into the music business thirty years ago, I can fairly say that there has never been a worse time for independent record labels. This is the most difficult it has ever been for Blind Pig to sell records and generate revenue. Although we join with the major record labels in our efforts to achieve a fair royalty rate from the Copyright Royalty Board in this proceeding, independent record labels face certain challenges that distinguish us from the majors.

Consolidation in the retail market for sound recordings has contributed to the financial woes facing independent record labels such as Blind Pig. Ten or so years ago, many cities and towns had independent record stores. These stores were our lifeblood. The local independent stores were usually owned and operated by people who really knew and loved music; they supported all kinds of music, were plugged into their local music scenes, and were responsive to independent record labels. Those stores would gladly stock our records, encourage customers to buy them, and put up our posters without charge (for which big chain stores today often charge record labels). Unfortunately, independent record stores have vanished in large numbers. The big retail record chains that now dominate the market simply don't care as much about niche musical genres or local music scenes. In fact, they even refer to the type of non-mainstream

music that we produce as "non-essential product." That label speaks volumes about the big retail stores' lack of commitment to selling our music. There is competition for bin space at the big chains (i.e., for getting albums stocked in a store), and it is extremely difficult for us to compete with the major record labels, which have many more resources at their disposal. Big stores commonly charge record companies for price and positioning -- that is, record companies have to pay to have their records placed in the stores, to have their recordings included in the stores' listening stations (places within the record stores where customers can use headphones to listen to songs), and to have the stores offer the records at discounted sale prices. We can almost never afford to pay the prices they charge for inclusion in these programs. This rising cost of doing business makes it increasingly difficult for Blind Pig to sell CDs. It is a battle just to get our albums into the stores, and if we don't pay for price and positioning, fewer people will see and buy our albums.

In addition, over the past several years I have noticed that our society has begun to devalue music. The availability of a wide range of music for free -- both illegally through rampant file-sharing and legally on a variety of Internet sites -- contributes to the notion in the public consciousness that music should be free. This is a troubling development for those of us who rely on selling and licensing sound recordings -- our intellectual property -- to make a living. Sound recordings are our principal source of revenue, and we cannot afford to license them at a discount.

B. The Economics of Independent Record Labels

We generate the vast majority of our revenue from CD sales. Most of our music is available on iTunes, and I estimate that digital sales make up about 13.5% of our gross

revenues.[1] The fact that this percentage is so high is more a reflection of the erosion of CD sales rather than a dramatic growth of digital downloads. Digital sales are no substitute for lost CD sales -- people frequently pay to download a single song, but it takes around ten of those to make up for the sale of a CD. We also generate some revenue from selling merchandise directly to customers through our web site, selling our recordings to our artists for off-stage sales, entering into licensing deals for the use of our music in television shows and commercials, licensing individual tracks to other record labels, and earning royalties from compulsory licenses for the use of our sound recordings and musical works for which we own the publishing rights.

Unfortunately, our CD sales have declined over the past five years, and we find that we are running faster and faster just to stay in the same place. For the first five months of our 2006 fiscal year (which runs from May 1 to April 30), Blind Pig lost approximately [[redacted]]. Whereas our gross revenues peaked in 1998 at about [[redacted]], our 2005 gross revenues were about [[redacted]], which represents a [[redacted]] decrease in business

Obviously, losing money is not a sustainable business model, and we have taken a variety of belt-tightening measures to account for our decreasing revenues. Because our new releases generally sell fewer units than our releases did several years ago, we are attempting to release more albums each year with the hope that we can make up for lost sales volume with extra releases. This compounds the already risky nature of the business because it requires us to sink costs into each new release; if one of those releases does not perform well, it only exacerbates the problem.

Sales of a record used to "build" as we generated more publicity, as the artists toured behind the release, and as word of mouth had a chance to affect sales. Nowadays, we have a

[1] I have marked several pieces of information in this testimony that I would not like to appear in the public record. All of the information I have marked is confidential and proprietary business information that we do not share with the public and that could put Blind Pig at a competitive disadvantage if other record labels or artists were to view it.

very short window in which to sell records -- our best sales usually occur in the first few weeks after release -- and after that the numbers begin to decline precipitously. We attribute some of this to illegal file sharing, and to customers burning, copying, and distributing free copies of the release to their friends. Another factor is that stores do not keep these new releases in their bins for very long; unless they see a title selling well right from the beginning, they return it after a short time. And they take in fewer titles (and fewer numbers of each title) than ever before; they limit the number of titles they carry as consumer demand for CDs decreases.

As a cost-cutting measure, we have cut back our staffing. In addition to Jerry and me, Blind Pig has six employees. At one point, we decreased all of our employees from working forty hours a week to working thirty-two hours a week. When one of them quit, instead of hiring a replacement, we increased everyone's hours back to forty a week, but gave everyone extra duties to cover for the work previously done by the departed employee. In other words, our six employees now share the workload formerly carried by seven employees.

To be clear, we've always operated Blind Pig on a tight budget. As the President and after thirty years at the company, my salary is $40,000 a year. Blind Pig's office is on the first floor of my house. Blind Pig used to pay me $1,350 per month in rent. This was a well below-market rate for San Francisco. If we had to rent comparable office space on the free market, we would pay substantially more. Nonetheless, as part of our efforts to reduce costs, we recently reduced Blind Pig's rent to $850 per month, which has imposed a personal hardship on me.

C. The Role of Independent Record Labels in Creating Sound Recordings

Independent record labels are responsible for recording, marketing, manufacturing and promoting an album. Record companies are the principal force behind the creation of a record. The artists, of course, provide the critical content for every record. But it is the record label that

does all of the other heavy lifting that goes into making an album and that takes all of the risks along the way. Blind Pig incurs all of the costs and bears all of the risks associated with finding artists, signing them, paying to record, manufacture and promote albums, paying royalties, and running a business. Every album that we release is a roll of the dice. Releasing an album is a speculative venture -- there are no guarantees of success. Blind Pig does not earn a profit on an album until its costs are recouped, and even when that happens, we do not receive that revenue until many months after the costs were incurred. And if an album does not earn a profit, we bear the full brunt of the financial loss.

The first step in creating an album is finding an artist whose music we'd like to release. After 30 years in the business, we are well connected in the Blues world and more often than not we hear about artists through word of mouth. We don't have the resources to turn an unknown artist into a superstar, however. We look for artists who are great musicians, but that alone is not enough. We want artists who are ambitious and willing and able to tour to support their albums. Touring is critical because it can be the best way to sell records. In fact, because touring and live performances are so important, we often travel to hear a musician play live if we haven't seen him or her perform. Those scouting trips require us to pay for travel costs.

When we sign an artist, we create a budget. Each project and each budget is different. In some instances, we set a budget amount and give that amount to the artist with the understanding that he will use the money to record the album and then keep whatever money is left over for himself. In other cases, we pay the artist an advance and then we pay the recording costs, too.

Our recording budgets vary from album to album, but most of them currently fall in the range of approximately [[redacted]]. These figures represent a decrease in the amount we can spend to record an album. In the past when our CD sales and revenues were stronger and

we could afford to spend more, our budgets were generally bigger, in the range of [ ]. Needless to say, it is harder to create a quality album on a tighter budget. Since we're forced to lower the recording budgets we can offer to artists, we're put in a position of insisting that our artists invest in their own recordings by making up the difference between the allotted budget and the actual recording costs by paying that difference out of their own pockets. Lower recording budgets also mean less time an artist can spend in a studio, thus possibly compromising the quality of the work. We also pay lower fees to the sidemen, or use fewer sidemen. In addition, we lower our cash outlay by structuring deals so that artists receive all or part of their advances in the form of finished goods (CDs) instead of cash. Thus, if we pay an artist with 1,000 CDs (which costs us $1,000 to manufacture, but which we value at an "artist price" of $6 per CD) instead of paying in cash, we save $5,000 in production costs.

Our recording budgets cover several categories of expenses. They include the costs of hiring musicians to play with the featured artist and of renting time in a commercial studio for recording sessions. Sometimes when we use guest artists or sidemen to record an album, we pay their travel and accommodation costs. In addition, we sometimes have to pay to rent recording equipment or instruments necessary for a particular album. In the studio, we pay for a recording engineer who is a highly trained professional responsible for getting the best possible sound for each recording. The engineer also works on mixing each song -- that is, each song may include multiple tracks of recorded vocals and instruments, and mixing involves determining which tracks sound best together and then combining them to form a single song. The budgets also cover the costs of hiring a producer -- this is someone who is in charge of the entire process and who works on a range of activities, including selecting material, re-arranging tunes, and generally supervising the recording process.

A recording budget, however, does not cover all of the expenses that we incur in creating an album. Once an album is recorded, significant costs remain -- and again, it is the record label who pays them. The album must be mastered, which is a critical final step that involves sequencing the songs and adjusting the sounds from one song to the next so that they are consistent. After the mastering is complete, the final sound recording has been created, but the album is not ready for sale to the public. The next step is to create the album art and text for the paper inserts into the CD's jewel box.

With the CD in final form, we then pay to manufacture thousands of CDs. We pay about $1 per CD in manufacturing costs, but this figure is somewhat misleading. Because each CD release is speculative by nature, it's never easy to predict how many copies of a CD to manufacture. There's no guarantee that a particular CD will reach even modest sales goals. But for the initial run, we must manufacture a sufficient number of commercial copies, plus thousands of promotional copies which are given away. Thus, if we manufacture even only 1,000 more CDs than we end up selling, we've lost $1,000 in manufacturing costs alone. By way of illustration, we recently spent $9,950 to manufacture 9,100 CDs of a new release, which to date has shipped (as opposed to "sold" because they can still be returned by retail) only 3,000 copies. So it's actually costing us $3 per CD for every one we've supposedly sold at this point in time.

We also invest considerable time and money into trying to promote our albums. We typically give away about 3,000 copies of a CD to the media and others to gain exposure for our albums. At $1 in manufacturing costs, this is an expensive give-away. In addition, postage charges for mailing out so many free CDs are expensive (we usually try to release two or more albums at a time just so that we can combine two or more CDs into a single mailing and save on

postage costs), and there are follow-up postage expenses and packaging costs from mailing out additional copies for ongoing tour support. Additionally, there are the expenses of phone charges and staff time in making the follow-up calls that must take place after the promotional mailing.

Like any small business, we also have to advertise our products. We pay for advertisements in some of the leading Blues publications, such as *Living Blues* and *Blues Revue*, and in national magazines such as *Guitar One*, as well as in some of the smaller Blues society newsletters. In the past, we have paid for placements of our CDs in national retail stores, but as I mentioned above, that has become prohibitively expensive.

We use a distributor to provide our CDs to retail outlets. The distributor takes a percentage of the wholesale price of each CD for its services. If those CDs are not sold by the retail outlets, they return them to our distributor. These "returns" are actually deducted from our current sales. Our return percentage for calendar year 2005 through national distribution was a whopping [[redacted]]. This means that for every 100 CDs we shipped in the U.S. through our distributor, [[redacted]] were returned. Our return rate for 2006 through September is [[redacted]]. With the recent bankruptcy and sale of the Tower Records chain to a liquidator, who will close the chain by the end of the year, that percentage is sure to increase. It's difficult to maintain a business whose cash flow from traditional retail sources is being slashed [[redacted]] every month.

We continue to incur costs even after an album has been recorded, manufactured, advertised and distributed. For each CD that is sold, we must pay mechanical royalties of 9.1¢ per song for songs of five minutes or less, and more for longer songs. (We own the musical composition copyrights for about one-third of the recordings we release.) If you figure there are about 10-12 songs on an album, these mechanical royalty costs add up quickly. And when an

artist's album recoups its costs, we must also pay royalties to the artist for every additional CD that is sold.

On top of all of these costs directly associated with creating a sound recording, Blind Pig, like any business, has certain overhead costs that we must pay in the ordinary course of business, including rent, utilities, salaries, taxes, insurance, supplies, computers and other equipment. No matter how many CDs we sell, we have to pay these bills to stay in business.

D. The Importance of the Statutory Royalty to Independent Labels

The Blues is a uniquely American art form. We believe that we play an integral role in preserving this musical heritage and in expanding its reach. We provide a valuable cultural service. Without us and other Blues labels, this indigenous American art form could disappear. It is an important part of our nation's cultural history, and it can only endure and grow if Blind Pig and others are able to operate our businesses. Blind Pig and other independent labels make it possible to share the Blues and other non-mainstream musical genres with the public. Without a fair return for every use of our intellectual property, I fear that we will not be able to generate enough revenue to support ourselves, our artists and our employees. The bottom line is that we will be forced out of business and the public will have fewer choices when it comes to listening to music.

As I mentioned above, Blind Pig prides itself on releasing albums not only from legendary Blues artists, but also from the new generation of artists who breathe new life into the Blues and have the potential to expose the Blues to a new generation of fans. Their fresh and original interpretations of the music and their willingness to transcend the genre's boundaries hold great promise for the future of the Blues. But it is generally harder to sell CDs by these less well-known artists than CDs by artists with better name recognition. When we sign an up-and-

coming artist, we recognize that we may need revenue from the sales of other albums in our catalog to compensate for the slower sales of the less well-known artist. But that formula only works when our label has enough other albums in our catalog selling well. And in the very new-release oriented retail record business, where retailers are no longer stocking back catalog, it's increasingly difficult to count on catalog sales to sustain new releases. When our sales are down across the board, and when we cannot generate sufficient revenue from other sources, it becomes increasingly difficult for us to release albums from less well-known artists. As a result, the public is deprived of these new voices and musical interpretations. Not only do we and our artists suffer, but ultimately the public does, as well.

III. The Satellite Radio Services

We are always grateful for new revenue sources, including the modest statutory royalties we earn from the satellite radio services. During the time these services have been operational, however, we certainly have not seen our sales improve. In fact, the opposite is true -- our sales have declined over the last five years. I understand that at the same time as our sales have decreased, the number of people listening to the satellite radio services has increased. We are glad to see that XM, in particular, has a Blues channel that has played some of our artists' music. We welcome any exposure we can get for our artists. But I have seen no evidence that our CD sales increase as a result of XM or Sirius playing our sound recordings.

XM's and Sirius' Blues channels are very entertaining and well programmed. They play a much wider and less predictable range of music than most terrestrial radio stations. I wouldn't be surprised if some Blues fans conclude that these stations satisfy their needs for listening to Blues music. If those fans find that satellite radio provides them with as much Blues music as they want, I am concerned that they will not purchase our CDs. This will exacerbate the serious

problem we face in declining sales and will place even greater strain on our limited resources. As music fans increasingly listen to music on satellite services and purchase fewer CDs, it is imperative that we receive fair compensation that reflects our significant contributions, the costs we incur and the risks that we take in making sound recordings available to the public.

Copyright owners and recording artists are entitled to a fair royalty rate for an even more fundamental reason: it is our music that is essential to the satellite radio services. We provide the intellectual property that they rely on in providing a service to their customers. Without our music, there's no way that they could charge customers $12.95 a month. Indeed, it is hard to imagine that XM and Sirius would have nearly so many subscribers as they do today if they didn't offer any music channels. The royalty rate set by the Copyright Royalty Board should reflect that our intellectual property is the very core of the satellite radio services.

Our hard work and the substantial risks that we take in creating an album benefit the satellite radio services and other services that stream our music, regardless of whether we generate any revenue for ourselves. Even when one of our albums loses money for us, the satellite radio services are free to play it and can use it to develop quality programming that attracts and maintains their subscribers. In this very real sense, our investment is generating revenue for XM and Sirius even when it is causing us to lose money.

In conclusion, I appreciate the opportunity to provide this testimony to the Copyright Royalty Board. I urge the Board to keep the contributions of independent record labels like Blind Pig in mind as it sets the royalty rate in this proceeding.

I declare under penalty of perjury that the foregoing testimony is true and correct to the best of my knowledge and belief.

Date: Oct. 27, 2006

Edward Chmelewski