

# Exhibit 3

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## Upstart Labels See File Sharing As Ally, Not Foe

By CHRIS NELSON

Four years ago, Rich Egan couldn't fathom the usefulness of Napster.

Mr. Egan, the co-owner and president of the independent music label Vagrant Records, had heard about the software -- which let users trade songs over the Internet without paying artists or labels -- and could not imagine how such a setup could benefit his business.

But as soon as Mr. Egan tried it, he was hooked. Today he says -- seemingly counterintuitively -- his label simply would not exist without file-sharing services like Napster and its successors KaZaA and Morpheus.

Even as the major labels of the music industry pursue file traders for copyright infringement through lawsuits and the court of public opinion, Vagrant and many other independent label owners cheer them on. File sharing, these owners say, helps their small companies compete against conglomerates with deeper pockets for advertising and greater access to radio programmers.

"Our music, by and large, when kids listen to it, they share it with their friends," Mr. Egan said. "Then they go buy the record; they take ownership of it."

As the music industry suffers through its third consecutive year of falling sales, a decline the major labels say is primarily a result of file sharing, Vagrant is one of many independent labels having some success. Of the 100 top-selling albums of 2003 through Sept. 14, six come from independent labels and collectively have sold six million copies, according to figures from Nielsen SoundScan. During all of 2002, only four independent releases made the Top 100 and together they sold 5.5 million copies.

And in an industry where the five major companies -- the Universal Music Group, which is owned by Vivendi Universal; BMG, a unit of Bertelsmann; AOL Time Warner Inc.; the Sony Corporation; and the EMI Group -- have more than 80 percent of sales, the independents have actually increased their market share this year by nearly a full percentage point.

By no means have the independents escaped the music business's three-year sales slump. In 2002, album sales dropped 17.3 percent, to 650 million units, from the year-end total of 785 million units in 2000. They are down another 8.6 percent for the first eight months of this year, compared with the period last year. "The industry's in a disastrous situation," said Josh Bernoff, a principal analyst at Forrester Research. File sharing, illegal CD burning, competition from other entertainment and the weak national economy are all cited as contributors to a downturn that has led to layoffs and budget cuts.

In January, one of the best-known independent labels, Artemis Records, laid off 15 people, 40 percent of its staff, said Danny Goldberg, its chief executive, who started the label in 1999 after running major labels like the Mercury Records

Group, Warner Brothers Records and Atlantic Records. "It's a battle," added Alan Meltzer, chief executive of Wind-up Records. "We go to war every day fighting for our little piece of territory."

Nonetheless, the sense of worry that permeates the mainstream industry does not consume the independent labels to the same degree. Wind-up, which is distributed in the United States by BMG, is one of the more successful modern independents. "Fallen," by the rock band Evanescence, has been a staple of the Top 10 for the last six months and has sold more than two million copies. Creed's "Human Clay" (1999) has sold more than 11 million copies, making it the seventh-best-selling album since SoundScan began tracking sales in 1991.

For some independent label executives, their confidence stems from subscribing to unconventional barometers of success. (For this article, an independent label is one that is majority-owned by a person or group outside of the five majors, although it may be distributed by a conglomerate. Because the independent companies surveyed are privately held, none would reveal annual earnings.) Success for Vagrant, Mr. Egan said, means bands can make a living from their music. Most Vagrant albums turn a profit after selling 25,000 copies. Some albums on the independent Minneapolis hip-hop label Rhymesayers Entertainment can be profitable after selling just 10,000 copies, according to Siddiq Ali, the label's co-owner and chief executive.

Financial success for a major label release often does not start until half a million copies are sold.

"None of us are buying Bentleys," Mr. Ali said, but the label's modest recording and promotion budgets are quickly recouped. The label's best-selling album, "God Loves Ugly" (2002) by Atmosphere, has sold 71,000 copies.

Jaime Meline, who co-owns the Definitive Jux hip-hop label and raps under the name El-P, counts his company fortunate because it has cash on hand to pay for six months' overhead and continues to split album earnings 50-50 with artists. (Major label artists often earn about 10 percent.) Definitive Jux's most popular disc, "Fantastic Damage" (2002) by El-P, has sold 48,000 copies.

In recent years, major labels, much like the movie industry, have depended increasingly on first-week sales to determine whether a release will be a hit. The cost of bringing a CD to the public, which often includes hiring a consultant to get a single on radio and a top director to shoot a video, not to mention the tab for recording, can run into millions of dollars.

If a CD does not show smash-hit potential immediately, a major label is likely to stop promoting it to concentrate on the next possible blockbuster, sometimes even dropping the band. Independent labels will often promote an album, single or tour a year after a CD's release. An informal survey of independent labels that vary in size from tiny (4 employees) to relatively large (50 employees), and in genre from rock to country to hip-hop, found executives crediting their successes to developing artists' careers over the long haul rather than the pursuit of immediate hits.

A prime example is Vagrant's rock band Dashboard Confessional. Their first album for Vagrant, "The Places You Have Come to Fear the Most" is also the label's most successful release, having sold 434,000 copies. But it took two and a half years to reach that total, Mr. Egan said.

That constant promotion continues to pay dividends. Dashboard Confessional's third album for Vagrant, "A Mark, A Mission, A Brand, A Scar," was No. 2 at its debut on Billboard magazine's album chart and has sold 256,000 copies in two months. The group is featured on the cover of the October Spin magazine and recently performed on "Late Night With David Letterman."

"An artist may make his or her best record three albums in, four albums in," Mr. Egan said. "We'd like to be there when they make that artistic statement."

Building an artist's career and building a fan base to support that career go hand in hand. As radio station playlists have shrunk in recent years, independent labels have turned to other avenues, including file-sharing software, to help listeners discover bands.

The unified response of the major labels has been an effort to shut the file-sharing programs, charging they foster piracy and, in turn, displace sales. On Sept. 8, the Recording Industry Association of America sued 261 file-sharers. The trade group represents the major labels and numerous independents.

Vagrant and Palm Pictures are among the independents that encourage file sharing. But even those who frown on it, like executives at Wind-up, Artemis and Definitive Jux, acknowledge that unauthorized downloading has been useful for exposing their artists to new audiences hungry for music.

"In artist development, file sharing -- it's not really hurting you," said Chris Blackwell, the chief executive of Palm Pictures, an independent label manufactured and distributed by the Warner Music Group. Mr. Blackwell, who in 1959 founded the independent Island Records, the original home to Bob Marley and U2, likens file sharers not to shoplifters, as the major labels do, but to grass-roots promoters whose efforts eventually increase sales.

"You want people to discover your artists," Mr. Blackwell said. "You're building for the future."

That tack may prove dependable, but it is still a volatile time in the industry.

"That's the chess game," said Mr. Meline of Definitive Jux, "to be able to hold on to the company and to still continue to grow while the rest of the industry is just completely going down in flames."