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The exclusive recording artist agreement used, with variations, by all record companies and independent record producers is one of the toughest and most sophisticated contracts a lawyer will ever encounter. However, since the record companies may agree to modifications, this article will outline the important provisions of a record company contract and suggest some possible areas of negotiation.

Exclusivity

Usually the record contract is an exclusive agreement extending for a period of one year or whatever time it takes to record and release one album and granting the record company options to extend for successive periods which, if all exercised, could yield a maximum term of six or seven years or an equal number of albums. Except in rare instances major label record companies will not enter into a non-exclusive agreement, sometimes called a “one off”. They feel they need long-term exclusivity because theirs is an industry where a substantial company investment is required before the creator can complete his work. Although an author of a book needs only a word processor to evolve his manuscript, a recording artist needs a studio, arrangements, back-up musicians, background vocalists, and other aspects of expensive production. The cost of a well-produced Jazz album is at least \$25,000 to \$35,000 and can often cost several times that.* Record company estimates are that less than one album in seven is successful, in terms of recoupment of recording costs against royalties. Therefore, the company hopes that in recording several albums by an artist it might eventually have one that will recoup the costs of all the others.

Minimum Recording and Release Obligations

The standard agreement will provide for recording of a minimum number of master recordings per year, or contract period, usually the equivalent of one album. Record companies also don't like to agree in writing to the release of recorded product, preferring to retain for themselves that final decision. Sometimes an artist can secure a concession that the company will not have the right to exercise an option to extend the term of the agreement unless previously recorded product has been released. Established artists can sometimes obtain a release commitment even on a worldwide basis and in general negotiate more favorable terms.

Cross Collateralization of Costs and Royalties

Payment to the artist is in the form of a royalty based on sales. However, before the artist receives any payments, the company deducts (or recoups) from royalties, any cash advances made to the artist or others, the entire cost of recording sessions, and in some cases promotional and tour support advances as well. If recording costs for an album are \$20,000, then at roughly \$1 per album royalty to the artist, which is the money

* Throughout this article I use the word Album to describe what in most cases is a CD. But cassettes and singles still exist and are important in the Pop and Rap areas and vinyl is making a comeback.

equivalent of a typical 10% of retail royalty calculation, the album would have to sell 20,000 copies before the artist receives any payment.

Most Jazz albums don't sell 20,000 copies; but even if the company does recoup the cost of that album, the contract provides that recording costs for all records the artist ever made for the label will be lumped together in one general royalty account and *then* recouped from all royalties paid to the artist for *all* CD's, cassettes or singles. This is called cross-collateralization of recording costs and royalties. Note that the record company can profit from a particular album *before* costs are recouped from the artist's royalty account, since the labels gross profit per album is greater than the approximately one dollar royalty payable to the artist and used for recoupment. Therefore when the costs have been recouped and the artist is "in the black," the record company has already made a substantial profit.

Since record companies account to an artist every six months, they have that period of time in which to sell records, receive income, and determine the commercial prospects of an artist. If an album is a hit, the company will quite often start to make another one - therefore incurring production expenses for the next record before they have to make a royalty payment and thereby reducing what they would otherwise pay to the artist as royalties for that period. As record companies go from album to album, the average artist rarely sees any substantial royalties and sometimes reaches the conclusion that he or she is being exploited.

From a negotiating point of view, this recoupment of royalties and cross-collateralization of the royalty account is something that a record company will rarely give up, (except possibly in the case of a "super star" pop artist with almost certain built-in sales). For this reason, most artists try to get cash advances on a yearly or per album basis. Although these are also recoupable from royalties, they at least create some cash flow for an artist.

Production Deals

Another way to get some money for the artist is the production deal. Here the artist, or artist's production company, (which may or may not be controlled by the artist) receives a lump sum in return for producing and delivering a finished album. The difference between the actual cost of the album and the lump sum received belongs to the artist and/or to the production company.

This device is also used by independent producers who find artists, record them, and then make deals with record companies. In such an independent production deal, the artist must negotiate with the independent producer as if the producer were the record company. This relationship could range from 50-50 with all decisions made mutually, to complete control for the independent producer which is the more usual case.

Royalties

Artist royalties can range from 10% or 12% of retail for a new artist to 16% or 18% of retail for an established, self-produced artist. It's also possible to negotiate

agreements whereby a successful album generates an escalation in royalties: either based on sales or on an album-to-album basis. And though the straight advance is the usual way of getting money for the artist, it is possible to negotiate signing advances or (in rare cases) bonuses once the album achieves a specific sales figure.

Royalty rates are based either on the wholesale price or the retail price of the album. The standard royalty rate for a beginning artist is 10% of the retail price or in the case of Sony Music, the only major to use a wholesale price system, 20% of the wholesale price. This would usually be in addition to a royalty for the producer, typically 2%-3%. Whatever price is used, it is not the actual price upon which the royalty is paid, which we call the Royalty Base Price. The record company always deducts a “packaging deduction” – usually 25% of the retail or wholesale price - to cover the cost of the album cover, sleeve, label, etc. The packaging deduction on cassettes and other non-digital configurations is 10%. Therefore, the Royalty Base Price is only 75% of the retail list price.

Moreover, most record companies do not pay on 100% of sales, paying instead on 90%. This is a carry-over from the days when records were made of shellac and 10% breakage was allowed. Though CDs don't break now, the 10% figure is still included in many standard agreements; and some record companies will not vary this policy. In fact, companies even pay on 90% of net sales (that is after deduction of returns, rebates, “free goods” and exchanges), which effectively reduces the percentage of royalty bearing sales to 85% or less.

Free Goods Deduction

Another standard provision is what is called a “free goods” allowance whereby record companies give the distributor a pre-determined number of free records for every quantity purchased. It is, in effect, a discount. Some record companies follow a policy of two free albums for every ten sold and three free singles for every ten.

Some record companies, including Sony, have a policy of “no free goods”. However, in analyzing royalty calculations by different companies, one finds that those with no free goods policies have a somewhat lower wholesale price; so from a royalty calculation point of view, the policy of no free goods is a somewhat illusory benefit.

From a negotiating point of view, a record company may agree to insert a provision in the agreement setting forth a predetermined free goods policy. Should the policy change to one less favorable to the artist, the company will be bound by the language contained in the agreement to the extent of having to pay royalties in accordance with the policy set forth in the agreement. However, a company will almost never restrict its right to promote and sell records with whatever methods and policies it feels are most effective.

Reduced Royalties: Tape & Foreign Sales

Record companies also pay reduced royalty rates on sales which are not ordinary retail sales. This would include sales to record clubs; sales in conjunction with a non-

record product (“premium sales”); budget priced sales; and sales through television advertising or via the Internet. Some modifications can be made in this language and can give a contractual right to more money; but many record companies are computerized and - short of an expensive audit - it is very difficult to police the various royalty rates and calculations which appear on the statement.

Foreign and non-retail sales are also subject to limitations. Foreign sales are usually paid at one-half the domestic rate. Most independent record companies work through licensees abroad and receive a net royalty themselves which ranges between 10%-15% of the European royalty price, called PPD or Published Price to Dealers, which is somewhere between retail and wholesale. They therefore are in a position to pay five or six percent of the list price to their artist. These rates can sometimes be negotiated up but a foreign royalty rate of higher than 10% of retail is rare.

Accounting

Record Companies almost always account on a semi-annual basis. Very little can be negotiated in these rather standard accounting paragraphs, except trying to limit and/or specify reserves which a record company will hold against returns. It is important to know what percentage of the royalties the company is holding in reserve and whether the reserve will be liquidated in a reasonable period of time (usually two years from the time the reserve is established).

These paragraphs always contain very shortened periods during which you can audit statements so that if a statement is not challenged within a period of time (usually one year), one is precluded from ever challenging that statement. Usually a record company will agree to extend the typical one-year period to two or three years.

Re-recording Restrictions

Another unique provision in record company contracts is the “re-recording restriction,” which provides that if an artist records a composition for his label and his contract terminates, he can’t record that composition for another record company for a period of five years after the expiration of the original agreement. In many standard forms this is so - even though the recording of the composition is never released. These provisions can be negotiated to some extent. The record company will never waive its re-recording restrictions; but it may agree to limit them to a period of two or three years from the expiration of the agreement, and on occasion it may agree to waive re-recording restrictions with regard to compositions recorded but not released either during the term of the agreement.

Rights in Recordings

All record company contracts contain very broad language granting to the record company all rights in the recordings and all reproductions, performances, and the like in perpetuity. Record companies are very hesitant to allow any inroads in this area, and the artist’s only remedy is one for damages in the event royalties are not paid.

In some cases an established artist or independent producer can own the masters

and lease them to the company. This is usually where the artist or independent producer has paid some or all of the production costs. This is important from the artist's point of view because those masters will revert to the artist after the termination of the agreement and can be very valuable either for the artist's own record label or – if currently recording for another label - to ensure that old product will not be released by the former record company to compete with the new product.

Pay or Play Clause

There is one provision in the standard form agreement which the record company will quite often waive or modify: the “pay or play” clause. This provides that in order to fulfill its obligation for recording whatever the minimum number of master recordings contracted, the record company need not actually record those “sides” but need only pay to the artist the union scale the artist *would* have received had those sides been recorded. This amounts to the artist being retained on an exclusive basis while possibly not having any product out in the marketplace. This is an especially harsh clause and record companies usually do not insist upon it (except possibly in the case of a completely new artist).

Music Publishing

Many standard form record company contracts make some reference to music publishing if the artist is a writer and/or publisher of his own material. Some record companies try to acquire publishing rights on the theory that they are making an overall investment in this artist and publishing royalties are just another way to recoup that investment.

If a record company does not insist on an interest in the publishing rights, it will often ask for a reduced rate on the mechanical royalties payable to the publisher with regard to compositions recorded. The U.S. Copyright Law now provides a mechanical royalty rate of 8 cents per composition and a $\frac{3}{4}$ rate is standard in almost all record agreements. There is also a per album cap of ten times this $\frac{3}{4}$ rate which can present a problem for an artist such as a jazz artist who will record original and standard material on the same album. The publisher of the standard work will insist on the full royalty, so the artist's own songs may not even get the $\frac{3}{4}$ rate because that would put the overall album royalty over the cap. In that case, the artist's work will get a reduced royalty (or in the extreme case, no royalty at all). Artist royalties and publisher royalties are treated separately in terms of recoupment, so the artist-publisher will receive mechanical royalties even though his artist royalty account is in an unrecouped position.

Options to Extend

Although the record company usually insists on several options to renew the usual one-year term of an agreement, it will quite often agree to escalate the remuneration during the option periods. It might agree to increase royalties and pay greater advances and production budgets since it is not committing itself to such increases at the execution of the agreement but only if it chooses to exercise its options if the product and the artist merit it.

Conclusion

It should be clear from the above that many points are subject to negotiation by the recording artist and his or her representatives. Although most of the power is usually with the recording company - especially with respect to a new artist - both sides realize that a satisfied artist has more desire to be successful. Therefore, the artist who seeks to improve the contract offered him will usually find the reputable record company reasonably amenable to contract modifications either at the outset or as the success of the artist grows. Keep in mind, however, that all record companies are not the same: it is important to try to deal at the outset with substantial companies who have a reputation for good artist relations, high standards of business dealing, and a history of improving agreements with their successful artists.