

The New (Record) Deal

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I. INTRODUCTION

Recording contracts for new artists need to change. It is almost unnecessary by now to note that traditional album sales have dropped steadily since 2002.¹ Music sales were down 16% in 2007.² And even though digital sales rose by almost 100% in 2006, only 60% of those sales were for entire albums, with the rest coming from a-la-carte, single song downloads.³ Consequently, digital sales have done little to ameliorate the demise of the CD. In fact the industry has declined from an \$11.8 billion dollar a year industry in 2003 to a projected \$4.7 billion a year industry in the 2007-2011 period.⁴ Clearly, a changed industry necessitates a change in the way the industry does business.

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¹ Brian Hiatt & Evan Serpick, *The Record Industry's Decline*, ROLLING STONE, June 19, 2007, available at http://www.rollingstone.com/news/story.15137581/the_record_industrys_decline.

² *Id.*

³ IFPI:07 Digital Music Report, <http://www.ifpi.org/content/library/digital-music-report-2007.pdf> (last visited Dec. 10, 2007).

⁴ Recording Industry Association of America, 2003 Yearend Statistics (2003); Price-Waterhouse Coopers, *Global Entertainment & Media Outlook: 2007-2011* (2007).

Many before me have advocated for a change in the way record labels contract with their artists. But if the record industry is going to abandon the model that had worked for them from the 1960s until the turn of the century, where should they go? Record-deal reformists like to point their fingers at how evil the record labels are, and unilaterally attack their position. “Get rid of the record labels!” they shout. I, if anyone, should agree with these label-haters after spending three years at the highly dysfunctional Virgin Records America (whose once-hip Los Angeles office is now a parking lot for the City of Beverly Hills’ broken-down police and postal cars). But these reformists forget that the record labels provide the recording, marketing and distribution funds for new artists. The Internet does increase exposure for artists, but how do you know what you want to listen to? As Hollywood music lawyer Dean Sheldon Serwin put it, “did you know you needed Crest Tartar Control toothpaste before they spent millions of dollars to tell you that you needed it?”⁵ Any product must have money spent on it for consumers to buy it. And the artist is the label’s product. Without the artist, the label does not have a business, and without the label, a new artist cannot break through the clutter. Thus, any solution to the broken record deal will have to be workable for both artists and labels.

II. OPTIONS FOR NEW ARTISTS

Most new artists are faced with a choice – sign with a label or do it yourself. Doing it yourself means you get to keep all the money that comes in, but it also means that you have to lay out all the money for your expenses up front.

In this issue, Vivek Mali proposes a third option – investment from private equity, hedge funds, or insurance.⁶ In his proposal, a financial vehicle would acquire a stable of artists much like a portfolio of companies. His suggestion reminds me of how most independent films are funded, and may be a temporary fix. But as soon as investors see how much money they are losing, that most artists never turn a profit from their records, they will go back to their day jobs. This investment strategy works for film so well because film is still “sexy”, in the words of Schuyler Moore.⁷ Sadly, music is not sexy any more.⁸

⁵ Telephone Interview with Dean Sheldon Serwin, Attorney at Law (Oct. 26, 2007).

⁶ Vivek V. Mali, *Alternative Model for the Record Industry Based on the Development and Application of Non-Traditional Financial Models*, 15 UCLA ENT. L. REV. 1 (2008).

⁷ UCLA Law professor and film financier extraordinaire.

⁸ Except for Justin Timberlake, who brought it back, temporarily, by selling more than 8,300,000 copies worldwide of his 2006 album *Futuresex/Lovesounds*, as of late November 2007, (which, by the way, is less than ‘N Sync’s highest selling album *No Strings Attached*, which is estimated to have sold over 15 million copies worldwide). See *Futuresex/*

Additionally, a new artist usually needs a label behind her to develop her career and help market her in order to break through the clutter. Mali's proposal works for established artists with a built-in fan base, but a new artist usually needs a label. Granted, as Mali rightly notes, the web has provided artists with unprecedented access to potential fans via the web. However, nobody has really figured out how to monetize that in a predictable fashion yet. Eventually they will, and Mali's proposal may very well turn into the model of the future. However, until then, if an artist wants to make money, she is faced with funding her career herself or going to a label for support.

Leaving the do-it-yourselfers aside, our job as scholars interested in the law and business of music should be to develop a better recording contract norm for new artists. This is one idea. Hopefully it is decent, but it is not the only answer. This Note is merely meant to start a debate on how to fix a system that is broken, and that those inside the industry have been unable to fix. As Serwin says, "if we are not going forward, we are going backward." Record label executives who are pretending that the walls are not caving in around them will only be left to sift through the rubble of a forgotten industry if they keep sitting on their hands. While my suggestions are flawed, maybe even unfeasible in some instances, the problems I address are real and need to be fixed. If we at the UCLA Entertainment Law Review can start a wider dialogue about possible solutions, maybe all of our voices will be heard and cause labels to start implementing a system that both they and new artists can live with.⁹

III. THE NEW SYSTEM

The new record deal should be of limited exclusivity, with a comprehensive revenue sharing model, based on a number of deliverable songs.

Under my proposal, artists could sign with multiple labels concurrently. At the same time, labels and artists would share in all of an artist's revenue streams, both traditional proceeds from direct sales of music, and also non-traditional revenue streams like touring, merchandising and publishing. Furthermore, artists would be paid by their labels as a percentage of the gross revenue they generate, removing much

Lovesounds, Wikipedia, The Free Encyclopedia, <http://en.wikipedia.org/wiki/Futuresex/Lovesounds> (last visited Dec. 10, 2007); No Strings Attached, Wikipedia, The Free Encyclopedia, http://en.wikipedia.org/wiki/No_Strings_Attached (last visited Dec. 10, 2007).

⁹ This is not the first time this journal has struggled with ideas for viable systems for the recording industry in the Digital Age. For an example all the way back at the turn of the century, see Corey Field, *The New Property*, 7 UCLA ENT. L. REV. 289 (2000).

of the accounting funny business from the current regime, and allowing artists to see additional proceeds beyond their advance.

By “comprehensive revenue sharing model,” I mean that the label would share in non-traditional areas such as touring, merchandising and publishing, while giving a little more of the recording income to the artist. This would encourage more cooperation between the artist and the label as each would be invested in the other’s traditional sources of revenue and would do their most to maximize both. Additionally, the money would not be distributed to the artist by points after costs and deductions, as it is now.¹⁰ I envision a simple percentage-of-gross-revenue system, with no costs besides the advance taken out of the artist’s share. This would allow for accounting transparency, which would foster trust between label and artist. It would also get money into the artist’s pocket sooner since costs are not deducted, and incremental increases in the artist’s percentage share could reward the artist in success. When the math is done, this method is not much more costly or risky to the label, because the artist still has to recoup their advance.

By “a minimum number of deliverable songs,” I mean that instead of being tied to deliver a certain number of albums, a new artist would have to deliver a certain number of individual tracks to a label within a period of time. This would minimize the risk for the labels since they would not have to lay out the recording, marketing and distribution costs for a traditional physical album. It would also give labels flexibility to take better advantage of diverse distribution channels, such as digital downloads of single tracks, which they now view as a thorn in their sides.

Taking the first prong last, by “limited exclusivity” I mean that an artist can sign more than one concurrent recording contract at a time. The artist’s current label will have first dibs on any songs in excess of the delivery requirement, so as to protect its investment, but the artist will not be stuck without an outlet for her songs if the label is not interested.

Additionally, taking the totality of my model, the artist’s income will be a truer reflection of the label’s profits, since money in to the label and money out to the artist bear no correlation to each other in current practice. Labels can make a profit off artists while artists can still be in the red based on the low percentage in which the money is

¹⁰ “Points” refer to the percentage of the money from album sales that are credited to an artist’s account by the labels. Labels traditionally take “costs” for all expenditures related to the production, distribution, and promotion of the album, as well as the more dubious “deductions” for free goods, returns, new media, etc.

shared with them and their responsibility for bearing the brunt of the costs associated with a release.

A. *Revenue Sharing*

With all of the ball-hiding that labels do—marking up expenses, taking deductions for fictional costs, reducing royalty rates, cross-colateralizing albums, and imposing controlled composition clauses—an artist can easily sell millions of albums, and never see a penny over the advance. The Goo Goo Doll's album *A Boy Named Goo* achieved double-platinum status,¹¹ yet the band found themselves in a legal battle with their record label, Metal Blade Records, after the band failed to earn any royalties from the album's sales.¹² However, the label can get rich off of the same hit album, since the artist's share is based on collecting money only after all of the costs associated with the recording, distribution and marketing are recouped by the label. Additionally, the labels take mysterious deductions for things like free goods and packaging, while reducing royalty rates for bargain CDs, international sales, and many other non-traditional distribution channels. In this current scenario, the label is happy, but the artist usually has to depend on touring to make any money. However, if the album is a flop, the label loses millions of dollars, and the artist still makes no money and has to depend on touring. But since the album flopped, there is probably not a huge audience for any tour.

In the revenue-sharing system that I envision, the artist would get a certain percentage of the money that the label takes in, *before costs to the label*. But what about the label? What if the album is a flop? Well, first there may not necessarily even be an album since the agreement is for songs, not albums. Thus the label would not have to outlay money to produce an entire album.¹³

If you are a record label representative reading this, your eyes have probably just stopped watering from laughter induced by the suggestion that the label pay the artist on the gross revenue, *before costs*. The labels would have a very good argument that with a new artist, marketing costs can easily exceed any possible revenues from selling music. Especially, they would add, if that music is just a couple songs sold (or even given away) digitally, as would be possible under my model. However, since my idea is a *comprehensive revenue-sharing sys-*

¹¹ Platinum refers to U.S. sales of 1 million albums or more. Double-platinum means at least 2 million albums were sold.

¹² See The Goo Goo Dolls, Wikipedia, The Free Encyclopedia, http://en.wikipedia.org/wiki/Goo_Goo_Dolls (last visited Dec. 10, 2007).

¹³ See Section III.B. for further exploration of this prong of the model.

tem, the label would have a chance to participate in the artist's revenues from other sources, especially touring, merchandising and publishing.

Now I may have upset the three artists reading this, who already do not trust the labels and balk at the label getting their hands on any more of their income. But artists should consider that if the label gets a cut of their other revenue sources, the label will have more incentive to develop artists' careers. The more an artist's recorded songs penetrate the market, the more people will buy a ticket to see that artist on tour. This may even prompt the record labels to start giving away songs for free, which they could never do now because getting consumers to pay for songs is the only way labels can make money. Most new artists would not be damaged by the label giving away their songs for free, since most receive very little from the record label after their advance anyways. Thus both the label and the artist benefit from each others' efforts. The artist will be motivated to produce songs during the term because she sees money before costs and deductions. And the label will be motivated to develop a long-term relationship between the artist and her fans because they will profit from the touring and merchandising. The artist will still be motivated to tour despite the record company taking a cut of the touring because touring helps sell recordings, and the artist's deal will be better if she shares in recording money on a pre-cost revenue basis.

One problem with this idea is that until the artist is selling out arenas, or at least clubs, touring can be a losing proposition. But if the label invests in the artist long-term, eventually they could see a payout. And even in the short-term, touring can help sell recordings, so paying for tour support can be viewed as another marketing expense for the labels.

Moving to a simple revenue-sharing system on a non-album-based term would also simplify accounting and foster trust between artists and labels. It is easy: if the label takes in money, they give the artist a percentage. And vice versa. No deductions. No recoupables. No funny accounting. For the label, paying the artist would be another cost of doing business, much like in television, or sports. Actors do not have to pay for the cost of running a show, and athletes do not have to pay for the cost of installing new luxury boxes in their stadium.

Since costs would not be deducted under my system, initial artist advances would be smaller. Also, the advance is still recoupable, which minimizes the risk to the label. The advance is the only recoupable recording expense by the label under my system. With a small advance, the artist would have to earn more money by actually releasing quality

songs. Then when the term of songs is up, the artist can negotiate for a better advance and deal terms, either with the same label, or out on the free agent market, much like in sports.

The major criticism of paying from gross is that it gives labels a disincentive to spend any money on artists, since the more labels spend, the less profit they keep. An obvious middle ground would be to use a net profits deal, where the artist is paid off of label profits, not revenue. This would reduce risk for the labels, but would open artists up to accounting abuses and expansive definitions of expenses, much like in the film industry.¹⁴ In order for a new deal to work, says Serwin, labels should only include “actual, verifiable, costs paid to a third party.” However, letting labels define net would allow the recoupable system to continue, albeit under a different name.

B. *Deliverable Songs, not Albums*

The current system does not sufficiently motivate artists to record songs.¹⁵ If a band with a fan base can tour and keep all the money for itself, why would its members go record an album, from which they will probably never see anything besides a rapidly shrinking advance? Moving away from an album-based term will motivate artists to get into the studio and record more often, since any time they do, they will at least see a bit of cash from the pre-cost label revenues. And labels should have no problem with putting up the dough to record and market the songs. The more an artist records, the more she will be in the public’s mind, and thus the more songs she will be able to sell. When the artist then goes on tour, still relevant in today’s fickle pop culture, the label will reap the benefits by sharing in the artist’s tour revenue.

On the other side of the coin, putting out a record only every few years can create a newsworthy event for an artist’s record, and can prevent fans from getting bored from overexposure of an artist. Additionally, Serwin points out that it is hard to create buzz for just one song. Singles are usually used to build hype for an album. However, putting

¹⁴ Actor Eddie Murphy famously called net profit points “monkey points,” as in only a monkey would be stupid enough to accept them, during the trial of *Buchwald v. Paramount Pictures Corp.* See Gregory Goodell, *Independent Feature Film Production: A Complete Guide From Concept Through Distribution* 12 (St. Martin’s Griffin rev. ed., 1998) (1982). See also John Horn, ‘*Forest Gump*’ Has Yet to Make a Net Profit, *THE JOURNAL RECORD* (Okla. City), May 25, 1995, available at http://findarticles.com/p/articles/mi_qn4182/is_19950525/ai_n10082506.

¹⁵ As the rap group Pharcyde lamented, “Every time I step up to the microphone, I put my soul on two-inch reels that I don’t even own.” See *Lyrics on Demand*, The Pharcyde Lyrics: Devil Music Lyrics, <http://www.lyricsondemand.com/p/pharcyde/lyrics/devilmusic/lyrics.html> (last visited Dec. 10, 2007).

out just songs and not albums conforms more to what consumers want nowadays – instant access to media content on any device. Modern consumers do not want product crammed down their throat. Long gone are the days when one song can sell a \$15 CD. If consumers just want the single, they will not buy the album. They will just plunk down 99 cents on iTunes for the track, or better yet, get it for free.

The labels should be happy to abandon an album-based system, since manufacturing and distribution costs are higher for physical albums. With a song-based system, labels would not have to outlay money for an entire album. They could record a hot song or two and focus their marketing dollars on developing the artist. These songs would be distributed digitally. Therefore, if those first couple songs tank, they can try to record a couple more, while continuing to develop the artist, and not losing millions from manufacturing and distributing albums. This gives a new artist more shots at having a song stick, and lessens her chance of getting dropped at the first sign of non-interest. It also does not require the labels to plunk down a huge up-front amount before the artist has ever even sold a single CD.

But what about the sacred album? Does my idea mean that we will never see another *Nebraska*, *Odelay*, or *Sgt. Pepper's*? No, it does not mean that. Since mine is a term deal by deliverable songs, if the label and artist agree that an album is appropriate, they could still go that route. Most artists know which category they fall into, and so do the labels. The problem now is that most albums are not “album-worthy,” they are just a couple of singles surrounded by interludes and fluff, not a comprehensive single piece of art. Seriously, why would you buy Rihanna’s album, when all you really want is “Umbrella”? Whereas “Umbrella” ended up selling 277,000 copies its opening week, Rihanna’s album *Good Girl Gone Bad* sold only 162,000 copies.¹⁶ Some artists should make albums. But they should also stay current by putting out songs more often between albums. With a song-based term, there would be no more holding out on releasing songs because of a contract – the artist would want to release them to get paid, as would the label.

C. *Limited Exclusivity*

Limited exclusivity in recording contracts would be a sea change in the way deals work now. The major problem with exclusive recording

¹⁶ See Billboard.biz, T-Pain Toasts First No. 1 Album (June 13, 2007), http://billboard.biz/bbbiz/content_display/charts/chart_alert/e3i2d5887633794139a17ba2365933e33; Jonathan Cohen, *Rihanna, Shop Boyz to top of singles chart*, REUTERS, May 31, 2007, available at <http://www.reuters.com/article/musicNews/idUSN3122070720070531>.

contracts, in the artist's view, is that an artist can be stuck with a label that is not releasing or promoting their songs.

Under the proposed system, the label that an artist is currently signed with would have to give the artist right of first refusal if the artist wanted to deliver more songs than required under their contract. Complete non-exclusivity would not work, notes Serwin, because label would not want to spend money creating a market for its product (the artist) when another label could just swoop in and capitalize on that demand. The label that makes the artist successful would lose value with total non-exclusivity, so it would be less likely to invest in the artist, because someone else could take advantage of their investment. In my model, the artist's current label has the ability to block the artist from giving extra songs to another label, but must compensate the artist to the tune of pre-negotiated advances if it wants delivery of additional tracks during the term.

IV. A SAMPLE CONTRACT

Now that I have summarized the proposal, how would a typical new artist contract look? Here are some sample basic terms, in decidedly non-legalese:

Term: Two years, with a label option for two consecutive annual options.

This gives the label time to develop the artist, and gives the artist time to go on tour and possibly record an album, while not being in danger of spending their whole career at one label.

Recoupable Advance: \$50,000. \$25,000 paid at start of year one and \$25,000 at start of year two, dependant on delivery in year one.

This is enough money for the artist to live on before she records her first songs. This is the only recoupable recording expense under my system, and is easy to calculate. Also, delaying the second half of the advance takes risk off of the label.

Minimum Guarantees: Artist agrees to deliver at least ten songs per year for the first two years, label agrees to release at least five songs during year one and eight songs during year two.

This forces the artist to record, and saves the label from releasing horrible songs. Also, the ten songs would be enough to make an album with if that is what the parties choose.

Recording Costs: Not recoupable by the label. Label agrees to fund recording for the minimum guarantees below. Label agrees to spend at least \$50,000 in recording costs during year one and \$100,000 in year two.

The recording costs are a business expense of the label – money they have to put into development of their product, which is the artist. Therefore it is not the artist's responsibility to pay it back through recoupment. The label does not have to spend any more than the minimums, although it may if it chooses.

Artist's cut from recordings: Artist must first recoup (make back) advance at 5% of total sale revenues before she starts getting additional income.

At a \$50,000 advance, the artist must sell \$1,000,000 worth of songs before the label owes the artist another penny. This greatly reduces risk to the label.

Then the artist gets 10% of all revenues collected by label for next \$1,000,000 (post-advance) of recording income collected by label.

This low percentage minimizes risk to label, while letting the artist share in a successful release.

Then 15% of all revenues to artist after initial \$1,000,000 collected by label.

At this point, the label has recovered most of its costs, and the artist seems like she will be successful, so she should share more in her own upside. Doing the math, if \$3 million is taken in by the label from recording sales, the artist would pocket about \$300,000,¹⁷ while the other \$2.7 million goes to the label pre-costs. After costs, the label still would take down a cool \$1.2 million in profit. In contrast, under the current system, an artist might only keep just over \$130,000 on \$3 million of recording revenues to the label, while the label still keeps over \$1 million in profit.¹⁸

¹⁷ \$50,000 advance, \$0 for the first \$1 million, \$100,000 for the next \$1 million, \$150,000 for the third \$1 million.

¹⁸ Here is how the math works out under my model for a typical song cycle:

Cumulative recording revenues to label*	Cumulative money paid to artist	Explanation of artist income
At \$0	\$50,000	Advance
At \$1,000,000	\$0	At this point, the label has recouped the artist advance at a 5% revenue rate.
At \$2,000,000	\$150,000	Between recouping the advance (at \$1,000,000), and hitting \$2 million in sales, the artist gets a 10% revenue sharing rate, for a total of \$100,000.
At \$3,000,000	\$300,000	With a \$50,000 advance, everything over \$2 million in revenues to the label is shared with the artist at a 15% rate. As the artist is more successful, they share in more of the revenues.

Of course, the label still has to pay its costs:

At \$3,000,000 of revenue:

\$300,000 in artist revenue share

\$150,000 in guaranteed recording costs

\$200,000 in guaranteed touring expenses

Label's cut from touring: Label shall put at least \$100,000 into touring per year. Label shall first recoup their costs, then gets 10% of all money collected by artist from touring.

If the label never recoups its costs from touring it is not fatal. It can still offset the costs since the touring will help sell songs, from which the label benefits.

Exclusivity: Additional tracks over the minimum delivery requirement shall be offered first to the label for pre-negotiated advances. If the label passes on any of the songs, the artist may make a deal with another label for those songs only, and may not share any touring, merchandising, or publishing revenues with the other label during the term.

V. CONCLUSION

Once again, my suggestion for a changed standard for record deals for new artists is of limited exclusivity, with a comprehensive revenue sharing model, based on a number of deliverable songs.

\$100,000 in mechanical license payments (less than with albums because less songs)
 \$500,000 in marketing
 \$400,000 in manufacturing and distribution (less than with mostly physical albums)
\$150,000 in overhead and miscellaneous
 \$1,800,000 in costs
 \$1,200,000 in profit to label (not including income from touring/merch/ publishing)

In contrast, here is how a typical deal would look under the current model:

Cumulative recording revenues to label*	Cumulative money paid to artist	Explanation of artist income
At \$0	\$100,000	Advance
At \$500,000	\$100,000	At a typical 15% royalty rate, the artist is still nowhere near recouped.
At \$1,500,000	\$100,000	At a 15% royalty rate and a \$100,000 advance, the artist should be recouped. But the label adds its costs on a rolling basis, so the artist is still nowhere near seeing any more money
At \$3,000,000	\$131,250	The label's "costs" barely exceed their revenues, so the artist, at \$3 million to the label, only gets about \$30,000 above her advance.

"Costs" to label under the current system:

At \$3,000,000 of revenue:

\$100,000 in artist advance

(\$375,000 in "distribution fees" (label pockets this, so not counted under this equation))

\$500,000 in manufacturing and distribution

\$500,000 in marketing

\$200,000 in tour support

\$300,000 in mechanical license payments

\$150,000 in overhead and miscellaneous

\$1,750,000 in costs

\$1,275,000 in profits to label (and no chance for additional revenue sources)

In conclusion, the proposed system could be simpler, fairer, and actually force labels and artists to work together to develop the artists' careers while providing both with new revenue sources. It could also be a disaster. But at least it is an attempt to fix a broken system. I look forward to seeing more comments in legal scholarship on this subject, either in this journal or others.