

# A Full 360: How the 360 Deal Challenges the Historical Resistance to Establishing a Fiduciary Duty Between Artist and Label

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## I. INTRODUCTION

The decline of the music industry since the turn of the century inevitably led to the decay of the traditional music business model, where labels were able to control and exploit the manufacturing, marketing and distribution of music created by artists contractually obligated to them. Though initially resisting change, labels have seemingly come to terms with the transformation of their market and, instead, are now looking for other means of remaining viable players in the music business.

One approach that has caught traction is the use of Multiple Rights Agreements, better known as 360 deals. The 360 deal has been described as a contractual agreement between a recording artist (“artist”) and a music company or record label (“label”), where the artist grants the label a portion of all revenue garnered by the artist (i.e. from live performances, merchandise sales, endorsements) in exchange for monetary support such as advances, funds for marketing, and tour support.<sup>1</sup> The speed at which the 360 deal has emerged in today’s music business has not allowed the legal system to adequately assess the implications of the arrangement. This article focuses on one potential, unintended legal consequence of this contractual arrangement: the creation of a fiduciary duty.

Recording artists have long wanted their relationship with labels to be considered a fiduciary, rather than merely a contractual, relationship because the former gives artists greater leverage in legal disputes. Recording contracts are notorious for being one-sided and mainly benefitting record labels during litigation.<sup>2</sup> A fiduciary relationship would give artists several legal avenues to pursue grievances against their respective record label.<sup>3</sup> A breach of fiduciary duty can result in

<sup>1</sup> Edward Pierson, *Negotiating a 360 Deal: Considerations on the Promises and Perils of a New Music Business Model*, 27-WTR ENT. & SPORTS LAW. 1, 1 (2010).

<sup>2</sup> See Wendy V. Bartholomew, *Fiduciary Duty Can It Help Calm the Fears of Underpaid Artists?*, 6 VAND. J. ENT. L. & PRAC. 246, 252 (2004).

<sup>3</sup> *Id.* at 256-257

punitive damages, rescission of contract, and can establish the basis for a claim of conversion or constructive trust.<sup>4</sup> It is for these reasons that many artists favor, and many labels disfavor, the establishment of a fiduciary duty.<sup>5</sup>

The courts have made their stance loud and clear in regard to whether artists and their respective labels owe a fiduciary duty to one another. Courts have consistently – sometimes vehemently – refused to establish a fiduciary duty among artists and their respective labels because the relationship is contractual and, according to the courts, it can be adequately governed by traditional contract principles.<sup>6</sup> The courts have stated on several occasions that additional factors are needed in order to change a contractual relationship, like that shared by artist and label, into a fiduciary relationship.<sup>7</sup> However, the music business has changed since many of the cases that denied finding a fiduciary duty.

Notably, labels have transitioned from using traditional recording agreements to using 360 deals. This new trend provides an ideal backdrop for courts to revisit the issue of fiduciary responsibility between artist and label.

This article espouses a simple theory: 360 deals can invoke a fiduciary duty between artist and label because they can transform the artist-label relationship into a partnership. A partnership is a formal relationship, which by law carries with it a fiduciary standard of conduct amongst all parties in the partnership. Under a 360 deal, artist and label operate more like a partnership than two parties bound by contract. This makes the relationship highly susceptible to a partnership finding. If the relationship is in fact found to be a partnership then, as a matter of law, there are fiduciary obligations that all partners owe to each other.

Part II of this article explains partnership law with a focus on the fiduciary obligations partners owe each other. Part III of this article discusses the 360 deal, the reasons for the transition to this style of contract, and the justification for its use. Part IV explores how a 360 deal can transform the artist-label relationship into a partnership, which then imposes a fiduciary standard of conduct among the two parties.

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<sup>4</sup> *Id.*

<sup>5</sup> See Colin Devenish, *The Royalty Battle Rages: Legislation Could Make Record Companies Open Books*, ROLLING STONE (May 7, 2004), <http://www.rollingstone.com/music/news/the-royalty-battle-rages-20040507> (covering record labels opposition to a proposed bill in the California legislature that would have made record sales royalty accounting a fiduciary duty).

<sup>6</sup> *Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Pub. Co.*, 306 N.Y.S.2d 599, 599 (N.Y. App. Div. 1969) (“We find and conclude that this was a purely commercial relationship and a purely commercial transaction. The action more properly may be considered an action for breach of contract with demonstrated failure by defendants to use their “best efforts”...”).

<sup>7</sup> *Rodgers v. Roulette Records, Inc.*, 677 F. Supp. 731, 739 (S.D.N.Y. 1988).

Lastly, Part V demonstrates how invoking a fiduciary duty between artist and label would actually benefit the music industry as a whole.

## II. PARTNERSHIP LAW

### A. *The Revised Uniform Partnership Act*

Prior to the Uniform Partnership Act (“UPA”), the law of partnership was primarily governed by case law. It varied from state to state and there was no authority at all on many important issues. This prompted the drafters of the UPA to seek conformity in the application of partnership law. Thus, in 1914, the National Conference of Commissioners on Uniform State Laws approved the Uniform Partnership Act for adoption.<sup>8</sup> The UPA has been amended on several occasions since 1914. The 1997 Act, the Revised Uniform Partnership Act (“RUPA”), was a significant amendment and has been cited in many legal articles.<sup>9</sup> Today, the UPA is in force in 49 states and the District of Columbia. The RUPA has been adopted by at least 24 states, including California,<sup>10</sup> Florida<sup>11</sup> and the District of Columbia,<sup>12</sup> although many of these states have adopted the RUPA with significant variations.<sup>13</sup>

### B. *Partnership*

Section 202 of the RUPA defines a partnership as “the association of two or more persons to carry on as co-owners a business for profit” and sets the ground rules for determining whether a relationship is a partnership.<sup>14</sup> Thus, section 202 is not only a definition but also a rule of law.<sup>15</sup> The RUPA, however, does not make any attempt to establish every instance where a partnership is formed; it leaves this job to the courts.<sup>16</sup>

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<sup>8</sup> See UNIF. P’SHP ACT, Prefatory Note (1997).

<sup>9</sup> This Article will defer to the RUPA

<sup>10</sup> CAL. CORP. CODE § 16100 (West 1996).

<sup>11</sup> FLA. STAT. ANN. § 620.81001 (West 1995).

<sup>12</sup> D.C. CODE § 33-101.01 (1997).

<sup>13</sup> Thomas R. Hurst, *Will the Revised Uniform Partnership Act (1994) Ever Be Uniformly Adopted?*, 48 FLA. L. REV. 575, 578 (1996).

<sup>14</sup> UNIF. P’SHP ACT §202(a) (1997).

<sup>15</sup> See UNIF. P’SHP ACT §202 cmt.1 (1997).

<sup>16</sup> See UNIF. P’SHP ACT §202 cmt. 3 (1997).

## 1. Co-Ownership

The phrase “co-owners” captures the essence of a partnership as defined by the RUPA. Co-ownership is distinct from mere ownership of business property.<sup>17</sup> “To state that partners are co-owners of a business is to state that they each have the power of ultimate control.”<sup>18</sup> Co-ownership tacitly requires that each partner have actual responsibility in the operation of the business. It is this requirement that distinguishes a partnership from other forms of joint ownership such as joint tenants, tenants in common, and tenants by the entirety.<sup>19</sup>

Certain instances point directly to co-ownership of a business, such as doing business,<sup>20</sup> filing assumed name certificates,<sup>21</sup> or holding licenses.<sup>22</sup> However, conceptually, co-ownership consists of two major components: profit sharing and joint control.

### a. Profit Sharing

Profit sharing is the primary attribute of a partnership because, unlike joint control, it receives a statutory presumption. Section 202(c)(3) of the RUPA states that if a person receives profits from a business, that person is presumed to be a partner of the business.<sup>23</sup> It is not necessary for partners to share profits equally;<sup>24</sup> they may agree on any proportion or formula.

Section 202(c)(2) of the RUPA provides that the profit sharing presumption does not apply to the sharing of gross profits even where the parties involved have a joint interest in the property from which the income is derived.<sup>25</sup> Sharing of gross profits is considered less persuasive than the sharing of net profits because participating in the latter subjects oneself to the fortunes and risks of the business to a much greater degree.<sup>26</sup>

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<sup>17</sup> See UNIF. P'SHIP ACT §202 cmt. 1 (1997).

<sup>18</sup> See UNIF. P'SHIP ACT §202 cmt. 1 (1997).

<sup>19</sup> UNIF. P'SHIP ACT §202(c)(1) (1997).

<sup>20</sup> *Anderson v. Nat'l Producing Co.*, 253 F.2d 834, 837 (2d Cir. 1958) cert. denied 357 U.S. 906 (1959).

<sup>21</sup> *Brand v. Elledge*, 419 P.2d 531, 535-536 (Ariz. 1966).

<sup>22</sup> *Wurm v. Metz*, 327 P.2d 969, 971 (Cal. Ct. App.1958) (“There is ample evidence to support the finding that Mr. Baker was a partner in the business. Pursuant to an application for a cash buyer’s license to handle poultry for the Baker and Metz Poultry Farm, a partnership consisting of Glenn Baker and Lester Metz, a cash buyer’s license was granted for one year from January 29, 1952”).

<sup>23</sup> UNIF. P'SHIP ACT § 202(c)(3) (1997); See also AM. JUR. 2D PARTNERSHIP § 152 (“The sharing of excess receipts over disbursements, without proof of separate individual operating expenses attributable to either partner, in effect constitutes a sharing of profits.”).

<sup>24</sup> *Constans v. Ross*, 235 P.2d 113, 117 (Cal. Ct. App. 1951).

<sup>25</sup> UNIF. P'SHIP ACT § 202(c)(2) (1997).

<sup>26</sup> *Fechteler v. Palm Bros. & Co.*, 133 F. 462, 470-471 (6th Cir. 1904).

Section 202(c)(3) also establishes several exceptions to the presumptive rule of profit sharing.<sup>27</sup> The presumption does not apply where the profits are: 1) paid as debt; 2) paid as wages to an employee; 3) paid as rent to a landlord; 4) paid as annuity to a widow; 5) represents interest on a loan, or 6) paid as consideration for the sale of good will of a business.<sup>28</sup> These exceptions apply regardless of whether the pay structure is a flat fee or a percentage ratio.<sup>29</sup>

Finally, section 202(c)(3) only creates a presumption of partnership and should not be taken as conclusive. If the presumption does not apply, the court will look to the other elements contained in the RUPA's definition and determine whether or not a partnership exists.<sup>30</sup>

#### b. Joint Control

Joint control is imperative to co-ownership.<sup>31</sup> Under the RUPA, partners are considered co-owners of a business; therefore, they must exhibit a certain amount of control over business affairs.<sup>32</sup> The question is whether each alleged partner has the control of a co-owner of the business.<sup>33</sup>

The RUPA does not have a specialized definition for control. Therefore, the ordinary definition of the term should be applied when making a control element inquiry. In his famous article, *Vicarious Liability and the Administration of Risk*, William Douglas defines the control of an "entrepreneur" as the ability to formulate and execute policy, i.e. to make decisions in respect to the production or marketing functions of a business.<sup>34</sup> Courts have found that control involves the

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<sup>27</sup> UNIF. P'SHIP ACT § 202 (c)(3) (1997).

<sup>28</sup> *Id.*

<sup>29</sup> *See* UNIF. P'SHIP ACT § 202 cmt. 3 (1997).

<sup>30</sup> *Murphy v. McDermott, Inc.*, 807 S.W.2d 606, 613 (Tex. App. 1991), writ denied, (June 19, 1991) ("Mere legal conclusions cannot give rise to an issue of a disputed fact such as the existence of a partnership").

<sup>31</sup> *Chocknok v. State, Commercial Fisheries Entry Comm'n*, 696 P.2d 669, 675 (Alaska 1985) ("Co-ownership of the business has been described as the most important characteristic of a partnership.").

<sup>32</sup> *See* UNIF. P'SHIP ACT § 202 cmt. 1 (1997).

<sup>33</sup> *See, e.g., Tuxedo Beach Club Corp. v. City Fed. Sav. Bank*, 749 F. Supp. 635, 646-47 (D.N.J. 1990) (holding control over the subject matter as an element of a partnership); *Chariton Feed & Grain, Inc. v. Harder*, 369 N.W.2d 777, 786 (Iowa 1985) (holding co-ownership of control to be a "key element in determining the existence of a partnership"); *Weingart v. C & W Taylor P'ship*, 809 P.2d 576, 578-79 (Mont. 1991) (holding that, in order for a partnership to exist, "each party must have a right of mutual control over the subject matter of the enterprise").

<sup>34</sup> William O. Douglas, *Vicarious Liability and the Administration of Risk*, 38 YALE L.J. 584, 595 (1929).

right to participate in management.<sup>35</sup> Generally, if a party participates to a significant degree in management functions, it is usually determined that they have sufficient control.<sup>36</sup> However, evidence of actual control is not always necessary. For example, a document setting out the rights of the parties may be sufficient evidence of control since the right of control is equivalent to actual control in partnership cases.<sup>37</sup>

## 2. Intent

The term “association” used in the RUPA’s definition of partnership connotes both voluntariness and intent.<sup>38</sup> Persons do not become partners by someone else’s acts.<sup>39</sup> The intent necessary to establish a partnership must be that of each of the alleged partners.<sup>40</sup>

The phrase “whether or not the persons intend to form a partnership” included in Section 202(a) is a codification of case law, which provides that a partnership can be formed regardless of the subjective intent of the alleged partners.<sup>41</sup> “The primary criterion is the parties’ intention to enter into a relationship which in law constitutes a partnership; intent to form a partnership is not necessary.”<sup>42</sup> If the important elements of a partnership exist, then intent is present.<sup>43</sup> Thus, parties can form a partnership even though they may have

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<sup>35</sup> 1 ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON PARTNERSHIP § 2.07(c)(1) (1988). See also *Chocknok*, 696 P.2d at 675 (“One aspect of co-ownership is the existence of a right in each partner to exercise authority in the management of the enterprise.”); *Higgins v. Higgins*, 486 A.2d 294, 296 (N.H. 1984) (finding non-partnership since defendant controlled the management of all of the various enterprises, and made all major financial decisions).

<sup>36</sup> *Minute Maid Corp. v. United Foods, Inc.*, 291 F.2d 577 (5th Cir. 1961) (finding joint control in financing party through (1) power to say what purchases would be acceptable collateral, and (2) right to agree on volume of purchases in anticipation of a price increase).

<sup>37</sup> See *Bengston v. Shain*, 255 P.2d 892, 895 (Wash. 1953); see also *Stilwell v. Trutanich*, 3 Cal. Rptr. 285, 290 (Cal. Ct. App. 1960) (“The fact that the defendants Trutanich had no right to direct their coadventurers in the making of the voyage, procuring of the seafood and selling of the products does not negative the existence of a joint venture since, by a written agreement, they delegated their authority.”).

<sup>38</sup> UNIF. P’SHP ACT §101, 6 U.L.A. 23-4 (1969) (“In the domain of private law the term association necessarily involves the idea that the association is voluntary.”).

<sup>39</sup> *H.T. Hackney Co. v. Robert E. Lee Hotel*, 300 S.W. 1, 3 (Tenn. 1927) (“It is said there is no such thing as a partnership by implication or operation of law. A partnership can only arise by a voluntary contract of the parties.”).

<sup>40</sup> *Id.*

<sup>41</sup> See UNIF. P’SHP ACT § 202 cmt. 1 (1997).

<sup>42</sup> *Arnold v. Erkmann*, 934 S.W.2d 621, 630 (Mo. Ct. App. 1996).

<sup>43</sup> *Martin v. Peyton*, 158 N.E. 77, 78 (N.Y. 1927) (“Mere words will not blind us to realities. Statements that no partnership is intended are not conclusive. If as a whole a contract contemplates an association of two or more persons to carry on as co-owners [of] a business for profit, a partnership there is.”).

expressed the intention not to do so.<sup>44</sup>

Although the term “association” implies intent, the RUPA does not require intent to form a partnership. However, the existing body of case law under the old UPA indicates clearly that intent is important in many partnership cases.<sup>45</sup>

### C. *A Partner’s Fiduciary Duty*

Perhaps the most important consequence of a partnership finding is its fiduciary obligations. The most quoted description of the fiduciary standard imposed upon partners is that of Justice Cardozo:

Many forms of conduct permissible in a workaday world for those acting at arm’s length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the ‘disintegrating erosion’ of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.<sup>46</sup>

The RUPA continues this characterization of partners as fiduciaries; however, the Act applies a less stringent fiduciary responsibility than the Cardozo standard. The RUPA no longer requires partners to act as disinterested trustees.<sup>47</sup> This allows for partners to legitimately pursue self-interests. Furthermore, the RUPA states that the only fiduciary duties a partner owes are the duties of loyalty and care, which are defined in the Act by a specific set of rules.<sup>48</sup>

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<sup>44</sup> *See id.*

<sup>45</sup> *Myrland v. Myrland*, 508 P.2d 757, 761 (Ariz. Ct. App. 1973) (“Although courts have encountered difficulty in setting forth exact tests by which to determine the existence or non-existence of a partnership relation, in the last analysis the facts, circumstances, and most important, the intention of the parties control.”); *See also Gammill v. Gammill*, 510 S.W.2d 66, 68 (Ark. 1974) (holding that primary test is intent); *Chariton Feed & Grain, Inc. v. Harder*, 369 N.W.2d 777, 785 (Iowa 1985) (noting that the intent to associate is the crucial test of partnership).

<sup>46</sup> *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

<sup>47</sup> UNIF. P’SHP ACT § 404(e)-(f) (1997); *See also* UNIF. P’SHP ACT § 404 cmt. 5 & 6 (1997).

<sup>48</sup> *See* UNIF. P’SHP ACT § 404(a)-(c) (1997).

## 1. Duty of Loyalty

Section 404(b) defines a partner's duty of loyalty in three parts.<sup>49</sup> First, a partner has a duty "to account" for any profits or benefits resulting from conducting partnership business or from the use of partnership property.<sup>50</sup> Second, a partner has a duty "to refrain from dealing with the partnership" on behalf of a party having an interest adverse to the partnership.<sup>51</sup> Third, a partner has a duty "to refrain from competing" with the partnership.<sup>52</sup>

As a part of the RUPA's deviation from the common law fiduciary standard, a partner may participate in any of the three instances above upon giving full disclosure to and receiving consent from all other partners.<sup>53</sup> However, if consent is not obtained and that partner proceeds, he or she is in violation of his or her duty of loyalty.

An agreement between partners cannot eliminate the duty of loyalty.<sup>54</sup> Parties may, however, identify specific categories of activities that do not violate the duty of loyalty so long as they are not manifestly unreasonable.<sup>55</sup> The courts will not enforce a contract that "broadly waives" a partner's fiduciary duty of loyalty.<sup>56</sup> For example, a provision giving a managing partner complete discretion to manage the business with no liability except for acts and omissions that constitute willful misconduct will not be enforced by the courts.<sup>57</sup> On the other hand, partners can consent, after the fact, to a particular transaction that may cause a conflict of interest between a particular partner and the partnership.<sup>58</sup>

## 2. Duty of Care

The RUPA imposes a gross negligence standard of conduct on partners. Section 404(c) provides that a partner's duty of care is limited to "refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law."<sup>59</sup> This standard is consistent with the standard generally recognized by the courts.<sup>60</sup>

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<sup>49</sup> UNIF. P'SHIP ACT § 404(b) (1997).

<sup>50</sup> UNIF. P'SHIP ACT § 404(b)(1) (1997).

<sup>51</sup> UNIF. P'SHIP ACT § 404(b)(2) (1997).

<sup>52</sup> UNIF. P'SHIP ACT § 404(b)(3) (1997).

<sup>53</sup> UNIF. P'SHIP ACT § 103(b)(3)(ii) (1997).

<sup>54</sup> UNIF. P'SHIP ACT § 103(b)(3) (1997).

<sup>55</sup> UNIF. P'SHIP ACT § 103(b)(3)(i) (1997).

<sup>56</sup> See UNIF. P'SHIP ACT § 103 cmt. 4 (1997).

<sup>57</sup> *Id.*

<sup>58</sup> See UNIF. P'SHIP ACT § 103 cmt. 4 (1997).

<sup>59</sup> UNIF. P'SHIP ACT § 404(c) (1997).

<sup>60</sup> See, e.g., *Rosenthal v. Rosenthal*, 543 A.2d 348, 352 (Me. 1988) (duty of care limited to

A partnership agreement may not “unreasonably reduce” the duty of care below the statutory standard set forth in Section 404(c).<sup>61</sup> Partners may agree to a list of conduct that they deem does not constitute gross negligence or willful misconduct.<sup>62</sup> Partners may also agree to indemnify partners whose actions were taken with an honest belief that they were in the best interests of the partnership.<sup>63</sup> However, a provision completely absolving partners of intentional misconduct would unlikely be enforced by the courts.<sup>64</sup>

### 3. Information Rights

Separate from the duties provided under Section 404, Section 403 provides obligations that can be considered fiduciary in nature. Section 403(a) establishes a duty to keep the partnership books and records.<sup>65</sup> Under the RUPA, there is no liability to either partners or third parties for the failure to keep books since partnerships are often informal.<sup>66</sup> However, a partner who undertakes to keep books must do so accurately and adequately.<sup>67</sup> At a minimum, a partnership should keep the books and records necessary to enable the partners to determine their share of profits and losses as well as their rights upon withdrawal.<sup>68</sup>

Section 403(b) establishes a partner’s right of access to partnership books and records.<sup>69</sup> This right is not conditioned on the partner’s purpose or motive.<sup>70</sup> However, an abuse of this right may constitute a violation of the obligation of good faith and fair dealing for which the other partners may have a remedy.<sup>71</sup> The right of access extends to agents, attorneys and former partners, although in regard to former partners, the right is limited to the books and records pertaining to the period of time during which the partnership existed.<sup>72</sup>

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acting in a manner that does not constitute gross negligence or willful misconduct).

<sup>61</sup> UNIF. P’SHP ACT § 103(b)(4) (1997).

<sup>62</sup> See UNIF. P’SHP ACT § 103 cmt. 6 (1997).

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> UNIF. P’SHP ACT § 403(a) (1997).

<sup>66</sup> See UNIF. P’SHP ACT § 403 cmt. 1(1997).

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> UNIF. P’SHP ACT § 403(b) (1997)

<sup>70</sup> See UNIF. P’SHP ACT § 403 cmt. 2 (1997).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

Section 403 provides an affirmative duty to disclose.<sup>73</sup> Section 403(c)(1) states that, without demand, a partner must provide any information required for the proper exercise of a partner's rights and duties.<sup>74</sup> This duty to disclose is more extensive than the duty to supply information upon the demand of a co-partner.<sup>75</sup> One case emphasizes that this duty to disclose includes pre-partnership transactions.<sup>76</sup>

Section 403 also provides for a duty to render information upon demand.<sup>77</sup> Section 403(c)(2) states that, on demand, a partner must provide any other information concerning the partnership's business and affairs, except in the event where such demand is unreasonable or improper.<sup>78</sup> The burden is on the partner "from whom the information is requested" to demonstrate that the demand is unreasonable or improper.<sup>79</sup>

#### 4. Good Faith and Fair Dealing

The RUPA provides that partners have an obligation of good faith and fair dealing when discharging their duties.<sup>80</sup> The obligation of good faith and fair dealing is rooted in contract law and is imposed on partners due to the consensual nature of their relationship.<sup>81</sup> The meaning of "good faith and fair dealing" has been left to court interpretation; however, some scholars have described this obligation as an "excluder" rule, one that is defined by what it excludes rather than by what it includes.<sup>82</sup> "Good faith and fair dealing" excludes various types of conduct characterized as involving "bad faith" because the conduct would violate community standards of decency, fairness, or reasonableness.<sup>83</sup>

The obligation of good faith and fair dealing may not be varied by agreement, except that the partners may "determine the standards by which the performance is to be measured so long as those standards are not manifestly unreasonable."<sup>84</sup> For example, partners can draft a

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<sup>73</sup> UNIF. P'SHIP ACT § 403 (1997).

<sup>74</sup> UNIF. P'SHIP ACT § 403(c)(1) (1997).

<sup>75</sup> See *Starr v. Fordham*, 648 N.E.2d 1261, 1268 (Mass. 1995).

<sup>76</sup> See *Latta v. Kilbourn*, 150 U.S. 524 (1893).

<sup>77</sup> UNIF. P'SHIP ACT § 403 (1997).

<sup>78</sup> UNIF. P'SHIP ACT § 403(c)(2) (1997).

<sup>79</sup> See UNIF. P'SHIP ACT § 403 cmt. 3 (1997).

<sup>80</sup> UNIF. P'SHIP ACT § 404(d) (1997).

<sup>81</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

<sup>82</sup> See Robert S. Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 41 VA. L. REV. 195, 262 (1968).

<sup>83</sup> RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

<sup>84</sup> UNIF. P'SHIP ACT § 103(b)(5) (1997).

provision in their agreement specifying that five days notice is adequate notice for a partner's meeting, but a provision waiving the obligation of good faith and fair dealing entirely is unenforceable.<sup>85</sup>

### III. THE 360 DEAL

#### A. *What Are 360 Deals?*

Three-sixty deals, also known as multiple rights agreements, have developed as a result of the financial changes record labels have undergone. The decline in album sales since the turn of the century forced labels to find other sources of income in order to sustain viability.<sup>86</sup> Naturally, the labels turned to their artists for this needed source of revenue. As the drop in album sales deepened, the artists' ancillary ventures, such as publishing, touring, and merchandising, proved more valuable to the fiscally distressed labels than the decaying record selling business. However, under traditional recording agreements, labels are precluded from the profits of such ventures because traditional recording agreements only give labels the right to share in the income derived from the sale of an artist's recordings.<sup>87</sup> Therefore, the fundamental purpose of the 360 deal is to grant labels the right to share all revenue generated by an artist.

Although the particulars of a 360 deal may vary, the initial execution of a 360 arrangement is the same as a traditional recording agreement.<sup>88</sup> Artists grant labels the right to manufacture and distribute their recordings in exchange for a percentage of net income received from the sale of those recordings.<sup>89</sup> This percentage of net income is known as record royalties.<sup>90</sup> Upon signing, the label pays the artist an advance payment against future royalties, used for recording expenses such as fees to producers and arrangers, studio and equipment rentals, and living expenses.<sup>91</sup>

In a 360 deal, however, the label has the right to a percentage of net

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<sup>85</sup> See UNIF. P'SHIP ACT § 103 cmt. 7 (1997).

<sup>86</sup> Jeff Leeds, *The New Deal: Band as Brand*, N.Y. TIMES (Nov. 11, 2007), [http://www.nytimes.com/2007/11/11/arts/music/11leed.html?pagewanted=1&\\_r=1&emc=eta1](http://www.nytimes.com/2007/11/11/arts/music/11leed.html?pagewanted=1&_r=1&emc=eta1).

<sup>87</sup> Richard Salmon, *Recording Contracts Explained: Our Guide to contract terms*, written by an Entertainment Attorney, SOUND ON SOUND (Apr. 2007), <http://www.soundonsound.com/sos/apr07/articles/contracts.htm>.

<sup>88</sup> See DONALD S. PASSMAN, ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS 96 (Free Press 7th ed.) (2009).

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* at 68

<sup>91</sup> *Id.*

income from non-record sale earnings such as from publishing, touring, merchandising, fan clubs, sponsorship money and motion picture acting. Most labels take between 10 and 35 percent of their artist's net income from these non-record sale sources.<sup>92</sup>

Three-sixty deals typically come in two varieties, passive interest deals and active interest deals.<sup>93</sup> In passive interest 360 deals, labels only agree to split the income generated from the exploitation of the rights covered under the deal.<sup>94</sup> Therefore, labels concede control of the rights covered under the agreement to their artists, allowing artists to freely contract with third parties without needing to first seek permission from the label.

However, some labels contract for a grant of rights rather than just a split of net income. This type of an arrangement is called an active interest 360 deal.<sup>95</sup> Under active interest 360 deals, the labels have ultimate control over the rights granted, which typically include final approval over rights such as the right to approve tour schedules, the right to set the salaries of certain tour and merchandise sales employees and the right to insist with whom the artist contracts for publishing and merchandising.<sup>96</sup>

The 360 deal has quickly become the standard in today's music business.<sup>97</sup> From major labels to independents, most companies insist on 360 deals.<sup>98</sup> In 2008, Edgar Bronfman, CEO of Warner Music Group, said that Warner Music requires "all new acts to sign [360] deals and that at least 1/3 of their artists are contracted under this arrangement."<sup>99</sup> Some of the major initiators of 360 deals are not traditional record labels. Companies like Live Nation, a tour promotion company, have recently signed multiple major acts such as Jay-Z, Madonna and Nickelback to large 360 deals.<sup>100</sup>

The 360 deal represents a new economic model for the music industry.<sup>101</sup> As the actual value of recorded music declines, the

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<sup>92</sup> *Id.* at 96

<sup>93</sup> *Id.* at 98.

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 96.

<sup>98</sup> *Id.*

<sup>99</sup> See Michael Arrington, *360 Deals Become Mandatory as Labels Prepare for Free Music*, THE TECH CRUNCH (Nov. 8, 2008), <http://techcrunch.com/2008/11/08/360-music-deals-become-mandatory-as-labels-prepare-for-free-music>.

<sup>100</sup> Leeds, *supra* note 86.

<sup>101</sup> Jeff Leeds, *In Rappers \$150 Million Deal, New Model for Ailing Business*, N.Y. TIMES (Apr. 3, 2008), <http://query.nytimes.com/gst/fullpage.html?res=9A0CE4DF1E31F930A35757C0A96E9C8B63&sc=1&sq=Jay-Z+%22Live+Nation%22&st=nyt>.

viability of an artist's brand and its different brand offerings becomes much more important. As a result of this phenomenon, some experts envision a music industry, in the very near future, where the music produced is nothing more than a promotional tool to draw fans to the artist's brand instead of to his or her music.<sup>102</sup>

### B. *Why 360 Deals?*

The justification for the 360 deal is the notion that labels can no longer rely on record sales as their sole source of income.<sup>103</sup> The traditional music business model relied heavily on record sales. The traditional recording agreement only gave labels the right to share income generated from the sales of an artist's recordings.<sup>104</sup> The industry has changed however. Factors such as music piracy have brought about a sharp decline in album sales revenue, which has eroded the traditional business model.<sup>105</sup> Ancillary ventures such as touring has become more profitable than record sales.<sup>106</sup>

Furthermore, labels devote a substantial amount of time, money and effort to develop an artist. Their efforts often contribute to the success of an artist's non-record sale businesses.<sup>107</sup> Absent an arrangement like the 360 deal, labels would be precluded from sharing income generated from these ancillary ventures.

For example, labels devote a great amount of time and effort to promoting an artist's single on the radio. It is standard for labels to have an entire department dedicated to radio promotion. Labels put forth this effort because the success of a song on the radio often correlates to larger sales of the single or album. However, this is not an exact science. Often, a song is a hit on the radio, but retail sales of the song or album are minimal. In such cases, the label takes a loss on the costs of their marketing and promotion effort, whereas the artist can still profit via ancillary ventures such as music publishing.<sup>108</sup> The

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<sup>102</sup> See Arrington, *supra* note 99; See generally DAVID KUSEK & GERD LEONHARD, THE FUTURE OF MUSIC: MANIFESTO FOR THE DIGITAL MUSIC REVOLUTION (Berklee Press 2005).

<sup>103</sup> See PASSMAN, *supra* note 88, at 95.

<sup>104</sup> *Id.* at 68

<sup>105</sup> See David Goldman, *Music's Lost Decade: Sales Cut In Half*, CNNMONEY.COM (Feb. 3, 2010), [http://money.cnn.com/2010/02/02/news/companies/napster\\_music\\_industry/](http://money.cnn.com/2010/02/02/news/companies/napster_music_industry/).

<sup>106</sup> Sara Karubian, *360° Deals: An Industry Reaction to the Devaluation of Recorded Music*, 18 S. CAL.INTERDISC. L.J. 395, 421 (2009).

<sup>107</sup> See Pierson, *supra* note 1, at 1.

<sup>108</sup> See PASSMAN, *supra* note 88, at 234. The more a song is played on the radio, the more income is generated from licensing fees charged to the radio station for permission to play the song.

labels are not able to share in this income because they have no right to their artists' publishing revenue under a traditional recording agreement, even though it was the label's promotional effort that helped make the song a success on the radio.

This justification does not only apply to publishing rights. The exposure generated by the label's marketing and promotion effort often motivates fans to see the artist live and to purchase artist's merchandise. Thus, the labels believe they rightfully deserve a piece of the revenue generated from non-record sale businesses.

A further justification for the 360 deal is that labels have expertise that can maximize the profitability of a 360 deal and this agreement gives them the incentive to put such expertise to use.<sup>109</sup> Unlike most artists, labels have the personnel, resources and influence to maximize the overall profit scheme of a 360 deal. Their ability to bundle items such as CDs, ringtones, concert tickets and merchandise can result in larger profits, which both the artist and label can share.<sup>110</sup>

Some argue that this justification does not apply to companies who may operate outside of their field of expertise with respect to certain rights.<sup>111</sup> Some believe that companies like Live Nation lack the ability to carry out the duties necessary to exploit many of the rights granted in a 360 deal.<sup>112</sup> Nevertheless, music companies like Live Nation provide other valuable services to an artist, such as the logistical ability to coordinate marketing tours, or the ability to accurately track an artist's popularity in certain regions of the country, that would make profit sharing justifiable.<sup>113</sup>

This new business model and its implicit declaration of the 360 deal as the new standard agreement require a review and determination of its legal implications. This will ensure that the rights of all parties involved are properly protected, and it will make for a smoother transition into this new era of the music business.

#### IV. THE 360 DEAL CAN INVOKE A FIDUCIARY DUTY BETWEEN ARTIST AND LABEL BY TRANSFORMING THE RELATIONSHIP INTO A PARTNERSHIP

##### A. *Establishing a Fiduciary Duty Between Artist and Label*

Courts have consistently refused to establish a fiduciary duty between artists and labels, as additional factors are necessary to

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<sup>109</sup> See Leeds, *supra* note 86.

<sup>110</sup> *Id.*

<sup>111</sup> Susan Butler, *Music Biz Lawyers Wary of Labels' New Grab*, REUTERS UK (Dec. 29, 2007), <http://uk.reuters.com/article/industryNews/idUKN2849012220071229>.

<sup>112</sup> *Id.*

<sup>113</sup> See Karubian, *supra* note 106, at 424.

convert a conventional contractual relationship into a fiduciary relationship.<sup>114</sup> According to case law, a fiduciary duty only arises in a contractual relationship, like that of artist and label, if 1) there is sufficient evidence to prove the existence of a formal relationship (i.e. attorney/client, trustee/beneficiary or a partnership), or 2) there are “special circumstances” exhibiting the necessary trust elements of a fiduciary.<sup>115</sup> Otherwise, the relationship is purely contractual and is subject to the ordinary contractual duties of good faith and fair dealing.<sup>116</sup>

Lawyers have used various legal theories in their attempts to establish a fiduciary duty between artist and label. Many of these theories relied solely on proving that there were “special circumstances” exhibiting the necessary trust elements of a fiduciary.<sup>117</sup> Courts are reluctant to apply a fiduciary duty to parties of a contract since the ordinary contractual duties of good faith and fair dealing will suffice in most cases.<sup>118</sup> Therefore, they continuously reject these claims, citing that the “special circumstances” in such cases do not rise to the level of significance necessary to invoke a strict standard of conduct like that of a fiduciary duty.<sup>119</sup>

Demonstrating a formal relationship such as a partnership is the easiest way to establish a fiduciary duty between parties to a contract. Once a formal relationship is proven, a fiduciary duty instantly arises.<sup>120</sup> This strategy is less difficult than trying to prove to the court that “special circumstances” warrant a fiduciary duty.<sup>121</sup> Moreover,

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<sup>114</sup> *Reuben H. Donnelly Corp. v. Mark I Mktg. Corp.*, 893 F. Supp. 285, 289 (S.D.N.Y. 1995); *Sony Music Entm't, Inc. v. Robison*, No. 01 CIV. 6415(LMM), 2002 WL 272406 (S.D.N.Y. Feb. 26, 2002).

<sup>115</sup> *See Cooper v. Sony Records Int'l*, No. 00 Civ. 233 (RMB), 2001 U.S. Dist. LEXIS 16436, \*18-19 (S.D.N.Y. Oct. 12, 2001).

<sup>116</sup> 37 AM JUR. 2D *Fraud and Deceit* § 32 (2002).

<sup>117</sup> *See Rodgers v. Roulette Records*, 677 F. Supp. 731 (S.D.N.Y. 1988) (Defendants collected money on behalf of plaintiff in the form of royalties or license fees); *Cooper*, 2001 U.S. Dist. LEXIS 16436 at \*18 (“Plaintiffs’ claim only that ‘the relationship between the plaintiffs and Sony was one of trust and confidence whereby Sony assumed exclusive control over the Masters for the term of the Agreement promising to share with the plaintiffs a certain percentage of the proceeds from the commercial exploitation of the Masters.’”).

<sup>118</sup> *See Mellencamp v. Riva Music Ltd.*, 698 F. Supp. 1154, 1159 (S.D.N.Y. 1988).

<sup>119</sup> *See id.*

<sup>120</sup> *See, Lonsdale v. Speyer*, 19 N.Y.S.2d 746, 764 (N.Y. Spec. Term 1938) (where the decision to grant a right of accounting was based on the finding of a joint venture).

<sup>121</sup> *Compare Apple Records, Inc. v. Capitol Records, Inc.*, 529 N.Y.S.2d 279, 283 (N.Y. App. Div. 1988) (plaintiff’s breach of fiduciary duty claim survived a motion to dismiss based on unique factors such as the duration of the parties business dealings and the popularity and success of the business relationship), *with Mellencamp*, 698 F. Supp. at 1160 (dismissing fiduciary duty claims between song-writer and recording company despite the relationship

there is no clear demarcation for when a contractual relationship crosses into fiduciary territory.<sup>122</sup> However, if a contractual relationship creates a formal relationship such as a partnership, then the law is clear on the fiduciary implications of that relationship.<sup>123</sup>

*Broadcast Music v. Taylor*<sup>124</sup> is one of the few examples in music business cases where a fiduciary duty was established by proving the existence of a formal relationship. *Broadcast Music v. Taylor* was an action for a declaratory judgment on the rights and legal relations of the American Society of Composers, Authors and Publishers (ASCAP) and its members.<sup>125</sup> ASCAP is a non-profit organization engaged in the business of issuing licenses for the musical compositions of its members, as well as distributing to its members the net fees they collect.<sup>126</sup> Its members consist of composers, songwriters and music publishers who grant ASCAP the exclusive right to issue licenses on their behalf.<sup>127</sup>

In *Broadcast*, the court determined that the relationship between ASCAP and its members constituted a joint venture.<sup>128</sup> In making this decision, the court emphasized that the division of profits and the conduct of the parties in executing their agreement were factors that demonstrated a joint venture.<sup>129</sup> As a result of this finding, the court ruled that the actions of the defendants constituted not only a breach of contract, but a breach of their fiduciary duty as well.<sup>130</sup>

*Broadcast* can be analogized to the execution of a 360 deal in two major ways. First, under a 360 arrangement, artists grant labels the

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exhibiting “trust elements.”) and *Rodgers*, 677 F. Supp. at 739 (Plaintiff’s fiduciary duty claim failed despite the fact Defendants collected money on behalf of plaintiff in the form of royalties or license fees) and *Cooper*, 2001 U.S. Dist. LEXIS 16436 at \*18-19 (Plaintiffs’ fiduciary duty claim failed despite Sony having exclusive control over the Masters for the term of the Agreement and promised to share with the plaintiffs a certain percentage of the proceeds from the commercial exploitation of the Masters).

<sup>122</sup> *CBS, Inc. v. Ahern*, No. 83 Civ. 7918 (VLB), 1985 U.S. Dist. LEXIS 18121, at \*\*30 (S.D.N.Y. July 9, 1985).

<sup>123</sup> See UNIF. P’SHIP ACT § 404(e)-(f) (1997).

<sup>124</sup> *Broadcast Music v. Taylor*, 55 N.Y.S.2d 94 (N.Y. Spec. Term 1945).

<sup>125</sup> *Id.* at 96. ASCAP was a defendant in this case, which was brought by its rival company, *Broadcast Music, Inc. Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> *Id.* at 102 (“All the circumstances established by the evidence make it clear that that relationship is basically a joint venture for the commercial exploitation of the performing rights to the songs in suit by Ascap...”).

<sup>129</sup> *Id.*

<sup>130</sup> *Id.* at 103 (“The consequences from this relationship follow clearly. It was a breach of its contract, and a breach of trust as well, for Marks to attempt to cut off the rights of its co-adventurers by licensing to BMI the performing rights to the songs in suit without their consent, and without their receiving any part of the consideration paid to Marks for the license.”).

exclusive right to exploit their music, just like the members granted ASCAP the right to exploit their compositions in the form of issuing licenses. Second, labels pay artists in royalty payments based on a percentage of monies collected, which is the same as the profit-dividing scheme employed in Broadcast.

The only clear difference between Broadcast and a 360 deal is that the Broadcast agreement was limited to the copyrights of songs in the ASCAP catalogue, while a 360 deal essentially encompasses all of an artist's rights to their music. Notwithstanding, Broadcast establishes a precedent, in the music business context, for establishing a fiduciary duty by demonstrating the existence of a formal relationship.

### B. *Partnership, Fiduciary Duty and the 360 Deal*

Three-sixty deals can transform the artist-label relationship into a partnership. A partnership is a formal relationship that carries with it fiduciary responsibilities. Therefore, 360 deals can invoke a fiduciary duty between artist and label.

Courts typically examine three factors when determining the existence of a partnership: 1) evidence of profit sharing; 2) evidence of joint control; and 3) the intent of the parties.<sup>131</sup> A closer examination of all three elements and the 360 deal shows that the artist-label relationship is highly susceptible to a partnership finding.

#### 1. The "Business" of a 360 Deal

Section 202 of the RUPA requires that partners be co-owners of a "business."<sup>132</sup> Recognizing the underlying "business" of an alleged partnership is crucial when analyzing whether the elements of partnership exist.<sup>133</sup> Without this knowledge there may be some confusion as to whether the alleged partners "jointly control" or "share in the profits" of the same venture or two separate enterprises. Therefore, a portion of this article must be designated to clarifying the current state of the music business, as recent changes to the industry may be overlooked.

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<sup>131</sup> UNIF. P'SHIP ACT §§ 6-7 (1914).

<sup>132</sup> UNIF. P'SHIP ACT § 202(a) (1997). "Business" is defined as "every trade, occupation, and profession." UNIF. P'SHIP ACT § 101(1) (1997).

<sup>133</sup> See, e.g., *Tuxedo Beach Club Corp. v. City Sav. Bank*, 749 F. Supp. 635, 646-47 (N.J. 1990) (holding control over the subject matter as an element of a partnership); *Chariton Feed & Grain, Inc. v. Harder*, 369 N.W.2d 777, 786 (Iowa 1985) (holding co-ownership of control to be a "key element in determining the existence of a partnership"); *Weingart v. C & W Taylor P'ship*, 809 P.2d 576, 578-79 (Mont. 1991) (holding that, in order for a partnership to exist, "each party must have a right of mutual control over the subject matter of the enterprise").

The music industry transitioned from an emphasis on the exploitation of an artist's recorded music to the exploitation of an artist's entire brand.<sup>134</sup> Instruments like the 360 deal confirm this transition. Before the 360 deal, the traditional recording agreement mainly focused on the rights to an artist's recorded material. This allowed the artist to enter into agreements with other entities in regards to their other rights.

For example, publishing rights are generally not included under traditional recording contracts.<sup>135</sup> Thus, artists may exploit this right and generate revenue independent of their obligations under a traditional recording agreement. The same applies to artists' merchandise rights, touring rights, and other rights not included in traditional recording agreements.

The 360 deal now merges these different rights and entities into one whole business—the exploitation of an artist's entire brand. The rights granted under a 360 deal range from traditional agreements as to distribution and master recording rights, to the right to split income from ancillary ventures like endorsement deals and merchandise sales. This collective of rights represents most, if not all, of the industries from the former, fragmented music business.

An artist's brand may be a difficult concept to grasp since brand appeal is an intangible asset and is not easily measurable like recorded music sales. However, brand appeal is quantifiable. Although one cannot physically touch brand appeal, one can sell it, which, therefore, makes it measurable. For example, endorsement deals are mainly based on brand appeal. When a company like L'Oreal endorses an artist like Beyonce, it seeks to profit from the appeal of the artist by luring consumers, who readily identify with the artist, to the company's products endorsed by that artist.

The same brand economics apply in the music industry. The profitability of an artist's tour or merchandise campaign is highly dependent upon the artist's appeal. Motivating consumers to purchase a \$30 t-shirt emblazoned with an artist's name and likeness often comes down to whether consumers relate to the artist personally rather than whether they like a song or two. Otherwise, the consumer could simply pay 99 cents for each single, or worse, illegally download it for free.

Thus, brand appeal is important in today's music context and is imperative in a partnership determination. When determining whether the artist-label relationship under a 360 deal demonstrates the requisite elements of a partnership, one must understand that the subject matter

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<sup>134</sup> See *A Change of Tune*, THE ECONOMIST (July 5, 2007), [http://www.economist.com/business/displaystory.cfm?story\\_id=9443082](http://www.economist.com/business/displaystory.cfm?story_id=9443082).

<sup>135</sup> Salmon, *supra* note 87.

of a 360 deal is the artist's brand rather than just the artist's recorded music. If emphasis is placed on the latter, the likely result would be a finding of no partnership.

## 2. Profit Sharing Element

The RUPA presumes that a person is a partner if he or she shares in the profits of an enterprise.<sup>136</sup> Three-sixty deals are essentially profit sharing agreements. Under a 360 arrangement, artist and label agree to split the profits received from the artist's different brand offerings, i.e. album sales, publishing fees, touring income, etc. This sharing of profits creates the presumption that artists and labels are partners.

Opponents to establishing a partnership between artist and label may argue that the profits received in a 360 deal are "gross profits"; thus, the profit sharing presumption does not apply. This claim is based on section 202(c)(2) of the RUPA, which provides that the profit sharing presumption does not apply to the sharing of "gross profits."<sup>137</sup> Sharing of gross profits is considered less persuasive than the sharing of net profits because the one who participates in the latter is subjecting himself to the fortunes and risks of the business to a much greater degree.<sup>138</sup> This does not reflect how a true partnership operates because in a partnership, the parties often share the costs of doing business. Thus, sharing in "gross profits" is very damaging to a partnership claim.

Those opposed to establishing a partnership may attempt to characterize the proceeds garnered under a 360 arrangement as gross profits rather than net profits. Black's Law Dictionary defines "gross income" as "total income from all sources before deductions, exemptions, or other tax reductions."<sup>139</sup> Case law has defined "net profits" as "the clear gains of any business venture, after deducting the capital invested in the business, the expenses incurred in its conduct, and the losses sustained in its prosecution."<sup>140</sup> Thus, the

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<sup>136</sup> UNIF. P'SHIP ACT § 202(c)(3) (1997).

<sup>137</sup> UNIF. P'SHIP ACT § 202(c)(2) (1997).

<sup>138</sup> *Fechteler v. Palm Bros. & Co.*, 133 F. 462, 470-471 (6th Cir. 1904); *Blankenship v. Hearst Corp.*, 519 F.2d 418 (9th Cir. 1975) ("...the carriers made collections from the subscribers, kept 20 percent of the gross proceeds, gave Blankenship 80 percent of the proceeds, and if a subscriber failed to pay his bill did not have to pay Blankenship the amount owed... they did not share in Blankenship's risks except to the limited extent of losing their profit if a subscriber failed to pay").

<sup>139</sup> BLACK'S LAW DICTIONARY 347 (Bryan A. Garner ed., Thomson West 3d Pocket Ed. 2001).

<sup>140</sup> *Boradori v. Peterson*, 261 P. 520, 523 (Cal. Ct. App. 1912) (citing *Park v. Grant Locomotive Works*, 3 A. 162 (N.J. Ch.1885); *Crawford v. Calkins*, 136 N.W. 369 (Mich.

characterization of profits as “net” or “gross” depends on whether the proceeds received account for costs, expenses and other deductions.

a. Net Profits v. Gross Profits

*Blankenship v. Hearst Corp.*<sup>141</sup> exemplifies an enterprise where the parties did not account for expenses and losses in their split of income and, thus, shared in “gross” profits. In *Blankenship*, the plaintiff engaged in the business of newspaper distribution.<sup>142</sup> The plaintiff initially purchased the papers from a publisher then dispatched them to his carriers.<sup>143</sup> The carriers delivered the newspapers and collected money from the subscribers.<sup>144</sup> The carriers kept 20 percent of the subscription fees and paid the balance to the plaintiff.<sup>145</sup> If a subscriber failed to pay, the carrier lost his 20 percent share, while the plaintiff suffered the investment costs of purchasing the newspapers and lost income.<sup>146</sup> The court in *Blankenship* determined that this operation was not a partnership because the parties shared in “gross” profits.<sup>147</sup> The court specifically cited that in the event of a loss, when subscribers failed to pay their subscription fees, the carriers did not owe the plaintiff anything.<sup>148</sup> Therefore, their share of the proceeds was “gross profits” since it did not account for the investment costs of doing business, such as purchasing the newspapers from the publisher.<sup>149</sup>

Those opposed to establishing a partnership would argue that the performance of a 360 deal resembles the operation in *Blankenship*. The profit sharing scheme of a 360 deal, with the label receiving all income from the venture and distributing a percentage of the proceeds to their artists, does not conspicuously indicate whether those proceeds account for cost and expenses. One can determine that the profits received from such an arrangement are “gross profits” and, thus, raise no presumption of partnership. However, defining the profits from a 360 deal is difficult and such a cursory review is ill-advised when making such a determination.

Profits from a 360 deal are difficult to define as distinctly “net” or “gross” because they come from several, different revenue streams. There are typically four major rights granted by artists in a 360 deal: 1)

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1912)).

<sup>141</sup> *Blankenship v. Hearst Corp.*, 519 F.2d 418 (9th Cir. 1975).

<sup>142</sup> *Id.* at 421.

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> *Id.* at 425.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

master recording rights, 2) music publishing rights, 3) touring rights and 4) merchandising rights, all of which contribute income to the overall profits from a 360 deal.<sup>150</sup> The problem with conclusively defining profits from a 360 deal as either “gross” or “net” is that each right, and its accompanied revenue stream, at one point represented a separate enterprises and may have its own traditional way of accounting for costs and expenses.

For example, the typical split under a traditional recording agreement accounts for the costs and expenses of exploiting the artist’s master recording rights.<sup>151</sup> The advance money paid to an artist includes funds allocated for the costs of recording, such as studio time, engineering fees and producer fees.<sup>152</sup> It is standard for labels to deduct advance money and other expenses from an artist’s future royalties.<sup>153</sup> This scheme of cost deductions and expense allocation allows for both artist and label to share the costs of doing business. Therefore, the proceeds from this venture can be defined as “net” profits.

On the other hand, the traditional split of income from a publishing agreement does not account for costs and expenses.<sup>154</sup> The traditional split in a publishing agreement is 50/50.<sup>155</sup> The publisher’s 50 percent goes to both overhead and profit, while the artist takes 50 percent free and clear of expenses.<sup>156</sup> Thus, the artist’s split constitutes “gross” profits because the costs and expenses of the venture are not deducted from his or her share.

The uniqueness of each 360 deal makes defining the profits from such an agreement challenging. Moreover, the fact that the total profit pool of a 360 deal can include both net and gross income further complicates the matter. Therefore, it is difficult to determine conclusively whether the proceeds derived from a 360 deal constitute “net” or “gross” profits.

Notwithstanding, now that the collection and distribution of profits from a 360 deal are administered by one company, the label, it is highly likely that the label will employ a uniform system of accounting

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<sup>150</sup> There are other rights that can be included in a 360 deal as well such as the right to share income from endorsements. See Pierson, *supra* note 1, at 32.

<sup>151</sup> PASSMAN, *supra* note 88, at 68.

<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> RICHARD STIM, MUSIC LAW: HOW TO RUN YOUR BAND’S BUSINESS 175-76 (Nolo 6th ed. 1998).

<sup>155</sup> *Id.*

<sup>156</sup> See PASSMAN, *supra* note 88, at 234.

for expenses and losses. If such is the case, characterizing the share of proceeds will be much easier. A simple review of whether the artists' share of income deducts the cost of doing business will determine whether their share constitutes "net" or "gross" profits.

Each determination must be made on a case-by-case basis and it is solely up to the trier of fact to determine whether the profits from a particular venture are "net" or "gross". Please note that section 202(c)(3) creates only a presumption of partnership and should not be taken as conclusive. Even if a court determines that an artist and label share in "gross profits" and does not apply the presumption, this does not preclude a finding of partnership.<sup>157</sup> It is only treated as less persuasive than sharing "net" profits.<sup>158</sup> The claimant will still have the opportunity to establish a partnership by proving the existence of the other elements.<sup>159</sup>

### 3. Joint Control Element

Joint control is an integral factor in a partnership determination. The controlling question is whether each alleged partner has the control of a co-owner.<sup>160</sup> Control of the business and the right to make management decisions are important indicators of joint control.<sup>161</sup> In most 360 deals, artists and labels share control of the business venture.

#### a. Artist Control v. Label Control.

Artists have the requisite amount of control in their relationship with labels as demonstrated by their ability to make brand decisions. Artists have the right to hire and fire managers,<sup>162</sup> book tour gigs,<sup>163</sup> contract with various third parties (merchandisers, publishers, sponsors),<sup>164</sup> and the power to make other decisions that substantially

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<sup>157</sup> *Murphy v. McDermott, Inc.*, 807 S.W.2d 606, 613 (Tex. App. 1991), writ denied, (June 19, 1991) ("Mere legal conclusions cannot give rise to an issue of a disputed fact such as the existence of a partnership").

<sup>158</sup> See *Fechteler v. Palm Bros. & Co.*, 133 F. 462, 470-471 (6th Cir. 1904).

<sup>159</sup> 59A AM JUR 2D *Partnership* § 150 (2011).

<sup>160</sup> *Harvey v. Childs & Potter*, 28 Ohio St. 319 (Ohio 1876).

<sup>161</sup> 1 ALAN R. BROMBERG & LARRY E. RIBSTEIN, *BROMBERG & RIBSTEIN ON PARTNERSHIP* § 2.07(c)(1) (1988). See also *Chocknok v. State, Commercial Fisheries Entry Comm'n*, 696 P.2d 669, 675 (Alaska 1985) ("One aspect of co-ownership is the existence of a right in each partner to exercise authority in the management of the enterprise."); *Higgins v. Higgins*, 486 A.2d 294, 296 (N.H. 1984) (finding of non-partnership since defendant controlled the management of all of the various enterprises, and made all major financial decisions).

<sup>162</sup> See XAVIER M. FRASCOGNA, JR & H. LEE HETHERINGTON, *THIS BUSINESS OF ARTIST MANAGEMENT* 23 (Billboard Books 4th ed.) (2004).

<sup>163</sup> Karubian, *supra* note 106, at 442.

<sup>164</sup> See PASSMAN, *supra* note 88, at 68.

affect their brand. Artists retain these powers under many 360 deals.<sup>165</sup>

On the other hand, much of the control labels had under traditional recording agreements remain unchanged under 360 deals. Labels still retain ownership of master recordings and can make decisions on matters pertaining to those rights.<sup>166</sup> Labels still maintain great leverage in negotiations with artists.<sup>167</sup> These components of the artist-label relationship have remained unchanged under most 360 deals.

Those opposed to establishing a partnership may point to the fact that many labels contract for final approval rights in 360 deals.<sup>168</sup> These types of deals are called “active interest, 360 deals.”<sup>169</sup> Opponents to establishing a partnership will argue that under these arrangements, control is not mutual since final approval of all important matters is vested in the label. Thus, a finding of co-ownership must fail. This may very well be the case and, if so, this would be a very persuasive argument.

However, not all 360 deals are the same. A lot of 360 deals only allow for labels to split the proceeds from the artist’s non-record sale businesses.<sup>170</sup> Under such agreements, labels still maintain ownership and control over master recording rights, thus, leaving the decision making rights to all other aspects of the music to the artists. Therefore, in many instances, joint control is still evident.

In conclusion, a joint control determination is highly fact-sensitive and contingent upon the evidence provided. Whether joint control exists under a particular 360 deal depends on how the two parties share their mutual responsibilities. If the label maintains its traditional role in the artist-label relationship, controlling the budget and master recording rights, but concedes final approval of everything else to the artist, a finding of joint control is very likely. If a particular 360 deal provides for the label to have final approval of all rights granted therein, this can result in a finding of no joint control. If a court decides there is no evidence of joint control, this does not preclude a finding of partnership.<sup>171</sup> The party proposing a partnership will still have the opportunity to prove the other elements of a partnership.

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<sup>165</sup> Pierson, *supra* note 1, at 1.

<sup>166</sup> PASSMAN, *supra* note 88 at 94.

<sup>167</sup> Karubian, *supra* note 106, at 442.

<sup>168</sup> Leeds, *supra* note 86

<sup>169</sup> PASSMAN, *supra* note 88, at 98.

<sup>170</sup> These types of 360 deals are called “passive interest, 360 deals.” *Id.*

<sup>171</sup> *Murphy v. McDermott, Inc.*, 807 S.W.2d 606, 613 (Tex. App. 1991), writ denied, (June 19, 1991) (“Mere legal conclusions cannot give rise to an issue of a disputed fact such as the existence of a partnership”).

#### 4. Intent Element

The requisite intent to establish a partnership is inherent in most 360 deals. The crucial question in an intent element inquiry is whether the parties intend to create a relationship that includes the essential elements of a partnership, namely, the right to share profits and joint control of the business.<sup>172</sup> If these important elements of a partnership are present, then the intent element is satisfied.<sup>173</sup>

The important elements of profit sharing and joint control can be established under a 360 deal. The essence of a 360 deal is a profit sharing arrangement where both artist and label contribute time, capital, skills and effort to maximize the profitability of an artist's brand. Thus, the intent element exists in a typical 360 deal because the important elements of a partnership can be established under such an arrangement.

##### a. Contract Interpretation

The requisite intent to establish a partnership can be demonstrated by the industry's switch from traditional recording agreements to 360 deals. In *Stevens v. Marco*, the court stated that the intent of an alleged partner is determined in accordance with the rules of contract law governing contract interpretation and construction.<sup>174</sup> According to contract law, if the court has to ascertain the intent of parties to a contract, it may consider the surrounding circumstances at the time the contract was made.<sup>175</sup> If a court considers the facts and reasoning surrounding the industry's transition to 360 deals, the court will likely find intent to form a partnership.

The transition from traditional recording agreements to 360 deals manifests the intent of both artists and labels to carry on as co-owners in the business of music. The rapid devaluation of recorded music devastated the bottom line of labels because traditional recording agreements only gave them the right to share income from record sales.<sup>176</sup> The labels turned to the total revenue sharing arrangement of the 360 deal because of their need to tap into the profitable ancillary businesses of their artists.<sup>177</sup> Many artists agreed to this new profit sharing scheme on the basis of concessions that generally were not

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<sup>172</sup> *Arnold v. Erkmann*, 934 S.W.2d 621, 630 (Mo.App. 1996).

<sup>173</sup> *Martin v. Peyton*, 158 N.E. 77, 78 (N.Y. 1927).

<sup>174</sup> *Stevens v. Marco*, 305 P.2d 669, 680 (Cal. Ct. App. 1956)

<sup>175</sup> 17 AM. JUR. 2D *Contracts* §74 (1964). See also *Cedars-Sinai Medical Center v. State Board of Equalization*, 208 Cal. Rptr. 837 (Cal. Ct. App. 1984).

<sup>176</sup> Leeds, *supra* note 86.

<sup>177</sup> PASSMAN, *supra* note 88, at 95.

offered by labels before, such as greater artistic control.<sup>178</sup> These facts and more demonstrate both parties' intent to form a relationship that involves the elements of partnership. Thus, intent is present under a 360 deal.

Opponents to establishing a partnership may argue that labels did not intend to partner with artists by switching from a traditional recording agreement to a 360 deal. The term "association" in the RUPA's definition of partnership connotes both voluntariness and intent.<sup>179</sup> Thus, a party's intent to enter into a partnership agreement must be an act of their own will. Those opposed to establishing a partnership will state that under the pressure of a rapid decline in record sales and a changing business model, the labels transition to a 360 deal was a decision forced by necessity. Their choices were simple: find a new source of revenue or find a new business. Therefore, the labels did not intend to partner with artists, but instead were attempting to save their business. Although this argument can be viewed as desperate and may be a far reach, the fact that labels did suffer such a rapid decline can be taken into consideration when determining the intent of parties to a 360 deal.

However, the law does not require intent to establish a partnership.<sup>180</sup> If the important elements of a partnership exist, then intent is present.<sup>181</sup> Therefore, a court can determine that the music industry's transition to the 360 deal was non-volitional and still decide that a partnership exists.

## 5. Fiduciary Duty and the Artist-Label Relationship

The 360 deal makes the artist-label relationship highly susceptible to a partnership finding. Partnerships carry with them fiduciary

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<sup>178</sup> Leeds, *supra* note 86.

<sup>179</sup> UNIF. P'SHIP ACT § 6, 7 cmt. subdiv. 1 (1914) ("In the domain of private law the term association necessarily involves the idea that the association is voluntary."). See also H.T. Hackney Co. v. Robert E. Lee Hotel, 300 S.W. 1, 3 (Tenn. 1927) ("It is said there is no such thing as a partnership by implication or operation of law. A partnership can only arise by a voluntary contract of the parties.").

<sup>180</sup> Constans v. Ross, 235 P.2d 113, 116 (Cal. Ct. App. 1951) ("The parties did intend to create exactly the relationship as shown by the contract, but did not intend that relationship to be called that of partnership. However, their intention in this respect is immaterial and if the contract by its terms establishes a partnership between the parties, even the expressed intent that it should not be so classed would be of no avail.").

<sup>181</sup> Martin v. Peyton, 158 N.E. 77, 78 (N.Y. 1927) ("Mere words will not blind us to realities. Statements that no partnership is intended are not conclusive. If as a whole a contract contemplates an association of two or more persons to carry on as co-owners [of] a business for profit, a partnership there is.").

obligations. If artists and labels are found to be partners under a 360 deal then, as a matter of law, they become fiduciaries to one another.

There has been a long-standing view that a fiduciary duty among artist and label will make the music industry as a whole inoperable.<sup>182</sup> This argument is valid when considering the stringent obligations inherent in Cardozo's common law application of a fiduciary duty.<sup>183</sup> However, the RUPA applies a less stringent fiduciary obligation among partners, one that fits well in the artist-label context.

The RUPA's version of fiduciary duty fits within the music business context because it has broken away from the traditional view of a fiduciary's obligations. The Cardozo standard demands partners to act with undivided loyalty. This conflicts directly with the functioning of the music industry. For example, labels would not be able to service multi-artist rosters under this definition of a fiduciary. However, the RUPA no longer requires a partner to act as a disinterested trustee of his or her partner.<sup>184</sup> This allows for the legitimate pursuit of self interest.

Furthermore, many of the RUPA's fiduciary duty rules already exist under the traditional artist-label relationship. For example, the RUPA's duty of good faith and fair dealing is the same as the good faith and fair dealing in all contractual relationships.<sup>185</sup> Moreover, in most traditional recording agreements artists have the right to audit their label,<sup>186</sup> which is in many instances similar to a partner's information rights under the RUPA. Thus, the inclusion of a fiduciary duty among artist and label would not render the relationship inoperable, but merely inconvenient at best.

## 6. Summary

All 360 deals have the potential of transforming the artist-label relationship into a partnership. 360 deals are essentially profit sharing arrangements where both artist and label contribute time, capital, skills and effort to maximize the profitability of an artist's brand. Therefore, inherent in the execution of all 360 deals are the partnership elements of profit sharing and joint control.

Notwithstanding, all partnership cases are highly dependent on the facts. 360 deals are also a fairly new trend and vary amongst each

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<sup>182</sup> Bartholomew, *supra* note 2, at 257-58 (citing Sen. Kevin Murray, *Recording Industry Practices Hearing Summary*, available at <http://democrats.sen.ca.gov/senator/murray> (last visited Mar. 25, 2004)).

<sup>183</sup> See *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

<sup>184</sup> UNIF. P'SHIP ACT §§ 404 (e)-(f) (1997); See also UNIF. P'SHIP ACT §404 cmt. 5-6 (1997).

<sup>185</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

<sup>186</sup> Bartholomew, *supra* note 2, at 250.

other. Therefore, a partnership determination under a 360 deal must be taken on a case-by-case basis.

Partnerships carry fiduciary obligations. If artist and label are found to be partners under a 360 deal, they will be subject to a fiduciary standard of conduct. Even though this standard of behavior may be to the disadvantage of some parties involved, the relationship as a whole can continue and may even flourish under a fiduciary duty.

#### V. HOW A FIDUCIARY DUTY BETWEEN ARTIST AND LABEL WILL BENEFIT THE MUSIC INDUSTRY

There are benefits to establishing a fiduciary duty in the artist-label relationship, especially in today's music industry. A balance of power and influence can be achieved by establishing a fiduciary relationship. This balance can increase the overall functioning of the music industry, as well as address some of its perpetual grievances.

##### A. *Setting Boundaries for a New Relationship*

Establishing a fiduciary duty can set the boundaries for the new business model created by the 360 deal. For a long time, the music business has been defined by two separate components. On the one hand, there are the labels' efforts to exploit, solely, the artists' recordings and, on the other hand, there are the artists' efforts to increase the profitability of their ancillary ventures such as touring, publishing, and merchandising, as well as their physical recordings. The 360 deal now merges these separate parts into one enterprise in hopes of maximizing benefits for all. However, this transition occurred quickly and a fiduciary duty can establish the foundation and boundaries for these former exclusive entities to build their new relationship.

Record label dominance in artist-label affairs has been a long-standing standard within the music industry.<sup>187</sup> Labels have often yielded this power in a manner that mainly favors their own interests.<sup>188</sup> This advantage has essentially gone unchecked because artists lack leverage in negotiations, which allows labels to manipulate contracts in their favor.<sup>189</sup>

Notwithstanding, artists had an incentive to maintain this unbalanced relationship. Traditional recording agreements only

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<sup>187</sup> Karubian, *supra* note 106, at 402.

<sup>188</sup> *Id.*

<sup>189</sup> *Id.* See also Bartholomew, *supra* note 2, at 246.

granted a label the right to an artist's physical recordings, leaving the remaining rights under the control of the artist.<sup>190</sup> This vacuum created a situation where artists often benefitted from the marketing and promotion efforts of the labels. This indirect effect was to the detriment of the labels since they were contractually cut off from such income under traditional recording agreements.

The RUPA's fiduciary duty rules will check this opportunistic behavior demonstrated by both artists and labels. Under the RUPA's fiduciary duty rules, neither party will be able to conduct business for the purpose of their own self interest without the consent of the other partners.<sup>191</sup> Therefore, any business opportunities acquired by way of the artist-label relationship will have to be disclosed by both parties and reconciled as a whole.

Artists will no longer be able to capitalize on the label's promotional efforts without the label sharing in these opportunities. Furthermore, the RUPA's obligation of good faith and fair dealing and its imposition of a gross negligence standard will ensure that record labels can no longer discharge their duties in a self-serving manner and avoid penalty by simply incorporating provisions in the recording contract that absolve them of such liabilities.

### B. *Royalty Accounting Practices*

The RUPA's fiduciary duty rules can also rectify a deep-rooted industry problem: labels' accounting practices. Royalty accounting has been the subject of many disputes between artists and their respective record labels.<sup>192</sup> It has been estimated that labels misreport or underpay artist royalties by 10 to 40 percent.<sup>193</sup> Furthermore, record labels have been effectively barred from penalty for underpaying royalties due to contract clauses that prevent them from being liable for more than the amount of royalties due.<sup>194</sup>

The fiduciary duty of accounting will close legal loopholes often exploited by labels in suits filed against them by their artists. Cases where artists sue their label often fail in the beginning stages for lack

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<sup>190</sup> Karubian, *supra* note 106, at 413.

<sup>191</sup> See UNIF. P'SHIP ACT § 404(b) (1997).

<sup>192</sup> See *Sony Music Entm't, Inc. v. Robison*, No. 01 CIV. 6415(LMM), 2002 WL 272406, at \*2 (S.D.N.Y. Feb. 26, 2002); *CBS, Inc. v. Ahern*, No. 83 Civ. 7918 (VLB), 1985 U.S. Dist. LEXIS 18121 (S.D.N.Y. July 9, 1985). See also Chuck Philips, *Music Labels Urged to Revise Royalties: A state Senate panel criticizes record firms' accounting and threatens to take action*, L.A. TIMES, Dec. 3, 2002, at C1; Jonathon Cohen, *Labels' Accounting Practices Under Fire*, DAILY MUSIC NEWS, July 24, 2002.

<sup>193</sup> Edna Gundersen, *Rights Issue Rocks the Music World*, USA TODAY, Sept. 16, 2002, at D1.

<sup>194</sup> JEFFREY BRABEC & TODD BRABEC, *MUSIC, MONEY & SUCCESS: THE INSIDER'S GUIDE TO THE MUSIC INDUSTRY* 79 (1994).

of information because cash-strapped artists are at a practical disadvantage when it comes to conducting the discovery necessary to substantiate their claims.<sup>195</sup> Either their contractual auditing rights are too limited<sup>196</sup> or the cost of the audit is too high.<sup>197</sup> This practical loophole can be avoided by inserting the duty of accounting into the artist-label relationship. If one partner has reason to believe that they were defrauded by another partner, but lacks the documentation to prove by exactly what amount, an accounting action has great merit.<sup>198</sup> The court would hear evidence and could determine what amount of profits had been siphoned off or exactly how much profit the disloyal partner made. Therefore, the duty of accounting can be a powerful deterrent for labels with errant accounting methods.

Establishing a fiduciary duty to account will enhance the overall functioning of the music industry by instituting a checks and balances system in royalty accounting practices. “If it is easier for an artist to check their record label’s books, perhaps record labels will decide to ensure they have accurate systems, rather than face liability.”<sup>199</sup> Furthermore, fewer lawsuits would result in a greater chance of cooperation, which is imperative for an industry under massive external pressure.<sup>200</sup>

## VI. CONCLUSION

In the past, there had been minimal utility for the theory that the artist-label relationship was in fact a partnership. In today’s music business, the prevalent use of the 360 deal forces one to reconsider. The profit sharing arrangement and joint control exhibited by parties to a 360 deal are persuasive in a partnership determination.

If the parties are found to be partners, then there are fiduciary obligations that all partners owe to each other, which would benefit today’s music industry. A fiduciary duty can provide the industry with a sufficient legal backbone in which to move forward into this new era

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<sup>195</sup> Bartholomew, *supra* note 2, at 250-251.

<sup>196</sup> Bartholomew, *supra* note 2, at 250 (“It has long been the policy of most labels, for example, to limit audits to the company’s royalty statements only, disallowing auditors from accessing any manufacturing documents.” quoting Chuck Philips, *Warner Rolls Out Royalty Reforms: Record company says move will make it easier for acts to determine what they are owed*, L.A. TIMES, Mar. 20, 2003, at C1).

<sup>197</sup> Bartholomew, *supra* note 2, at 250.

<sup>198</sup> See generally *Johnson v. Buck*, 540 S.W.2d 393 (Tex. App. 1976).

<sup>199</sup> Bartholomew, *supra* note 2, at 257.

<sup>200</sup> i.e. new technology eroding the traditional fundamentals of the business, lack of resources to deal with a digital piracy problem and declining record sales.

of the music business. With its innate system of constraints on selfish opportunism, a fiduciary duty can establish the boundaries for today's music industry, making for a more transparent and trusting industry than the one of yesterday.

