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RECORDING CONTRACTS 101: THE BASICS

Like the bands, artists and musicians they encumber, record contracts come in all shapes and sizes. This is because there are hundreds – if not thousands – of different record companies. From the major labels to the independents, the size and complexity of the contract depends largely on the type of record company offering it.

When you first see your contract, if you are like most artists, the first thing you do is sit down and read it. However, you'll quickly realize that it is written in another language – legalese. Sentences go on for pages; words that you have never seen before are used regularly throughout, and sentences constantly make reference throughout to each other. Where do you start? Normally, the prudent artist starts by seeking out someone who's familiar with record contracts. This is usually an entertainment attorney, though not all of the time.

Most of the time, the artist or band will be aware of and have already negotiated the "deal points" – or the basics of the contract – prior to hiring an attorney. However, just like anything else in this business, the devil is in the details.

First, all legitimate record contracts will require the artist to sign an exclusivity agreement. This means that, without permission, you will not be able to record for anyone else other than the record company during the "term" of your contract. The term is how long the contract lasts. Contrary to popular belief, record companies do not sign you and guarantee you a certain number of albums. For example, you may get a four album deal, but nothing obligates the label to record four albums. A four album deal simply means that the record label has the **option** to record four albums. As a result, a record company – especially the majors – will typically record one album and see how it does. If it sells well, they will exercise their option to record a second album. If the first album does not do well, the label usually drops you. The reason labels require long term option contracts is because if the artist does do well, the label wants to make sure that the artists stays with them. This ensures that the label will be able to share the success of the artist over a long period of time. Finally, the "territory" of most contracts is world-wide. This means that the label has exclusive rights to the artist's services throughout the world.

As an artist faced with a record contract, it is essential to remember that the record business is exactly that – a business. Record companies exist to primarily to make money. It should be no surprise, therefore, that in many contracts, the financial terms can run over 15 pages.

The golden rule in record contracts is what the label gives you with one hand, it takes away with the other. The fundamental benchmark of record contracts are "points." The term "points" refers to how many percentage points an artist will receive as their royalty rate. Major labels usually offer the artist between 10 and 15 percent. While there is significant variance on smaller labels, they typically

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offer 9 to 12 percent. However, points are just the beginning of the discussion: the thinking artist's first question should be "a percentage of what?"

Generally, the royalty rate is based on a percentage of the standard retail selling price. That means that, as the artist, you get your full royalty rate for each full price CD or tape you sell through **normal retail channels**. Normal retail channels are usually retail record stores like Tower Records. With respect to other places you sell your CD's, labels normally pay you a fraction of your royalty rate for sales not through normal retail channels. For example, you may receive 65% of your royalty rate for sales outside the United States, 50% of your royalty rate for CD's sold below standard retail price (i.e. albums sold at a discount) and 40% of your royalty rate for sales through record clubs. In fact, most of your CD's will not be sold through normal retail channels. Although you may have a 12% royalty rate, you will only get a 6% royalty rate on record club sales. Obviously, this can get very confusing.

It is important to note that labels try to make the royalty rate paid to artists as attractive as possible. As a result, they may give you a generous royalty rate. Unfortunately, however, in addition to the reduced royalty rate on CD's sold outside normal retail channels, there are also many reductions in the artist royalty rate (hence the 15 page financial terms in most record contracts).

While there are entire chapters in books written about all the various deductions, here are a few examples:

- Artists normally get no royalties on records given away free for promotional purposes
- "All-in" royalty rate deductions: most royalty rates are "all-in." This means that you must pay the producer out of your royalties. Typically, a producer will take 3 points (3%) which lowers your royalty rate even further.
- "Packaging" deductions: the theory behind this deduction is that the band pays for the packaging of the CD and tape. Typically, these deductions range from 15 to 30 percent of your royalty rate. As a result, a 12% royalty rate and a 25% packaging deduction lowers your actual royalty rate to 9%.

It is essential that an artist takes into consideration all of their deductions when evaluating a royalty rate. On average, a band or artist can expect about \$1.00 in royalties for each full-priced (\$16.98) CD sold through normal retail channels. This is assuming the band even actually receives royalties. There is still the issue of "recoupment."

"Recoupment" basically means pay back. Because labels normally expend a lot of money on artists through studio time, advances, and marketing, they construe all of this money as a loan to the artist which must be paid back. The artist pays back the record label out of their royalties. Obviously this has significant implications. If a major label spends \$100,000 to record an album, the artist must make over \$100,000 in royalties until they receive their first royalty check. It is only after an artist sells enough records to pay back the amount to the record label that the artist has recouped. At that point, the artist will begin to receive royalties on future record sales. Approximately 80% of albums never reach this point. Obviously, this means that most artists never receive any royalty checks.

Another salient point in record contracts is the artist advance. Like everything else in recording contracts, the amount of the advance is also not as simple as it seems. In the past, labels would sign artists, write signing bonus checks, and then pay to record an album. Because many artists abused this and went over-budget on recording, record companies developed the "recording fund." The recording fund is the recording budget **and** advance rolled into one. As a result, if your contract states that you have one lump sum to record your album, and if you are under-budget, anything left over is your advance.

This leads to the next question: how much of an advance is good? Once again, this depends on the label and the circumstances of your signing. Basically, the larger the label, the more of an advance you should expect. In addition, the more interest in the artist, the higher the price becomes. However, is a large advance always the best? It depends. The artist should always remember, however, that the more money received as an advance, the more money the artist has to pay back in recoupment before receiving royalties. If you take a huge advance and your album does not live up to expectations, a label may be quicker to drop you and cut its losses. On the other hand, as noted above, most artists never reach recoupment. Accordingly, the advance may be the only money they ever get from the label. Thus, it makes sense to take as much as possible. There is no right or wrong answer to this question. Ultimately, it depends on the artist.

Legitimate recording contracts are usually never simple. Artists should never think that they have "made it" simply because they get offered a record contract. Record contracts are routinely negotiated and a slight change in wording here and there can have a huge financial impact for an artist. Because this is often a deal with the devil, it is essential to have someone knowledgeable about record contracts negotiate the agreement on your behalf.

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