

## **Record Contract Basics by Michael McCready**

Record contracts come in many forms. This stems from the fact that there are hundreds of different record companies. From the so-called "major labels" (EMI, Sony, Warner, PolyGram, BMG or one of their related corporations) to "mini-majors" (A&M, Island and Virgin, in the days of their independence, were the most obvious examples) to the "independents", the contract depends largely on the type of record company offering it.

When you first see your contract, if you are like most bands, you immediately sit down and read it. However, you soon realize that it is written in a manner which defies grammatical English. Sentences run on for 14 lines, with little if any punctuation. There are terms and words which you have never encountered. Finally, the sentences constantly make reference to each other ("pursuant to 1(A)3(c)(ii)"). Where do you begin? The first place is with someone familiar with record contracts. This is usually an entertainment attorney, though not all of the time.

Often, a band will be aware of and have already negotiated the "deal points" prior to retaining independent counsel on their behalf. Deal points are the basics of the contract: the advance, number of albums and royalty rate. However, the devil is in the details.

In all record contracts, you will be signing an exclusive agreement. This means that 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 seven albums. It may be a seven album deal, but nothing obligates the label to record seven albums. The seven albums means that the record label has the option to record seven albums. Typically, a record company will 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.

Record companies require long term option contracts because if the band does do well, the label wants to make sure that the band stays with their company. Since they invested so much and signed the band in the first place, they want to be able to share the success of the band over a long period of time. For example, REM recently finished out the last of their options with their record company. REM's new contract guarantees a \$10 million advance per album in the future. Try getting that advance for your first contract!

Finally, the "territory" of most contracts is world-wide meaning that the record company has exclusive rights to your services as a band throughout the world.

I find that almost all bands initially form to make music, as opposed to make money. Think back to when you began - it was for the love of music and not money that was the motivating factor. However, when it comes to a record contract, it is about money. A record company puts a record out to make money. Creativity and integrity play a part, but it is a financial relationship.

In many contracts, the financial terms will run over 15 pages. The rule in record contracts is what the record company gives you with one hand, it takes away with the other. The fundamental touchstone of record contracts are "points." Points refer to how many percentage points a band will receive as their royalty rate. On a major label, this will run between 10 and 15 percent and typically 9 to 12 percent on a smaller label. The percent royalty rate is just the beginning, however. The first question you should ask is, "a percentage of what?"

Generally, the royalty rate is based on a percentage of the standard retail selling price. You will get your full royalty rate for each full price CD or tape you sell through normal retail channels. Normal retail channels are usually record stores like Tower Records or Sam Goody.

What about other places you sell your CDs? Record companies will pay you a fraction of your royalty rate for sales not through normal retail channels. For example, you may receive 75% of your royalty rate for sales outside the United States, 60% of your royalty rate for CDs sold below standard retail price (i.e. albums sold at a discount) and 50% of your royalty rate for sales through record clubs. In fact, most of your CDs 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. Confused yet?

Record companies try to make the royalty rate paid to artists as attractive as possible. They may give you a generous royalty rate. However, in addition to the reduced royalty rate on CDs sold outside normal retail channels, there are also many reductions in your royalty rate. I said that the financial terms are often 15 pages or more. Well, your royalty rate is on the first page and the remaining pages are all the reductions.

It is impossible to determine how much a band will get for selling a CD without a calculator. When I represent a band negotiating a record contract, I sit down with them and show them the calculations to determine how much (or little) they will receive for each CD and tape sold.

There are entire chapters in books written about all the various deductions. I will mention but a few here. First, you get no royalties on records given away free for promotional purposes. A large deduction is the so-called "packaging" deduction. 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. In effect, a 12% royalty rate and a 25% packaging deduction lowers your rate to 9%.

In addition, your royalty rate is often an "all-in" royalty rate which 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.

Your royalty rate is meaningless unless it is viewed in the context of all the deductions. A band can expect an average of \$1.00 in royalties for each full-priced (\$16.98) CD sold through normal retail channels.

Did I say the band was going to actually receive royalties? Not so fast. The other major concept involved in record contracts is the term "recoupment". Recoupment is a fancy word for pay back. Record companies expend a lot of money on bands. They pay for all the studio time, give the band an advance, promote the band, etc. All of this money is a loan to the band which the band must pay back. This is recoupment. The band pays back the record label out of their royalties.

For example, if a major label spends \$250,000 to record an album, the band must make over \$250,000 in royalties until they receive their first royalty check. Once a band sells enough records to pay back the amount to the record label, the band has recouped and will receive royalties on future record sales. Approximately 80% of albums never reach this point which means that most bands NEVER receive any royalty checks. Do the math yourself - if you owe the record company \$250,000 and you make \$1.00 per CD, that is a quarter of a million CDs you must sell before you collect royalties.

The one redeeming feature is if the band does not sell enough CDs to recoup, they don't have to pay the record company back. It does not come out of the band's personal pocketbook.

There are other places a band can make money when they have a record out other than royalties. In past articles, I have discussed publishing. There is also money from live personal performances (concerts). This is money that the band gets to keep - most of the time that is. Some record company contracts, particularly small independent labels who cannot afford to lose as much money as the major labels, allow the label to recoup money from other sources, such as publishing. Although this should be called robbery, the practice actually has a name and is called "cross-collateralization". This term means the band will not receive ANY money until the label gets paid back, i.e. the band is recouped. Of course, you don't need to sell as many albums to become recouped on an independent label.

Now for the topic everyone asks about: "How much is my advance?" Not surprisingly, this question is also not as simple as it seems. In the past, record labels would sign a band and write a check to the band as a signing bonus and then pay and record an album. Some bands abused this and went over-budget on recording, much to the record company's dissatisfaction. To remedy this abuse, record companies developed the "recording fund."

The recording fund is the recording budget AND the advance rolled into one. The contract states that you have one lump sum to record your album, and if you are under-budget, anything left over is your advance. If you want to stay at the Ritz and waste time in the studio, that means less money for you for your advance. This has proved a marvelous incentive for bands to be efficient in the studio.

How much of an advance is good? Once again, this depends on the label and the circumstances of your signing. Generally speaking, the larger the label, the more of an advance you should expect. In addition, the more interest in the band, the higher the price becomes. However, is a large advance always the best? There is much disagreement on this issue.

Keep in mind, the more money you get as an advance, the more money you have to pay back (remember recoupment?) before you receive 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, most bands who sign record contracts never reach recoupment so the advance may be the only money they ever get from the label so why not take as much as possible? There is no right or wrong answer to the size of the advance and I try to get a sense from my clients as to their feelings. Some have a "show me the money" attitude and others think about longevity within the industry.

These are a few of the main points in record contracts. Often, a contract will be over 40 pages long. Needless to say, there is a lot more in there than I have had a chance to get into. However, I hope this column has given you a better sense of how record contracts operate.

Don't think that you have finally "made it" simply because you get offered a record contract. Often, it is a deal with the devil. There are many attendant drawbacks to signing a record contract. It is vital to have someone knowledgeable about record contracts negotiate the agreement on your behalf. Record contracts are routinely negotiated. A slight change in wording here and there can have a huge financial impact for a band.

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