

Major Label Contract Clause Critique

Preface

We've all heard the stories criticizing major record label contracts. Anecdotally we understand that many of the deals signed by artists are bad, but what does "bad" mean and just how bad are these deals? More importantly, how exactly are they bad?

These are questions that Future of Music Coalition (FMC) has been trying to answer for more than a year now with much help from the legal and artistic community. We began this process first by picking the brains of over a dozen major label and artist attorneys to identify which major label contract clauses and standard industry deductions are considered to be the most onerous. Then we began preparing this document, which quotes ACTUAL contract language from ACTUAL record label contracts, with care taken to preserve the doublespeak that makes the documents so confusing. Finally, we translated these onerous and confusing contract clauses into PLAIN ENGLISH and paired them with easy-to-understand critiques in the hopes that even those who are completely unfamiliar with the music business can understand the implications that result from signing a standard major label deal. This is a first step and nowhere near the final word in criticizing traditional record contract language.

In publishing this document we are not attempting to say that these clauses are illegal nor are we suggesting that artists who sign these contracts do so without excellent representation.

What we are saying is this:

1. The majority of these clauses exist in the boilerplate language of the standard contracts offered to artists by each of the five major labels.
2. The majority of these contract clauses are considered "deal breakers" for all but the most powerful artists.
3. The majority of artists regularly sign contracts that seem to go against their best interest as a concession for gaining access to the means of production, distribution and promotion that is increasingly controlled by five labels and their parent corporations.
4. Outside of the major label music world many of these clauses are seen as an affront to basic logic.
 - a) If, for example, a label is offering a specific mechanical royalty rate that is decreed by statute and dictated by law, why should they then be allowed to artificially diminish that rate contractually through "controlled composition clauses"?

- b) If easily broken acetate recordings are no longer manufactured or sold, why should artists be forced to sign contracts that diminish their royalties due to "breakage fees" which entered the standard contract language back when a legitimate amount of manufactured records were broken before they could be sold?
5. We can't understand why, in a supposedly fair market economy with full competition, one of these five labels hasn't seen the competitive value of removing these seemingly illogical clauses and offering a better deal to artists.

These questions and many others can only be raised once the discussion of "what is fair to include in a label contract?" moves out of the contract rooms and into public discussion.

We hope this document can be used as a tool to encourage the dialogue that is beginning to emerge from a better-educated public. We hope this will be considered a "must read" for any artist considering the possibility of signing a major label deal, and any concerned citizen who is worried about the standard treatment of the creators they love. Critiques of this document and augmentations are more than welcome. Together let's build a more complete and public record of the musician's experience.

Clause 1: Transference of ownership

You own nothing, ever!

What the clause says:

"You grant and convey to Label, and confirm that Label shall be the exclusive, perpetual owner of all Masters throughout the universe, including without limitation, all copyrights therein as a "work made for hire". Label and all parties authorized by Label shall have the exclusive right to exploit the Masters, and to use your name, voice and likeness in connection with such exploitation. The right to use your name, voice and likeness shall be exclusive during the term and non-exclusive thereafter."

What the clause means:

Unless Congress and/or the courts speak up and say otherwise, you have no ownership or control whatsoever in the sound recording copyright created under the contract.

If you don't recoup the costs necessary to produce, market, and distribute the record, you will never see another penny beyond your advance (unless you wrote some of the songs, and even then it's not probable).

Nor will you likely be able to get your hands on the dust-gathering CDs sitting in the label's warehouse to sell on your website or on tour.

Nor will you be able to authorize/license anyone else to do the same.

Nor will you be able to license/authorize the use of the sound recording in any movie, advertisement, TV show, talking cupie doll, or otherwise.

And don't think you can simply jump in the studio and re-record the songs on a new CD (at least for a long time after the end of your deal), because a separate part of the contract will prevent it.

Clause 2: Length of term

"How does 'forever' sound?"

What the clause says:

TERM:

The Term shall consist of an Initial Period and of the Option Periods (defined below) for which Company shall have exercised the options hereafter provided. The Initial Period and each Option Period are each hereafter sometimes referred to as a "Contract Period". The Initial Period shall commence on the date hereof and shall continue until the earlier of the dates referred to in paragraphs (a) and (b) immediately below:

- a) the date twelve (12) months after the Delivery to Company, as defined in paragraph 19.09 below, of the fully equalized, digital tape Masters to be used in manufacturing the Phonograph Record units to be made for distribution in the United States from the last Master Recordings made in fulfillment of your Recording Commitment for the Contract Period concerned under Article 3 below; or
- b) the date nine (9) months after the initial commercial release in the United States of the Album required to be delivered in fulfillment of your Recording Commitment for the Contract Period concerned; but will not end earlier than one (1) year after the date of its commencement.

2.02 You grant Company separate options to extend that Term for additional Contract Periods ("Option Periods") on the same terms and conditions, except as otherwise provided herein. Company may exercise each of those options by sending you a written notice not later than the expiration date of the Contract Period, which is then in effect (the "Current Contract Period"). If Company exercises such an option, the Option Period concerned will begin immediately after the end of the Current Contract Period and shall continue until the earlier of the dates referred to in paragraphs 2.01 (a) and (b) above.

What the clause means:

Do not be deceived into thinking that the document you sign only affects you until then end of the Contract Period, i.e. until you deliver your last album or the contract ends for some other reason. The contract affects you for much, much longer via the "grant of rights clause", among others.

Clause 3: Key Man Clause

Hey, man...where'd you go?

If you have nothing in your contract stating that part of the inducement to sign at Label A over Label B is based on your personal relationships with the people who signed you, then you are stuck at that label even if those people leave. So if the label head who promised the big push on your record gets the ax, or the A & R man who told you he'd be taking you straight to radio decides he'd rather work for another record label, then you are probably stuck with whoever now runs the label and with whatever A & R staff it sends your way.

The Key Man Clause, which is awfully difficult to get, allows you to leave if certain key figures leave the label. A similar provision (that is even more difficult to get) is to say that if the label is merged, sold, dissolved, etc.; you have the right to get out of the contract.

Clause 4: Delivery/acceptance

Give us radio ready material

What the clauses say:

“DELIVERY”: Delivery means Company's receipt of two (2), two track stereo tapes, fully edited, mixed, leadered and equalized, together with a track by track list (personnel list) of all featured vocal performers, background vocal performers and instrumental performers on each Master Recording identifying their performances, and all necessary licenses, approvals, consents and permissions.

“ACCEPTANCE”: Each Master Recording shall be subject to Company's approval as satisfactory for the manufacture and sale of records. Upon Company's request, Artist shall record additional Compositions and/or re-record any Composition recorded hereunder, as necessary, until a Master Recording which in Company's sole judgment is satisfactory for the manufacture and sale of records shall have been obtained.

What the clauses mean:

Depending upon the definition of “delivery” and “acceptance”, the clause requires the artist to product either “commercially satisfactory” or “technically satisfactory” masters. The former is much more favorable to the label, allowing it to require what it deems saleable in the marketplace. If you can't get the “technically satisfactory” standard, try to negotiate limits upon the label's discretion. *NB*: Delivery includes not only acceptance of the masters, but of all associated material, i.e. proper licenses, governmental forms, etc. The delivery and acceptance sections are important not just because they control obligations surrounding product, but because they are the basis of time triggers in the contract governing how long an artist is contractually obligated to the label.

Clause 5: The Controlled Composition Clause

Feeling a bit out of control?

NOTE: This is the most important clause in need of reform. Record companies do not recoup recording costs and advances from mechanical royalties. For singer/songwriters, mechanical royalties may be the ONLY money they ever see.

What the clause says:

(a) "Controlled Composition" is hereby defined as each musical composition wholly or partially written by You [Artist], or owned or controlled directly or indirectly by You or by any party associated or affiliated with You. If and to the extent Controlled Compositions are recorded hereunder, each such Composition is hereby licensed to [Company], for the United States and Canada, at 3/4 of the current minimum fixed statutory copyright royalty rate (the "Applicable Rate") on the earlier of (i) the date the recording commences or (ii) the date the recording is required to be delivered; provided that [Company] will not be required to pay more than then (10) times the Applicable Rate for an Album and no more than two (2) times the Applicable Rate for a seven-inch or twelve-inch singles record. Without limiting Company's rights, it is agreed that [Company] shall have the Offset Right if mechanical royalties payable by Company are in excess of such amounts.

(b) No mechanical royalty whatsoever shall be payable for (i) records cut out of the [Company] catalog and sold as discontinued merchandise or records sold as "scrap," "overstock" or "surplus"; (ii) any work which is non-musical; (iii) records distributed by [Company] which are not "Records Sold" (as defined herein); (iv) any work which consists of an arrangement of a work in the public domain; or (v) any more than one use of any work on a particular record.

What the clause means:

The Copyright Office sets the statutory rate for mechanical royalties, increasing every two years according to changes in cost of living as determined by the Consumer Price Index. The rate increases are by authority of the 1976 amendment to the Copyright Act. The first rate increase was in 1981. It was at about this time that the Controlled Composition clause became commonplace in record contracts.

The main purpose of the controlled composition clause is to NOT pay artists the statutory rate and to NOT increase royalties as costs of living increases; basically, to thwart copyright law.

The controlled composition clause limits the amount of mechanical royalties the company is required to pay for records it releases, and holds the *artist* responsible for the excess. In essence, the record companies are compelling artists to subsidize the payment of mechanical royalties. Here's how they do it: (all examples assume today's royalty rate of \$.0755).

1) Artist gets 75% of the statutory rate per song = \$0.056 per song, not \$0.0755

This is based on the *minimum* statutory rate, so the company calculates the same rate for a 10-minute song as for a 2-minute song. This thwarts the statute, which provides increased rates for songs over 5 minutes.

2) Artists gets royalties on maximum of 10 songs = \$0.56 per album total

Under the statute, an album with 12 songs would earn \$.90. Under this clause, the maximum royalties payable would be \$0.56. If the maximum is exceeded (by using a cover song or a producer demanding a higher rate), the artist is held responsible for that excess.

3) Rate is fixed on date master is delivered.

The reduced rate will never increase, thwarting the Copyright Office statutory cost of living increases. Record labels lock in the earliest date possible. Some contracts fix the date at execution of the contract signing, knowing full well that the record won't hit the shelves for two years.

4) Not pay royalties on "free goods"

Under the compulsory license provisions of Copyright Act, record labels are required to pay mechanical royalties on all records "made and distributed." Instead, record labels thwart this law by refusing to pay for so-called "free goods." This confusing word "free-goods" is not defined as promo albums. Rather, all major labels define "free goods" as 15% of the records they sell. Using this provision, major labels calculate royalties on only 85% of records sold.

5) Reduced rate applies to all "controlled compositions"

The definition of "controlled composition" casts a wide net. It includes songs written by producers on the album. Customarily, the record company hires these producers without negotiating a reduced mechanical royalty rate. The artist is forced to make up the difference. This is particularly egregious because most artists have no control over producers.

6) Hold Artist responsible for excess mechanical royalties.

If the total amount paid by the company *does* exceed the specified maximums, the difference will be deducted from the artist's royalties. The possibilities of the artist running afoul of all these provisions are endless and, potentially, very expensive for the artist.

The following example illustrates the devastating effect this clause has on royalties:

Example: Artist has agreed to be responsible for any costs of mechanicals over \$0.56 (75% of statutory times 10 songs). Artist has no say over what is recorded. She records 15 songs written by the record label's "affiliated publisher" who charges the full statutory rate of \$.075 per song, or \$1.13 for the album. The Artist now OWES the record label \$0.57 per record. In five years, when the statutory rate increases to \$.91 per song, but the artist's rate stays the same, the artist will OWE \$0.85 per album! Each record sold puts her deeper in the hole, and farther away from ever recouping.

Clauses 6, 7, 8, 9: Returns, reserves, and other standard deductions

How do you turn a 16% royalty into a 6% royalty?
It's easy. Standard. Industry. Deductions.

What the clauses say:

1. Definition of "Net Sales":
"...eighty five percent (85%) of gross sales, less returns, credits, and reserves against anticipated returns and credits."
2. Container Charge:
"the applicable percentage, specified below of the Gross Royalty Base applicable to the Records concerned: ...Compact discs, New Technology Configurations...25%"
3. In the royalty paragraphs:
"Notwithstanding anything to the contrary herein, the royalty rate for any Record in the audio only compact disc configuration shall be eighty percent (80%) of the otherwise applicable royalty rate set forth in this agreement." (New Tech is 75%)
4. From that same royalty section:
"No royalties shall be payable to you in respect of Records sold or distributed....as "free", "no charge", or "bonus" Records (whether or not intended for resale; whether billed or invoiced as a discount in the price to [Record Label's] customers or as a Record shipped at no charge)."

That paragraph contains a host of other carve-outs for such things as promo records, etc.

What they mean:

Take care of your advance money, because it's all you'll see for awhile, unless you wrote the songs. Songwriters get a mechanical on each record sold, but they also get a reduced rate due to the controlled comp clause (see above for definition).

To start with, clause #1 indicates that the labels are going to reduce your royalty based on records that might get returned because you only get paid on royalty bearing units -- which means if you don't have a cap on free/promo goods (#4), you're in trouble.

As an example, let's think about a CD that has a value of \$10. The "net sales" definition means you're only going to get paid on 85 of every 100 units shipped. However, there are further deductions. Clause #2 indicates that \$2.50 cents comes off that \$10 before you apply the royalty percentage. But wait, there's more. Clause #3 means that your royalty percentage (the one you apply to the dollar figure after figuring in the 85% rule and the 25% container charge) is further reduced by 20%. Have I mentioned the absurdity of a container charge for "New Tech" i.e. digital distribution where there are no manufacturing costs? (And don't forget that the reduction there is 25%, not 20% as with CDs).

Here it is important to remember that artists' contract royalty rate is not statutory, transparent nor is it public. Traditional contract royalties begin at a much smaller "11 -13 percent" and allow for that royalty amount to be further diminished through a process of unfair deductions that are standardized within the industry.

To understand this royalty reduction, multiply an 11 percent royalty rate by 85 percent for a "free goods" deduction. Then multiply it by 75 percent for a "packaging" deduction. Then multiply it again by 75 percent for a "new media" deduction. After this process of deduction, an 11 percent royalty is effectively reduced to less than 6 percent.

Clause 10: Cross-Collateralization

No, no...the *other* contract...

What the clause says:

NOTE: There is no segregation linking particular advances and particular royalties to particular albums. All advances are recoupable from all royalties.

"The term "Advance" shall mean prepayment of royalties. Company may recoup Advances from royalties to be paid to you or on your behalf pursuant to this Agreement or any other agreement between you and Company's affiliates. Except as otherwise set forth herein, Advances shall be non-refundable."

What the clause means:

This clause gives the label the right to recoup advances from monies musicians receive not only under the instant document, but all others between you and the label, past and future. For example, you sign a contract in 1990 and put out a few hits. Later you sign contract #2 in 1995, and that album is huge and raises more than enough money to pay back the costs from the manufacture and promotion of that release. On the surface it would seem that you would be in a very good position as an artist to begin to make royalties and share in the financial success of your musical triumph.

It would seem, but then due to the cross-collateralization clause look what begins to happen. Label one gets to take royalties from album 2 to recover monies advanced to you under album one. This can be true if you either if you have signed two contracts with different labels or you have signed an adjusted second contract with the same label. In other words, in the rare case that you are one of the .03 percent of artists who actually recoup then once you are successful you are risking all of your money all of the time. Once you realize that you won't make any royalties on your second record there is certainly less incentive to make it.

Clause 11: Coupling Clause

Nickname: Pick Your Partner (Unless We Pick For You)

What the clause says:

"Artist hereby grants to Company in perpetuity, throughout the Universe the right to couple Masters recorded hereunder on records which contain master recordings embodying performances of other artists, and the perpetual right to include records hereunder in packages with records not recorded hereunder."

What it means:

As we've seen the breadth and depth of the typical "grant of rights" clause gives the label far-reaching rights to do what it wants with the artist's music created under the contract. The coupling clause takes this a step further, making explicit the label's right to couple an artist's recordings with other artists – or make compilations. Perpetuity is a long time, and the Universe is a big territory.

This is yet another area where the labels wrestle away artistic control and integrity. And it is not standard for labels to allow the artist's consent to first be obtained. Therefore, if I'm a Christian artist, I may likely someday see my song compiled with an explicit rap song on "Greatest Hits of the Millennium" in the sales bin at the gas station.

NB: Due to some recent suggestions that digital subscription services are simply huge compilations (giving artists the right to refuse the placement of their material on them), many coupling clauses now contain language to pre-empt that argument. The language will read something like: "...except in the case of a consumer selected or influenced service..."

Clause 12: Reserve Limits, Accounting & Audits

"Oh, you mean *those* royalties... we plumb forgot about 'em."

What the clause says:

10.01. Company shall send to you statements for royalties payable hereunder on or before October 1st for the semi-annual period ending the preceding June 30th and on or before April 1st for the semi-annual period ending the preceding December 31st, together with payment of royalties, if any, earned by you hereunder during the semi-annual period for which the statement is rendered, less all Advances and other charges under this Agreement. Company shall have the right to retain, as a reserve against charges, credits, or returns, such portion of payable royalties as shall be reasonable in Company's best business judgment. You shall reimburse Company on demand for any overpayments, and Company may also deduct the amount thereof from any monies payable to you hereunder or under any other agreement between you and Company or Company's affiliates. Royalties paid by Company on Phonograph Records subsequently returned shall be deemed overpayments.

10.02. No royalties shall be payable to you on sales of Phonograph Records by any of Company's licensees or distributors until payment on those sales has been received by Company in the United States. Sales by a licensee or distributor shall be deemed to have occurred in the semi-annual accounting period during which that licensee or distributor shall have rendered to Company accounting statements and payments for those sales.

10.03

- a) Royalties on Phonograph Record sales outside of the United States shall be computed in the national currency in which Company's licensees pay to Company, shall be credited to your royalty account hereunder at the same rate of exchange at which Company's licensees pay to Company, and shall be proportionately subject to any withholding or comparable taxes which may be imposed upon Company's receipts.

- b) If Company shall not receive payment in United States dollars in the United States for any sales of Phonograph Records outside of the United States, royalties on those sales shall not be credited to your royalty account hereunder. Company shall, however, at your written request and if Company is reasonably able to do so, accept payment for those sales in foreign currency and shall deposit in a foreign bank or other depository, at your expense, in that foreign currency, that portion thereof, if any, as shall equal the royalties which would have been payable to you hereunder on those sales had payment for those sales been made to Company in United States dollars in the United States. Deposit as aforesaid shall fulfill Company's royalty obligations hereunder as to those sales. If any law, ruling or other governmental restriction limits the amount a licensee can remit to Company, Company may reduce your royalties hereunder by an amount proportionate to the reduction in Company's licensee's remittance to Company.

10.04. Company will maintain books and records which report the sales of Phonograph Records, on which royalties are payable to you. You may, but not more than once a year, at your own expense, examine those books and records, as provided in this paragraph 10.04 only. You may make those examinations only for the purpose of verifying the accuracy of the statements sent to you under paragraph 10.01. All such examinations shall be in accordance with GAAP procedures and regulations. You may make such an examination for a particular statement only once, and only within one (1) year after the date when Company is required to send you that statement under paragraph 10.01. You may make such an examination only during Company's usual business hours, and at the place where Company keeps the books and records to be examined. If you wish to make an examination you will be required to notify Company at least thirty (30) days before the date when you plan to begin it. Company may postpone the commencement of your examination by notice given to you not later than five (5) days before the commencement date specified in your notice; if Company does so, the running of the time within which the examination may be made will be suspended during the postponement. If your examination has not been completed within one (1) month from the time you begin it, Company may require you to terminate it on seven (7) days' notice to you at any time; Company will not be required to permit you to continue the examination after the end of that seven (7) day period. You will not be entitled to examine any manufacturing records or any other records that do not specifically report sales or other distributions of Phonograph Records on which royalties are payable to you. You may appoint a certified public accountant to make such an examination for you, but not if (s)he or his/her firm has begun an examination of Company's books and records for any Person except you unless the examination has been concluded and any applicable audit issues have been resolved. Such certified public accountant will act only under a Letter of Confidentiality which provides that any information derived from such audit or examination will not be knowingly released, divulged or

published to any person, firm or corporation, other than to you or to a judicial or administrative body in connection with any proceeding relating to this Agreement.

10.05. If you have any objections to a royalty statement, you will give Company specific notice of that objection and your reasons for it within one (1) year after the date when Company is required to send you that statement under paragraph 10.01. Each royalty statement will become conclusively binding on you at the end of that one (1) year period, and you will no longer have any right to make any other objections to it. You will not have the right to sue Company in connection with any royalty accounting, or to sue Company for royalties on Records sold during the period a royalty accounting covers, unless you commence the suit within that one (1) year period. If you commence suit on any controversy or claim concerning royalty accountings rendered to you under this agreement in a court of competent jurisdiction (as provided in paragraph 23.09 below), the scope of the proceeding will be limited to determination of the amount of the royalties due for the accounting periods concerned, and the court will have no authority to consider any other issues or award any relief except recovery of any royalties found owing. Your recovery of any such royalties will be the sole remedy available to you or the Artist by reason of any claim related to Company's royalty accountings. Without limiting the generality of the preceding sentence, neither you nor the Artist will have any right to seek termination of this Agreement or avoid the performance of your obligations under it by reason of any such claim.

10.06. Company shall have the right to deduct from any amounts payable to you hereunder that portion thereof as may be required to be deducted under any statute, regulation, treaty or other law, or under any union or guild agreement, and you shall promptly execute and deliver to Company any forms or other documents as may be required in connection therewith.

10.07. Each payment made by Company to you or the Artist under this Agreement, other than union scale payments under Article 5 hereof, shall, at Company's election, be made by a single check payable to _____. All payments herein are contingent upon Company receiving properly completed W-9 and/or 1001 IRS tax forms, as applicable.

What it means:

The reserve limits are some of the murkiest and therefore most fraught with potential for abuse. Briefly, they exist because of the nature of record retailing—in a hits-driven, high-risk business, the retailers insist upon being able to return product they can't sell. The labels shift that risk/burden to the artist by holding onto a portion of royalty payments until they can verify product shipped has been scanned and sold. An artist should try to negotiate the lowest percentage possible of reserves (hint: get rid of the

“label’s best business judgment” language), and pay close attention to the liquidation requirements. *NB:* In my mind, reserve requirements should not apply to digital deliveries.

The foreign limitations (i.e. no royalties if label gets paid in non-US dollars) are ludicrous—like a big multinational can’t figure how to convert? This auditing language is particularly onerous. For example, it states the artist only has one year from when the label should have rendered a statement to audit—i.e. if the label is 300 days late, you only have 65 days to audit. The “purpose” clause should come out—it shouldn’t matter why an artist wants to conduct the audit. Same for the “length of audit” language—what if the artist finds big problems and it takes more than a month to sort them out?

As to objections based upon the findings of an audit, the artist here is limited in several respects. The innocent looking “court of competent jurisdiction” language with reference to another subparagraph is the label’s way of snagging home court advantage—a discouragement to suit. (i.e. artist lives in Texas won’t be thrilled about having to sue in New York). Same objections as above about timing—the trigger should be from when artist actually receives a statement, not when label is supposed to render (and shoot for two years, not one). Sole remedy language is also over-reaching (although some might disagree). Artists should go for (but tough to get depending on clout) a “10% discrepancy clause”, i.e. label pays for audit if more than 10% discrepancy allowed. My negotiating technique on that is to keep increasing the percentage to test whether the label has good faith or simply won’t go for this clause no matter what (i.e. if they won’t agree to a clause with 25%, I don’t think they’re operating in good faith)

In addition, many record companies discourage audits by stipulating in the contract that no audit may be done on a “contingency” basis. The artist must actually pay the auditor, not bring an auditor in on the promise of a percentage of the audit proceeds. Paying a flat, upfront fee (as opposed to contingency) for an audit is EXPENSIVE. The cost usually exceeds by many times any discrepancy in the artist’s favor.