

Why Artists Should “Do a 180” on “360 Deals”

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A new type of record label contract has come to be known as a “360 deal” (as in “360 degrees in a circle”) since it seeks to make the label a participant in revenue streams from every quarter of an artist’s career.

In his popular music industry blog, Bob Lefsetz wants to know why artists would consider such a contract. With typical humor, he writes:

If you’re contemplating a major label deal and your success is not based on terrestrial radio play, and you don’t make pop music, YOU’RE A FUCKING IDIOT!... But where were the attorneys? Oh, I know they were afraid of pissing off the labels, not eating themselves. Are they interested in their clients or THEMSELVES?

Background

I’ve been very fortunate to be affiliated with artists and their managers who have collectively sold over 300 million records. Not once during my three decades in practice did I ever get a call from a record company executive who said, “Hey Bob, we just had a phenomenally profitable year and therefore we are sending your client a big bonus check to show our appreciation for making the label lots of money.” Now that the record business economy is faltering, label honchos are complaining that they can’t make enough money from record sales alone, and—perhaps not surprisingly—they expect their own recording artists to subsidize executive compensation packages worthy of Wall Street.

In the past, when record labels faced additional costs associated with new modes of doing business, they simply passed those costs along to their artists in the form of artist royalty reductions (such as the so-called “research and development” costs associated with manufacturing compact discs in the 1980s). This time, the power grab is much more insidious because it involves taking a

portion of income from categories which—for the entire history of the modern music industry—have belonged exclusively to the artist.

Under the terms of a typical 360 deal (which the record company representatives would prefer to call by the more innocuous phrase “multiple rights deal”), labels are demanding a portion of an artist’s income from touring, publishing, endorsements, and sale of merchandise, in addition to the vast majority of the record sale income that labels have always enjoyed. And when you read the fine print, you’ll also discover that the labels want to make money from the books that artists write, the Hollywood movies in which they act, and the fan clubs they create. In fact the labels want to share in absolutely everything. Does that sound fair to you?

Traditional Record Deals

Let’s briefly examine the economics of the record business, which until recently has been a profitable ATM for the multi-national entertainment companies which control the major record labels. In general terms, the record label is entitled to receive 85% of net income, and the recording artist receives the remaining 15%. Any funds that the labels advanced to the artist are then repaid solely out of the artist’s 15%. Now here’s the best part of all from the label’s perspective: in exchange for the advance paid to the artist, the label owns the copyrights to the master recordings in perpetuity. This is analogous to taking out a mortgage on a house, repaying the mortgage in full, but the bank winds up owning your house.

But wait, it gets better... for the record labels.

The labels will insist that they will be able to deduct from the artist’s share of income 50% of all independently contracted marketing, promotion, and publicity costs, 100% of the cost of making music videos (but the labels get to own the videos), and 50% of website costs (but the labels own the website).

And that’s still not all. If an artist signs a traditional major label deal today, the contract will call for the delivery to the label of approximately five albums. Since it takes an average of 1-½ years from the creation of one album

until the commencement of recording of the next album, the artist will be indentured exclusively to that label for about eight years. The record companies explain that they need these egregiously long terms in order to allow for a reasonable return on their investment. But compare this to other fields of entertainment. The film business eliminated its equivalent of this practice (the so-called “studio system”) more than 50 years ago. And if you sign a book deal with Simon & Schuster, you typically sign a book deal, as in a single book. Aren’t film companies and book publishers also investing in “building the brand” of their creative partners? How come they don’t require an 8-year/5 movie or 5 book obligation to justify their ROI?

Until the recent downturn in the music business, the record companies had carved out a lucrative arrangement where they were making between \$2.50 and \$4 in profit for each CD sold. (And don’t forget that, in this business model, the record company traditionally breaks even before the artist pays back her portion of costs and advances!) Labels have reaped billions of dollars in profits during the past few decades, but now that the business is not as profitable as it once was, the labels want the *artists* to reach into their pockets to improve the labels’ diminished bottom line.

What’s Wrong With 360 Deals ?

Let’s focus on the terms of 360 deals, and I will explain why I’m so passionately opposed to them. First of all, in many of these 360 deals the record company will demand that their earnings come out of the gross revenues, meaning that, if the cash that the labels actually receive has been reduced by any parties in the middle of the transaction (even if those parties themselves add value, as, for example, many music publishers do), then the label will add those amounts back in before calculating the percentage of revenue they retain. Think about that for a moment. The manager doesn’t get paid on gross, and the artist certainly doesn’t get paid on gross—why then should the record company be paid on gross?

The 360 deals that I've reviewed require the artist to relinquish between 5% and 50% of revenues from sources other than record sales. To illustrate this point, let's use 20% as the percentage that the record company is seeking from an artist's live touring income. If that artist is paying all of the traditional touring costs (e.g. hotels, transportation, etc.) as well as paying her manager a 20% commission, her booking agent a 15% commission, and her lawyer and business manager 5% each, then that could result in a record company receiving half of every net touring dollar which winds up in the artist's pocket. Does that seem fair to you?

And here are a few more things wrong with this model. Record companies love to cross-collateralize. This thirty-one-point Scrabble word refers to the practice of taking an artist's positive earnings from one category (e.g. publishing income) and applying it as a record company expense that affects the artist's unrecouped balance in another category (e.g. the record royalty account). In summary, the labels are postponing, for as long as possible, the day when the artist actually receives a positive cash flow from her end of the pipeline. Yet when it comes to the income which they would like to receive from an artist's 360 income streams, the labels would like to keep one hundred percent of the money to which they are entitled, without applying (i.e. cross-collateralizing) any of it to reduce the artist's debt to the record company. Apparently, what's good for the goose... is only good for the goose.

360 deals are also rife with conflicts of interests. For example, will an artist still be free to accept a sponsorship from a company whose business is in direct competition with one of the record label's non-music divisions? Are the labels going to defer their commissions (as managers and artists often do) in one phase of their business (like merchandise) in order to ensure that there will be enough money for a tour to stay on the road? And how will record companies deal with fiduciary obligations to their artists (which they were previously able to avoid?) And why are the record companies acquiring significant interests in merchandise when many of them don't own merchandise divisions? And how do record companies think they are going to get around the booking agency laws in California and other states? And then there is the mother of all conflicts that

occurs when an artist's management company is owned by the same entity that owns the artist's record company.

What's *Right* With 360 Deals?

Labels justify profiting from multiple rights because they are making a substantial investment in the artist. And in all fairness, sometimes this is true. Our firm represents a young artist called Owl City who recently scored the number #1 single on the pop charts. I would be disingenuous if I didn't acknowledge that such success would not have happened without the financial commitment and promotional and marketing experience of the Universal/Republic label team. The Owl City success underscores the point made by Bob Lefsetz that major labels are still the best way to break an artist whose music is uniquely suited to pop radio.

As an artist lawyer, I would be receptive to a 360 deal where the record company is obligated to make an investment in a band's career. I'm not talking about what a label tells you that they plan to do and spend in relation to each album. I'm talking about what a label is contractually obligated to do and spend. But just try to get a label to commit in the contract to spending \$40K on publicity, \$250K on marketing and \$350K on promotion for each album. It just won't happen (unless you have an artist who is being aggressively pursued by several labels).

Here's another way that I could support the 360 deal. If the record companies took their "360-degree interests" as collateral against their out-of-pocket investment in an artist, and then reverted those 360 rights to the artist when the company's investment was repaid, these deals would make more sense to me. I still wouldn't be happy with this model, but I could appreciate the rationale. But in many of these 360 deals, the label's rights continue well beyond their recoupment of their investment. In fact, in some 360 deals the artist is required to pay her record company a share of her touring/merchandise/music publishing earnings long after the artist has been dropped by that label, and sometimes the payments are forever. Does that seem fair to you?

Alternative Record Deals: The Net Profits Deal

Is there an alternative to the 360 deal? I believe there are several. In the past few years many independent record companies have relied on the so-called “net profits” deal. In this business model the record company is able to minimize its risk by having the right to deduct all of its’ costs “off-the-top” (including those costs (such as manufacturing, distribution and marketing) which are normally not recoupable under the terms of a traditional record contract. The remaining net profits are then shared on a 50/50 (or other) basis between the artist and record company. Net profit deals don’t typically have a 360 deal type of obligation because the deal formula is structured to grant the record company a more favorable return of their initial investment.

Artist Self-Release Record Deal

Another alternative is the self-release model. If a band is willing to make financial and other commitments that are necessary to function as their own record company, it is in their best interest to do so. I realize this is easier said than done, and the road is littered with the carcasses of artists who have tried this and failed (including such luminaries as the Rolling Stones and Pearl Jam). But this is an especially opportune moment for artists. Thanks to the reduced price of innovative recording equipment and software such as Pro Tools, many bands are now able to finance the recording of their own album masters without becoming indebted to the record companies. This means an artist can now justifiably retain the ownership of the copyrights in her own master recordings.

There are also many positive technological developments that weigh in the artist’s favor. Social networking platforms like MySpace and YouTube provide a marketplace to expose and promote new music. And they are free.

Yet another factor that encourages artists to take control of their own business is that 95% of all digital download sales result from just three sites: iTunes, Amazon, and Rhapsody. And all three of these sites are easily accessible

through digital aggregators—such as Tunecore, InGrooves and The Orchard—for a distribution fee of just 10% to 20%. It's even possible for artists to control their own “hard goods sales” (i.e. CD's) by selling them over the band's website or using an intermediary service like CDBaby.

But I don't want to imply that any of this is easy (it isn't), problem free (it really isn't), or inexpensive (it really, *really* isn't). Prior to the Wall Street meltdown in the fall of 2008, venture capital money was flowing into the music business to replace the funding that was formerly supplied by the major labels. Music entrepreneurs found themselves able to cherry pick from a substantial pool of experienced and skilled music industry professionals who (as the Brits so beautifully describe it) were made “redundant” at the major labels. In addition to a great corps of former record execs, the Erteguns and Gordys of tomorrow could also hire from the same list of great independent publicists, marketing companies and record promoters as those used by the majors. And best of all from the artist's point-of-view, these new start-ups were not demanding 360 rights. In fact most were not even requiring the artists to surrender the ownership of the copyrights to their master recordings. Unfortunately the Crash of 2008 came before this new business model ever really had a chance to flourish.

While we await the return of the venture capitalists, I urge artists to look for new solutions. There is a British company called Polyphonic, which was started by the manager of Radiohead and seems very artist-friendly. There is an American company called ArtistShare, which helps artists finance their own recordings by allowing the fans to purchase the right to become one of the album's executive producers or to invest some money in return for an all-access pass to the artist's next tour. The technological innovations (like digital downloading and social networking) that revolutionized the music industry grew from the minds of young people who loved music, not from large record companies who sold music. I believe these same young innovators will also dictate the future of the music business for those artists who did not mortgage their futures by making 360 deals.

Conclusion

I genuinely believe that this is an especially propitious moment for artists to take control of their own destinies. And I expect record companies, who have always been the artist's partner in record sales, to remain an important part of the equation, but not at the artist's expense. Record companies say that they are seeking 360 rights because they are making a significant investment in the careers of the artists. If they mean it, they should put it into the contract. And if they don't, then I sincerely hope artists will "do a 180" on 360 deals.