

WHAT'S THE DEAL WITH PRODUCTION DEALS?

by Bob Donnelly, Esq.

The production agreement is the singular most regressive and anti-artist contract introduced in the music industry during the last two decades. If I told you that there are many artists who have signed a deal which, in return for little or no advance, provides that they: (1) give up the administrative control of their music publishing and 25%-50% of their publishing income to a company that never has, and never will be, a true music publisher, (2) give up 50% of their merchandising income to a company that never has, and never will be, a real merchandiser and (3) give up their recording rights for the next 14 years in return for a retail record royalty of only 3% to 5% -- you probably would think I was referring to the dark days of the 1950's when Afro-American recording artists were routinely deceived by white managers and record companies. While the days of cheating unsuspecting bluesmen may be over -- I'm sorry to say the days of ripping-off naive rappers and hip hoppers is in its ascendancy. The only difference is that this time it's often black managers, producers and record companies who are taking advantage of black artists (...frequently with the assistance of white music lawyers). But the use of the production deal concept is not limited to black music and its' popularity seems to be growing exponentially into all other musical genres. God help us if that's what passes as progress in the music business these days.

In order to understand why a production deal is so virulently anti-artist, you must understand how a production deal works. In a conventional recording agreement an artist is signed directly to the label. Let's assume for the sake of creating a hypothetical that the artist was offered a signing advance of \$50,000, a recording fund of \$200,000 (...out of which \$180,000 went to pay off third-party recording costs and \$20,000 in "back-end" money was left over to distribute to the artist) and a retail record royalty of 12%. That means that in this direct artist-to-label signing the artist winds up with \$70,000 and 9% royalty (...after deducting 3% for an outside producer). If that same artist signed the same deal with identical terms but did it through a production agreement in which the production company is entitled to 50% of whatever the artist receives -- the artist would be lucky to net \$35,000 and a 6% royalty. But it gets much worse. Many production agreements provide that all costs (including recording costs) are recoupable solely against the artist's share of royalties. It is also common for production deals to require that the royalty payable to the producer of the album (usually 3%) is coming solely out of the artist's share of royalties (thus reducing

the artist in my hypothetical to a total royalty of 3%). The effect of these provisions is that the entire \$250,000 paid out by the record company so far will be recouped only against the artist's meager royalty share rather than on an equal basis with the production company who is gladly willing to accept 50% of the "upside" but only a disproportionately small percentage of the "downside."

Reminiscent of the days of Robert Johnson, Muddy Waters and others, many artists are still not represented by a music attorney at the time when they enter into these agreements. If the artist is wise enough to use an experienced music lawyer there is some reason to hope that a production deal might be improved in the artist's favor. For example, the production company might agree to split the financial responsibility for the royalty paid to the producer (...even though this is still more disingenuous than generous since the artist's principal motivation for signing with a production company in the first place was to allow them to handle all production responsibilities and to be compensated for doing so out of their share of the proceeds). Unfortunately, many rap and hip hop artists come from disadvantaged urban neighborhoods and can't afford to pay what often amounts to sizable legal fees. As a result, these artists are sometimes encouraged to sign retainer agreements whereby they agree to pay their attorney 5% to 10% of all gross royalties and gross advances (in perpetuity!). Applying this arrangement to our hypothetical production deal the artist who used this retainer plan would be required to pay their lawyer \$25,000 (i.e. 10% of the gross signing advance of \$50,000 and 10% of the gross recording fund of \$200,000) and a royalty of 1.2% (10% of the gross royalty of 12%). So even if we assume that the artist's attorney was able to get the production company to reduce its share of record royalties by one half of the producer's royalty (i.e. by 1.5%), the 6% royalty due to the artist for their half of the original 12% royalty would still amount to only 4.5%. If you then reduce it by the 1.2% due to the lawyer that royalty would equal an embarrassingly low 3.3%. And when you deduct the attorney's share of the advances (i.e. \$25,000) from the \$35,000 which the artist was due to receive, the artist will actually net a paltry \$10,000.

And just when you might be saying to yourself it can't possibly get any worse than that -- it does! Most production agreements allow the production company to recoup any costs which it incurred prior to entering into the recording/distribution agreement. Conceptually this makes sense because anyone who makes a capital investment in an artist's career should have the opportunity to recover that investment. At this point, I doubt that it would surprise anyone to discover that the entire amount of the production company's investment (...let's say it was \$10,000) can be recovered 100% out of the artist's share of income despite the fact that the production company stands to gain 50% of all the monies earned under this deal! So if the production company exercises

its right to deduct this \$10,000 the artist in my hypothetical is now left with a royalty of 3.3% and an advance of zero dollars. It can't get worse than zero, you say? I say it can because it is not uncommon for artists under these circumstances to also sign a management agreement with a "division" of the production company at the same time as they enter into the production agreement. Hopefully, the production company will avoid the outright conflict-of-interest and not commission the artist's income from the production deal. But if they do commission it, or if a third party manager is involved, the artist's royalty points (...which are currently 3.3%) could be diminished by an additional 20% (...leaving the artist with a whopping royalty of 2%!). In other words, the artist who is the engine that drives this entire process may actually wind-up receiving only 17% of the total royalty points in the deal and 0% of all the money which the record company handed over to the production company in order to acquire the artist's services.

Can it possibly get any worse than that, you ask? Of course it can! Most production agreements contain a clause which allows the production company to award themselves a substantial portion of the artist's publishing rights for free. (This is exceptionally greedy when you consider that in many cases the production company already owns half of the publishing because they provided the "tracks"). Young artists have been trained through music business seminars, self-help books and the advice of fellow musicians to adhere to the mantra, "Never ever give away your publishing rights." Apparently, there are still many young artists who are not getting the same good advice. As a result, they are routinely assigning over these rights for little or no consideration. They don't understand that in doing so they are: (i) granting control over the administration of their compositions to a production company which is free to do whatever they wish to the artist's songs from changing the songs' titles and lyrics to licensing the artist's songs for a "Worst Songs of the 90's" compilation album, (ii) permitting the production companies to directly collect the majority of the publishing income, which means that the artist will probably be paid at a date which is considerably later than the date on which the production company actually receives that money, (iii) granting the production company's publishing entity the right to charge a 10% administration fee for doing exactly what they promised to do when the production company took the artist's publishing interest for free in the first place (...is there no end to the hubris of these people?) and (iv) allowing the production companies to "cross collateralize" the artist's share of publishing royalties against any unrecouped balances in the record deal. Probably the greatest irony of this publishing situation is that the major labels (which are the entities usually taking most of the financial risk by funding the cost of recording, manufacturing, distributing and marketing of the artist's albums) are themselves receiving 0% of the artist's publishing (...which probably

makes production companies the highest paid middlemen in the history of the music business!).

And yes, of course, it gets worse. Many production agreements also include a clause which allows them to own a 50% interest in the artist's merchandise rights. Do they get this interest in return for the large amount of capital that they have tied-up in manufacturing and distributing the artist's merchandise? Of course not. They get it for precisely the same reason that they were able to command 50% of the artist's record royalties and the artist's music publishing royalties -- they get it because they can. And they can get it because they are part of an industry that would prefer not to confront a system that works for everyone ... except the artist. If a record label deals directly with an artist, it costs them a 12% royalty. If a record label deals with a production company for the services of that same artist, it still costs them a 12% royalty. So why should they care? How about ... because it's wrong to allow anyone to be exploited ... especially those who form the heart and soul of our business.

Production agreements prove the old adage that "no good deed goes unpunished." The genesis of these deals was an attempt to reward producers who could get new artists signed to record deals just by dint of their affiliation with those artists. For example, if a producer with the stature of R.Kelly or L.A. and Babyface agree to produce a previously unknown and unsigned act, chances are that it won't be long before several major record labels will be beating down the door to sign that artist. L. A. and Babyface probably receive a 4% producer's royalty to produce an album by an established performer like Whitney Houston. Therefore, it makes sense that they should receive something more than their normal producer's royalty if it was really their stature as producers (...rather than that of the artist) which caused the record label to sign the new artist in the first place. Consequently, the concept of the production agreement was born.

One reason for the growth of production deals is that record companies have abandoned a good portion of the obligation to "develop" new artists. If a production company truly takes on the responsibility for helping an artist to locate good songwriters, choose the right producers, fund the recording of an album and "shop" for a deal....then I believe the production company is entitled to share in any financial rewards which the artist may receive. But like so many other things that have a benign and logical beginning, this process has become increasingly bastardized so that today it is not uncommon to find high school students who have never had a single record released handing out production agreements to young "wannabe" recording stars. Even more distressing for me is what I perceive to be "racial profiling" on the part of some of my colleagues. If a white rock and roll artist comes to a lawyer with a production agreement that requires the artist to turn over 50% of their record royalties, a

substantial portion of their publishing royalties and 50% of their merchandise royalties to a production company when there is no record deal on the table -- most of us will discourage that artist from mortgaging their future simply to have the opportunity to record a few demos. But if you assume the identical scenario only this time the artist is a black rapper -- I believe most music attorneys will try to negotiate better terms --- but will allow the deal to go forward. At best, there is a double standard in play here ... at worst it is a classic form of racism. In either case it is the artists (...and ultimately the entire music industry) who are the big losers.

Here are my suggestions of what can be done to fix this problem:

1. Record companies should dramatically curtail the number of artists who they sign through production deals. I realize that this will be tough to do because everyone knows that "you don't look a gift horse in the mouth" and right now, the most profitable area of the record industry is the area that contains the greatest percentage of production deals -- rap and hip hop. But in the end, the most important relationship that any label has is with its artists and once an artist starts to sell a large number of albums and receives a small royalty they are going to be understandably upset. (The "Pebbles" and "TLC" cases are perfect cases in point.) We all know that the "majors" can get together when it is in their best interest to do so. Wouldn't it be great to see them act together for the benefit of their artists. (...And here's the best part -- it won't cost them one extra dollar to do so!).

2. Only real production companies with major label affiliations should sign artists to multiple album deals. If a producer with a proven track record for success is interested in working to develop a new artist a production deal may be warranted. Why? Because the mere affiliation of a hot producer is often enough to earn a project a long hard look and listen by some top labels. If a record deal is not consummated within nine months, the artist should have the option to terminate the production agreement and all rights to the artist's masters should thereafter be co-owned by the artist and the production company with neither party having the right to exploit these masters without the prior written consent of the other party.

3. The royalties and advances payable under production agreements must reflect each party's actual contribution to the ultimate success of this project. Any third party producer royalties and advances should be paid "off the top" of the deal. Thereafter all royalties and advances should be split between the artist and production company according to the following schedule: Album #1: 65% Artist/35% P.C. Album #2: 75% Artist/25% P.C. Album #3: 85% Artist/15% P.C. Album #4 (and beyond) 90% Artist/10% P.C.

4. Production company agreements must be fair for both sides. All "recoupable" amounts must come out of both parties shares in proportion to their royalty interests. The artist should be paid directly by the record company at the same time and subject to the same calculation of royalties as the production company is paid.

5. Let's not encourage artists to sign production agreements when a finder's fee agreement might be a suitable alternative. If someone is going to use the master recordings which were financed and recorded by the artist (...as opposed to investing a substantial amount of their own capital to record some new demos) -- this is a classic finder's fee arrangement. In this situation the artist should not be signing a production agreement but should enter into a deal which rewards the successful finder a portion of royalties and net advances. (...I would suggest starting at 10% and then decreasing this amount for each succeeding album in the deal.)

6. Music attorneys should remember that artists and production companies retain them to be their legal representatives -- not their partners. If a lawyer acts as a "finder" of a record deal I have no objection to that lawyer being paid as a finder (... see paragraph 5 above). But I am appalled that lawyers who are providing conventional legal services to artists are expecting to receive 5% to 10% of that artist's "gross" earnings "in perpetuity" while simultaneously arguing that managers and production companies who deal with the artist's career for many, many more hours each day than the lawyer ever will be should be paid on "net" monies against a very short "sunset" clause.

7. Production agreements should not require an artist to give away any portion of their music publishing or merchandising rights. If a production company wants these rights, they should pay fair market value for them.

8. Let's agree that every production agreement must publish a calculation of what the artist will actually receive in net advances and royalties in bold type on page 1 of each contract. Most of the people who are likely to read this article are probably experienced music business professionals. Nevertheless, I'll bet most of you had difficulty in following the pea as it moved from shell to shell when I explained the typical calculation of royalties in my hypothetical production deal. Just imagine how difficult it must be for an 18 year old first time artist with no business experience whatsoever to understand the ramifications of the contract he or she is being asked to execute. I'd like to believe that if production companies and their lawyers had to disclose a "truth-in-contract" clause in large, bold type that clearly acknowledges that artists like the one in my hypothetical would receive an embarrassingly low royalty and

advance -- it might be harder for them to convince the artists to go along so willingly with this type of production agreement.

9. Let's not wait for a musician's union or a Congressional commission or a state statute to tell us to clean up our act - let's do it ourselves simply because it's the right thing to do.

(Bob Donnelly is an entertainment attorney who has specialized in music industry matters for the past 22 years. Telephone number: (212)683 8775). E-Mail address: MusikAtty@AOL.COM). The above article appeared in the July 31, 1999 issue of Billboard.