Making Records in the 21st Century

Stanley Thompson

A while ago, we decided to start a record company. Our first step was the one some lawyers take (and all lawyers advise their clients to take) when launching an enterprise in a field in which they are not expert: We asked experts what we ought to know up front. And who better to ask than the Recording Industry Association of America (RIAA) – "the trade organization that supports and promotes the creative and financial vitality of the major music companies . . . [that] create, manufacture and/or distribute approximately 85% of all legitimate recorded music produced and sold in the United States"?* So we did ask, and the people at the RIAA were kind enough to give our little start-up an answer. Here is what they said.

– *The Editors*

Dear *Green Bag*,

Thank you for your letter indicating that the *Green Bag* is releasing its first record and is interested to know more about record labels and their role in the music industry.

Presented here is a short practical guide on record label basics, including contractual considerations in standard recording agreements and labels' place in the new and expanding digital marketplace.

I hope it's helpful. Welcome to the music business!

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* *See* www.riaa.com/aboutus.php?content_selector=about-who-we-are-riaa.

I.
THE ESSENTIAL ROLE OF RECORD LABELS IN THE MUSIC INDUSTRY

A. An Industry of Investors

At the purest level, a record company's essential function is to use its collective resources to support the work and livelihood of its artists.[1] New signings, which materialize into new commercial releases, are the very lifeblood of the business.[2] Yet, an inherent reality of the recording industry is the tremendous risk labels undertake to develop and distribute fresh talent.[3] Although record companies devote considerable resources to identify and develop the next superstar, the music market is defined by its volatility.[4]

With calculated investment an accepted truism in the recording industry, each signing represents a substantial financial commitment.[5] Labels invest a considerable percentage of revenues into Artist and Repertoire (A&R) discovery, the process in which official "talent scouts" are dispatched to identify and nurture new talent.[6] In fact, the total proportion of revenue labels direct toward discovering and developing new artists generally exceeds comparable expenditures in similar industries.[7]

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[1] INT'L FED'N OF THE PHONOGRAPHIC INDUS., INVESTING IN MUSIC 6 (2010), www.ifpi.org/content/library/investing_in_music.pdf [hereinafter INVESTING IN MUSIC].

[2] *Id.*

[3] Brian Day, *In Defense of Copyright: Record Labels, Creativity, and the Future of Music*, 21 Seton Hall J. Sports & Ent. L. 61, 74 (2011).

[4] *Adjustment of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services: Hearing Before the Copyright Royalty Bd.* (2006) (amended statement of David Hughes, Senior Vice President of Tech., Recording Indus. Ass'n of America), www.loc.gov/crb/proceedings/2006-3/riaa-hughes-amended.pdf [hereinafter Hughes].

[5] INVESTING IN MUSIC, *supra* note 1, at 9.

[6] *Id.*

[7] *Id.* at 7 (Traditionally "research intensive" industries such as manufacturing, on average, invest only 10 percent of profit turnover into comparable research and development operations. Record labels typically invest considerably more.).

The simple reality is that only a very small fraction of artists ever reach measurable commercial success. Of course, any return from that small percentage of successes must not only cover the many more losses, but also must be reinvested in the effort to find that elusive next success.[8] Thus, record labels are the quintessential venture capitalists – investing in many "projects" and hoping for that one breakthrough artist that will pay for the others and allow the business to continue to grow.

Without a doubt, the music business functions as a delicate marriage between art and commerce, and recording a professional caliber album is a daunting, labor-intensive process. Regardless of an artist's stature in the music industry, access to upfront capital is often fundamental to an uninhibited creative process.[9] Moreover, the cost of making a polished, technically sophisticated product is prohibitively expensive for most working artists.[10] Even for the most talented, having to wait tables to pay for studio time is not conducive to creativity. Label support gives artists the financial stability they need to concentrate on writing, rehearsing and performing music exclusively.[11]

The nature of artist investment doesn't end there. Music companies also facilitate product manufacturing, physical and digital distribution, and a host of other services to signed talent.[12] Additionally, record labels redirect a considerable percentage of revenues toward

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[8] Day, *supra* note 3, at 63.

[9] INVESTING IN MUSIC, *supra*, note 1, at 10.

[10] *See* Zoe Chase, *How Much Does It Cost To Make A Hit Song?*, NATIONAL PUBLIC RADIO (June 30, 2011, 3:58 PM), [hereinafter Chase] www.npr.org/blogs/money/2011/07/05/137530847/how-much-does-it-cost-to-make-a-hit-song (referencing the hit single "Man Down," as performed by pop star Rihanna: "[A]bout $53,000 [was] spent on the song . . . before Rihanna even steps into the studio . . . [t]he cost of the writing camp, plus fees for the songwriter, producer, vocal producer, and the [mixing and mastering process] comes to $78,000.").

[11] INVESTING IN MUSIC, *supra* note 1, at 10.

[12] DONALD PASSMAN, ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS 63 (5th ed. 2003).

marketing costs.[13] The aggregated expenses of promoting singles to music critics, plugging radio and TV shows, and financing music videos and promotional tours means that labels provide the typical new artist with more than $1,000,000 in capital to support an album.[14] Thus, record companies bear the risk of significant financial loss with each new artist signed, and every song released to the marketplace.[15]

B. Getting Down to Business: Key Contractual Considerations for Record Companies

1. The Core Agreement

Typically, when a new artist signs to a label, s/he agrees to provide services for the purpose of creating commercially exploitable "records" on an exclusive basis.[16] The term "record" is broadly defined in most contractual language, and generally includes "hard" formats like CDs and cassettes as well as interactive media, digital transmissions, and synchronized video.[17] Newly created studio recordings are called "masters." Labels work very closely with artists throughout the recording process, though contracts frequently provide that all master recordings delivered to the label must be both technically and commercially satisfactory in nature.[18]

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[13] *Id.* at 9; *see also* Chase, *supra* note 10 (quoting manager Ray Daniels: "The reason [marketing] costs so much . . . is because I need everything to click at once. You want them to turn on the radio and hear Rihanna, turn on BET and see Rihanna, walk down the street and see a poster of Rihanna, look on Billboard, the iTunes chart, I want you to see Rihanna first. All of that costs.").

[14] Day, *supra* note 3, at 75; *The Universal Music Group-EMI Merger and the Future of Online Music: Hearing Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the S. Comm. on the Judiciary*, 112th Cong. 8 (2012) [hereinafter Mills] (statement of Martin Mills, Chairman, Beggars Group).

[15] INVESTING IN MUSIC, *supra* note 1, at 10.

[16] M. WILLIAM KRASILOVSKY & SIDNEY SCEMEL, THIS BUSINESS OF MUSIC 11 (9th ed. 2003).

[17] *Id.*

[18] PASSMAN, *supra* note 12, at 108-9.

Under standard agreements, the duration of the artist's contract is based on the delivery of a specified number of master recordings or full-length albums. Additional, post-delivery periods are also commonplace, to allow for the full commercial development of the product.[19] Furthermore, record companies generally retain the right to multiple option periods following the initial term, contingent on the market success of the release. Although both parties certainly hope for a profitable venture at the onset of the artist/label partnership, should fame and fortune prove elusive, the label has no obligation to pick up the artist's option beyond the initial period.

2. Risk and Return

After an artist signs a recording agreement, the label will provide a sizeable cash advance to cover living expenses, as well as a mutually approved recording budget to finance the creation of an album.[20] In the event commercial success eludes newly signed talent – as is frequently the case – the label never recovers the advance.[21] The financial returns from record sales and licensing deals are governed by an intricate system of revenue sharing and contractual royalty allowances.[22] A detailed overview of royalty computation is an essential aspect of a recording agreement and, since many artists, particularly those signed to major labels, venture beyond the borders of the United States, a thoroughly written contract should also stipulate the territory of the agreement. Frequently, record deals define the controlling territory as "the world" or "the universe," to avoid any confusion or potential legal wrangling.[23]

Beyond these essential points, record deals also account for various other business components of a successful music act. This might

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[19] KRASILOVSKY & SCEMEL, *supra* note 16, at 12.

[20] Day, *supra* note 3, at 74; PASSMAN, *supra* note 12, at 93.

[21] Day, *supra* note 3, at 82; PASSMAN, *supra* note 12, at 93.

[22] KRASILOVSKY & SCEMEL, *supra* note 16, at 24; Armen Boyajian, *The Sound of Money: Securing Copyright, Royalties, and Creative "Progress" in the Digital Music Revolution*, 62 Fed. Comm. L.J. 587, 598 (2010).

[23] PASSMAN, *supra* note 12, at 145.

include provisions relating to fan clubs, televised performances and tour support. Naturally, the degree of record label investment that occurs outside of the recording studio varies from company to company. As pirated music has cut into traditional streams of revenue, many recording contracts now include considerations for merchandising, concert sales, and third party endorsement deals.[24] These more expansive agreements, sometimes called "360" or "all rights" deals, are designed to allow a company to see a return on its investment in an artist's career by broadening the potential income pool in today's environment where rampant piracy dampens sales.[25] While the industry is certainly trending toward more collaborative agreements between artists and labels, to be certain, some relationships in the business remain confined to points regarding the creation and sale of records in general.

3. Copyright: The Rights at Issue

Most recorded music[26] represents two separate categories of copyrightable authorship: the underlying musical composition, which includes any accompanying lyrics, and the sound recording itself.[27] Contrary to popular belief, works do not need to be registered with the United States Copyright Office.[28] Rather, a copyright

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[24] *Id.* at 399.

[25] SHERRI L. BURR, ENTERTAINMENT LAW: CASES AND MATERIALS IN ESTABLISHED AND EMERGING MEDIA 549 (1st ed. 2011).

[26] Robert J. Delchin, *Musical Copyright Law: Past, Present and Future of Online Music Distribution*, 22 Cardozo Arts & Ent. L.J. 343, 346-9 (2004) (Early iterations of U.S. copyright law excluded sound recordings from consideration, as sophisticated audio broadcasting was not yet widespread. As such, sound recordings fixed before 1972 are without federal protection.).

[27] *See* 17 U.S.C. § 102(a)(2), (7)); 17 U.S.C. § 101 (defines "sound recordings" as "works that result from the fixation of a series of musical, spoken, or other sounds . . . regardless of the nature of the material objects . . . in which they are embodied").

[28] Official registration merely provides an added safeguard and helps to guarantee rights holders the full range of federal protection and penalties; *see generally* Drum Maj. Music Entm't Inc. v. Young Money Entm't, LLC, No. 11 Civ. 1980, 2012 U.S. Dist. Lexis 17290, at 14 (S.D.N.Y. Feb. 7, 2012) (Holding registering for

automatically vests once an original work is "fixed" in a physical medium of some kind – for example, the moment a song's notes or lyrics are written down or the performance is committed to audiotape.[29] Legal protections granted to copyright owners include the exclusive rights to reproduction, distribution, public performance, and digital transmission, as well as the right to profit from derivative adaptations of the work.[30]

C. Thinking Independent: Special Considerations for Small Record Labels

How, then, should someone interested in starting his or her own label apply this information? A fair and clear contract is absolutely essential in the music business, especially when both parties want to remain on cordial terms. Arguably the most important consideration for a small label owner is the nature and scope of artist investment.

Some independents invest significant resources to holistically develop and promote talent. Other companies may provide only general legal and business services, or use their technical knowhow to facilitate recording or distribution. For some, providing an artist with a physical space to record and the tools to make their music commercially available will be the extent of their activities as a music company. In this context, labels should be pragmatic about their return expectations, and work toward compensating talent on a reasonable and proportional basis.

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copyright protection *after* initiating a lawsuit is "not good enough" to sustain a claim for infringement. Music producer Darius Harrison brought a claim against popular hip-hop recording artist Dwayne Carter, p/k/a Lil' Wayne, for copyright infringement and breach of contract, alleging that Carter published 16 musical compositions on a mixtape entitled "Tha Carter 2, Part 2" without permission. At the time of the mixtape's public release, Harrison had not registered his works with the United States Copyright Office, and furthermore, waited until after filing suit to begin the registration process.).

[29] Boyajian, *supra* note 22, at 594.

[30] 17 U.S.C. § 106 (2007); *see also* Boyajian, *supra* note 22, at 592.

II.
THE STATE OF THE MUSIC BUSINESS IN THE 21ST CENTURY

A. The Digital Revolution

The United States music industry now earns more than half of its total revenue from digital formats.[31] At a time when other creative industries, in particular film and book publishing, are rapidly shifting to online and mobile distribution channels, the music business's level of digital immersion dwarfs that of nearly all comparable sectors.[32] As of this writing, there are over 500 digital services authorized by major and independent music companies worldwide, offering legal access to over 20 million tracks, and counting.[33]

The digital music landscape, broadly speaking, has evolved into two segmented consumption models – "ownership" and "access."[34] Though both continue to make impressive strides, access models like streaming Internet radio and subscription services have seen impressive recent growth thanks to innovative social network integration and bundling their services with established ISP offerings.[35] The progression of the music industry has not only empowered consumer choice, but has likewise become a critical factor in driving platform adaptation, broadband penetration and the surge in demand for the newest generation of tablets and smartphones.[36] Music is not only at the heart of our collective cultural identity, but is an

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[31] *The Future of Audio: Hearing Before the Subcomm. on Communications and Technology of the H. Comm. on Energy and Commerce*, 112th Cong. 1 (2012) [hereinafter Sherman] (statement of Cary Sherman, Chairman and CEO, RIAA).

[32] INT'L FED'N OF THE PHONOGRAPHIC INDUS., DIGITAL MUSIC REPORT 2012 6, www.ifpi.org/content/library/DMR2012.pdf [hereinafter DIGITAL MUSIC REPORT].

[33] Sherman, *supra* note 31, at 2.

[34] DIGITAL MUSIC REPORT, *supra* note 32, at 7.

[35] *Id.*; *see also The Universal Music Group-EMI Merger and the Future of Online Music: Hearing Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the S. Comm. on the Judiciary*, 112th Cong. 2-4 (2012) [hereinafter Bronfman] (statement of Edgar Bronfman Jr., Director, Warner Music Group).

[36] *Id.* at 2; DIGITAL MUSIC REPORT, *supra* note 32, at 7.

essential component to the growth and sustainment of the digital economy.[37] Yet, the industry's 21st century transformation remains largely in adolescence. Digitization and Internet distribution have profoundly affected the economic and legal framework that governs the music business.[38]

B. Wagging the Long Tail

Wired Magazine editor Chris Anderson famously explored the emerging model of digital egalitarianism in his 2006 bestseller *The Long Tail: Why the Future of Business is Selling Less of More.*[39] According to Anderson, as music fans discover and connect with independent and obscure musical offerings (the tail), they will do so at the commercial expense of the "hit" records played on terrestrial radio or featured in this month's edition of *Rolling Stone* (the head).[40] With a larger selection of products to choose from, the public will be able to identify releases that better match their personal tastes and preferences.[41]

Coupled with vast peer-to-peer networks and increasingly sophisticated Internet search and filtering tools, modern consumers possess unprecedented access to culture and content of all sorts.[42] This, according to Anderson and likeminded critics, will spell the end for the conventional record label structure, and shift the market toward an artist-centric business paradigm.

For all the newfound choice of the digital era, however, record labels and the investment and business services they provide appear

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[37] Bronfman, *supra* note 35, at 2.

[38] LISA CAMERON & COLEMAN BAZELON, THE BRATTLE GRP., INC., THE IMPACT OF DIGITIZATION ON BUSINESS MODELS IN COPYRIGHT-DRIVEN INDUSTRIES: A REVIEW OF THE ECONOMIC ISSUES 5 (2011).

[39] *See generally* CHRIS ANDERSON, THE LONG TAIL: WHY THE FUTURE OF BUSINESS IS SELLING LESS OF MORE (Hyperion 2008).

[40] *Id.*

[41] ANITA ELBERSE & FELIX OLERHOLZER-GEE, SUPERSTARS AND UNDERDOGS: AN EXAMINATION OF THE LONG TAIL PHENOMENON IN VIDEO SALES 6-7 (2007).

[42] ANDERSON, *supra* note 39, at 3.

as necessary for industry success as ever. In 2010, of the more than 75,000 albums released, 80% sold 100 or fewer, and 94% sold 1000 or fewer.[43]

A core component of Anderson's thesis – that web-based distribution will lead to increased consumer choice – certainly appears to have come to fruition. However, while the digital era has given music lovers access to a litany of new artistic offerings, the hard data suggests that consumption has in fact become increasingly more concentrated in recent years. With an increasing frequency, technology not only fails to help great new music rise to the top, it actually inhibits it.[44] Twenty years ago, the core dilemma facing artists was how to get their music available to the public.[45] Today, however, the problem appears to be how to convince anyone to actually listen to it, much less buy it.[46] The bottom line is that, while the tail may in fact be long, it is extraordinarily low on the graph relative to the head. In other words, contrary to Anderson's thesis, there may be much more music out there to discover, but only a very small percentage is able to break through the clutter, largely aided by record labels.

C. Looking Forward

A mere decade ago, artist promotion involved stapling fliers to telephone poles and aimlessly mailing postcards and grainy demo tapes to venue owners.[47] Without dedicated management, even the most talented amateurs were lucky to earn gas money from sparsely attended gigs. Yet today, the oft-romanticized version of the recording industry, replete with vast amounts of fame and fortune, has always been, and remains, much more fantasy than reality.

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[43] *See generally* THE NIELSEN COMPANY, www.nielsen.com/us/en/industries/media-entertainment/music.html (last visited Jan. 30, 2013, 6:06 PM).

[44] Day, *supra* note 3, at 85.

[45] *Id.*

[46] *Id.*

[47] Matt Rosoff, *Does the Internet Help Aspiring Rock Stars?*, CNET, Jan. 22, 2010, news.cnet.com/8301-13526_3-10439710-27.html.

In a recent editorial, industry veteran John Mellencamp aptly described the challenges facing newcomers in the music business:

> These days, some people suggest that it is up to the artist to create avenues to sell the music of his own creation. In today's environment, is it realistic to expect someone to be a songwriter, recording artist, record company and the P.T. Barnum, so to speak, of his own career? . . . [An acquaintance] once told me a story about a reception she was at where Bob Dylan was in attendance. The business people there were quietly commenting on how unsociable Dylan seemed to them . . . [but] Bob Dylan was not put on this earth to participate in cocktail chatter with strangers. Bob Dylan's purpose in life is to write great songs like "Blowin' in the Wind" and "The Times They Are A' Changin'." . . . The artist is here to give the listener the opportunity to dream, a very profound and special gift even if he's minimally successful.[48]

And therein lies the enduring function of record companies large and small – to identify gifted artists and provide them with the resources they need to distinguish themselves amid a crowded field of amateurs. When artists do not have to worry about navigating the complex maze of legal and financial pitfalls awaiting them in the marketplace, digital or otherwise, they can spend more time doing what actually matters most – creating truly great music.

[48] John Mellencamp, *On My Mind: The State of the Music Business*, THE HUFFINGTON POST, Mar. 22, 2009, www.huffingtonpost.com/john-mellencamp/on-my-mind-the-state-of-t_b_177836.html.