

## **Recording and Distribution Contracts with Independent Labels**

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An alternative to seeking a major label recording contract or raising funds to produce your own recording is to approach independent record companies. Many independent record labels have become very successful in reaching and developing niche markets. By researching these labels, you may find one that successfully markets music that fits your style and is interested in producing, manufacturing and distributing your record. Some of these independent labels have been very successful and have become subsidiaries to major recording labels, such as Def Jam (Universal), Aftermath (Interscope/Universal), Maverick (Warner Bros. Music), and LaFace and Zomba (Sony BMG), or have developed affiliations with major label branch distribution, such as Rounder Records and Concord Records.

### Small Label Advantages

The chief advantages of releasing your album with independent record labels are similar to the reasons for signing with major labels. They generally have a distribution mechanism in place. They are organized to handle the time and costs of financing and administering the production, manufacture, marketing and distribution of records. They can better absorb the financial risks and have more leverage in collecting money from the wholesalers and retailers of records. In addition, the company may have developed a reputation in the music community for a certain style of music and can move a great volume of records in a wide geographical territory.

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Bear in mind, however, that if a small label invests time and money in your career and is successful in generating a reasonable level of income for you, you should carefully weigh the benefits of signing with a major label if asked (where you probably will be one of many)—against staying with the smaller one (where you may be the star!). Far too often, the benefits of a smaller label are discovered only after an unhappy relationship with a major recording label occurs. Much depends on the style of music involved, for example, pop and rock may get more attention from a major label than music aimed at more narrow and focused audiences, such as jazz, new age, children's music, or Yiddish folk songs. Both small and large labels have demonstrated effectiveness at marketing heavy metal, dance, hip-hop and rap music.

### Contracts

Although contracts with independent labels can be very similar to those negotiated with major labels, smaller independent companies sometimes work out arrangements that do not mirror these standards. These companies may be willing to step away from obtuse and confusing language to create a contract in plain English that is balanced between the interests of the record company and those of the artist to more equitably share the economic benefits realized from the skills and talents of the artist and the business expertise and mechanisms of the recording company, either by paying a respectable royalty or perhaps even agreeing to a profit split. Smaller labels, however, increasingly are reflecting the contractual style and approach of the major labels, perhaps because of the investment costs and financial risks incurred in developing an artist and the desire to be secure that the contract with the artist is sufficiently strong so that a larger label will not be in a position to tempt the artist to switch labels without the smaller label

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participating in the benefits of that switch. Many smaller labels also insist on participating in some or all of the music publishing of the artist. That is an issue that needs to be carefully examined and should be the subject of a separate deal.

Here are some options with smaller labels not usually available to musicians signing with major labels:

### Distribution Deals

In this type of deal, you deliver an agreed amount of packaged compact discs to a record company. Some labels only distribute your product, while you do the marketing and promotion; others do everything.

In a distribution only deal, the record label will either contract directly with stores or deal with networks of independent distributors or both, selling to them at wholesale prices.

If the company only distributes your record, you will receive a sum equivalent to the wholesale price, minus a fee of 20% to 30% and other direct expenses that you authorize the company to spend, but you pay for all the manufacturing costs and all associated marketing and promotion costs. A standard contractual agreement is that you will receive money only on records actually sold and paid for, and even then reserves against returns will be held for up to two years, and sometimes longer.

These types of deals often result after bands release recordings for a regional audience, find themselves with growing popularity, and use the added leverage to make a deal that will broaden their audiences.

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Unlike major recording labels, independent labels sometimes encourage the sale of compact discs at performances or to fan mailing lists. In this case, a clause can be added to the standard recording contract that will state that the musician can buy product at a low wholesale price. This inventory may be provided as an "advance" against the royalties or other fees that will be owing. This practice is actively discouraged by most major recording labels.

## Pressing and Distribution (P&D) Deals

In P&D deals, you deliver a fully mixed recording master and artwork to the record label, which then assumes the responsibility of manufacturing and distributing your records, cassettes or compact discs. If the label advances the manufacturing costs, it will reimburse itself out of the sales proceeds of your recordings, plus, perhaps, some value for the use of its money, in addition to the distribution fee.

If the record label also picks up promotion, publicity and marketing, then the deal is usually structured as a royalty deal that will leave the record label with a sufficient margin to cover all of its costs and make a reasonable profit. The royalty is sometimes higher than in standard recording contracts because you have already invested the costs of recording and producing. That is not always the case, however. When negotiating this type of deal, ask that any royalty percentages be specified as net cents per unit for each configuration for both physical product and digital deliveries.

As an alternative, if providing marketing and promotional duties by the company are involved, these expenses could be deducted as direct costs also, along with the distribution fee and manufacturing costs, with the balance paid to you, but more likely the

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deal will be structured on a royalty basis, with a royalty of anywhere from 10% to 18% of retail, plus mechanical royalties on the music.

### Production Deals

In this type of deal, you sign as an artist with a production company. The company is responsible for recording your music and for obtaining distribution through independent distributors or a record company. In many cases, contracts for these deals are structured similarly to record contracts because the production company will typically make a pressing and distribution deal with a record label that also includes marketing and promotion and then contract with you for a percentage of the royalty paid to it by the record company.

For example, a production company may have a deal with a record company that pays 14% to 18% of the retail selling price on records sold, depending in part on whether the recording costs are paid by the production company or advanced by the record company. The production company might then have contracted with the artist to pay a royalty from between 6% and 10% of the retail selling price or 50% to 60% of the royalty paid to the production company by the record company.

### Net Profits Deals

There are some smaller labels that have adopted a policy of doing fifty-fifty shares of their “net income” with the artists in lieu of paying a royalty per unit. In other words, once the label has recovered all of its costs of recording the album and its publishing royalties, marketing, promotion and publicity costs, as well as manufacturing, art design,

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and distribution costs, and perhaps a percentage of income attributed to overhead, for example, 10%, then it splits the remaining “net” one-half to itself and one-half to the artist. Whether this is a better deal for the artist will depend on the attitude and values of the people running the record company and how the term, “net income” is defined. At the end of the day, unless the record sells very well, it will mean that the artists will not see any money on the sales of their records if there are no net profits. Of course, that often can be the case under the more traditional way of paying an artist a royalty per unit as discussed elsewhere in this article and in related articles in this book, given how labels recoup the costs of recording, and even some, if not all, of promotion and publicity and sometimes marketing costs out of just the artist’s royalty as opposed to the full dollars that come in. By way of illustration, the profile below gives a comparison of income of an artist on a fifty-fifty split and a 15% of retail royalty assuming equal costs to the label for the project.

Total recording costs - \$20,000

Total manufacturing costs for 10,000 units - \$10,000

Art and design costs - \$4,000

Marketing budget - \$5,000

Promotion budget - \$6,000

Publicity budget - \$5,000

Mechanicals ( $9.1¢ \times 75\% \times 12 \text{ per unit} \times 10,000 \text{ units}$ ) - \$8,190

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Distribution and shipping - \$2,000

Miscellaneous - \$2,000

Overhead (10% of \$75,000 in sales at \$7.50 per unit for 10,000 units) - \$7,500

Total costs - \$69,690

Assuming that all 10,000 units are sold and paid-for with an average wholesale price of \$7.50, the aggregate income is \$75,000. After expenses of \$69,690, on a fifty-fifty split, the artist would see one-half of \$5,310, which is \$2,655. In addition, if the artist owned all of the publishing, and his/her share of mechanicals was not included in the 50% split, the artist would get an additional \$8,190 for mechanicals.

On a 15% of retail (\$15.98) per unit royalty, which, with standard packaging deductions and other take-aways, would generally net down to approximately 9.5% of retail, the artist would see an aggregate royalty of \$15,181 ( $9.5\% \times \$15.98 \times 10,000$ ) (assuming no free goods). After applying that amount to recoupment of recording costs of \$20,000, and 50% of marketing, promotion and publicity costs, which equals \$7,500. That leaves an unrecouped balance of \$12,319, i.e.,  $\$15,181 - (\$20,000 + \$7,500)$ . Obviously, the fifty-fifty split is preferable. Even in this example, if the artist is getting the more traditional master royalty, the artist generally would still be getting his/her mechanicals from the first unit sold since mechanicals are not usually used to recoup recording costs and other recoupable expenditures. Those mechanicals would be \$8,190 as computed in the above illustration.

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An example of a fifty-fifty clause from a label, which provides some likelihood that the artist may actually see a 50% share of net follows:

“Royalty. On paid-for phonorecords of the Album sold by Company under this Agreement, Company shall pay Artist an all-in master royalty (i.e., inclusive of Artist, producer, and any other person providing services and for any samples used on the Masters), at the rate of fifty percent (50%) of Company's Net Receipts as defined below (“Master Royalty”) consisting entirely of phonorecords of Masters subject to this Agreement and based on the payments received by Company from its Net Sales of phonorecords of the Album and other uses of the Masters. Company will pay Artist a Master Royalty prospectively after Company has recovered from all income from the Masters its recoverable costs as further described below. It shall be the responsibility of Artist to pay producers, and all third party royalty participants, including for samples, from Artist’s all-in Master Royalty described in this Agreement. No Master Royalty shall be paid to Artist under this Agreement until Company has recouped from all income received by and derived from sales of phonorecords of the Masters and other uses of the Masters a sum equal to all of Company's costs for recording and mastering all of the Masters under this Agreement, as well as all of the costs incurred and paid to third parties from time to time for independent promotion and publicity support; special marketing procedures, such as, for example only, audio interview tapes and electronic press kits; retail store listening posts; videos; and travel costs, accommodations, and meals of Artist in connection with fulfilling public relations and promotion activities; album packaging, manufacturing, mechanical royalties for Non-Controlled Compositions, and all other out-of-pocket costs. Artist’s mechanical royalties for Controlled Compositions will be

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included in Artist's fifty percent (50%) share of Net Receipts. The term "Net Sales" shall mean one hundred percent (100%) of sales for which Company has been paid, less returns, credits, and reasonable reserves against anticipated returns and credits, and less free goods as from time to time prescribed by the policies of Company or its primary distributors. The term "Net Receipts" shall mean all money paid to and received by Company for its sales of phonorecords and other uses of the Masters minus all of Company's out-of-pocket costs incurred in connection with the Masters."

*In the above example, the 50% allocation to the artist is a true split of net, and if the label does not overspend on marketing relative to paid-for sales, there is a greater likelihood that there will be some net for the label and artist to share at the end of the day.*

An example of a fifty-fifty clause from a label, which provides little likelihood that the artist will see any 50% share of money follows:

"Net Profits: We shall pay you the following Net Profits:

(a) "Gross Income" is hereby defined as all income received by us from all sources in connection with our commercial release of records embodying the Masters or any other exploitation of the Masters, prorated if applicable (but not including any shipping or handling type charges received by us) and including any synchronization fees paid in respect to the Masters in the Territory, except as otherwise provided for herein.

(b) Unless otherwise specified herein, "Gross Expenses" is hereby defined as: (i) \$1.10 per unit manufactured by us in Jewel Box 6 panel 4/1 folder, 4/0 tray card 3 colors on

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compact disc (other configurations to be marked up at similar ratios); and (ii) all expenses incurred by us related to all sales and marketing hereunder, including, but not limited to, artwork/packaging, photographs, shipping/ mailing/ courier service and supplies, phone costs, advertising, point-of-purchase displays and related costs, publicity, promotion, video production, additional manufacturing costs/overruns, taxes (e.g., sale and VAT, but excluding income tax), licensing costs and expenses and collection fees, etc.

Notwithstanding the foregoing, you shall be charged the so-called published rates by companies with which we have procured discounts. Further, notwithstanding the foregoing, you hereby acknowledge that the cost of administration of certain expenses (e.g., postage and supplies) would exceed the actual cost or expense of such materials, and therefore our estimate of such Expenses shall be conclusive and binding upon you. Prior to the release of each Album, you shall have reasonable approval of the total expenses to be deducted hereunder for each sales level, provided, however, in the event of a dispute between you and us in connection with such expenses, our decision shall be controlling.

(c) "Net Profits" (e.g., your share of Net Profits) is hereby defined as: (i) 45% of the first \$350,000 of Gross Income in any one calendar year; and (ii) 60% of Gross Income which exceeds \$350,000 in any one calendar year; (iii) after deducting any and all Gross Expenses, returns, and reserves from such 45% or 60% share.

*This means that all expenses are taken from the artist's share of Gross Income.*

(d) Product sold to you for your resale: We hereby agree to sell to you, solely for your resale at live concerts, a reasonable number of copies of any of your physical Albums

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distributed by us at a per unit price equal to \$4.50 plus any shipping and credit card (if applicable) charges. All invoices must be prepaid. Any monies received by us in connection with this subparagraph shall not be included in Gross Income.

(e) Your share of Net Profits shall include all royalties and other monies payable to any producers, mixers, third party publishers, or any other persons entitled to royalties and other monies payable in connection with the sale and other exploitation of the Masters (including, without limitation, mechanical and synchronization royalties). You hereby agree that your share of Net Profits as described in this paragraph is in lieu of all other royalties with respect to the sales of records embodying the Master(s), including, without limitation, any mechanical royalties which would otherwise be due and owing to you, and any other exploitation of the Masters hereunder.”

*In this example, all of the gross expenses incurred by the label are deducted from only the artist's share of gross income rather than from the total gross income. So, while this deal is described by the label as a share of gross, all of the expenses are charged to the artist's share, and the computation is much different than that provided in the first illustration, which is a true equal share of net.*

## Arrangements on Digital Rights

Most independent labels, when entering into a deal with the artist, as is the case with major labels, will insist on the right to handle the artist's product not just in the physical medium, but also will want to have the right to distribute and sell the artist's recordings in the digital medium through such outlets as Apple's iTunes, Napster, MusicNet, Yahoo!, and the like, including downloads to computers and over-the-air downloads to

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mobile devices for both full track downloads (OTAs), ringtones, ringbacks, and other wireless uses. Most labels that work on a royalty basis will try to maintain the payment of just a royalty to the artist in the same way that a royalty is paid on a physical sale, but generally without factoring in packaging deductions and free goods, since those elements are not relevant. The labels obviously get a good advantage on this approach as they have no manufacturing, warehousing, shipping, or distribution costs. Payment of a 15% royalty on a 99¢ download (i.e., 15¢), plus statutory mechanicals (namely, 9.1¢, at the rate in effect as of January 1, 2006), leaves a nice margin for the label, with the digital music service downloader paying the label 70¢ on the download. If the label goes to an aggregator, like IODA, DRA, or The Orchard, then that label likely will pay the aggregator about 15% as a fee for providing the “middle person” service (which is actually a very reasonable charge). Even with an aggregator as part of the picture, the label on a 15% royalty to the artist is still doing very well, netting approximately 36¢ (70¢ minus 9.1¢ mechanical, minus 15¢ to the artist, minus 10¢ to the aggregator).

If the artist’s deal with the label, however, is for a fifty-fifty split of net, the artist will do much better than a royalty deal of 15%. On a fifty-fifty split of the net, even with an aggregator, the artist will see about 25¢ (70¢ minus 15% or 10¢ to the aggregator, minus 9.1¢ mechanicals, divided by 2), plus mechanicals at 9.1¢, for a total of 34.5¢, whereas with the royalty deal, the artist will see just 15¢ against a 99¢ retail download, plus the 9.1¢ for mechanicals if the song is the artist’s, for a total of 24.1¢.

The other consideration to keep in mind is whether the label will account on a fifty-fifty split separately for the digital downloads or whether it will apply its receipts from that distribution mechanism against its costs in the physical medium. There also are some

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labels that have taken the approach that they will only distribute product digitally and leave rights to sell the masters in physical media, such as CDs (physical rights), at least to some extent, to the artist, and then reassume physical rights if the artist gets sufficiently established so that the costs of being in the physical market are more likely to be covered by receipts from that market.