

An Excerpt from *All You Need to Know About the Music Business*

By Donald S. Passman

Cross-Collateralization

An important concept tied to recoupment is that of cross-collateralization. Remember the illustration on page 101, where there are two towers side-by-side, and two 1,000-gallon wells? The water tank for one of the wells contains exactly one thousand gallons, which means the well is full and the water usable. But the other tank has only five hundred gallons, so you can't reach the water. Suppose we dug a hole in the ground connection these two wells. In that case, the same 1,500 gallons (five hundred from Well A and one thousand from Well B) would be distributed evenly between the wells (750 gallons in each), and you couldn't reach the water in either of them (see Figure 8 below).

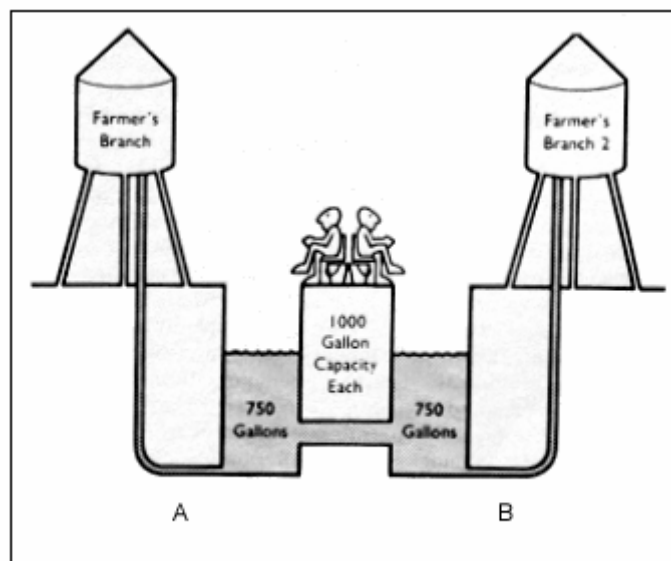


Figure 8. Cross-collateralization.

Figure 8. Cross-collateralization.

Cross-collateralization works exactly the same way, and it's built into every deal. Let's assume you get a \$100,000 advance for album number 1, plus another \$100,000 for album number 2. Let's further assume album number 1 earns royalties of \$10,000, and album number 2 earns royalties of \$120,000.

If the two albums were not cross-collateralized (the two wells were not connected), you would get nothing for album number 1 (it only earned back \$10,000 of the \$100,000 advance, so it's \$90,000 unrecovered), but you would be paid \$20,000 for album number 2 (the \$20,000 earned in excess of the \$100,000 needed to recoup the \$100,000 advance). However, this only happens in Fairyland. In the real world, the two albums are always cross-collateralized (i.e., the wells are connected), which means the entire \$200,000 deficit (\$100,000 for each album) is recouped from the entire \$130,000 earnings (\$10,000 from album number 1 plus \$120,000 from album number

2). Accordingly, your account is \$70,000 unrecouped (\$200,000 less \$130,000), and this deficit carries forward against the next album(s).

Cross-Collateralization of Deals

Besides referring to royalties and recoupment on different albums, cross-collateralization can also refer to different agreements. These can be simultaneous agreements (for example, an artist signing a recording and publishing agreement with the same company), or they can be sequential (such as an artist who, at the end or renegotiation of one record agreement, signs a new deal with the same company). In either case, the concept is that advances under either agreement can be recouped from royalties under both. This is *never* good for the artist. NEVER.

Most companies include language in their form contract that automatically cross-collateralizes the deal with all other deals. Major record companies don't really try to cross-collateralize a record deal with a publishing deal, but small labels may (see page 267). However, everyone tries to cross-collateralize *sequentially*, meaning that advances under your current recording deal are cross-collateralized with royalties under past and future record deals, and vice versa. The language that does this is buried innocently in the recoupment language and can easily be missed by the untrained eye. It says that advances can be recouped from royalties payable, and royalties can be used to recoup advances paid, "under this *or any other agreement*." (Your eye is now trained—so don't miss it!) I've been reasonably successful in knocking this language out in artists' first deals by arguing that the issue should be discussed later, if and when there is a second contract. My argument is that there is no other deal to cross-collateralize with, and until there is, the language is meaningless. That reduces the point down to who is more likely to forget about it—the artist or the company—at the time of the new deal. (Don't worry: The company won't forget.)

--From *All You Need to Know About the Music Business*, by Donald S. Passman.
Copyright (c) 1991, 1994, 1997, 2000 by Donald S. Passman

The materials in this section represent the opinions of the author and may not be applicable to all situations. Many circumstances appear similar, but differ in respects which may be legally significant. In addition, laws and customs change over time, and by necessity of the lapse in time between the writing and publication of this material, some aspects may be out of date even upon first publication. Accordingly, the author and publisher assume no responsibility for actions taken by readers based upon any advice offered in this material. Each reader should use caution in applying any material contained in this book to his or her specific circumstance, and should seek the advice of an appropriate professional.

Visit Don Passman's website at <http://www.donpassman.com/>.

Don Passman: On Royalties

An Excerpt from *All You Need to Know About the Music Business*

By Donald S. Passman

Basic Royalty Computations

For historical reasons, the division of proceeds between the artist and the record company is more complicated than the puppy deal. The companies don't simply divide the money they get (that would be too easy, and I'd be out of a job). Instead, almost all of the companies compute artist royalties as a percentage of the record's suggested retail list price (SRLP to its friends). The SRLP is an approximation of the price received by the retailer, which has nothing to do with the wholesale price received by the company. (Even those few companies that compute royalties based on the wholesale price don't just divide up the company's actual receipts; there are a bunch of artificial adjustments, as you'll see.)

To follow the next part we'll need to use a little math. Don't worry if numbers aren't your strong suit—I'll keep it simple and go slowly. I've explained these concepts to my cousin David, who has to take off his shoes and socks to count to twenty, and he understood them.

Here's how it works:

The artist's royalty is stated as a percentage of the suggested retail list price, such as "10% of retail." I'll use retail for this example because the vast majority of the business uses it. The wholesale computation is the same as retail, except that the royalty is roughly doubled, since the wholesale price is approximately one-half of the retail price. To use simple numbers, 20% of a \$4.50 wholesale price (90¢) is the same as 10% of a \$9.00 retail price (90¢). (In actuality, the wholesale price is more than half of retail, so the equivalent wholesale royalty is less than twice the retail royalty.)

Note that the royalty is based on the *suggested* retail list price, which has absolutely nothing to do with what you pay at your local record store (in my experience, no two record stores ever have the same price for the same record anyway). Currently, the SRLP for the majority of newly released analog (non-digital) cassette albums of superstars is \$11.98, and for CDs is \$16.98. (As I'm sure you know, you can almost always buy records for less than this.)

Each percentage point of retail or wholesale is known as a point. So if you have a 10% royalty, you have ten "points."

From this price, the company first deducts a packaging charge (also called a packaging deduction). In *theory*, this is the cost of the "package," and it's deducted because the artist should get a royalty only on the record, not the package. In *reality*, it's a charge of much more than any package actually costs, and is thus only an artificial way to reduce the artist's royalty.

The packaging charge is stated as a percentage of the SRLP, and the industry norm is 20% for cassettes and 25% for compact discs and other "new configurations."

The result of this (i.e., the SRLP after deducting the packaging charge) is called a base price or royalty base. This is the figure you apply your royalty percentage against.

Here's an example of an analog cassette royalty base computation:

Retail price of cassette	\$11.98
Less: Packaging (20% of \$10.98)	<u>-2.39</u>
ROYALTY BASE	\$9.59

Thus, in this example, if an artist has a 10% royalty, he or she gets 95.9¢ (10% of \$9.59) for analog cassettes. (CDs, DVDs, and other new technologies are more complicated, so I'm saving them for later.)

--From *All You Need to Know About the Music Business*, by Donald S. Passman.
Copyright (c) 1991, 1994, 1997, 2000 by Donald S. Passman

The materials in this section represent the opinions of the author and may not be applicable to all situations. Many circumstances appear similar, but differ in respects which may be legally significant. In addition, laws and customs change over time, and by necessity of the lapse in time between the writing and publication of this material, some aspects may be out of date even upon first publication. Accordingly, the author and publisher assume no responsibility for actions taken by readers based upon any advice offered in this material. Each reader should use caution in applying any material contained in this book to his or her specific circumstance, and should seek the advice of an appropriate professional.

Visit Don Passman's website at <http://www.donpassman.com/>.

Advances: The Basic Concept

An Excerpt from *All You Need to Know About the Music Business*

By Donald S. Passman

Advances: The Basic Concept

Back to Jules and his bulldogs. Our friends at Royal Family charged him a \$300 stud fee for the services of Winston. Let's suppose Jules didn't have the \$300 (or at least didn't want to invest it in this particular endeavor). So Corky (who is raising the puppies in exchange for 50% of the sales prices) comes up with an idea: She agrees to pay Jules the \$300, or to pay it directly to Royal Family, and then take her money back from Jules's share of money from the puppies. For example, if the puppies sell for \$200 each (so that Corky gets \$100 and Jules gets \$100 for each dog), Corky would keep Jules's \$100 share of the first three puppies (\$300) to get back the stud fee.

This is exactly how an advance works. The record company pays a sum of money to the artist (the \$300 stud fee) and then keeps the artist's royalties (the proceeds from selling the puppies) until it gets its money back. So if a company gives an artist \$10,000 to sign a record deal, it keeps the first \$10,000 of artist's royalties that would otherwise be payable. The process of keeping the money to recover an advance is called recoupment, and we say an advance is recoupable from royalties. The amount of unrecouped monies is called your deficit or red position (from the accounting use of red ink to signify a business loss), since this is the amount that has to be recovered before you get paid. So if you got a \$100,000 advance and earned \$75,000 in royalties, you have recouped \$75,000 of the advance, and your deficit is \$25,000 (you are \$25,000 "*in the red*," or \$25,000 *unrecouped*).

Here's another way to look at it:

Figure 7. Separate accounts.

When I grew up in Texas, it was a big deal to drive just outside the city and see the huge water tanks with the names of towns painted on the side. (It takes very little to make me happy.) In fact, Farmer's Branch, a city outside Dallas, had a water tower that was a major local site. (not as big as its post office, however, because the sign there said FARMER'S BRANCH BRANCH. Honest.) Anyway, picture a water tower with a large connecting pipe that runs deep into the ground. The connecting pipe feeds into a narrow dry well that needs a thousand gallons of water to fill it up to ground level. If there were no other access to the water, you'd have to wait until the water tower filled the well up to ground level (that is, until a thousand gallons had been poured in) before you could get any water. If there were only five hundred gallons, you couldn't reach it (see Illustration A in Figure 7 above), but when another five hundred gallons was added, you could (see Illustration B).

Recoupment works exactly the same way. The water represents your sales, and the ditch is your deficit account. If you got a \$1,000 advance from the record company, your

account is \$1,000 unrecouped. Until you earn \$1,000 of royalties (i.e., until you have enough water to fill the well), you don't get anything. Just like the first thousand gallons of water have to fill the hole before you can get a drink, the record company keeps the first \$1,000 in royalties to get its money back before you get any royalties.

Other Goodies

Monies paid directly to the artist are not the only recoupable monies. Recording costs are also recoupable from royalties, and so are some portion of video production costs, monies paid on behalf of the artist (for example, to buy equipment or to support a personal appearance tour), and anything else not nailed down.

Recoupable recording costs include everything you can think of, which is often a page-long list in your record deal. It's not just studio time; it includes equipment rental, travel, arranging, instrument transportation, etc. It also includes union scale (*scale* means the minimum amount a union requires everyone to pay its members) paid to you and others to perform at recording sessions.

In addition to a specific list of recoupable stuff (like cash to you, recording costs, and video costs), almost every contract has a general provision that says all amounts "paid to you or on your behalf, or otherwise paid in connection with this agreement" are recoupable unless the contract specifically provides otherwise. You can feel the history jumping from the pages on this one—Charlie Artist asked his company to advance the cost of a trip to see his mom, and then argued the money was non-recoupable because the contract didn't say it was recoupable. This of course is wrong, but the above broad language solution is overbearing and overkill—sort of like using a sledgehammer to squash a fly (which is effective, but messes up the kitchen). In fact, there are a number of costs paid on your behalf or in connection with the agreement that are never recouped under industry custom. These include such things as manufacturing costs, promotion costs, advertising, marketing, shipping, etc. In practice, the companies don't abuse this language, but I like to carve out the items I just ticked off, together with my own broad language, saying they can't recoup amounts that are "customarily nonrecoupable in the industry."

Risk of Loss

What happens if you don't sell enough records to get back the full amount of the advance? With very rare exceptions, advances are nonreturnable, which means it's totally the record company's risk. So if you don't sell any records, it will never get back its advances. (This nonreturnable aspect is also significant because it means advances are taxable income when you get them, as opposed to when they're recouped.)

--From *All You Need to Know About the Music Business*, by Donald S. Passman.
Copyright (c) 1991, 1994, 1997, 2000 by Donald S. Passman

The materials in this section represent the opinions of the author and may not be applicable to all situations. Many circumstances appear similar, but differ in respects which may be legally significant. In addition, laws and customs change over time, and by necessity of the lapse in time between the writing and publication of this material,

some aspects may be out of date even upon first publication. Accordingly, the author and publisher assume no responsibility for actions taken by readers based upon any advice offered in this material. Each reader should use caution in applying any material contained in this book to his or her specific circumstance, and should seek the advice of an appropriate professional.

Visit Don Passman's website at <http://www.donpassman.com/>.

The Major Publishers

[BMG Music Publishing](#)

Roster includes: Nelly, Robbie Williams, Coldplay, Erykah Badu, Beck, Bee Gees, Jim Brickman, The Cure, Cypress Hill, Juan Gabriel, Manau, Misia, M People, Eros Ramazzotti, Rammstein, HIM, Bomfunk MCs, Reamon, Elvis Costello, Kevin Cadogan (ex-Third Eye Blind).

[Universal Music Publishing Group](#)

Roster includes: Jason Epperson, Godsmack, Bloodhound Gang, 3 Doors Down, D'Angelo, Ice Cube, Kelly Price, Mary J. Blige, Common, U2, Foo Fighters, Anastacia.

[Sony/ATV Music Publishing](#)

Roster includes: Babyface, Cat Stevens now known as Yusuf Islam, Cory Rooney, Cyndi Lauper, Destiny's Child, Graham Nash, Joni Mitchell, Lauryn Hill, Marc Anthony, Mariah Carey, Maxwell, Neil Diamond, Phil Galdston, Sade, Sarah McLachlan, Stephen Stills, Stevie Nicks, System Of A Down, Walter Afanasieff, Wyclef Jean.

[Warner/Chappell Music](#)

Roster includes: The Afghan Whigs, Leah Andreone, The Black Crowes, Sammy Cahn, Sheryl Crow, Deftones, Bernard Edwards, Gamble and Huff, George & Ira Gershwin, Green Day, Joe Henry, Alan Jackson, Jewel, Keb' Mo', Kool & The Gang, Moby, The Ohio Players, Carole Bayer Sager, Marty Stuart, Sugar Ray, The Wallflowers, White Zombie.

[EMI Music Publishing](#)

Roster includes: The Prodigy, M-People, Meredith Brooks, Simply Red, Carole King, Janet Jackson, Lenny Kravitz, Enya, Queen, Ziggy Marley, Jamiroquai, Usher, Aerosmith, Sting, Billy Joel, Crowded House, Tina Arena, Matchbox 20, Third Eye Blind, Robbie Williams, Goo Goo Dolls, Gloria Estefan, Shawn Mullins, Jay-Z, Hootie and the Blowfish, The Verve, Foo Fighters.

Performing Rights Organizations

[ASCAP - The American Society of Composers, Authors and Publishers](#)

This is the home site of ASCAP, an association of hundreds of thousands of composers, songwriters, and music publishers that protects the rights of its members by licensing and distributing royalties for non-dramatic public performances of their copyrighted music. The site includes online membership forms, explanations of benefits, a job board, career advice, and other services for music professionals.

[BMI - Broadcast Music, Inc.](#)

BMI is a performing rights organization that pools the rights of individual artists to the music they have written, and then compensates those artists for public performances of their music, whether on radio, television, internet, or live. The BMI site includes online membership forms, music news, online music, an events calendar, and more.

[SESAC](#)

SESAC, headquartered in Nashville, is the smallest of the major US performing rights organizations, and prides itself on close, personal relationships with its member artists. SESAC has a selective process for affiliation, and a creative staff which works directly with artists to develop their careers. This site provides information about the organization, an online database of artists, songwriters, and music, artist profiles, and more.