21
RECORD DISTRIBUTION DEALS

THERE ARE THREE CLASSIC TYPES OF RECORD DISTRIBUTION DEAL. THESE ARE LABEL DEALS, PRESSING AND DISTRIBUTION DEALS, AND MASTER LICENCE DEALS. THEY ALL INVOLVE THE DISTRIBUTION OF THE RECORD BUT INVOLVE VARIOUS PERFORMANCE OBLIGATIONS. IT MUST BE EMPHASISED THAT THERE ARE MANY VARIATIONS TO THE CLASSIC TYPES DISCUSSED. DIGITAL DISTRIBUTION HAS CHANGED THE GAME, BUT PHYSICAL DISTRIBUTION IS STILL A SERIOUS BUSINESS.

LABEL DEALS

You will often come across the expression 'label deal' in the record industry. It is a generic description for a whole range of structures and schemes which are meant to give Independents and individuals access to the Majors' facilities, while allowing the Independents to sell records in their own name.

Most label deals resemble complicated master licence deals. They set out how the Independent will make its master recordings, who will provide the funding and how, and the terms of the licence to the Major. The Major's role is to manufacture records from the masters delivered by the Independent, promote them and sell them. The Independent gets a royalty from the Major for each of its records the Major sells. That's the theory anyway.

In most label deals, the Independent is responsible for:

- contracting with the artists
- administering the recording process
- delivering the audio and video master recordings to the Major
- creating artwork for record covers
- making sure the artist is available to support the Major's promotional activities.

Before considering the mechanics of label deals, it is worthwhile considering just what 'labels' are, and what label deals are supposed to achieve.

WHAT ARE LABELS?

Record companies sell their records under a variety of so-called labels. The label itself is a brand: a distinctive name or logo, which can be a trade mark, an image, or just a name or words. The Majors each use many different labels at any one time. The labels are used to help record buyers tell where a particular record came from and (perhaps) what kind of music it is, before they have even heard it. Record companies go to great lengths to protect labels. There is no point in having a label and promoting it if it can be confused with someone else's, or if someone else uses it without consent.

Labels can get a reputation for quality or a particular musical style, which helps marketing. The Blue Note jazz label is a perfect example of a label that managed to define its musical style so powerfully that the record-buying public can more or less tell what they will get as soon as they see a Blue Note label on the record. The label identification is so strong that when the company decided to release classical recordings, it had to devise another label for those new recordings.

Labels in other genres of music have been successful in defining themselves by their labels too. No one would expect Harmonia Mundi to release rock and roll any more than American Recordings would release chamber music. Any potential buyer looking at a record on the Verve label would know the recording's musical genre.

A successful label helps to sell records. Often, they are one of the most valuable assets an Independent can acquire, besides its master recordings. We will look at the ways to protect labels later in this chapter.

LABEL OWNERSHIP

You can see the diversity of labels just by browsing the internet or through any surviving record shop. If you are unsure who owns a particular label or master, or who is licensed to use it, ARIA keeps a register of the owners and licensees of many of the labels used in Australia. It is updated annually, to keep track of label movements between record companies and to note any new labels as they are introduced. Sometimes old labels are dropped and replaced by new ones. Sometimes old ones are revived after years of disuse. Informal database resources like Wikipedia can also be helpful, at least as a first port of call.

If a label has been registered as a trade mark, it is easy to search the trade mark register on IP Australia's website to find who owns (or owned) it. Many, though, are just used for a while, then fade away. Some are sold off to new owners, or change hands as companies are sold or merged over the years. This can make them hard to track down, but may have little adverse effect on the label's worth as a marketing tool.

WHY DO A LABEL DEAL?

Label deals are usually structured so an Independent can sell records under its own label. This way, if the recording or artist is successful, the artist is associated with the label rather than the Major that distributes the records, so the label can acquire a public profile, which attracts other artists who want to be associated with its success.

Often, the idea behind a label deal (at least in the minds of the people starting the Independent) is that the label will sign new artists (using a Major's funds as its bank), have a few successes and eventually sell the company off. This process has actually been one of the features of the growth of the music industry over the years. In fact, most of the Majors achieved their accelerated growth by buying and absorbing other labels. A few examples: the Atlantic label started as an Independent, distributed by Warner, who eventually bought it (along with another Independent, Electra) and combined their operations to form the WEA company. Herb Albert learned (and earned) enough from his days heading the Tijuana Brass, to form A&M Records with Jerry Moss. A&M was remarkably successful and was bought eventually by PolyGram. Robert Stigwood's RSO label made a fortune during the disco-fever phase and its catalogue was too attractive for PolyGram to ignore. In turn, PolyGram was snapped up by Universal, one of the world's biggest Majors.

The Independents are usually the result of the fire in the belly of one person. For example, David Geffen was manager to many of the big names of the 1960s, such as Joni Mitchell, Neil Young and Crosby, Stills and Nash. In 1970 he founded Asylum Records. Asylum's roster included the major names of the 1970s and was eventually sold to Elektra, which was sold to Warner, creating WEA. Not content with that, in 1980 (presumably when the non-compete clause in his contract expired), he founded Geffen Records, which carried Guns N' Roses, Elton John, Don Henley, Whitesnake and Aerosmith. MCA bought Geffen Records in 1989. Geffen then went off to be a founder of DreamWorks.

The great Australian example of fire in the belly was Michael Gudinski who founded Mushroom Records (and an octopus of vertically-integrated entertainment businesses). Mushroom had a label deal with Festival. Over two decades it amassed a large and important catalogue and was eventually taken over by Festival (which in turn was bought by Warner Music).

The list of successful labels goes on and on. Unfortunately, the list of unsuccessful labels is many times longer!

Label deals have been rather unkindly criticised as being a 'Clayton's A&R policy' for Majors, because the Major is relying on the Independent to make the A&R decisions. Despite the apparent inherent contradiction of a Major paying someone else to make A&R decisions, most Majors recognise the value of this kind of deal and continue to do them. By doing a label deal with an Independent, the Major gets a fully recoupable A&R department. In the Major's books, the advances that fund the label are advances against the label's royalties. As the Major will not actually have to pay any royalties until the advances have been recouped in its books, the deal can be quite advantageous for it, if the label earns good money off its catalogue of recordings.

In addition, the Major can get the wholesale margin (the profit on the sale to the retailers) when it also distributes the records. Of course, it is still only profitable if enough records are sold.

NEGOTIATING LABEL DEALS

A label deal has to work at two levels. Before it even gets to the mechanics of record distribution (royalties, rights, etc.), it has to define the relationship between the Independent and the Major that will distribute its records. This is rarely easy, because of the basic conflict between the Independent wanting to have as little interference as possible from the Major, and the Major wanting to influence how the Independent spends the funds that the Major will be providing.

The parties have to spend a lot of time making sure they agree on the basics of the relationship. This can be strongly influenced by the personalities of the people involved and this is the great intangible that can make or break a label deal. If either side has unrealistic expectations, negotiations can be very difficult. Making promises that cannot be met will almost certainly result in a fundamentally flawed deal. Experienced advisers, involved from the start, can do much to minimise these problems.

LABEL IDENTITY

The agreement has to set out the extent of the label's freedom to make A&R decisions. This will largely depend on how financially independent the label is and the relationship between the people involved in the label and those in the Major.

The label should always insist on having the final say as to what records will be released. 'Cherry picking' by the Major is the alternative – a very unsatisfactory situation for a label, where the Major can decide whether or not to release any particular recording. If this is the case, the label cannot give its artists any guarantee that their records will be released. Without a release guarantee, if the Major says 'no thanks', the artists and the label will be in a difficult position. They will have significant recording costs but may never see the recording released, so cannot earn royalties to recoup them. The Independent will have to find another way of releasing the record which, at the very least, will delay any release and may antagonise the artist and put extreme financial pressure on the Independent.

FUNDING

The label needs sufficient funds to run its infrastructure and make recordings. There is no future for the deal if the Major keeps the purse strings so tightly drawn that the label slowly starves. Good budgets are essential, so the Independent can make a realistic estimate of its needs.

In most deals, all the funds advanced by the Major will be recoupable from all royalties payable to the label. This is usually called a 'cross-recoupable' deal because all royalties, regardless of which of the label's artists earned them, are retained by the Major until all the advances are recouped. This can lead to problems if, say, one of the artists has a huge success and starts earning royalties, but the Major is still retaining all royalties because there are other advances (for other artists) still to be recouped. This possibility has to be considered and a mutually acceptable solution worked out before it happens. (One solution is for the agreement to state that the Major will pay through the artist royalty to any artist who actually is recouped.)

Sometimes the Major will agree to treat each artist separately. Each artist has a separate account in the Major's royalty account system and as advances are paid to the label, they are recorded in the relevant artist's account. That way, the successful artists do not, in effect, subsidise the unsuccessful ones. This structure only works if a label has a small roster of artists. Once it gets the size of, say, Interscope or the like, the label can generate enough cash flow to easily meet its royalty commitments, so it does not need to worry about cross-recoupment.

As in all record deals, it is vital that the contract spells out exactly when advances are payable. The Independent needs the money in advance, to pay recording costs, but the Major will usually want to have the funds payable on delivery of master tapes, video clips or whatever the funds were spent on. The usual compromise is half in advance and half on delivery, or progress payments. Whatever is agreed, the contract must be unambiguous about when the payments are due and how they are to be paid.

GRANT OF RIGHTS

The rights granted in the master recordings are much the same as in any master licence, so it is not necessary to repeat them here. Obviously, the label has to make sure that the rights it gives to the Major do not exceed the rights it has under its recording contract with the artist. If they do, things can become extremely tense (e.g. if the artist asks the label why their records were released as a budget record, or used in an advertisement without the artist's permission, in breach of the artist's contract with the label). It is important to remember that the label really should retain the right to approve any unusual sales methods or activities that might adversely affect the royalty it receives.

DURING THE TERM

During the term, the label will deliver more than one master recording and will certainly deliver quite a few different batches of costly artwork and video clips. Assuming the Major has to release everything delivered to it, then there will be quite a few different releases by different artists. It is in the label's own interests to keep accurate files recording:

- when each recording was completed
- when it was delivered to the Major (remembering that 'delivered' may be defined to mean very much more than just sending a master recording to the Major's office)
- what artwork was sent (and keeping a copy of the signed assignment letter from whoever designed the art, otherwise the label may not actually have the right to deal with the artwork)
- to whom each master recording was sent and how
- any video clips or other promotional material supplied, to whom and how sent
- any costs that the Major is meant to repay (this will depend on the terms of the agreement)
- when records are scheduled to be released
- the date they are actually released
- any special arrangements made with the Major for promotional efforts and expenditure
- whether copies have been sent to the Major's affiliates overseas, in an effort to secure an overseas release
- how much every item cost! (If the label does not know this, it cannot hope to keep any useful books of account, nor can it tell how much it is to recoup from each of its artists before it has to start writing royalty cheques.)

It is amazing how many label deals are done without any thought being given to who will keep accounting records. It is absolutely essential to have a competent accountant if the label is to have any hope of surviving. Anyone setting up a label deal owes it to themselves, their artists and to the Major, which is probably providing the funds to run the operation, to keep track of funds moving in and out of the label. Specialist accounting and legal advice will pay for itself many times over by minimising foul-ups and avoidable errors that could leave the label, and the people running it, liable for thousands of dollars in damages. Besides, if you don't have proper accounts, you are wide open when the Taxation Office decides to audit you and the label. Without proper accounts and files, all those deductions you claimed won't be allowed. Penalty tax will be charged. End of story.

REVERSION OF RIGHTS

There are particular things to consider when a label deal comes to the end of its term. The label naturally wants to be in the position to take its catalogue and its artists and deal with it without interference from the Major. On the other hand, the Major will want to ensure that it has a chance to recover its investment because, from past experience, it expects to be unrecouped at the end of the term. This is one of the main areas for negotiation when the deal is being put together. The lawyers' job is to find a balance between the parties' wishes.

Most Majors will insist that they keep the exclusive licence of any recordings for some period after the end of the deal.

For example, say Label A does a three-year deal with Majorco. At the end of the three-year term, Label A will be free to do a deal with another Major, but the recordings delivered to Majorco during that time will remain with Majorco for some additional period. Sometimes it is expressed as a number of years (often referred to as the 'retention period' or 'rights period'). Sometimes, it is 'until recouped'.

Unfortunately, this approach creates several problems because:

- Majorco will want to keep selling the records in their original packaging, and will not want to have to remove the label from the remaining or future stocks of records
- the label may not want to have its catalogue split up over two or more Majors, especially as this may mean some artists will have records released by two different Majors (which can confuse retailers when they come to order stocks)
- the new Major may want an exclusive right to use the 'labels', but Majorco may want to have the right to keep using it.

In spite of the fact that there are lots of examples of labels that have product split between two distributors (particularly while the first company's retention period is running out), it is to the label's advantage to find a way to consolidate its catalogue. This usually means paying back any unrecouped advances, or paying some percentage of future sales to Majorco. Leave the negotiating and structuring of this to the lawyers!

TERRITORY

Like any other licence deal, label deals can give Majorco rights for the world, one country, or anything between. This will be the subject of much negotiation when the deal is being worked out.

From the label's point of view, the important thing is to achieve releases in as many countries as possible. If Majorco cannot secure overseas releases in a reasonable time, the label has to have the right to seek offers elsewhere. These releases should be under the label's own label, but sometimes overseas licensees will resist this. If this happens, the label has to decide whether this is a deal-breaking point, or whether to agree and be satisfied with a big production credit on the record and its packaging and any promotional material.

ROYALTIES

More importantly though, a label's primary source of income is the royalty from each record sold. Labels do not have the benefit of getting the margin between the wholesale price and the actual cost of the record, as the Major/distributor keeps that. This means the only opportunity for the label to make a profit is to keep the difference between the royalty it receives and the royalty it pays the artist. Accordingly, labels have to offer lower royalty rates to their artists than those a Major can afford to offer (assuming, of course, it was ever willing to pay the maximum).

Also, royalties from overseas sources have to come through yet another party, which will, of course, take a share for its trouble. With a Major, the royalties usually go from the local company to the central company, and from the central company to the Australian company, which distributes it to the artist. This can delay the royalty accounting for perhaps 18 months or more, especially if the Major works on half-yearly accounting.

Quarterly accounting will significantly reduce the telescoping of royalty accounting. Fortunately, most of the Majors use monthly accounting within their respective inter-company accountings.

AUDIT RIGHTS

Though it's something likely to affect only a few artists, it ought to be remembered that if you are an artist who is contracted to an Independent, you do not have audit rights that extend to the Major's books of account. You could certainly audit the label's books, but that is as far as you could go. If you did an audit and happened to discover a problem, the label (not you) would have to take the matter up with the Major, which might be a bit unnerving for the label, seeing the Major is its main source of funds.

ARTISTS AND LABEL DEALS

ADVANTAGES FOR ARTISTS

As an artist signed to an Independent with a label deal, you stand to get personal attention and (if you are lucky) greater artistic freedom. You can also benefit from being associated with a successful label, which can boost your profile. If a label is perceived as being 'hot' then, by association, everyone signed to them is seen as having the potential to be 'hot' too.

Label deals particularly suit developing artists but the fact is, most artists who are successful under a label deal will eventually move from the Independent label to a Major. After all, Majors generally have bigger chequebooks, come record contract renegotiation time.

POINTS FOR ARTISTS TO WATCH

If you are an artist signed to an Independent that has a label deal with a Major, you are affected in several vital ways because the label relies upon the Major for:

- Funding. If the label deal should end, your label could be left without funds to make your recordings or, in a worst-case scenario, may not be able to pay your royalties.
- Physical manufacture and distribution of the label's recordings. If there is no deal with a Major, the label may have no facilities for getting physical records made or distributed.
- Funds for promotion and/or use of the Major's promotions staff. If the label deal should be terminated, there may be no funds to promote the label's catalogue or artists.
- Many policies relating to accounting, retention of royalties to allow for returned records, and sales policies (all of which have an impact on your royalties) may not be in the control of the Independent label. The label's records will be sold under the Major's usual trading terms, so these terms have to be reflected in the terms of your recording agreement, which can reduce the label's flexibility in negotiations with its own artists.

If you are negotiating a record deal with an Independent, which relies upon a label deal with a Major for its funding/distribution, try to find out everything you can about the Major's policies, its relationship with the label, the depth of that relationship, the term of the deal and whether the Major has to release everything recorded by the label or can cherry pick. Try to meet with the people in the Major who will be working your product – don't just rely on the say-so of the Independent.

PRESSING AND DISTRIBUTING DEALS

Pressing and Distribution deals are usually abbreviated to 'P&D deals'. You need to be careful with the terminology though. The term is a bit rubbery. Some people use it when they actually mean a master licence deal. This can cause confusion because there are quite fundamental differences between P&D deals and master licences. This will become clear as we get into this chapter. For the moment, just remember: P&D deals do not involve the licensing of copyright but rather, just the physical distribution of the physical product. Thus, in their classical form, they don't cover digital rights.

We will use the expression 'distributor' here, rather than 'record company' because the distributor need not be a record company. Anyone who can deliver records to retailers and collect payment could do the job, although record companies are the logical choice because they are already set up to do it.

There are two basic kinds of P&D deal: one is selling and distribution (where you use the Major's sale's force); and the other is distribution-only, and the Independent does the sell-in to the retailers.

WHY DO P&D DEALS?

Let's assume you own a master recording but need the records made and distributed. P&D deals give you maximum control over the way the records are presented and advertised. Once the records are in the warehouse, all the distributor need do is take orders and ship goods. The distributor has no financial stake in the goods, no money at risk, and need not have any involvement in how the goods are promoted, unless it chooses to. As far as the distributor is concerned, you could be selling carpet slippers for all it mattered. If you do a P&D deal with a Major, you can get access to the Major's national distribution network, while remaining essentially independent of any A&R intrusion.

P&D VERSUS MASTER LICENCE

Under a P&D deal, you own the master recording from which the records are made and also the records themselves, at least until they are sold to retailers. In a master licence deal, however, the record company pays for the records and owns them. This makes the record company worry about the number pressed, the number sold and any returns. In a P&D deal, the distributor just keeps the records in the warehouse and ships them out to meet demand whipped up, no doubt, by your brilliant promotional campaign (which, by the way, you have to pay for).

Owning the records not only gives you great control over how the records will be presented and promoted, it also means you can get a greater share of the total dollars generated from the sale of your records. In a master licence deal, the record company pays you a royalty of (assuming it was being generous) around 20% of the retail price, less the usual deductions. By comparison in a P&D deal the distributor keeps around 20% to 25% (it can vary a bit, especially if you are a big label, but this is a ball-park figure) of the proceeds of each sale, and you get the rest.

A word of caution though: P&D deals can be very hungry for capital funds. (This is dealt with in detail later in this chapter in the section headed **Funding**.) In a P&D deal, if your records start to sell really well, you still have to pay for additional stocks to be manufactured. This may be fine once the money starts coming in. Meanwhile, unless the distributor is prepared to make an advance against future sales, you have to find the funds. Fortunately, if your records start selling really well there is a good chance of flipping the deal over to a licence deal. Then, the distributor will be paying for the stock to be made and will carry the risk of not selling all of them.

SELECTING A DISTRIBUTOR

You can go via the independent distributors or you can go for one of the Majors that still offer P&D deals. Some will only do master licence deals. Others will also give you the option to flip a P&D deal over to a licence deal, should sales really take off.

You have to shop around. Find out who their main customers are. The Majors deal with traditional record outlets but tend not to deal with independent outlets. Independent distributors sometimes do not supply major retail outlets. You can only find out by asking. Check the *Australasian Music Industry Directory* or the *Black Book*. These directories list distributors and the labels they distribute. There is no substitute for doing your homework.

Once you have decided which distributors seem the most suitable, see whether they can or will take the job. This usually involves you convincing them that you will sell a reasonable number of records. Unless you can sell more than a minimum number, it is not worth any distributor's time to take on the work. Be realistic, most single artist or single album P&D deals don't make much money for anyone.

Ask for details of their distribution terms. If you can get it, a copy of their standard agreement is the best place to start. You can compare terms and conditions, to see who offers what services and at what cost. Then ask around retailers, to see if the distributors you have short-listed have a good reputation for service.

EXPENSES

In P&D deals, the owner gets most of the proceeds from each sale. Up to 70%–75%, depending upon the distribution fee. Before you get excited though, remember that out of that 80%, you still have to pay:

- all risk funding of the entire recording process
- the manufacturing cost of physical records and packaging
- artwork origination
- artist's royalties
- mechanical copyright royalties
- marketing and promotional costs
- GST
- business overhead, including warehousing of physical stock (distributors may only be willing to hold the number of records they feel they need, not the number pressed)
- returns and obsolescence of physical stock. The administrative processing is done by the distributor, but the cost of it (i.e. the loss

of value of physical records returned or which become obsolete, damaged, etc.), is all borne by you. Both parties suffer when there are returns or obsolete stock.

The residue (if any) after all these deductions is your profit. Welcome to the world of being a record company!

FUNDING

The downside of P&D deals is that you have to fund them. You have to fund not only the recording process itself but also any promotional materials (e.g. videos, record packaging, art) as well as the costs of manufacturing and promoting your records. You need plenty of capital to be able to do this properly. Most people in the music business do not have private wealth or a tame bank manager. They usually have to do a deal with a major record company, just to get an advance to pay for the recording costs. Paying for manufacturing and promotion is out of the question for most people.

Subject to complying with the horribly complex tax and corporation laws, it may be possible to arrange for a group of investors to finance you. This is lawyer territory and requires planning and a great deal of expert advice. This is particularly true if you intend to raise funds in a way that legally requires a prospectus to be produced. A prospectus is a very formal (and expensive) document, setting out the whole scheme in detail. This kind of thing is only justified if the returns will be truly spectacular, or some of your friends need a tax loss.

There are ways that the capital drain can be at least slowed down a bit. With the distributor's agreement, you may be able to defer manufacturing costs and mechanicals until you actually start to receive income from record sales. This has to be dealt with when you first do your deal with the distributor and is usually only possible if the distributor is a major record company.

WHO DOES WHAT?

You should take a look at the list at the beginning of Master Licences, to check the licensee's responsibilities in a master licence agreement. This will highlight the differences between master licence deals and P&D deals.

In typical P&D deals, the owner of the master recording is responsible for:

- paying for physical records and their packaging to be manufactured and delivered to the distributor's warehouse
- advertising the records
- keeping adequate stocks of physical records in the warehouse
- ensuring mechanical copyright royalties are paid
- taking back any surplus stocks of physical records left in the warehouse at the end of the deal and disposing of them (hopefully,

in a way that will help give a return on them, rather than just having them dumped at the local tip)
- ensuring that the proper GST is paid.

The distributor is responsible for:

- including the records in release sheets and putting the titles and catalogue numbers into the distributor's catalogue
- fulfilling orders and shipping the records to the retailers
- collecting payment
- remitting the owner's proceeds, after deducting the various costs and fees.

If the distributor is a Major, it will often arrange for the records to be made for the owner (unless the owner has already done this, by making arrangements directly with another manufacturer), although the cost is charged to the owner.

MANUFACTURING PHYSICAL RECORDS

You pay for the records manufactured. If your distributor is a record company that has its own manufacturing plant, there are obvious benefits in doing a deal for their plant to make your records. The record company will bill you. You will have to pay the whole lot within (usually) 30 days, or (if they are generous) the record company might agree to treat it as an advance against your proceeds from the sale of those records and deduct it when the accounting is done.

Record companies have usually negotiated very cheap rates with record manufacturers. As an individual, you are very unlikely to get a comparable price. If you are using a record company as a distributor, try to get the records ordered from their usual manufacturer on your behalf. This is likely to reduce your manufacturing costs considerably.

If you make your own arrangements to have the records manufactured, you will probably have to pay for the records on delivery. This will drain your capital rapidly. Remember, a CD can cost you around $3 per unit once you include the costs of creating and printing artwork, getting the discs made, having the packaging inserted and the whole lot delivered to your door. You can negotiate better prices if you are ordering larger quantities but it is always important to judge carefully whether the savings are real or illusory: if you can sell the stock readily the savings will be real. If not, the cost of storage, insurance, handling, interest, and the general inconvenience, make the ordering process one of keen judgement rather than mere optimism.

It is always worth seeing if the distributor will agree to you deferring payment of the manufacturing costs until they can be deducted by the distributor from the proceeds of the sales. This can be done in the course of their accounting to you.

WHO OWNS THE RECORDS?

You pay for the records, so you own them. You should always have final say as to how they are to be sold, though this has to be consistent with the distributor's methods and trading terms.

Make absolutely sure that the distributor knows that you, not it, own the records. Otherwise, your records may be gathered up inadvertently in the course of a warehouse clear-out (which distributors regularly do to remove surplus stock). Stocks of your records may be scrapped along with the distributor's own stock unless precautions are taken. Worse still, they might be sold as 'deletions' to retailers. The distributor would ordinarily have to reimburse you for any records it mishandled (and probably for any loss of profits you might sustain) but it could take quite a while to convince the record company to find its chequebook (even if it acknowledged its mistake). In the meantime, your records are out of stock as far as the company's system is concerned.

Any records returned by retailers have to be put back into your stock or a full credit given by the Major that is doing the distribution.

STOCK CONTROL

Most distributors will try to put the responsibility for stock control back onto you. This means the distributor will not order new stocks unless you say to. You have to watch the stock levels and sales trends constantly. If, for example, you have a big promotional campaign planned, don't forget to top-up the stock levels or to prepare your manufacturer so it can respond promptly to orders for additional stock if needed. A well-advertised but out of stock album is an embarrassing thing to behold and makes you no money either.

PROMOTION

Since this is likely to be your concern, there will be no one else to blame if things go wrong. Plan this properly. Do not overestimate your abilities, or underestimate the cost. If in doubt, engage an experienced freelance promotions person.

Distributors may agree to take promotion over from you and to pay for it but, in return, they will take a bigger percentage of the takings. Only you can decide if this is a worthwhile trade-off. Sometimes you can do it cheaper and better than the distributor. Sometimes the campaign will simply demand more money and resources than you can muster.

PROMOTIONAL COPIES

It is in your interest to keep tight reign on the number of promotional copies, including limiting copies that can be ordered by your distributor's staff. There is certainly promotional value in having the record available to the staff, even if they do not pay for it, but the numbers have to be reasonable. Any records given away free by the distributor should be exempt from its distribution fee (or subject to a reduced fee).

You should try to retain sufficient copies to meet promotional needs, rather than take copies out of the distributor's warehouse. This will save you time and money. Make sure the distributor knows what your promotional plans are and agree in advance to whom, if anyone, the distributor may provide promotional copies. Usually, if you are dealing with a Major, they will agree to simply drop copies off to their main media connections (radio programmers, DJs and the like) as part of their usual promotions work, provided it does not require any additional time or effort.

DISTRIBUTION

Most P&D deals give the distributor 'the exclusive right to distribute' in the nominated territory. This is not a copyright licence, but is still enforceable as a condition of the contract. If you think you will want to distribute any records yourself, then reserve that right in the contract. This right can be particularly useful if you do a lot of live work and can sell records after the show. (Now quickly read Chapter 27, **Merchandising**!) You might even be able to arrange some to be sold through mail order or via your website. To do these things, you need to reserve the rights up-front, or risk annoying your distributor when your records turn up in unexpected places. Basically, record companies are good at selling to record retailers. Other non-traditional outlets are outside their area, so you will have to tackle those yourself. A bit of creative thinking can generate a surprising number of sales.

Assuming you made your own arrangements for the physical records and packaging to be manufactured, the distributor's work only starts once the records are delivered to its warehouse. Then, it will load the record's catalogue number into its sales system and put the title into its catalogue. From then on, the records are available for dealers to order in the same way they would order any other record. As far as the retailers are concerned, for most purposes (except returns) there is no difference between records sold by the distributor under its own labels, and those it is distributing on your behalf.

TRADING TERMS

The retailer buys the records in accordance with the distributor's 'trading terms'. These are the rules that regulate the distributor's interaction with its customers (the retailers). The terms of trade determine:

- how records are ordered by the retailers
- how and when they will be delivered
- if and how records may be returned by the retailer
- when and how the retailer pays for them.

You have to accept that the distributor's trading terms will apply to all its transactions. You cannot expect them to be changed just for your product. You have to find out what those terms are, before you do the deal, so you can make appropriate plans to deal with any parts you might not like.

For example, you should reserve the right to decide when the records can be discounted, and to know what price they'll be sold for. If you do not, you could get a very nasty surprise should your records come out at a reduced (or increased) price. You should also determine whether sales must be 'firm'; or whether they can be 'sale or return'. You should insist on being advised, in advance, of any changes to the relevant trading terms. You will also get an unpleasant surprise if the distributor's firm sales policy is changed so that retailers are permitted to take the stock 'on spec' and then return it at any time if the stock doesn't sell.

DISTRIBUTION FEES

Like most things in the record industry, the fee the distributor wants in return for its services is negotiable. It will vary according to your bargaining strength and the amount of work the distributor will have to do to get its fee. The more it does, the more it will charge. You have to decide what work is genuinely extra and what work is routine and effectively not costing the distributor anything it would not ordinarily spend anyway. Hanging out for a bottom-line fee will be false economy if this encourages the distributor to put your record even lower down its list of priorities than it already is.

Most record companies will calculate and pay mechanical copyright royalties for you at no extra cost. Their system will be processing your record sales anyway, so it's very little extra work to have it calculate the mechanicals at the end of the quarter and send off a payment on your behalf. Naturally, the payment will be deducted from any payments due to you from sales of those records.

Be very wary of distribution fees exceeding 30% of the wholesale price less GST. This is the top rate for physical distribution, unless the distributor is handling and paying for advertising. Distribution fees above this may leave you with too little from the proceeds of each sale to cover all your costs, let alone to make a profit.

Also, be wary of additional handling fees charged as administration fees. (What do they think you are paying them the distribution fee for? Out of pity?) Shun delivery fees and the like. The distribution fee is meant to cover the distributor's costs and leave it with a profit. Any added-on fees have to be questioned. Some may be legitimate but most are just another way of making a 20% distribution fee add up to a 30% one.

Because the handling and administration of returns is expensive, some companies will also charge an additional fee for returns. As you will have no control over returns policy (it is determined by the distributor's terms of trade – remember?) you must try to cap this. Others allow a percentage as returns, but will charge an additional fee per returned record once a certain number has been reached, usually calculated as a percentage of the number of records shipped to retailers in that period. Either way, these additional fees can bump up your distribution costs, so watch out for them and whenever they are proposed, get them explained to you in full before signing on the dotted line.

DEDUCTIONS AND ACCOUNTING

You must make sure what the actual basis of the payment calculations of net proceeds will be. The usual basis will be either the retail price after deduction of GST, or the wholesale price after deduction of GST. Either way, you need to be sure that there are no other deductions (such as delivery charges or processing fees) applied before division of the proceeds.

Typically, an accounting from a distributor will show:

Net proceeds from sales	
minus	mechanical copyright fees (1)
minus	distribution fee (2)
minus	cost of record (3)
leaves	your share (4)

1. This assumes that this will be calculated and paid in accordance with the Copyright Act and the ARIA/AMCOS Agreement.
2. This will be calculated as a percentage of the net proceeds figure before deduction of mechanicals or other fees.
3. This will only apply if you have arranged for the record distributor to do this on your behalf and it has agreed to defer such payment. Otherwise, you will already have paid for it.
4. Out of this, you will have to meet your artists' royalty obligations, promotional costs and set-up costs. Anything left over is your profit.

Accounting statements and remittances are usually timed to coincide with the record distributor's usual royalty statement run. Quarterly accounting is common but monthly is better because cash flow is essential for paying all the other costs.

GOODS AND SERVICES TAX

This is a really knotty area of P&D deals and, frankly, is completely misunderstood by most people. GST law is too complex to be dealt with in this book. However, it is vital that you be aware of its importance and that you consult professional help in advance (preferably from an accountant who deals with trading enterprises, rather than doing tax returns for pensioners) to make sure you do not inadvertently pay too little (or too much) GST on records sold through a P&D deal.

Essentially, the manufacturer will charge you the manufacturing cost plus the GST. Assuming you are then selling to the record shop (through the distributor as agent) you will charge the dealer the published price to dealer (PPD) plus GST. Of course you will then be charged GST in respect of the distribution commission and fees that you are charged by the distributor. You then remit the GST to the ATO less the GST you have already paid. Simple, right? NOT!

The moral is: get professional advice on GST and stick to it. The GST issues in P&D deals are very complicated and the companies have had to spend a lot of money getting advice on how to make their systems comply with these laws.

DURING THE DEAL

It pays to check with retailers, to see if the record company is actually making your records available to retailers and delivering them. The best thing to do is to order a few at randomly selected retail outlets and see how they go.

Keep close contact with the departments looking after stock control at your distributor. The people there are best placed to know how well or badly your record is selling and when you should order more stock (or make arrangements with your creditors!).

Call at least every 10 days for a stock report and, if possible, get a copy of the stock report dealing with your record(s) so you can see sales trends, numbers given away, etc. If your distributor's information system allows, get daily reports.

AT THE END OF THE DEAL

When the deal ends, you will usually be required to take your stock out of the warehouse within a specified time otherwise the record company will probably sell or dump it. The removal costs are usually yours. You are, of course, free to do whatever you like with the records after that.

MASTER LICENCE DEALS

For simplicity, the expressions 'master recordings' or 'masters' will be used here to refer to audio-only master recordings, whatever format they are in. In practice of course, masters can take many forms but these days they are usually delivered on a hard drive containing the relevant sound files in digital form. Even commercial compact discs are occasionally used when the original masters cannot be located.

Master licences deal with the end result of the recording contract, not with the recording process itself. They are one of the basic transactions in the record industry. They are the means by which the owner of a master recording can formally permit or license others to use that master and to commercially exploit the copyright in it, without the owner relinquishing copyright ownership.

Master licences can deal with all of the copyright in a master recording, or just a part of it. They can deal with one master recording or many. They can cover any or all of the formats. It all depends upon the agreement. This flexibility is the major attribute of master licensing. The parties can tailor their deals precisely to suit their needs.

EXCLUSIVITY

Like other copyright licensing, master licences can be exclusive or non-exclusive. Exclusive licences are the most common kind, although, as will be seen later, non-exclusive licences have their place. Because of the Copyright Act, exclusive licences must be written down and signed by the party granting the licence (the licensor). If they are not, they risk being unenforceable by the recipient of the licence (generally referred to as the licensee) against infringers. (The terms licensee and licensor will be used in this chapter, though occasionally other names are used in practice so as to reduce the chance of confusion in documents, since the words are not that dissimilar. The name itself is not especially important. It is the nature and extent of the rights granted that count.)

The Copyright Act allows non-exclusive licences to be either verbal or in writing. The basic difference between exclusive and non-exclusive licences is that in an exclusive licence, the licensor gives the rights to the licensee 'to the exclusion of all others' (as the Copyright Act so succinctly puts it), whereas in a non-exclusive licence, there can be any number of non-exclusive licensees, all having identical rights in the masters in question. The commercial ramifications of exclusivity as opposed to non-exclusivity, will be explored in detail in here.

BASIC ELEMENTS OF MASTER LICENCES

The following aspects are essential elements of all master licences, both exclusive and non-exclusive:

THE PARTIES

Master licences are done at all levels of the record industry. For example, a recording made in the United States by an Independent (let's call it Indy Co) might be:

- licensed in the United States by Indy Co to a Major in the same country (let's call it Major Co), giving Major Co exclusive rights for the world
- Major Co might license the recording to an affiliate in Australia, giving the affiliate exclusive rights in Australia
- the Australian affiliate might license a television production company in Australia, giving it non-exclusive rights to include certain tracks in one of the company's shows, and perhaps a 'Music From…' style 'soundtrack' album released in association with the production company or network
- the Australian affiliate might also grant a film producer a non-exclusive licence to reproduce the recording in a film soundtrack and exploit that film throughout the world.

PROOF OF COPYRIGHT

At each step of the chain, the party granting the rights will be a 'licensor' and the recipient of the rights will be a 'licensee'. Each licensor depends upon the person before them for its rights to be valid. If someone in the chain makes a mistake or enters into an agreement that exceeds their authority, this will invalidate the rights of everyone below them in the chain. This is sometimes called the 'withered root' theory of copyright and is based on the obvious analogy of a tree with problems of a fundamental kind. In other words, know who you are dealing with. Get warranties of ownership. If you have any doubts at all, get objective proof of ownership before you conclude a deal with a licensor who you know is not the person who actually made the recording. Remember, a warranty gives nothing more than a right to sue. It cannot cure the defect in the copyright chain.

THE LICENSED RIGHTS

Master licences must give the licensee record company the right to make copies of the master and to sell copies to the public in the nominated territory for a nominated period of time. After that, the rights will be as wide or as narrow as the parties agree.

The rights granted and the degree of scope the licensee will have in dealing with the master depends upon the relative bargaining strength of the parties and whether the would-be licensor really trusts the would-be licensee. When in doubt, keep the rights under tight control.

The agreement may even specify technical standards that the licensee must meet, limit which formats of records may be released, and specify the ways the records may be marketed.

In most cases, the licensee has no rights in the master other than the licence to make and sell copies. Thus, the licensee may not alter the master in any way, nor attempt to exercise any rights that were not granted by the licensor. Basically, the licensee may only do those things specified in the agreement. Any deviation (like the right to remix or alter the track, or sell it with bonus tracks, etc.) will usually require the licensor's prior consent. Most licensors even require licensees to get permission before allowing their records to be sold as mid-price or budget records, or in conjunction with an advertising campaign.

THE MASTERS

Master recordings are usually defined as 'recordings of sound technically suitable for the commercial manufacture of records' or similar. Most licence agreements also specify the format in which the master must be delivered to the licensee.

Where the masters already exist, it is easy to identify them in the agreement by artist and track. If the masters are yet to be recorded, it becomes more complicated. The contract has to identify the master unambiguously. Unless this is done properly, an unscrupulous licensor could deliver any old rubbish that approximated the description of the master to be delivered and claim to have met its obligations under the contract.

The masters have to contain the correct recordings and be in first-class technical condition. If not, they will be commercially useless. Masters should be checked as soon as they are delivered and any faults reported without delay, so a replacement can be supplied (at no charge of course!).

Most licensees will also require delivery of a 'PQ sheet' containing data about the location and timing of tracks on the master, as well as details of the International Standard Recording Code (ISRC) setting out the country of origin of the master, as well as the copyright ownership and the designated identification number for each track. There may also be 'metadata', which is desirable or necessary for digital distribution.

Most master licences also require the licensor to deliver, at least, an accurate list of musical works reproduced on the Master as this simplifies the licensee's task of complying with mechanical copyright requirements. The licensee can use this list when notifying the publishers of the works being reproduced in the records made from that master.

ADDITIONAL MATERIALS

Records are more than flat pieces of plastic, or a series of 0s and 1s. The packaging and accompanying artwork and material is an integral part of the goods being offered to the public. A master licence has to specify:

- in what packaging the physical records are to be sold, or what artwork must accompany the digital version
- who will pay for original artwork and production parts to be made
- in what form production parts are to be supplied, assuming the licensor is to supply them (e.g. whether as artwork or as photographic negatives or digital files)
- when the parts must be delivered. (Remember that it usually takes longer to print packaging than to make the records.)

TERRITORY

This can be as widely or narrowly defined as the parties agree. If you are a licensor, ensure the definition of the territory is neither ambiguous nor extends beyond the territory you actually control. If you are a licensee, you will want the widest possible territory, but your licensor will probably want the narrowest definition it can negotiate.

Where an Independent (Indie Co) is licensing a master to a Major (Major Co), and they know Major Co's affiliates are going to release the records in several territories, it may suit both sides for Major Co to get rights for a territory greater than its own domestic territory, so it can do the licensing. Indie Co could choose to negotiate the licence to the affiliate or it could ask Major Co to act as the licensor because Major Co will probably already have an inter-company licence agreement in place with its affiliates. In most cases though, Major Co will only agree to act as licensor if it gets a percentage of the licence royalty flowing to Indie Co from those external territories.

Conversely, Indie Co might choose to do the additional work of negotiating the licensing directly, if there are significant financial advantages (e.g. additional advances) sufficient to outweigh the extra work.

Major Co might only be prepared to sign the licence deal if it is for 'all available territories' – meaning all countries where Indie Co has not yet already secured releases itself. This is a matter for negotiation. Indie Co needs to make sure though that if Major Co cannot secure a release in a reasonable time (usually between 90 and 180 days, depending upon the kind of recording), then Indie Co must get back the right to seek alternative licensees overseas. If that happens, Major Co ought not to share in royalty income generated from licences it did not secure, although this will be more difficult to secure if Indie Co is also looking to Major Co for a large royalty advance.

In times where retail sales of records are shrinking, and so synchronisation licensing with TV, film and computer games is a key source of income from masters, one hot topic of negotiation in master deals is whether the licensee can grant, out of their territory (say, Australia and New Zealand), worldwide synchronisation licences if the synchronisation deal originates in that territory. (Whether the local licensee can even contemplate granting such a licence depends on the specific rights granted in the agreement – see **Rights Licensed** below – but if they can, it will almost certainly be in a non-exclusive basis.)

TERM

Most licences are for three to five years, though there's no magic in the number. It may be that three years is long enough for most licensees to make a profit, but not such a long time that the licensor feels they have lost control of the recording. There is no standard term, but as a general rule, pop recordings are licensed for a fairly short time. Classical and jazz recordings need to be licensed for a longer time because they tend to sell at a slower rate.

Licensors usually want to keep the term as short as possible. As a licensee, you will usually want the term to be as long as possible. Sometimes, licensees are given the opportunity to extend the term, if they achieve specified sales targets or other goals.

Defining the term can become complicated where a licensee has options to acquire additional masters that do not yet exist. For example, Indie Co may have signed an artist and recorded one album. It has the right to record several more. Indie Co and Major Co may agree that Major Co will have first opportunity to obtain a licence of each album as it is finished. This kind of deal will need some fancy drafting by lawyers for the agreement to be workable. The parties have to consider whether all the rights in the repertoire will revert to the licensor at the same time, or whether each recording will be licensed for a number of years as it becomes available. The former is neater but the latter gives the licensee more chance to recoup any advances paid for the master last delivered.

In addition to the 'Term' (the period during which time the licensee can exercise all the rights granted under the licence) there is usually a 'sell-off' period of between 6 and 12 months, during which time the licensee is permitted to sell off stocks of records that were in existence at the time the term ended. Some agreements include elaborate provisions to prevent the licensee from filling its warehouse with records in anticipation of the term finishing, or selling the records off at discount prices. This is because the sell-off period is usually non-exclusive in that the licensor may grant to another party altogether a licence for the same recordings and this licence will usually start at the end of the term of the previous licence. This can become very important if the licensed recordings are still selling well as the licence enters its last few months.

RIGHTS LICENSED

Most licences give the licensee the exclusive right in the territory during the term, to:

- reproduce the master recordings
- communicate the recordings to the public
- reproduce the other materials and video clips supplied as part of the package, subject to whatever particular limitations the licensor requires.

Most licensors go to great lengths to limit the ways its licensee may sell records. The licensee will always be able to sell full-price records through so-called 'traditional or normal retail outlets' (i.e. record shops and major digital distributors like Apple's iTunes), but other methods will usually require the licensor's prior approval. The licensor has to protect itself from unscrupulous licensees. It also has to ensure that any special obligations, owed to the artist under the recording contract, are passed along to all licensees via the licence agreements. If a licensee wants to sell records through, say, record clubs, or service stations or via digital download services or as something other than an ordinary full-price record, then the licensor will have to approve first.

In general, licensors tend to restrict the rights granted, so that they retain maximum control over the many ways a master may be exploited. For example, most licensors will specifically reserve the right to authorise synchronisation of their masters into film soundtracks, advertising and the like. This helps stop licensees from getting out of control and also helps the licensor co-ordinate the way the record is marketed in several territories.

As mentioned above, film, TV and games soundtracks can be a valuable licensing right for licensees. Licenses of such rights usually attract a significant lump-sum payment, which some licensors will try to claim as their own, no matter where the film or other product originates. Other licensors take a more pragmatic attitude and share synchronisation fees with the licensee, which can be a significant incentive for a licensee to propose one recording in favour of another when the time comes! Soundtrack and TV uses are also useful because they can promote interest in a recording and can even form the basis for a promotional tour by the artist, if the film has sufficient profile.

Generally, licensors will also forbid a licensee (other than a Major) from itself granting exclusive sub-licences, unless it first gets the licensor's express consent in each instance. Licensors like to know who is dealing with their recordings. Besides, it is that much harder to keep track of, and collect, royalties from sub-licensees.

DELIVERY OF MASTERS AND OTHER MANUFACTURING PARTS

Most licence agreements are done in haste. There are always time constraints imposed by promotional activities, touring and availability of personnel, as well as the licensor's need for money ('Pay the advance now and trust me!'). Combine that with a licensee who wants to get the records out as soon as possible and soon the licensor starts handing over the master recordings and manufacturing parts even before the deal is actually struck.

Now, this point may seem obvious when you read this at your leisure, but when you are in the middle of frantic last-minute negotiations, do not part with your masters or your manufacturing parts until the deal is actually done and signed. It is quite astonishing how many deals are signed after the records are actually on sale. This lemming-like behaviour invites disaster because it instantly escalates any last-minute misunderstanding or disagreement into a huge drama with commercial implications and the threat of nasty litigation, rather than it just being another point to negotiate before the final draft of the agreement is printed before signing.

Licensees should always check each master for technical quality (and that it is in fact the correct master) as soon as it arrives. The same applies to manufacturing parts such as negatives or digital artwork files for record packaging, metadata for digital records and promotional videos.

MANUFACTURING RECORDS AND PACKAGING

The licensee is responsible for having the physical records and the packaging manufactured and getting them in the warehouse by the scheduled release date.

The licensee has to pay for all stocks from the proceeds of each sale. As no sale equals no proceeds, most licensees try to keep initial orders for records to a minimum. Initial quantities should be discussed with the licensee, but the licensor ought to respect the licensee's knowledge of its own market and conditions. It takes less time to top-up stock than to first manufacture it, but the delay can still be inconvenient and, at worst, could lead to the records being out of stock, which means lost sales.

It can take quite a long time from placement of initial orders until records are manufactured and delivered, especially as Christmas approaches. This is when the Majors are gearing up to fill their warehouses in readiness for the most active sales period of the year and manufacturing capacity is usually booked and over-booked in the last quarter of every year.

No matter what the time of year, the licensor should always deliver the parts to the licensee in ample time to allow for mishaps, errors and plain old stupidity. The release date can certainly be adjusted if the records are obviously not going to be ready in time, but this is not desirable as it may force the promotions department to spread their time over more records than they can properly deal with at any one time.

PROMOTION

Licensors will usually want guarantees from licensees that the licensee will make reasonable (and sometimes, even unreasonable) efforts to promote the records. Commercial common sense suggests that a licensee would do that anyway but just to make sure, some licensors insist on a minimum amount being spent by the licensee on promotional activities. These provisions are usually difficult to enforce and cannot guarantee a record's success anyway.

Most licences oblige the licensee to supply a minimum number of sample records to the licensor. The proper purpose of these is to verify quality of manufacture but sometimes the number to be provided can be very significant. Whatever the number, these copies should be exempt from royalties.

The expression 'promotional activities' can range from a sullen office junior dropping a copy of the video and a sample record onto a radio programmer's desk, through to the promotions department mounting a co-ordinated campaign with a street team, posters, place mats, a media party and a hot air balloon from which the artist dangles, wearing only bicycle shorts and a smile. The point is, if you have a particular promotional campaign in mind, and both the licensor and the licensee agree to it, make that a part of the agreement. This gives the licensor some certainty and protects the licensee from the allegation (should sales not meet expectations) that it did not promote the records properly.

Wherever possible, the licensee should be required to keep the licensor advised of promotional activities as they may be relevant to the licensor's own plans in some way.

Most promotional activities are the licensee's responsibility, but some kinds of promotional work can be so expensive that the licensee has to get assistance from the licensor. Some promotional activities have an impact on the royalty rates. For example, television advertising is so expensive that it is only commercially viable if the retailer pays a premium on the wholesale price of television advertised records (as they do in the United Kingdom) and/or the licensor takes a reduction in royalty rate (which is the usual approach in Australia). The usual reduction is 50%. The tricky part (for your lawyer) is defining the term 'television advertised records'.

MECHANICAL COPYRIGHT FEES

These are the fees payable by the licensee to whichever publisher or person controls the copyright in the music reproduced in the master recording. The licensee has to comply with the requirements of the Copyright Act, though the practice is varied somewhat by the AMCOS/ARIA Agreement (see Chapter 9, **Music Publishing**, for a description of how this agreement works).

The Majors are all set up to comply with these requirements as a matter of course. If the record company distributing your records is not an ARIA member, contact AMCOS.

ROYALTIES

If you have not already read it, this is a good time to turn to Chapter 23, **Record Royalties**. The principles discussed in that chapter apply here too.

If you are a licensor (like our example, Indie Co) you will want to maximise your royalty but at the same time, you will not want to remove the licensee's incentive to maximise sales. All licensors have to set the royalty rate high enough to cover all their costs (e.g. recording the master and making the video and the cover art), their royalty obligations, and still leave enough to make a profit.

Conversely, a licensee will always be trying to keep the royalty as low as possible, because it is an expense that reduces the licensee's profitability. If you are a licensee, you should to do a proper budget before concluding any deal. Use realistic sales estimates and current costs figures. This is the only way you will be able to see how many records you have to sell before you break even (i.e. make neither a profit nor a loss). Better still, do several calculations. One using worst-case figures, another using the number of units you genuinely feel you will sell and another using wildly optimistic figures (you will need to do this one to restore your confidence after you see the results of the other two calculations!) This is the only way you can sensibly decide whether the deal has any hope of making a profit or whether the advance the licensor is demanding is realistic.

As a licensee, your chief concern is to make sure the royalty rate you have to pay to the licensor is not so high that the exercise becomes uneconomic. Deciding what is a reasonable rate under the circumstances will be influenced by a number of factors.

- The nature of the rights you are getting, the territory of the licence, and the term. You need to determine whether anyone else has competing rights in the territory. Has any previous licensee or importer spoiled the market so that your sales will be affected? Do your rights give you enough scope to exploit the copyrights properly?
- Your financial calculations will vary depending upon whether you are manufacturing and distributing the records yourself or doing

it through a third party. Virtually everyone except the Majors rely upon someone else to manufacture and distribute their records. Every licensee in that position has to set its in-coming royalty rate sufficiently high to enable it to cover its royalty obligations and other expenses, and still leave it with a profit. If your out-going royalty is more than 60% of your royalty income, you may not have sufficient margin to make it worthwhile, unless the record is a phenomenal success.

- Your set-up costs (e.g. manufacturing records and packaging) will need to be taken into account, as you have to pay these from your income.
- You need to allow for the amount of any advance you have to pay.
- Don't forget your overhead costs. Running a business always involves rents, salaries, IT costs, stationery, insurances and so on.

The royalty rates for master licences tend to be higher than those paid to recording artists under direct signings. This is because the licensee can judge the finished product for itself, so the risk is lower. Also, whoever actually made the recording will want to make a reasonable return on their investment and effort. The licensor will have royalty obligations, either to the artist or to another licensor. The royalty the licensor gets must comfortably exceed its royalty obligations, or it cannot make a profit, no matter how successful the record might be.

Basic master licence royalty rates in Australia range from a paltry 12% of dealer price (with the usual deductions) up to 30% of dealer price (with the deductions) for a really spectacular catalogue. Master licences for catalogues rarely differentiate between recordings in that catalogue. Major catalogues may attract a premium if they are especially prestigious or can guarantee to provide a significant cash flow to the licensee.

It is standard practice for licensees to request reductions in royalties (a 'royalty break') for records sold other than at full price. These provisions are dealt with in Chapter 23, **Record Royalties**. The licensor may agree to adjust the royalty rate, provided it feels the potential benefits outweigh the reduction in royalty per unit – i.e. whether the increase in the number of sales will be great enough to offset the reduction in the royalty per unit otherwise paid on a full price record. Most licensors insist that non-standard methods of selling be subject to their prior approval, especially if it has an effect on the royalty rate.

When masters are licensed from overseas, it is usual for the licensee also to get the right to control public performance and broadcast copyrights. The licensor will allow the licensee to retain a percentage (up to 50%) of fees received from the Phonographic Performance Company of Australia Ltd (PPCA) to whoever is the copyright owner/exclusive licensee in Australia.

Most licensors reserve the right to approve requests to synchronise their recordings into film and television soundtracks. Some will let their licensees negotiate such licensing provided they consult with the licensor. Others insist on doing it themselves and keeping any fees due.

ADVANCES

An advance is supposed to be a pre-payment of royalties. If a licensor wants an advance that is more than that, the would-be licensee has to evaluate whether the extra money (and risk) is justified under the circumstances. Sometimes the excess is just part of the price of securing the deal, especially if there are several parties interested in it.

Overseas licensors keep forgetting that the potential market in Australia is only slightly larger than New York or Greater London, so their initial suggestions for advances tend to be excessive.

Something every potential licensee must remember is that imports invariably account for a number of sales of both moderately popular and niche market records that originate from overseas. This means that the number of sales the licensee can make may not bear any relationship with the total market for that recording. It is extremely difficult to calculate a reasonable advance in such circumstances. In spite of this, most licensees still have to pay advances because this is the best way a licensor has to guarantee at least a minimum payment for the licence. In the unlikely event that the total royalties due to the licensor exceed the advance, the licensor will no doubt be pleased, if perhaps surprised, to start getting royalty cheques.

If you are a licensee and you have to pay an advance, try to get a concession from the licensor, allowing you to extend the term if you are under-recouped at the date that the term would otherwise end. This way, you can even agree to a slightly higher advance than would otherwise be prudent, because you have the opportunity to continue exploiting the masters and generating royalties.

ACCOUNTING

This is usually quarterly, but can be every half year, depending on the terms of the deal. Licensees should always comply strictly with all accounting dates and requirements and so must be careful not to agree to any accounting requirements they cannot actually fulfil.

The agreement will set out the details to be included in royalty statements. Licensees must make sure they do not promise to supply accounting information they do not have or cannot get. Any deviation or late payment could give an aggressive licensor the opportunity to terminate the licence for breach of the contract. This could be catastrophic, especially if the licensee paid a big advance and it is still unrecouped.

Most licence agreements include detailed clauses that give the licensor the right to conduct detailed financial examinations of the licensee's books of account. If you are a licensee, it is in your interest to keep the terms of any examination as narrow as possible and to ensure that it occurs no later than two or three years after the end of the Term, in order to give you some finality. Royalty audits are terribly disruptive affairs and tend to be expensive, which is why there have been so few between licensors and licensees in Australia. In the United States, because the market is so big and therefore the amounts of money in the system are so large, there is a great tradition of licensors auditing licensees. Perhaps it will catch on here too, if the market does not shrink too much to make in commercially unfeasible to audit.

Conversely, if you are a licensor, you will of course be deeply suspicious of the licensee and will try to insist on the right, as part of an audit, to use an endoscope on the licensee's managing director. You will want to insist on unrestricted access to all the licensee's books and records relating to licensing, promotions and manufacturing but, in practice, a licensee that is administering a large number of licences will demand some practical limitations on audit levels so that its own business is not unduly disrupted.

TERMINATION

Licence agreements usually end because the term expires, but sometimes they end because one of the parties does something to give the other cause to terminate the agreement for breach of contract. This is when all the lawyers start turning to the back of the contract to the 'miscellaneous' clauses no one wanted to look at when the licence agreement was being negotiated.

Well-drafted licence agreements have comprehensive provisions setting out what events will amount to a breach of the contract and what happens if a breach occurs.

Most licences give the licensee some 'days to cure' should they make a mistake, but some events, such as the licensee's insolvency, bankruptcy or any failure to deliver accounting statements on time, will usually give the licensor the right to terminate the licence immediately. Usually, termination for breach will also annul any sell-off period.

At the end of any licence deal, the licensee should always be obliged to destroy manufacturing parts and provide a sworn statement (a certificate of destruction) verifying that it was done. If there is a sell-off period, then the licensee may continue to sell remaining stocks at full price. Once the sell-off period ends, the licensee should have to destroy any remaining stocks and provide a certificate of destruction. Usually, video masters will be deleted, or sent to the new licensee.

MISCELLANEOUS

This is the title usually given to the part of the licence agreement that deals with such things as which country's laws should apply when things go wrong. These clauses can actually be quite important if there is a breach of the agreement. Most overseas licensors try to make sure their own laws and courts have sole jurisdiction over the licence agreement and any disputes. Imagine the problems this could cause for an Australian licensee, if it has to sue in, say, California, under Californian law! Try at least to give Australian courts jurisdiction, even if they have to apply the law of the licensor's nominated country.

WITHHOLDING TAX

This is a subject that deserves a book of its own, so it is not possible to give a comprehensive treatment of its working. However, licensees who deal with overseas licensors need to be aware of it and how it can affect their remittances of advances and royalties to overseas licensors.

Withholding tax is a tax levied on remittances of advances and royalties to licensors outside Australia. There is a specific department of the Australian Taxation Office (ATO) that deals with withholding tax. The people there are helpful and will answer telephone queries and supply the necessary forms on request. The ATO's website also contains pretty much anything you need to know.

The practical effect of withholding tax laws is that all licensees have to deduct a specific percentage of all royalty and advance payments and pay it to the ATO accompanied by the appropriate form. The percentage varies, depending upon the country to which the royalties are being paid. It can range from 5% to 10% (for countries with tax treaties with Australia) up to over 40% (for non-treaty countries), which is why you have to contact the ATO before you make the remittance.

The licence agreement should always allow the licensee to deduct withholding tax before calculating the remittance, otherwise the licensor could insist that you pay the tax out of your own pocket. For example: if an advance of $10 000 is agreed, and the withholding tax rate is 10%, then you will send $9000 to your licensor and $1000 to the ATO. If, however, there is no clause in the contract allowing withholding tax to be deducted from the advance, then the licensor could insist you pay $10 000 to it, and you will still have to pay the $1000 withholding tax. In that event, your total expenditure has gone up to $11 000 and the extra $1000 will not be recoupable as part of the advance. The same applies to royalty remittances.

The licensee must obtain a receipt from the ATO, which can take months. This receipt is then sent to the licensor. As far as the licensor is concerned, withholding tax is usually treated as a pre-payment of tax in its own country.

This means the licensor pays $1000 less tax for that year in its own country. Of course, this only helps a licensor that is actually liable to pay tax in its own country. If the licensor is making a loss, then the tax paid in Australia cannot be reclaimed in its own country.

DIGITAL-ONLY DISTRIBUTION

With the advent of legitimate, centralised and easy-to-use pan-global digital distribution systems like Apple's iTunes Store, increasing numbers of catalogue owners are eschewing local physical distribution deals and instead simply activate distribution in a particular territory or market with the tap of a key. Of course, even with digital-only distribution, there is still a place for a local promotional campaign to make the most of the release. In fact most labels will combine physical and digital releases of new material in the same strategy.

There is more than one effective and legitimate digital distribution service, but at the time of writing one could be forgiven for thinking that there's only one that matters: Apple's iTunes Store software-based online music shop. Within a year of its introduction in the US in 2003, it had sold over 25 million songs. The iTunes Store was a complete game-changer for the music distribution industry. We didn't get it in Australia until 2005: its launch was a very significant date for the music industry – at last the public had a legal way to download music.

Like withholding tax, above, the iTunes Store could be the subject of its own (much more interesting!) book. The iTunes story contains many twists and turns: battles with the Majors over catalogue, digital rights protection experiments, sound quality developments and regulatory issues created by its monopoly position, but this is not the place for the tale.

The basic iTunes Store distribution licence is a non-exclusive master licence of the digital reproduction and communication rights in the master and associated artwork, but if the licensor gives another digital distributor more favourable terms, they are obliged to give iTunes the same deal. Apple 're-sells' the tracks to customers with access to the iTunes software application, under the contractual terms of the customers' end-user licence agreement for that software and the iTunes Store's *Terms of Use*. The terms include permission to burn copies of the tracks (subject of course to the provisions of the Copyright Act), store and use the tracks on several devices at the same time and generally use the tracks for personal, non-commercial use.

The basic term of the contract is around 3 years, but either party can pull down the licensed content if they believe they no longer have the right to authorise its distribution. The iTunes Store must be able to sell each of the licensed tracks separately, whether the track is released elsewhere as a 'single' in the traditional sense or not (though Apple may agree to a 'sale-as-an-album-only' period as part of a promotional or launch strategy).

The licensor has to pay all artist and producer and other royalties payable for the exploitation of the masters via the iTunes Store, but Apple is responsible for the mechanical, performance and communication royalties (usually administered by APRA/AMCOS). The default setting is that no album will be sold for more than the aggregate price of all the separate tracks on it. Income is accounted for and paid monthly (which is very frequently for a business previously dedicated to half-yearly accounting!), and is based on a band of standard wholesale price points within quaintly named price bands such as 'Back', 'Mid/Front' and 'Front Plus' – recalling retail CD shelving back in the whimsical world of physical CD retail.

So, for a wholesale price of 99 cents per track, for example, the iTunes Store might sell the track for $1.69 at retail, and after paying APRA/AMCOS 9% of the retail price for the mechanical and communication rights (about 15 cents), Apple trousers 55 cents. Which means that, in contrast to the distribution fee of between 15% and 30% of wholesale that physical distributors charge, Apple charges a fee of 55% of wholesale. Presumably, given its market dominance, licensors just can't afford **not** to pay that much to get access to the iTunes Store.