Key Findings from a 2002 Study of Recording Industry Contracts Are Still Relevant Today

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In 2002 the California State Legislature convened a hearing to consider changes to California Labor Code Section 2855, which, if enacted, would have placed certain new restrictions on contracts governing the financial relationships between recording artists and record companies. In the end, reflecting a belief that the proposed changes were not warranted, Section 2855 was left unchanged. Today the Legislature is once again considering changing significant elements of that law as they pertain to artist-record company contracts.

I attended the 2002 hearing and presented findings from an extensive economic study of contracts between record companies and artists that I conducted. I reviewed artist contracts negotiated by all of the major record companies during the year 2000, and, for comparison purposes, a smaller set of contracts written during the years 1994-1996.[1] I also examined the outcomes for the artist and their recordings and the incidence of success.

To briefly recap what I found, from my detailed review of hundreds of contracts and artistic products, I found that for both artists and individual recordings, uncertainty regarding future success, or lack thereof, was a pervasive feature of the industry. The analysis showed that both the artists and the record companies benefitted from the role recording contracts played in managing that uncertainty. Record labels' investments in artists - before the success level is known - relieve the financial burdens on artists and allow them to focus on developing their careers. Both successful and more obscure artists often benefit significantly from the support offered by labels. For the economics of this investment to work, record labels must be able to earn profits from the successful artists in which they have invested. Because past

[1] Wildman, Steven S., "An Economic Analysis of Recording Contracts," July 22, 2002.

success is a predicter of future success, record companies are willing and frequently do renegotiate contracts with successful artists to increase the artists' earnings in exchange for extending the lengths of their contracts, often at the artists' request.

These considerations suggest that the Legislature was well-advised in rejecting changes to California's labor law in 2002 that risked upending the complex economic and creative partnership between artists and the labels they choose to work with. The recording industry has changed in many ways in the intervening years, but none of changes that I have observed suggest that the need for contractual flexibility, which the 2002 study showed to be critical to mutually beneficial artist-recording company relationships and the proposed legislation would curtail, has been diminished.

New technologies and evolving tastes in music have produced a music industry that today differs in many ways from the industry of 2002. Perhaps most notable are changes that have occurred as the internet has become a central component of recording companies' relationships with artists and with the music-consuming public. Today the internet has emerged as the primary channel through which recordings are purchased and, through streaming and digital downloads, delivered. In 2002 physical recordings, mostly CDs, but also a comparatively small number of vinyl records, accounted for almost the entirety of revenues generated by consumers' music purchases. Gold and platinum designations of sales success were determined entirely from sales of physical product. By contrast, in today's music industry, digital delivery in the form of streaming and downloads dominates sales figures. In its year-end report on the US recording industry's 2020 revenues, RIAA reports that streaming services accounted for 83 percent of 2020 retail revenues, compared to 9 percent from the sale of physical recordings and 6 percent for digital downloads.[2]

Online streaming services like YouTube, Spotify, Amazon Music and Apple Music have become major vehicles through which consumers discover new music they want to listen to and artists they want to follow. Because music consumers actively share their finds via social media services, including, prominently, YouTube and Tik Tok, recordings by formerly obscure

[2] Friedlander, Joshua P., ***Year-End-2020 RIAA Revenue Statistics***, RIAA.

artists can go viral and turn unknowns into recognizable stars. The new online channels have also made it possible for talented artists to achieve a degree of consumer recognition and acceptance and in doing so have opened up financially viable career options that did not exist before for artists who elect to develop careers without assistance from recording companies.

Not surprisingly, tracking of consumer trends online has become a critical component of talent discovery for record companies. Digital analytics in the form of spotting, tracking, and analyzing trends in online music consumption now play a critical role in the promotion of music and artists, and in the management of artists' careers more broadly. The major music companies have invested heavily to develop these capabilities, commonly called label services, which they also sell to independent record companies for use in managing their own artists' careers.

It is often true that changes in contractual practices are required to effectively adapt to changing industry conditions. However, there may be risk-sharing challenges and impediments to investment that contracts address that remain essentially unchanged even as an industry is transformed. Therefore, changes observed within an industry should not by themselves be taken as evidence that any specific limitations on the ability to enter into mutually-agreeable contracts should be imposed or relieved, because doing so risks the potential for substantial, and possibly irreversible, harm to the industry and its participants. Technological changes, which are pervasive in our economy, have profoundly affected many industries, but the fundamental economic principles by which both parties to a contract benefit from the ability to reach mutually agreeable deals without unnecessary legal impediments have not changed. When determining whether and, if so, how contracting practices should be proscribed by law, it is important to ask to what extent the risk-sharing challenges and impediments to investment that contracts addressed in the past must still be overcome today in order to facilitate mutually advantageous arrangements between artists and record companies. While the recording industry has changed in many ways, these changes have not eliminated the uncertainties and the associated risk-sharing needs that historically have been addressed by record company contracts.

I am currently studying current contracts between artists and record companies that is an updated version of the 2002 study with Dr. Debra Aron of Charles River Associates. While it is too early to release a final report, it is already clear that recording contracts have changed in many ways as the industry has evolved. For example, royalty calculations now include earnings from revenue sources, such as streaming and downloads, that were of no material concern in 2002. Indeed, record companies now offer a much broader array of services to artists, and contracts reflect a much broader variety of structures—from full-service relationships to narrower, a la carte arrangements, than they did in the past.

While preliminary, our work to this point suggests that that the following findings from the 2002 study are likely also true today.

- The hit records that attracted the most attention and made recording artists recognizable stars are statistical rarities.

- Similarly, the artists who produce recognizable hits are vastly outnumbered by those who ultimately remain relatively obscure, including many who have benefitted from record company investments in their careers.

- For both recordings and artists, future success, or lack thereof, is very difficult to predict. While record companies' evaluations of talent can reduce that uncertainty somewhat, ultimately it is music consumers in a highly unpredictable marketplace who separate those artists who succeed from those who do not.

- By giving them certain early payments to finance their work, record companies make substantial upfront investments in promising, but still unproven, talent that can largely eliminate the financial burdens of new artists trying to make it in the music business.

- Artists who do make it big have typically benefitted from substantial recording company assistance.

- Because success is uncertain, record companies' ability and willingness to invest in artists' careers are dependent on their ability to earn sufficient profits on artists who enjoy substantial success.

- Artists with a record of prior success are more likely to be successful in the future than those with no track record of success. Because past success is a predictor of future success, record companies are willing and frequently do renegotiate contracts with successful artists to increase their earnings in exchange for extending the lengths of their contracts, often at the artists' request.

These commonalities between today's recording industry and that of 20 years ago strongly suggest that restrictions Assembly Bill No. 1385 would place on contracts would limit the range of financially feasible contractual arrangements in ways that would harm the interests of artists and undermine investment in their development and careers, especially new and unproven artists at the beginnings of their careers. Record companies, independents as well as the majors, would be hurt, along with the recording industry as a whole, especially the very vital part of the industry based in California.

The views expressed herein are the views and opinions of the author.