

THE BEGINNING OF A NEW AGE?:

THE UNCONSCIONABILITY OF THE
“360-DEGREE” DEAL ♦

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“[T]his is the only industry in which, after you pay off the mortgage, the bank still owns the house.”

—Senator Orrin Hatch¹

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¹ *Recording Contracts: Contractual Issues*, RECORDING ARTISTS’ COALITION, http://www.recordingartistscoalition.com/issues_recordingcontracts.php (last visited Feb. 7, 2008).

I. INTRODUCTION

As noted by Senator Hatch, the standard practices of the record industry leave many artists with little to show for their hard work. In fact, some veteran artists liken major label recording agreements to “indentured servitude.”² However, despite such pervasive feelings in the industry, most struggling musicians still believe that a major label record deal is the only viable avenue to commercial success. As a result, new artists have been forced to accept recording agreements that are arguably unconscionable as a matter of law. Because courts of law have never considered the unconscionability of major label recording agreements, the terms in these agreements have come to be regarded as standard throughout the industry.

Today, one need not look far to gain a sense of the current state of the recording industry. A few examples of the apocalyptic predictions given by the media to describe the effects of the declining compact disc market over the past decade include *The Record Industry’s Decline*,³ *Death of the Record Label*,⁴ and *Rock N’ Roll Will Never Die, but Labels Look Ill*.⁵ Exacerbating this problem, major recording acts are beginning to forego record labels by adopting more innovative approaches. In early 2008, the English band Radiohead shocked the music industry by announcing that they would release their new album, entitled *In Rainbows*, directly to the public via their website, while allowing fans to choose whatever price they were willing to pay.⁶ Prince “gave away” roughly three million copies of his new album with the British tabloid, *The Mail on Sunday*, a week before it was scheduled for release.⁷ Madonna, one of the top-selling recording artists of the last twenty years, recently signed an agreement with Live Nation, a concert promoter,

² See *Musicians Protest Ahead of Grammys*, BBC NEWS, Feb. 25, 2002, <http://news.bbc.co.uk/2/hi/entertainment/1839677.stm> (last visited Jan. 31, 2009).

³ Brian Hiatt & Evan Serpick, *The Record Industry’s Decline*, ROLLINGSTONE.COM, June 28, 2007, http://www.rollingstone.com/news/story/15137581/the_record_industrys_decline (last visited Jan. 31, 2009).

⁴ Andy Ross, *Death of the Record Label*, Mar. 3, 2007, <http://www.bbc.co.uk/dna/collective/A989328>.

⁵ Gerard Wright, *Rock N’ Roll Will Never Die, But Labels Look Ill*, THE SYDNEY MORNING HERALD, Oct. 17, 2007, available at <http://www.smh.com.au/news/music/rocknroll-will-never-die-but-labels-look-ill/2007/10/16/1192300765432.html>.

⁶ Josh Tyrangiel, *Radiohead Says: Pay What You Want*, TIME.COM, Oct. 1, 2007, <http://www.time.com/time/arts/article/0,8599,1666973,00.html> (last visited Jan. 31, 2009). One year later, Warner Chappell, Radiohead’s publisher, revealed that the album generated more revenue in its initial digital release than the total revenue for the previous album. *Warner Chappell Reveals Radiohead’s ‘In Rainbows’ Pot of Gold*, MUSIC ALLEY, Oct. 15, 2008, <http://musically.com/blog/2008/10/15/exclusive-warner-chappell-reveals-radioheads-in-rainbows-pot-of-gold>.

⁷ Jumana Farouky, *Why Prince’s CD Ploy Worked*, TIME.COM, July 18, 2007, <http://www.time.com/time/arts/article/0,8599,1644427,00.html> (last visited Jan. 31, 2009).

which encompasses not only future albums, but also her brand name, touring, merchandising, and media projects.⁸

Consequently, the major record labels have been experimenting with new business techniques in an attempt to regain the abundant revenues they once enjoyed. One such notable practice has been the introduction of new language in the standard major label recording agreement under which artists relinquish specific rights that are ancillary to the recording process.⁹ New and emerging artists are increasingly being pressured to agree to these contracts, now known as “360-degree” deals.¹⁰ Nevertheless, ancillary rights language only augments the unconscionable character of the standard major label recording agreement.

While the applicability of the unconscionability doctrine to standard major label recording agreements has been discussed in prior scholarship,¹¹ the emergence of “360-degree” deals, along with modifications to the standard form, warrants further analysis of the topic. This Note will demonstrate that, despite an absence of judicial determination on the issue, the standard major label recording agreements offered to new artists are arguably unconscionable as a matter of law. Moreover, the “360-degree” deal further thrusts these contracts into the realm of unconscionability. Part II of this Note will discuss the doctrine of unconscionability, focusing particularly on its common law development in New York and California. Part III outlines the standard, major label recording agreement and its application to the doctrine. Part IV concludes by outlining the ancillary rights included in a “360-degree” deal and argues that inclusion of such into standard industry practice could adversely affect the legality of major label recording agreements.

⁸ *Madonna Announces Huge Live Nation Deal*, MSNBC.COM, Oct. 16, 2007, <http://www.msnbc.msn.com/id/21324512> (last visited Jan. 31, 2009). Subsequently, other artists and groups such as U2, Jay-Z, and Nickelback have signed similar deals with Live Nation. See Eliot Van Buskirk, *Nickelback Latest to Sign with Live Nation*, WIRED.COM, July 8, 2008, <http://blog.wired.com/music/2008/07/nickelback-late.html> (last visited Jan. 31, 2009).

⁹ Such ancillary rights include, but are not limited to, publishing, touring revenue, and merchandise revenue. See Jeff Leeds, *The New Deal: Band as Brand*, N.Y. TIMES, Nov. 11, 2007, [available at http://www.nytimes.com/2007/11/11/arts/music/11leed.html?_r=1&oref=slogin](http://www.nytimes.com/2007/11/11/arts/music/11leed.html?_r=1&oref=slogin).

¹⁰ See *id.*

¹¹ See Omar Anorga, *Music Contracts Have Musicians Playing in the Key of Unconscionability*, 24 WHITTIER L. REV. 739 (2003); Phillip W. Hall, Jr., *Smells Like Slavery: Unconscionability in Recording Industry Contracts*, 25 HASTINGS COMM. & ENT. L.J. 189 (2002).

II. THE DOCTRINE OF UNCONSCIONABILITY

The doctrine of unconscionability has long been recognized by the courts of equity as part of the common law of England.¹² In the seminal case, *Chesterfield v. Janssen*, Lord Hardwicke described an “unconscientious” bargain as one in which it “may be apparent from the intrinsic nature and subject of the bargain itself such as no man in his senses, and not under delusion, would make on the one hand, and as no honest and fair man would accept on the other”¹³ During the nineteenth century, this equitable principle was slowly integrated into the American court system, giving the judiciary the power to limit damages or invalidate contracts if, even in the absence of direct fraud, the court felt “in conscience”¹⁴ that the entire contract, or a portion thereof, should not be binding on one of the parties.¹⁵ At the outset, courts used unconscionability as a means to condemn contracts that resulted in clearly oppressive or unfair results.¹⁶ However, during the nineteenth to mid-twentieth century, varying judicial constructions of unconscionability led to unpredictable applications of the doctrine.¹⁷

It was against this backdrop, together with the perceived need within American jurisprudence to demonstrate that unconscionable behavior would not be tolerated,¹⁸ that § 2-302 of the Uniform Commercial Code (“U.C.C.”) was drafted. Section 2-302 provides that,

[i]f the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.¹⁹

In practice, once unconscionability is raised as a defense to breach of contract, courts will permit both parties to “present evidence as to the commercial setting, purpose, and effect” of the contract as

¹² See, e.g., *Chesterfield v. Janssen*, [1751] 2 Ves. Sen. 125.

¹³ *Id.* at 155.

¹⁴ *Hepburn & Dundas' Heirs & Ex'rs v. Dunlop & Co.*, 14 U.S. 179, 197 (1816).

¹⁵ See, e.g., *Hume v. United States*, 132 U.S. 406, 415 (1889) (citing *Chesterfield*); *Eyre v. Potter*, 56 U.S. 42, 43 (1854) (arguing that courts of equity have the ability to invalidate contracts that are so grossly inadequate as to “shock the conscience.”). See also *Scott v. United States*, 79 U.S. 443, 445 (1870) (holding that if it is found to be unconscionable, damages will be limited to what the party suing on the contract is equitably entitled to).

¹⁶ Donald R. Price, *The Conscience of Judge and Jury: Statutory Unconscionability as a Mixed Question of Law and Fact*, 54 TEMP. L.Q. 743, 746 (1981).

¹⁷ John E. Murray, Jr., *Unconscionability: Unconscionability*, 31 U. PITT. L. REV. 1, 4-5 (1969).

¹⁸ Price, *supra* note 16.

¹⁹ U.C.C. § 2-302(1) (2003).

demonstrated by specific terms contained therein.²⁰ As a result, the determination of “unconscionability” can be made in a more thorough and well-balanced manner.

At first glance, the language of § 2-302 of the U.C.C. does not resolve the discretionary nature of unconscionability determinations that plagued applications of the doctrine in the past. However, the official comment to the section contains a guide to aid the judiciary in making such determinations as a matter of law. “The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the term or contract involved is so one-sided as to be unconscionable under the circumstances existing at the time of making the contract.”²¹ The comment further states that the purpose of the section is to prevent “oppression and unfair surprise” in contracting and not to disturb allocations of risk due to disparities in bargaining power.²²

While it expressly governs only the sale or lease of goods, the U.C.C. has historically been applied to other types of contracts.²³ Following its adoption by many states, the language and commentaries of § 2-302 have been cited by almost all jurisdictions as the controlling guide for determining unconscionability in a variety of contract law areas.²⁴ For example, the California Civil Code, quoting verbatim the language of the U.C.C.,²⁵ states in its introductory comment that the doctrine of unconscionability is not limited to commercial transactions, but rather applies to contract law in general.²⁶

The applicability of U.C.C. § 2-302 outside its expressed scope was strengthened by the drafting of the Restatement (Second) of Contracts in 1978.²⁷ Section 208 of the Restatement provides that:

If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the uncon-

²⁰ U.C.C. § 2-302(2).

²¹ U.C.C. § 2-302 cmt. 1.

²² *Id.*

²³ David G. Dennis, *Kelly v. Widner: Unconscionability Through the Looking Glass*, 53 MONT. L. REV. 99, 104 (1992).

²⁴ *See, e.g., Wille v. Southwestern Bell Tel. Co.*, 549 P.2d. 903, 905-06 (Kan. 1976) (applying U.C.C. § 2-302, then codified under Kansas Law, to an advertising contract on the basis that limiting application of the U.C.C. to only contracts for the sale or lease of goods would defeat its purpose); *U.S. Leasing Corp. v. Franklin Plaza Apartments, Inc.*, 65 Misc. 2d 1082, 1086 (N.Y. Civ. Ct. 1971) (noting that the application of U.C.C. § 2-302 is not limited solely to contracts for the sale or lease of goods); *Sinkoff Beverage Co. v. Jos. Schlitz Brewing Co.*, 51 Misc. 2d 446, 448 (N.Y. Sup. Ct. 1966) (applying U.C.C. § 2-302 to determine whether a distributorship agreement was unconscionable).

²⁵ CAL. CIV. CODE § 1670.5 (2007).

²⁶ *Id.* at introductory cmt.

²⁷ RESTATEMENT (SECOND) OF CONTRACTS (1978).

scionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result.²⁸

Although it is not legally binding, the Restatement is regarded as authoritative by legal commentators.²⁹ In contrast to the U.C.C., the Restatement does not limit the doctrine of unconscionability to the sale or lease of goods, opting for universal application within contract law. The Restatement did follow the U.C.C. by including commentary to aid in the judicial determination of unconscionability, rather than defining the term outright.³⁰ Therefore, the determination of contractual unconscionability has been left to individual judges, acting within their discretionary authority.

A. *Common Law Development of Unconscionability*

Where both the U.C.C. and Restatement fail to provide a judicially cognizable definition for unconscionability, the courts have been left with a mandate to create their own formulations of the doctrine. This has inevitably lead to diverse applications.³¹ Nearly ten years after the drafting of the U.C.C., Judge Wright's majority opinion in *Williams v. Walker-Thomas Furniture Co.*³² expounded the most well-accepted and generally cited formulation of unconscionability. *Williams* involved a challenge to the enforceability of a furniture company's installment payment contract, which provided that in the event of customer default, the company may repossess purchased items under other contracts for which the customer was still making payments.³³ In remanding the case for further consideration, the District of Columbia Circuit for the United States Court of Appeals held that "[u]nconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."³⁴ Professor Arthur Leff clarified Judge Wright's opinion by labeling these two elements as procedural and substantive unconscionability.³⁵

²⁸ RESTATEMENT (SECOND) OF CONTRACTS § 208.

²⁹ Evelyn L. Brown, *The Uncertainty of U.C.C. Section 2-302: Why Unconscionability Has Become a Relic*, 105 COM. L.J. 287, 295 (2000) (quoting CHARLES L. KNAPP & NATHAN M. CRYSTAL, RULES OF CONTRACT LAW 128 (1993)).

³⁰ See RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. a, c-d.

³¹ Carol B. Swanson, *Unconscionable Quandary: UCC Article 2 and the Unconscionability Doctrine*, 31 N.M. L. REV. 359, 364 (2001).

³² 350 F.2d 445 (D.C. Cir. 1965).

³³ *Id.* at 447.

³⁴ *Id.* at 449.

³⁵ Arthur Alan Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 487 (1967).

1. Procedural Unconscionability

Procedural unconscionability has often been referred to as “bargaining naughtiness”³⁶ or, as the official comment to § 2-302 implies, unfair surprise.³⁷ Generally, procedural unconscionability is found in the bargaining process leading up to contract formation.³⁸ The *Williams* court suggested a totality-of-circumstances approach, examining the facts surrounding the transaction to determine whether meaningful choice existed.³⁹ In the past, courts have found procedural unconscionability under a number of circumstances, including the use of unreasonably hard-to-read print,⁴⁰ incomprehensible language,⁴¹ or sharp bargaining practices.⁴²

While it could be argued that the major label recording agreement constitutes a contract of adhesion due to the fact that artists have a very limited range of negotiation⁴³ and leverage, these types of agreements have not been held to be unconscionable *per se*.⁴⁴ An adhesion contract has been defined as a standardized agreement that is drafted completely by the party of superior bargaining strength and offered to the weaker party with only the option to accept or reject it.⁴⁵ Such contracts have been viewed as a part of the modern economic landscape and are so ingrained into the notion of free contracting that rendering them unconscionable *per se* would be contrary to public policy.⁴⁶

Therefore, most jurisdictions require the party claiming unconscionability to demonstrate substantive unconscionability in order to render a contract of adhesion unenforceable.⁴⁷ Califor-

³⁶ Brown, *supra* note 29, at 296 (quoting Leff, *supra* note 35, at 485, 487).

³⁷ U.C.C. § 2-302 cmt. 1.

³⁸ Craig Horowitz, *Reviving the Law of Substantive Unconscionability: Applying the Implied Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts*, 33 UCLA L. Rev. 940, 944 (1986).

³⁹ *Id.* at 944.

⁴⁰ See, e.g., *John Deere Leasing Co. v. Blubaugh*, 636 F. Supp. 1569, 1571-74 (D. Kan. 1986) (holding that a lease agreement was procedurally unconscionable because some of the terms were in “very light colored, fine print.”).

⁴¹ See, e.g., *Seabrook v. Commuter Hous. Co.*, 72 Misc. 2d 6, 10 (N.Y. Civ. Ct. 1972) (holding a tenancy lease unconscionable in part because it contained a significant amount of highly technical legal terms “not commonly used or understood by the occasional lessee”).

⁴² See, e.g., *Merten v. Nathan*, 108 Wis. 2d 205 (1982) (holding a liability release contract unconscionable because it contained a false statement which was relevant to a reasonable person’s decision whether to execute the contract).

⁴³ Generally, for new artists, negotiations on specific provisions are limited to industry-wide standards set over time by the major labels themselves. See DONALD S. PASSMAN, *ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS* 61-194 (6th ed. 2006).

⁴⁴ 8 RICHARD A. LORD, *WILLISTON ON CONTRACTS* § 18:10 (4th ed. 2008).

⁴⁵ See *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165, 171 (Cal. 1981). See also BLACK’S LAW DICTIONARY 342 (8th ed. 2004).

⁴⁶ See *Graham*, 623 P.2d 165.

⁴⁷ Swanson, *supra* note 31, at 367-68.

nia law imposes two limits on the enforcement of adhesion contracts.⁴⁸ Either the contract will be unenforceable because it does not fall “within the reasonable expectations of the weaker . . . party”⁴⁹ or, despite consistency with their reasonable expectations, when “considered in its context, [the contract] . . . is unduly oppressive or unconscionable.”⁵⁰

2. Substantive Unconscionability

Substantive unconscionability has generally been held to exist when there are “contract terms which are unreasonably favorable to the other party.”⁵¹ Such contracts are unconscionable because they unjustifiably “reallocate[] the risks of the bargain in an objectively unreasonable or unexpected manner.”⁵² Contract terms are not substantively unconscionable solely because of any disproportionate risk allocation stemming from the unequal bargaining power of the parties.⁵³ The terms of the contract must *unreasonably* favor the stronger party in order to be held substantively unconscionable.⁵⁴ Section 2-302 of the U.C.C. implies that substantive unconscionability should be evaluated as of the time the contract was executed,⁵⁵ as well as against the general commercial background and commercial needs of the particular trade or case.⁵⁶ If the contract as a whole, or a particular term therein, is so one-sided as to offend the “mores and business practices of the time and place,”⁵⁷ then it has generally been found to possess substantive unconscionability.

B. *Application of Procedural and Substantive Unconscionability in New York and California*

Since most recording contracts are governed by either New York or California law,⁵⁸ it is necessary to understand how the courts in those states have applied the procedural and substantive elements of unconscionability. The most frequently cited defini-

⁴⁸ *Graham*, 623 P.2d at 172.

⁴⁹ *Id.*

⁵⁰ *Id.* at 173.

⁵¹ *Williams*, 350 F.2d at 449. *See also* *Johnson v. Mobil Oil Corp.*, 415 F. Supp. 264, 268 (D. Mich. 1976) (defining substantive unconscionability as commercially unreasonable contract terms); *Bank of Ind., Nat'l Ass'n v. Holyfield*, 476 F. Supp. 104, 110 (D. Miss. 1979) (“[s]ubstantive unconscionability is found when the terms of the contract are of such an oppressive character as to be unconscionable”).

⁵² *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 487 (Cal. Ct. App. 1982).

⁵³ RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. d.

⁵⁴ *Id.*

⁵⁵ U.C.C. § 2-302(1).

⁵⁶ U.C.C. § 2-302 cmt. 1.

⁵⁷ *Williams*, 350 F.2d at 450.

⁵⁸ M. WILLIAM KRASILOVSKY & SIDNEY SHEMEL, *THIS BUSINESS OF MUSIC: THE DEFINITIVE GUIDE TO THE MUSIC INDUSTRY* 14 (8th ed. 2000).

tion of procedural unconscionability under New York law can be found in *Gillman v. Chase Manhattan Bank*.⁵⁹ *Gillman* involved a claim that a security agreement between two commercial entities should be legally unenforceable on the grounds that it is unconscionable.⁶⁰ The New York Court of Appeals defined procedural unconscionability as an “absence of meaningful choice.”⁶¹

In order to determine the presence of procedural unconscionability, New York courts are required to examine the contract formation process and the alleged lack of meaningful choice. Specifically, a court focuses on the “size and commercial setting of the transaction, whether deceptive or high-pressured tactics were employed, the use of fine print in the contract, the experience and education of the party claiming unconscionability, and whether there was a disparity in bargaining power.”⁶² In rejecting the claim of procedural unconscionability, the *Gillman* court focused on the location of execution, the sufficiency of time available for review and discussion, and the fact that the contract was of the type “routinely entered into in the course of [appellant’s] business.”⁶³ In addition, the court noted that there were no allegations of deception, high-pressured tactics, or lack of expertise.⁶⁴

Under California law, procedural unconscionability exists when the court finds “oppression” or “surprise.”⁶⁵ Oppression exists when there is an “inequality of bargaining power which results in no real negotiation and an absence of meaningful choice.”⁶⁶ Surprise “involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in [a contract] drafted by the party seeking to enforce the disputed terms.”⁶⁷ California law considers adhesive contracts as procedurally unconscionable *per se*.⁶⁸

New York and California treat substantive unconscionability in fundamentally the same manner. In both jurisdictions, the underlying purpose of substantive unconscionability is to prevent the enforcement of contractual terms that are unduly harsh or oppressive.⁶⁹ However, New York and California disagree on the correct standard to apply to the determination as a matter of law. In

⁵⁹ 534 N.E.2d 824 (N.Y. 1988).

⁶⁰ *See id.*

⁶¹ *Id.* at 828.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *A & M Produce*, 135 Cal. App. 3d at 486.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *See Stirlen v. Supercuts, Inc.*, 51 Cal. App. 4th 1519, 1533 (Cal. Ct. App. 1997).

⁶⁹ *See, e.g., Stirlen*, 51 Cal. App. 4th at 1532; *State v. Wolowitz*, 96 A.D.2d 47, 68 (N.Y. App. Div. 1983) (arguing that since parties are free to contract, terms or contracts are substantively unconscionable if they contravene public policy).

Gillman, the New York Court of Appeals explained that the question of whether a contract is substantively unconscionable requires an “analysis of the substance of the bargain to determine whether the terms were unreasonably favorable to the party against whom unconscionability is urged.”⁷⁰ On the other hand, the California Court of Appeals has explicitly rejected such a reasonableness standard in favor of an inquiry into whether the term(s) or contract “shock[s] the conscience.”⁷¹ Consequently, a party invoking unconscionability in California will bear a much higher burden of proof than in New York.

Generally, New York and California require a showing of both procedural and substantive unconscionability in order for the court to hold the contract unconscionable.⁷² However, when the terms of the contract are exceptionally egregious, New York courts have been willing to void a contract for unconscionability despite *only* a showing of substantive unconscionability.⁷³ On the other hand, California courts have been disinclined to find unconscionability without a showing of both elements, but will invoke a “sliding scale”⁷⁴ into the determination. Under this “sliding scale” approach, both procedural and substantive elements must be present, but they need not be present in the same degree. For example, a greater degree of substantive unfairness found in a contract or term requires less evidence of procedural unconscionability to support a holding of unconscionability and vice versa.⁷⁵

III. UNCONSCIONABILITY AS APPLIED TO MAJOR LABEL RECORDING CONTRACTS

Whether the doctrine of unconscionability is applicable to major label recording contracts is a question that has never been considered by a United States court of law. Artists either do not have sufficient financial resources to bring such a claim or, in the case of established artists, the major labels choose to re-negotiate

⁷⁰ *Gillman*, 534 N.E.2d at 829.

⁷¹ *Cal. Grocers Ass'n v. Bank of America*, 22 Cal. App. 4th 205, 214-15 (Cal. Ct. App. 1994) (arguing that the reasonableness standard is inherently subjective).

⁷² *See, e.g., Stirlen*, 51 Cal. App. 4th at 1533 (“[t]he prevailing view is that these two elements must both be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability”); *Gillman*, 534 N.E.2d at 828 (“[a] determination of unconscionability generally requires a showing that the contract was both procedurally and substantively unconscionable when made . . .”).

⁷³ *Gillman*, 534 N.E.2d at 829 (citing *State v. Wolowitz*, 96 A.D.2d 47, 68 (N.Y. App. Div. 1983). *See, e.g., Jones v. Star Credit Corp.*, 59 Misc. 2d 189 (N.Y. Sup. Ct. 1969) (holding a contract for the purchase of a home freezer unit unconscionable “on its face” due to the great disparity between the price paid by the defendants and the actual price of the unit); *State of New York v. ITM, Inc.*, 52 Misc. 2d 39 (N.Y. Sup. Ct. 1966) (holding the increased price paid by consumers under retail installment contracts unconscionable).

⁷⁴ *Armentariz v. Found. Health Psychcare Servs.*, 6 P.3d 669, 690 (Cal. 2000).

⁷⁵ *Id.* at 690.

these contracts rather than engage in protracted and public litigation.⁷⁶ As a result, artists continue to enter into agreements that are tantamount to "professional slavery."⁷⁷ Through an examination of the contract formation and bargaining process, as well as the resulting terms, it is evident that some aspects of both procedural and substantive unconscionability are present. Were the question to be litigated, there exists a strong argument that the standard major label recording agreement should be unenforceable due to unconscionability.

A. *Procedural Unconscionability in Major Label Recording Contracts*

Procedural unconscionability, as the New York Court of Appeals held in *Gillman*, requires a showing of an absence of meaningful choice.⁷⁸ Alternatively, under California common law, there must be evidence of "oppression" or "surprise."⁷⁹ In the context of major label recording contracts, arguments for "surprise" are generally unpersuasive due to the fact that most artists are represented by counsel; therefore, "oppression" becomes the main concern. In either jurisdiction, an examination of the contract formation process is necessary in order to determine whether an absence of meaningful choice existed.⁸⁰

Under New York law, some of the factors to be considered in determining whether an absence of meaningful choice existed include: the size and commercial setting of the transaction; whether deceptive or high-pressured tactics were used; the experience and education of the parties involved; and any disparity in bargaining power.⁸¹ Many, if not all, of these factors play an important role in the formation of standard major label recording contracts. Even for artists who obtain an attorney, the standard major label recording agreement can span one hundred pages, containing legalese and hidden meanings that demand counsel specializing in music law.⁸² Such an agreement is "virtually impossible" for an un-

⁷⁶ See, e.g., PATRICK BURKART & TOM MCCOURT, *DIGITAL MUSIC WARS* 20 (2006); Joe D'Angelo, *Courtney Love, Universal Music Reach Settlement; Nirvana Material Freed Up for Release*, MTV.COM, Sept. 30, 2002, <http://www.mtv.com/news/articles/1457846/20020930/story.jhtml> (last visited Jan. 31, 2009).

⁷⁷ STAN SOOCHER, *THEY FOUGHT THE LAW: ROCK MUSIC GOES TO COURT* 46 (1999) (quoting recording artist George Michael).

⁷⁸ *Gillman*, 534 N.E.2d at 828.

⁷⁹ *Navellier v. Sletten*, 262 F.3d 923, 940 (9th Cir. 2001).

⁸⁰ *Gillman*, 534 N.E.2d at 828-29; see also *Stirlen*, 51 Cal. App. 4th at 1532; *Carboni v. Arrospide*, 2 Cal. App. 4th 76, 85-86 (Cal. Ct. App. 1991); but see *Anorga*, *supra* note 11 (focusing the procedural unconscionability inquiry on whether recording agreements constitute adhesive contracts).

⁸¹ *Gillman*, 534 N.E.2d at 828.

⁸² JEFFREY BRABEC & TODD BRABEC, *MUSIC MONEY AND SUCCESS* 110 (5th ed. 2006).

represented artist to comprehend.⁸³ Additionally, these contracts endeavor to protect the major labels at all costs.⁸⁴ Many of the principal terms, through repeated usage, have come to constitute non-negotiable industry standards or, at best, negotiable within limits established by the record labels over time.⁸⁵

While these factors support an argument for an absence of meaningful choice, the disparity in bargaining power between the “Big Four”⁸⁶ and recording artists represents the most persuasive evidence of procedural unconscionability under New York and California law. Notwithstanding the decline of the Big Four’s stronghold on the music industry in the United States,⁸⁷ a band or artist is still more likely to achieve commercial success by signing with a major label rather than with an independent one.⁸⁸ Major labels possess larger distribution channels, potentially greater promotional and marketing power, and larger budgets.⁸⁹ Since the Sony-BMG merger in 2004, the “Big Four” control more than seventy percent of the global music market share,⁹⁰ effectively functioning as an oligopoly.⁹¹ As such, they are able to integrate every facet of the music business, such as publishing firms, record distributors, marketing teams, and digital sales services, under one umbrella corporation.⁹²

This oligopoly presents numerous barriers for any artist trying to achieve independent success within the music industry. Commercial success depends largely on access to the global market and its vast distribution networks.⁹³ Unlike the majors, independent labels must contract with outside distributors or, as is usually the

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ See PASSMAN, *supra* note 43, at 61-194.

⁸⁶ BURKART & MCCOURT, *supra* note 76, at 25. Since 2004, EMI, Sony BMG, Universal, and Warner have been the four major record companies in the world. *Id.*

⁸⁷ Nielsen Soundscan reported that independent labels represented 18.13 percent of the United States music market share in 2005 compared to a 16.36 percent market share in 2002. See *Digital Music Futures and the Independent Music Industry*, Feb. 1, 2007, <http://clicknoise.net/digital-music-futures-and-the-independent-music-industry> [hereinafter *Digital Music Futures*].

⁸⁸ See BURKART & MCCOURT, *supra* note 76, at 26.

⁸⁹ RICH STIM, MUSIC LAW: HOW TO RUN YOUR BAND’S BUSINESS § 14/3 (2003).

⁹⁰ According to The International Federation for the Phonographic Industry (“IFPI”), the four major labels represented 71.7% of the global market share in 2004. This market share increased to 81.8% in 2005 (IFPI did not release figures for 2005). See *IFPI Releases Definitive Statistics on Global Market for Recorded Music*, Aug. 2, 2005, http://www.ifpi.org/content/section_news/20050802.html; Chris Morris, Uni Music Tops '05 Market Share with 35%, THE HOLLYWOOD REPORTER, Jan. 5, 2006, available at <http://www.fmqb.com/article.asp?id=266932>.

⁹¹ BURKART & MCCOURT, *supra* note 76, at 24 (arguing that while there are numerous independent labels, the recording industry is “so completely dominated by four companies that it is, in effect, an oligopoly”).

⁹² *Id.* at 25-26.

⁹³ *Id.* at 26.

case, the major labels themselves in order to place their artists’ records in the international marketplace. Under either option, independents are forced to share profits with the distributors and, even worse, relinquish control over material distribution decisions regarding their records.⁹⁴ Moreover, unless they contract with a major-controlled distributor, independent labels can be denied access to distribution in some markets, effectively eliminating the potential for new audiences entirely.⁹⁵ In addition, creating a “hit” record requires an enormous financial investment.⁹⁶ Independent labels simply do not possess the financial resources to compete with the “Big Four’s” capital availability and marketing and promotion efforts.

Consequently, many struggling artists view the major label record deal as the only viable avenue to fame and commercial success.⁹⁷ While it is not impossible for an artist to achieve success with an independent label, the presence of an oligopoly and its corresponding market control makes it extremely difficult. This reality increases the already wide disparity in bargaining power inherent in contract negotiations between a large corporation and an individual. Either the artist can sign a largely non-negotiated record deal with a major label or sign with an independent, in which case commercial success is less likely.⁹⁸

B. *Substantive Unconscionability in Major Label Recording Contracts*

Despite the inherent absence of meaningful choice surrounding the standard major label recording agreement, courts will be unwilling to hold such contracts unenforceable without evidence of substantive unconscionability.⁹⁹ Since prior scholarship on this topic has failed to address the application of the differing standards for substantive unconscionability found in New York and California,¹⁰⁰ an examination of the terms of the standard major label recording contract is necessary to determine whether key provisions unreasonably favor the record labels and are so one-sided as to “shock the conscience.”

⁹⁴ *Id.*

⁹⁵ See STIM, *supra* note 89, at § 14/2-3.

⁹⁶ Selling large numbers of records usually depends on substantial capital investment and intricate marketing schemes, in addition to vast distribution. *Id.*

⁹⁷ See Paul Sloan, *Why Record Labels Matter Now More Than Ever*, FORTUNE, Nov. 5, 2007, available at <http://money.cnn.com/2007/11/02/magazines/fortune/matchbox.fortune>; Alex Veiga, *Do Superstars Still Need Record Labels?*, USA TODAY, Oct. 12, 2007, available at http://www.usatoday.com/life/music/2007-10-12-1840331408_x.htm.

⁹⁸ *Cf.* Hall, *supra* note 11 (focusing on “pay-for-play” and music video production to support an argument for procedural unconscionability).

⁹⁹ See, e.g., *Stirlen*, 51 Cal. App. 4th at 1533; *Gillman*, 534 N.E.2d at 828.

¹⁰⁰ See Anorga, *supra* note 11; Hall, *supra* note 11.

1. Term Provisions

The term of an agreement is one of the most fundamental provisions in any contract. It sets forth the period of time during which the contract is in force between the parties.¹⁰¹ With respect to major label recording contracts, its importance is exacerbated since the artist is bound exclusively to the recording company for the duration of the term.¹⁰²

The term of the standard major label recording contract begins on the date the contract is signed and expires six to nine months following either the recording and delivery of a long-playing album, known as an LP, or the commercial release of that album.¹⁰³ Once the term has been completed, an artist is not free to negotiate a better deal with another record label. The term provision in all major label recording agreements grants the label the exclusive right to exercise a number of options¹⁰⁴ that will extend the contract for additional periods of time on the same conditions as in the initial term.¹⁰⁵ The record label also retains the sole right to terminate the agreement at any time without further obligation to the artist.¹⁰⁶

The term provisions contained in the standard major label recording agreement appear sufficiently one-sided to support a finding of substantive unconscionability under New York law.¹⁰⁷ These provisions grant record labels the unilateral right to either continue exercising their options to extend the contract upon the initially "agreed-upon" terms or to terminate it at will without any further obligations to the artist.¹⁰⁸ Conversely, the artist must fully perform or risk liability for breach of contract. Such a lack in mutuality of obligation amounts to oppression and is consistent with the principles underlying New York's standard for substantive unconscionability.¹⁰⁹

¹⁰¹ See PASSMAN, *supra* note 43, at 99.

¹⁰² *Id.* at 131.

¹⁰³ BRABEC, *supra* note 82, at 112.

¹⁰⁴ Major label recording agreements require four to nine options. *Id.* at 113.

¹⁰⁵ See *Major Label Contract Clause Critique*, FUTURE OF MUSIC COALITION, Oct. 3, 2001, available at <http://www.futureofmusic.org/contractcrit.cfm>.

¹⁰⁶ KRASILOVSKY, *supra* note 58 (sample exclusive recording agreement found in the accompanying CD-ROM).

¹⁰⁷ The author notes that prior scholarship on this topic has focused the unconscionability inquiry with respect to term provisions on an application to California statutory law. See, e.g., Anorga, *supra* note 11, at 759-63; Hall, *supra* note 11, at 216-19. Since New York has no equivalent statute as of this time, it is important to evaluate such provisions under its common law standard for substantive unconscionability.

¹⁰⁸ See RICHARD SCHULENBERG, *LEGAL ASPECTS OF THE MUSIC INDUSTRY: AN INSIDER'S VIEW* 36 (2005). The only exception occurs when the label does not permit the artist to record any music. Under this circumstance, the recording agreement obligates the label to pay minimum union scale for an album. PASSMAN, *supra* note 43, at 95.

¹⁰⁹ See *State of New York v. Avco Fin. Serv., Inc.*, 406 N.E.2d 1075, 1078 (N.Y. 1980) (holding the purpose of unconscionability to be the prevention of oppression).

The term provisions also appear to permit the major record labels to engage in activities contrary to public policy. Under the California Labor Code, “a contract to render personal service . . . may not be enforced against the employee beyond seven years from the commencement of service under it.”¹¹⁰ Nonetheless, it is entirely possible for an artist to remain bound to a record agreement for longer than seven years. In fact, numerous options and other provisions limiting creative output,¹¹¹ combined with the realities of the music industry,¹¹² make it nearly impossible for artists to fulfill a recording agreement within the statutory time frame.¹¹³ Courtney Love, lead singer for Hole, testified before the California Senate that her record label prevented her from fulfilling her current recording agreement within seven years regardless of her intentions to do so.¹¹⁴

While the California Legislature amended the Labor Code to effectively exempt recording artists from protection,¹¹⁵ the amendment was the product of intense lobbying by the Recording Industry Association of America (“RIAA”) on behalf of the major record companies, rather than a reflection of public will.¹¹⁶ Since its adoption, the amendment has been the subject of numerous attacks and attempts to repeal it¹¹⁷ because it forces artists into, as one California State Senator put it, “indentured servitude”¹¹⁸ by enabling record labels to hold recording artists to their contracts

¹¹⁰ CAL. LAB. CODE § 2855 (2007). *See also* De Haviland v. Warner Bros. Pictures, 153 P.2d 983, 988 (Cal. Ct. App. 1944) (reasoning that public policy dictates limiting personal service contracts to seven years on, among other things, the grounds that a person should be free to obtain the “highest obtainable compensation” for their services as their skill level increases).

¹¹¹ Standard major label recording contracts provide that records cannot be delivered within, at least, six months from the date of delivery of the prior record. PASSMAN, *supra* note 43, at 101.

¹¹² PASSMAN, *supra* note 43, at 99-100 (arguing that, following completion of the first record, touring, promotion, more creative control, and creative difficulties all cause subsequent recording processes to take much longer than before).

¹¹³ *See California Labor Code Section 2855 and Recording Artists’ Contracts*, 116 HARV. L. REV. 2632, 2641-42 (2003) [hereinafter *Recording Artists’ Contracts*].

¹¹⁴ *See* Teri VanHorn, *Courtney Love, Don Henley, LeAnn Rimes Testify on Artists’ Rights*, MTV.COM, Sept. 6, 2001, http://www.mtv.com/news/articles/1448678/20010906/henley_don.jhtml (last visited Feb. 3, 2009).

¹¹⁵ If they terminate their contracts under the provisions of § 2855, the amendment subjects recording artists to a claim for damages based on the relative worth of any remaining albums due under the contract. CAL. LAB. CODE § 2855(b)(3).

¹¹⁶ *See Recording Artists’ Contracts*, *supra* note 113, at 2636; Corey Moss, *Beck, Deftones, Others Rally for Bill That Could Change Recording Contracts*, MTV.COM, Jan. 24, 2002, <http://www.mtv.com/news/articles/1451908/20020123/beck.jhtml> (last visited Feb. 3, 2009).

¹¹⁷ *See, e.g.*, Eric de Fontenay, *Should Artists Pay for the Labels’ Mistakes?*, MUSICDISH.COM, Sept. 6, 2001, <http://www.musicdish.com/mag/?id=4452> (last visited Feb. 9, 2009); Moss, *supra* note 116.

¹¹⁸ Kevin Murray, *Recording Industry Practices*, RECORDING ARTISTS’ COALITION, <http://www.recordingartistscoalition.com/industrypractices.php>.

for their entire careers.¹¹⁹ The foregoing provides strong support for an argument that the term provisions of the standard major label recording agreement are a sufficient “shock to the conscience” to render them substantively unconscionable under California law.¹²⁰

2. Artist Royalties and Label Recoupment

Royalty provisions determine an artist’s monetary compensation from the sale of physical sound recordings, including digital phonorecord deliveries (“DPDs”)¹²¹ and audiovisual works.¹²² Royalties are calculated in terms of a percentage of either the suggested retail list price or wholesale price of each recording sold.¹²³ For new artists, royalties are usually between ten and twelve percent of the suggested retail list price¹²⁴ for those recordings sold through normal retail channels.¹²⁵ Recordings *not* sold through normal retail channels¹²⁶ are subject to a number of royalty reductions.

On sales of singles, the agreement provides for a reduced royalty, notwithstanding the fact that the percentage is applied to an already significantly reduced base price.¹²⁷ Royalties on single sales do not receive the same (if any) escalations based on sales achievements as do albums sold through normal retail channels.¹²⁸ This notion becomes especially deleterious to artists, if, as is cur-

¹¹⁹ Fontenay, *supra* note 117.

¹²⁰ See also Tracy C. Gardner, *Expanding the Rights of Recording Artists: An Argument to Repeal Section 2855(b) of the California Labor Code*, 72 BROOK. L. REV. 721, 753-56 (analogizing recording contracts to the personal service contract at issue in *De Haviland v. Warner Bros. Pictures*, universally recognized as controlling precedent for interpretation of § 2855, and arguing for the absence of any distinguishing factors).

¹²¹ A digital phonorecord delivery is defined as “[e]ach individual delivery of a phonorecord by digital transmission of a sound recording which results in a specifically identifiable reproduction by or for any transmission recipient of a phonorecord of that sound recording, regardless of whether the digital transmission is also a public performance of the sound recording or any non-dramatic musical work embodied therein.” 17 U.S.C. § 115(d) (2007).

¹²² BRABEC, *supra* note 82, at 114. “‘Audiovisual works’ are works that consist of a series of related images which are intrinsically intended to be shown by the use of machines or devices such as projectors, viewers, or electronic equipment, together with accompanying sounds. . . .” 17 U.S.C. § 101 (2008).

¹²³ The suggested retail list price represents the approximate price received by the retailer while the wholesale price represents the published price to dealers. See PASSMAN, *supra* note 43, at 69-72.

¹²⁴ BRABEC, *supra* note 82, at 114. Theoretically, this percentage should double if the record label computes royalties based on the wholesale price of each record. *Id.*

¹²⁵ The full royalty rate is only given to full price sales of physical recordings in the United States through record stores (or the like) by the company’s normal distribution channels. See PASSMAN, *supra* note 43, at 153.

¹²⁶ For example, foreign and discounted sales. See *id.*

¹²⁷ See PETER M. THALL, WHAT THEY’LL NEVER TELL YOU ABOUT THE MUSIC BUSINESS 28 (2002).

¹²⁸ *Id.*

rently predicted,¹²⁹ music sales shift back to a singles-driven market.

Following a record’s initial run, record labels can offer albums at discounted prices to encourage consumption. Such albums are known as “mid-price” or “budget” records and recording agreements provide that the artist’s royalty rate will be reduced under these circumstances as well.¹³⁰ New artists are typically paid seventy-five percent of their full price royalty for sales of mid-price records and fifty percent for sales of budget records.¹³¹ Record labels justify these reductions, arguing that their profit margin is lower because the wholesale or retail price has been reduced.¹³² However, since discounting encourages consumers to purchase products they would not have otherwise, record labels are able to recoup some of the potential lost revenues from un-sold, full-price records. This strategy earns revenue for the record label yet the artist is paid proportionately less.¹³³

Royalty rate reductions also apply to sales through record clubs,¹³⁴ which, under the recording contract, reduces the royalty rate to one-half of the artist’s basic rate.¹³⁵ Record labels argue that such a reduction is justified due to the fact that marketing costs associated with sales are higher for record clubs than through normal retail channels, and because of losses arising from the high number of record club members’ debts that are never repaid.¹³⁶ However, this argument stands without merit because the label is able to recoup its marketing costs before the artist ever receives a royalty payment.¹³⁷ Furthermore, even at a discount, records sold through direct club operations are at higher prices than sales to a dealer at wholesale prices.¹³⁸

Whether direct or through a third party, club operations are able to give away copies of artists’ records for free to their mem-

¹²⁹ See Geoff Duncan, *U.S. CD Sales Down 20 Percent*, DIGITALTRENDS, Mar. 22, 2007, http://news.digitaltrends.com/news/story/12526/us_cd_sales_down_20_percent (last visited Feb. 3, 2009).

¹³⁰ The contractual definition of a mid-price record is one with a price between 65% and 85% of newly released top-line records. The contractual definition of a budget record is one with a price of less than 65% of newly released top-line records. PASSMAN, *supra* note 43, at 169-70.

¹³¹ *See id.*

¹³² *Id.*

¹³³ *See id.*

¹³⁴ Record clubs are organizations that offer members free or heavily discounted records but require a purchase commitment to join. *See id.* at 171. For purposes of royalty reductions, there is a distinction between direct and outside record clubs. Direct clubs are those owned by the record label or a subsidiary, while outside clubs are not owned by the record label and must therefore license the recordings. *See* THALL, *supra* note 127, at 29.

¹³⁵ THALL, *supra* note 127, at 29.

¹³⁶ *See* PASSMAN, *supra* note 43, at 171-72.

¹³⁷ *See infra* pp. 185-87.

¹³⁸ THALL, *supra* note 127, at 29.

bers as incentives to join and purchase even more records.¹³⁹ Major label recording agreements exclude from royalties gratis records given away as part of merchandising or discount programs¹⁴⁰ despite the fact that royalty-free promotions are effectively loss-leaders. They act as incentives for people to join record clubs, thereby generating more revenue that, in the case of direct club operations, flows directly to the record labels themselves.

One final royalty reduction provided for in the standard major label recording agreement relates to any televised marketing campaigns for the artist.¹⁴¹ This reduction, usually fifty percent of the artist's basic rate, is applied to the accounting period during which the campaign initially took place.¹⁴² The argument in favor of such a reduction is based on the fact that television advertising campaigns are extremely expensive.¹⁴³ However, under the terms of the recording agreement, the company has the ability to recoup most, if not all, of the costs of independent promotion prior to making any royalty payments.¹⁴⁴ Consequently, since an artist's royalty rate can be reduced by half for up to six months at a time, such a reduction only lengthens the period for which artists remain indebted to their labels.

The appropriate royalty rate, whether it is the basic or a reduced rate, must be applied to a base to determine how much compensation an artist will receive for the sale of each record.¹⁴⁵ This royalty base will equal the suggested retail list price or wholesale price of the record. However, major record labels include several provisions in their standard recording contracts that automatically deduct specific expenses from an artist's royalty base.¹⁴⁶

Packaging represents one of the largest deductions from an artist's royalty base.¹⁴⁷ The packaging deduction is customarily a percentage of the royalty base price of a record that is then deducted before calculating any royalties.¹⁴⁸ Record labels justify the deduction on the grounds that the artist should only receive a roy-

¹³⁹ See THALL, *supra* note 127, at 29.

¹⁴⁰ BRABEC, *supra* note 82, at 120.

¹⁴¹ THALL, *supra* note 127, at 34.

¹⁴² For example, if the record label commenced a television campaign coinciding with the beginning of their semiannual period, then, irrespective of length, the artist's royalty will be reduced for the entire period. See *id.*

¹⁴³ See PASSMAN, *supra* note 43, at 166.

¹⁴⁴ For new artists, independent promotion expenses are usually 100% recoupable by the label. See BRABEC, *supra* note 82, at 131.

¹⁴⁵ See PASSMAN, *supra* note 43, at 73.

¹⁴⁶ Such costs are known as deductions. See STIM, *supra* note 89, at § 14/5.

¹⁴⁷ Packaging represents the cost of covers, sleeves, and containers in which the recording is packaged. BRABEC, *supra* note 82, at 119.

¹⁴⁸ See PASSMAN, *supra* note 43, at 73. The "industry norm" for packaging deductions is 25% for compact discs and digital phonorecord deliveries. *Id.*

alty on the record, not the package.¹⁴⁹ However, the charge against the artist is substantially greater than the actual cost of packaging.¹⁵⁰

As discussed, the standard major label recording agreement does not require payment of royalties on records given away for promotional or merchandising purposes. This exception is expressed in terms of a percentage of total records sold.¹⁵¹ While the "free goods" exception does not apply to royalties that are calculated based on the wholesale or published price to dealers, artists still receive roughly the same amount of royalties for each recording sold.¹⁵² Non-payment of royalties for records given away for promotional purposes, on its face, seems acceptable. In the context of distribution, such a free goods exception is unreasonably favorable for the record labels. Rather than selling records at a reduced price to attract more consumers but thereby reducing profit margins, record labels provide retailers or wholesalers with free records as part of record shipments, effectively discounting the entire purchase price while avoiding payment of some royalties.¹⁵³

No artist is paid royalties until all advances have been recouped.¹⁵⁴ In fact, most money paid to or on behalf of the artist by the record label will constitute an advance that is either fully or partially recoupable against an artist's royalties.¹⁵⁵ While they initially benefit the artist, advances grant the record labels the right to retain control over important decision-making issues, as well as the ability to earn profits on the recording long before the artist.

Upon execution of the agreement, money is paid to the artist in the form of a "fund" to be allocated for direct recording costs¹⁵⁶ associated with the creation of the master recording.¹⁵⁷ Depending on the artist, the record label may agree to provide an additional fund for the purchase of new musical equipment.¹⁵⁸ Under

¹⁴⁹ *Id.*

¹⁵⁰ *See id.*

¹⁵¹ *See* BRABEC, *supra* note 82, at 120-21.

¹⁵² Since the suggested retail list price is significantly greater, the wholesale price of a sound recording generally approximates the royalty base price once packaging and free goods have been deducted from the suggested retail list price. *See id.* at 380-81.

¹⁵³ *Id.* at 120-21.

¹⁵⁴ *See* PASSMAN, *supra* note 43, at 78. Recoupment is the process of keeping an artist's royalties that would otherwise be payable in order to recover all advances, as defined by the recording agreement, paid by the record label. *Id.*

¹⁵⁵ *See* PASSMAN, *supra* note 43, at 80.

¹⁵⁶ For example, studio time, engineering, mixing, mastering, union scale payments for performers, and travel arrangements all constitute recording costs. *See* THALL, *supra* note 127, at 25.

¹⁵⁷ *See* PASSMAN, *supra* note 43, at 89. The artist retains any of the funds not spent on recording costs. *Id.* Urban/hip-hop and pop artists receive a smaller advance along with a mutually approved recording budget. *Id.* at 90.

¹⁵⁸ BRABEC, *supra* note 82, at 125.

the recording contract, these funds always constitute advances that are fully recoupable from any royalties due to the artist.¹⁵⁹ Even though the “fund” is owned by the artist, the record label generally retains a right of approval over the recording budget.¹⁶⁰

New artists, along with many established ones, require significant promotion to make the record a “hit.”¹⁶¹ While record labels used to provide most of it as an overhead expense,¹⁶² promotion and marketing are now outsourced to individuals or organizations and are collectively referred to as independent promotion.¹⁶³ For new artists, the standard major label recording agreement provides that all costs associated with independent promotion will be recouped out of the artist’s royalties.¹⁶⁴ Nonetheless, the record label retains the right to make all final marketing and promotion decisions,¹⁶⁵ whereas the artist is the party indebted for the resulting expenses.

Touring also represents a form of promotion, allowing artists to significantly further their careers by building a fan base. However, expenses cause a majority of new artists to lose money on touring.¹⁶⁶ The standard major label recording agreement typically provides for tour support that can cover any losses an artist incurs from going on the road prior to or following the recording of an album.¹⁶⁷ Tour support always constitutes an advance that is fully recoupable from an artist’s royalties. Thus, the artists completely bear the financial burden of touring despite the real possibility that it can lead to a significant increase in album sales¹⁶⁸ which generates more revenue for the label itself.

Taken together, these royalty provisions are arguably substantively unconscionable under New York and California law. As discussed above, an artist does not receive any royalty payments until the label has recouped all advances. Despite the fact that record labels receive a significant percentage of revenue derived from the sale of each recording, only those royalties due to the artist are

¹⁵⁹ See *id.* at 125, 132.

¹⁶⁰ See PASSMAN, *supra* note 43, at 90.

¹⁶¹ See BRABEC, *supra* note 82, at 131. See also Jacob Slichter, Op-Ed., *The Price of Fame*, N.Y. TIMES, July 29, 2005, available at <http://www.nytimes.com/2005/07/29/opinion/29slichter.html>.

¹⁶² THALL, *supra* note 127, at 34.

¹⁶³ See *id.* at 122.

¹⁶⁴ BRABEC, *supra* note 82, at 131.

¹⁶⁵ *Id.* Record labels will only agree to “consult” with the artist regarding marketing and promotion decisions. *Id.*

¹⁶⁶ PASSMAN, *supra* note 43, at 143.

¹⁶⁷ See *id.* Under the standard agreement, the amount of tour support given to an artist is limited to actual losses resulting from a tour not exceeding a specified maximum limit. *Id.* at 144.

¹⁶⁸ See *id.* at 143; THALL, *supra* note 127, at 33.

applied towards recoupment of advances.¹⁶⁹ For example, twelve percent of each record sold is applied to recoup expenses while the remaining eighty-eight percent is paid to the record label outright. While it is possible that a record label may never recoup expenses it has incurred in connection with an artist, the royalty provisions found in the standard major label recording agreement are unreasonably favorable because they provide the record labels with the ability to recover their investment and earn profits on a recording long before the artist receives any income from the exploitation of his or her work.¹⁷⁰

When considered under California law, the terms by which royalties are paid are arguably analogous to the film studio’s net profit formula at issue in *Buchwald v. Paramount Pictures*.¹⁷¹ In *Buchwald*, the plaintiff entered into an agreement with Paramount under which he transferred the sole and exclusive motion picture rights to “King For a Day” in return for consideration contingent upon it becoming the basis of a feature-length film.¹⁷² The California Superior Court held the net profit formula used by the studio to calculate plaintiff’s royalties to be substantively unconscionable.¹⁷³ Specifically, the court found the provisions contained therein were “overly harsh” and “one-sided” because they either had no rational justification,¹⁷⁴ contained charges bearing no relation to actual costs,¹⁷⁵ or prevented the individual from receiving royalties while the corporation continued to make a profit on the endeavor.¹⁷⁶ As discussed herein, the royalty provisions of the standard major label recording agreement produce strikingly similar results. Therefore, there exists a strong argument that, by analogy to *Buchwald*, these royalty provisions are substantively unconscionable under California law.

In his Note on the unconscionability of recording contracts, Omar Anorga incorrectly argues that the likely basis for a finding of unconscionability can be found by considering the major labels’ potential to earn tremendous profits under the contract, as well as

¹⁶⁹ See PASSMAN, *supra* note 43, at 78-79.

¹⁷⁰ See, e.g., Lynn Morrow, *The Recording Artist Agreement: Does it Empower or Enslave?*, 3 VAND. J. ENT. L. & PRAC. 40, 50-52 (2001) (using a hypothetical example of Shania Twain to show that under the standard recording agreement, approximately one million records would need to be sold in order for costs to be fully recouped).

¹⁷¹ *Buchwald v. Paramount Pictures Corp.*, No. C 706083, 1990 Cal. App. LEXIS 634 (Cal. App. Dep’t Super. Ct. 1990), reprinted in PIERCE O’DONNELL & DENNIS MCDUGAL, FATAL SUBTRACTION: THE INSIDE STORY OF BUCHWALD V. PARAMOUNT app. B (1992).

¹⁷² See *Buchwald v. Paramount Pictures Corp.*, No. C 706083, 1990 Cal. App. LEXIS 634 (Cal. App. Dep’t Super. Ct. 1990).

¹⁷³ See *id.* at 551.

¹⁷⁴ See *id.* at 550-51.

¹⁷⁵ See *id.*

¹⁷⁶ See *id.*

their superior ability to assume the risks.¹⁷⁷ However, the comment to U.C.C. § 2-302 explicitly states that the unconscionability doctrine should not be applied to prevent disproportionate risk allocations.¹⁷⁸ Rather, the focus of the substantive unconscionability inquiry should be whether the terms result in oppression or unfair surprise.¹⁷⁹ Therefore, the fact that the royalty provisions of the standard major label recording agreement permit one party to profit much earlier than the other provides a more persuasive argument for a finding of substantive unconscionability under New York law. Additionally, since *Buchwald* relied heavily on the net profits formula in holding the agreement substantively unconscionable, the argument that royalty provisions of the standard major label recording agreement are analogous comports more closely with California precedent.

3. Digital Compensation

Beginning with the opening of Apple's online iTunes store in 2003,¹⁸⁰ digital phonorecord deliveries ("DPDs") have increasingly represented a significant portion of the revenue generated from the sale of album recordings.¹⁸¹ If this trend continues as predicted,¹⁸² DPDs could soon become the preferred method for purchasing music. Nevertheless, under the current standard major label recording agreement, the record labels receive the lion's share of the revenue generated from online digital sales.

While in the past, such sales were characterized as "new technology" carrying a reduced royalty rate,¹⁸³ the current standard major label recording agreement equates DPD sales to those of physical recordings. As such, the artist's album royalty rate is applied to the price received by the record label for the sale,¹⁸⁴ which has been approximated at seventy cents per download.¹⁸⁵ Conse-

¹⁷⁷ See Anorga, *supra* note 11, at 765.

¹⁷⁸ U.C.C. § 2-302, cmt. 1. See also *infra* Part II(A)(2).

¹⁷⁹ U.C.C. § 2-302, cmt. 1.

¹⁸⁰ See DAVID KUSEK & GERD LEONHARD, *THE FUTURE OF MUSIC: MANIFESTO FOR THE DIGITAL MUSIC REVOLUTION 6* (Susan Gedutis Lindsay ed., Berklee Press 2005).

¹⁸¹ In 2007, the amount of paid song downloads increased from the previous year by approximately forty-five percent while physical album sales decreased by fifteen percent during the same period. See Alex Veiga, *U.S. Album Sales Down, Digital Sales Up*, SFGATE.COM, Jan. 3, 2008, available at <http://sfgate.com/cgi-bin/article.cgi?f=/n/a/2008/01/03/entertainment/e122651S88.DTL>.

¹⁸² According to a report published by The Yankee Group, an independent technology research and consulting firm, digital music revenue will reach \$5.34 billion in the U.S. by the year 2012. Sean O'Driscoll & Alex Veiga, *Yankee Group Sees Record Industry Fall*, BOSTON.COM, Jan. 8, 2008, available at http://www.boston.com/business/technology/articles/2008/01/08/yankee_group_sees_record_industry_fall.

¹⁸³ BRABEC, *supra* note 82, at 121-22.

¹⁸⁴ See PASSMAN, *supra* note 43, at 158-59.

¹⁸⁵ BRABEC, *supra* note 82, at 378; May Wong, *Apple Renews Record Label Deals, Sticks with 99*

quently, artists must sell more DPDs than previously necessary with physical recordings in order to receive any royalty payments.

The characterization of DPDs as sales of physical recordings by the standard recording agreement unreasonably favors the record label by permitting it to circumvent more favorable terms that have been granted to the artist with respect to licensing. In conjunction with the licensing of any master recording to a third party for distribution within the United States, an artist will receive fifty percent of net receipts received by the record company.¹⁸⁶ By its own account, Apple acts as a licensee of the record labels in order to distribute music via iTunes, the largest online music store.¹⁸⁷ However, artists do not receive fifty percent of net receipts received from online music distributors because record labels have succeeded in contracting around this language by inappropriately characterizing DPDs as sales of physical recordings. When considered with the argument that royalty provisions regarding sales of physical recordings are substantively unconscionable,¹⁸⁸ such a result enhances the unreasonably favorable nature of royalty calculations, and thus is arguably one-sided to “shock the conscience.”¹⁸⁹

4. Controlled Composition Clauses

In order to reproduce a recording containing one or more musical compositions,¹⁹⁰ a record label must first obtain a mechanical license from the publisher who owns or administers the work.¹⁹¹ This mechanical license entitles the author of the composition(s) to a mechanical royalty, set by statute,¹⁹² for each record containing the composition(s) that is manufactured and distributed by the licensee.¹⁹³ When, as frequently is the case, the re-

Cents Per Song, USA TODAY, May 2, 2006, available at http://www.usatoday.com/tech/news/2006-05-02-itunes-pricing_x.htm.

¹⁸⁶ See Complaint at 3, *Allman Brothers Band v. Sony BMG Music Entm't*, No. 1:06-cv-03252-GBD (S.D.N.Y.) RULE 10.8.3; THALL, *supra* note 127, at 44.

¹⁸⁷ Steve Jobs, *Thoughts on Music*, APPLE, Feb. 6, 2007, <http://www.apple.com/hotnews/thoughtsonmusic>.

¹⁸⁸ See *infra* Part III(B)(2).

¹⁸⁹ At the time of publication, the Allman Brothers Band and Cheap Trick have brought a class action suit against Sony BMG, alleging breach of contract, in part, on the grounds that Sony BMG wrongfully characterizes digital downloads as physical sales rather than as licenses and thus grossly underreports money owed to artists. See Allman Complaint, *supra* note 186, at 2-3.

¹⁹⁰ A musical composition constitutes a literary work under copyright law. ROBERT A. GORMAN & JANE C. GINSBURG, *COPYRIGHT: CASES AND MATERIALS* 589 (7th ed. 2006). Literary works “are works, other than audiovisual works, expressed in words, numbers, or other verbal or numerical symbols or indicia, regardless of the nature of the material objects, such as books, periodicals, manuscripts, phonorecords, film, tapes, disks, or cards, in which they are embodied.” 17 U.S.C. § 101 (2006).

¹⁹¹ BRABEC, *supra* note 82, at 32.

¹⁹² The current mechanical royalty rate is either 9.1 cents per song or 1.75 cents per minute, whichever is greater. U.S. Copyright Office, *Mechanical License Royalty Rates*, *available at* <http://www.copyright.gov/carp/m200a.html>.

¹⁹³ See PASSMAN, *supra* note 43, at 212.

ording artist is also the author of the composition to be reproduced, those songs are referred to as “controlled compositions.”¹⁹⁴ Under the terms of the standard major label recording agreement, controlled compositions are not subject to recoupment of advances,¹⁹⁵ therefore, mechanical royalties represent income immediately due to the artist from “record one.”¹⁹⁶

While Congress felt it necessary to set a statutory rate, major record labels have historically disregarded that rate by including provisions in their recording agreements that limit the amount of mechanical royalties paid by the label for compositions, whether controlled or non-controlled, included in an album. Generally, new artists receive seventy-five percent of the minimum statutory rate¹⁹⁷ with no allowance for any changes in order to conform to potential future escalations by the Copyright Royalty Board.¹⁹⁸ Additionally, controlled composition clauses impose a cap on total mechanical royalties that a record label is required to pay for a particular album.¹⁹⁹ Such a cap either potentially releases the record label from payment of a portion of mechanical royalties or, in the case of non-controlled compositions, forces the artist to bear the cost of any exceeding amount.²⁰⁰

Through these reductions and limitations, the controlled composition clauses of the standard major label recording agreement are sufficiently one-sided to warrant a finding of substantive unconscionability. Contracting to limit the amount of statutorily-required mechanical royalties an artist receives for controlled compositions unreasonably favors the record labels by unilaterally reducing the only source of artist income required to be remitted prior to recoupment of the label’s total investment. While under California law, some statutory rights can be waived by private agreement,²⁰¹ such an agreement may not contravene a law established for a public purpose.²⁰² The articulated purpose of establishing mechanical rights was to alleviate Congress’ fear that the record labels would monopolize the copyrights of musical compo-

¹⁹⁴ Controlled compositions are songs written, owned, or controlled by the artist, either in whole or in part. *Id.* at 214.

¹⁹⁵ *See id.* at 215.

¹⁹⁶ An industry term used to refer to the time at which the first record is sold. *See id.* at 115.

¹⁹⁷ *See* PASSMAN, *supra* note 43, at 216. The minimum statutory rate represents the per song mechanical royalty rate on the date of recording, delivery of the master(s), or first release, depending on the language of the agreement. *Id.* at 217.

¹⁹⁸ *Id.* at 216. The 1976 Copyright Act authorizes the Copyright Royalty Board to make adjustments to the mechanical royalty rate; thus, since 1976, it has increased the minimum statutory rate several times from the original 2.75 cents per song. *See id.* at 203.

¹⁹⁹ *Id.* at 219. For new artists, the cap is almost always ten times 75% of the statutory rate.

²⁰⁰ *See id.* at 219-20.

²⁰¹ *See* Armendariz, *supra* note 74, at 680.

²⁰² *See id.*

sitions,²⁰³ thereby diminishing *public* entertainment. Therefore, under California law, the strongest argument for the substantive unconscionability of the controlled composition clause is based on the grounds that it impermissibly waives a statutorily-created right.

With respect to controlled composition clauses, Omar Anorga bases his substantive unconscionability argument on an unpersuasive analogy to the arbitration provision at issue in *Graham*.²⁰⁴ In *Graham*, the California Supreme Court noted that California law expressly permits parties to an arbitration to freely agree to its proceedings by way of contract or otherwise.²⁰⁵ However, in holding it unconscionable, the court noted that the arbitration clause at issue did not satisfy the “minimum levels of integrity” required by the California Supreme Court because it was held to be an essentially “illusory” proceeding.²⁰⁶ Therefore, in order to support a finding of substantive unconscionability based on an analogy to *Graham*, controlled composition clauses would have to meet a significantly high burden of not possessing “minimum levels of integrity.”

5. Accounting

All artists must rely on their record labels to account for sales figures of a recording and the amount, if any, of royalties that are due.²⁰⁷ The standard major label recording agreement requires the record company to provide its artists with semi-annual royalty statements, outlining royalty payments due at that time.²⁰⁸ Once a royalty statement has been received, all artists are entitled to audit the record company’s books to verify the accuracy of the report.²⁰⁹ However, the terms of the agreement permit only one audit per year, per royalty statement,²¹⁰ and place other restrictions on the process.²¹¹

External pressures have forced major record labels to alter their accounting practices such that the bases for arguments contained in prior scholarship on the topic are no longer applicable.

²⁰³ See PASSMAN, *supra* note 43, at 201; Lydia Pallas Loren, *Untangling the Web of Music Copyrights*, 53 CASE W. RES. L. REV. 673, 681 (2003) (noting that Congress created a compulsory license for mechanical reproductions for the purpose of avoiding monopolization by the music industry).

²⁰⁴ See Anorga, *supra* note 11, at 766 (arguing that controlled composition clauses are analogous to the arbitration provision in *Graham* because the purpose of both is to avoid external judgment).

²⁰⁵ See *Graham*, 623 P.2d at 173-75.

²⁰⁶ See *id.* at 176.

²⁰⁷ See BRABEC, *supra* note 82, at 122-23; THALL, *supra* note 127, at 41.

²⁰⁸ See BRABEC, *supra* note 82, at 122-23.

²⁰⁹ See PASSMAN, *supra* note 43, at 149-50.

²¹⁰ See *id.* at 150.

²¹¹ Auditors may only examine the books at the record company’s regular place of business during normal business hours. See BRABEC, *supra* note 82, at 123.

In the past, contracts provided for a *one year* audit right from the date at which a statement *was to be rendered*.²¹² Currently, agreements grant artists the right to audit the company's books pertaining to a specific statement provided that an objection is made within *three years of sending or receipt* of such statement.²¹³ Moreover, record labels no longer place a time limit on or have the unilateral right to terminate the audit process.²¹⁴ Lastly, and perhaps most importantly, auditors are now given access to manufacturing records, which are crucial to the accuracy of the process.²¹⁵ These modifications have reduced, but not eliminated, the substantively unconscionable nature of accounting provisions.

While this process may on its face seem fair for both parties, in practice, these accounting provisions promote the underreporting of royalties to artists.²¹⁶ For most artists, the cost-prohibitive nature of auditing,²¹⁷ along with the likelihood that they are still indebted to their record label,²¹⁸ represents a substantial barrier to conducting audits of royalty statements. In addition, if an audit is conducted and unaccounted royalties are uncovered, artists must choose to either accept a reduced settlement²¹⁹ or bear the burden of necessary legal fees to challenge the accountings in court.²²⁰ Therefore, in the absence of any fiduciary duties to artists,²²¹ record labels have little incentive to verify the accuracy of their royalty statements. This is evidenced by the high percentage of underreporting found by some auditors²²² and the resulting, publicized lawsuits.²²³ Such a deterrent-less and one-sided struc-

²¹² See Anorga, *supra* note 11, at 768; Hall, *supra* note 11, at 208-09.

²¹³ See BRABEC, *supra* note 82, at 123. See also PASSMAN, *supra* note 43, at 150.

²¹⁴ See CAL. CIV. CODE §§ 2500-2501 (2008).

²¹⁵ See, e.g., Edna Gunderson, *Bye, Bye, a Piece of the Pie*, USA TODAY, May 16, 2004, available at http://www.usatoday.com/life/music/news/2004-05-16-royalties-main_x.htm. Cf. Corrina Cree Clover, *Accounting Accountability: Should Record Labels Have a Fiduciary Duty to Report Accurate Royalties to Recording Artists?*, 23 LOY. L.A. ENT. L. REV. 395, 418 (2003); Hall, *supra* note 11, at 208-09.

²¹⁶ See Clover, *supra* note 215, at 419.

²¹⁷ The typical audit costs approximately fifty-thousand dollars. Chuck Philips, *Auditors Put New Spin on Revolt Over Royalties*, L.A. TIMES, Feb. 26, 2002, at A15.

²¹⁸ See *supra* Part III(B)(2).

²¹⁹ See Philips, *supra* note 217, at A15.

²²⁰ See *id.*

²²¹ See, e.g., *Cusano v. Klein*, 280 F. Supp. 2d 1035, 1040-41 (C.D. Cal. 2003) (holding that a music publishing company's contractual duties to collect, account for, and pay royalties do not create a fiduciary relationship among the parties); *Cooper v. Sony Records Int'l*, 2001 U.S. Dist. LEXIS 16436, at *18-19 (S.D.N.Y. 2001) (noting that courts in the Southern District of New York have routinely refused to recognize a fiduciary relationship between a recording artist and a record company).

²²² One industry insider estimates that over 99% of audits find that the record label has underpaid the artist. See Neil Strauss, *Behind the Grammys, Revolt in the Industry*, N.Y. TIMES, Feb. 24, 2002, available at <http://query.nytimes.com/gst/fullpage.html?res=9406E1DC113EF937A15751C0A9649C8B63>.

²²³ The Dixie Chicks, Meatloaf, the Beatles, and the Ronettes have received large settle-

ture unreasonably favors the record label, justifying the conclusion that these accounting provisions are substantively unconscionable under New York law.

By contracting around public policy determinations, the one-sidedness of accounting provisions found in the standard major label recording agreement has the ability to “shock the conscience.” Once a cause of action has accrued, a party is legally permitted to file a claim at any point within the applicable statute of limitations prescribed by state law.²²⁴ In the context of contracts, the California State Legislature has provided for a four year statute of limitations.²²⁵ Nonetheless, the standard major label recording agreement imposes a statute of limitations for an artist’s breach of contract claim due to underpayment of royalties of, at the most, three years.²²⁶ This unilaterally-created statute of limitations disregards valid public policy,²²⁷ determined after balancing the interest of sufficient notice of a breach of contract with the interest of parties to be free from litigation of stale claims. Under California law, parties are free to agree upon a shorter statute of limitations, but the time period must be sufficiently reasonable so as not to lead to imposition or undue advantage.²²⁸ Thus, whether the shortened statute of limitations for challenging royalty statements is unreasonable and, therefore, substantively unconscionable under California law is an issue decided on a case-by-case basis, keeping in mind that they are to be construed with strictness against the invoking party.²²⁹

IV. ANCILLARY RIGHTS / “360-DEGREE” DEALS

360-degree deals (“360 deals”) expand the scope of standard major label recording agreements to encompass everything that an artist or band holds rights to and, thus, can potentially earn revenue from.²³⁰ While it has yet to become the standard form, 360 deals are increasingly being employed by the major record labels when contracting with new artists.²³¹

ments as a result of filing claims against their record labels for underpaying royalties. *See* Clover, *supra* note 215, at 395-97.

²²⁴ CAL. CIV. PROC. CODE § 312 (2007).

²²⁵ *Id.* § 337.

²²⁶ *See* PASSMAN, *supra* note 43, at 149-50; THALL, *supra* note 127, at 180.

²²⁷ California has a four-year statute of limitations for actions based on a contract. CAL. CIV. PROC. CODE § 337 (2007).

²²⁸ *See* Capehart v. Heady, 206 Cal. App. 2d 386, 388 (1962).

²²⁹ *Lewis v. Hopper*, 140 Cal. App. 2d 365, 367 (1956) (basing its holding on the fact that “contractual stipulations which limit the right to sue to a period shorter than that granted by statute, are not looked upon with favor because they are in derogation of the statutory limitation”).

²³⁰ *See* Steve Knopper, *Reinventing Record Deals*, ROLLING STONE, Nov. 29, 2007, at 13.

²³¹ Rolf Schmidt-Holtz, the chief executive officer of Sony BMG, was quoted in an interview as stating that, as of March 24, 2008, Sony BMG had 252 artists contractually bound to 360 deals. Eliot Van Buskirk, *Sony/BMG Supports Unlimited Music, Says Profits Rose 15 Percent*,

In late 2007, the *New York Times* described a 360 deal offered to a band by Atlantic Records, a subsidiary of Warner Music Group.²³² Once the first album had been released, the record label had the unilateral option to receive an interest²³³ in all net income derived from touring, merchandising, fan-club fees, and endorsements.²³⁴ The label would also be given final decision-making rights in conjunction with these ancillary areas such as tour schedules and merchandise expenses.²³⁵ Under most 360 deals, the record label and artist also share publishing rights for the compositions recorded under the agreement.²³⁶ Therefore, with respect to controlled compositions, labels will derive half of the net income received by the artist from commercial licensing, including uses in commercials, television, and movies, as well as monies received pursuant to mechanical and public performance licenses. In exchange, the record label is only obligated to pay the artist a larger advance.²³⁷

In their current state, these additional terms are unreasonably favorable and thus, impermissibly enhance the already substantively unconscionable nature of the standard major label recording agreement. As a whole, 360 deals confer major record labels a substantial financial interest in areas of artists' careers in which they are neither actively involved nor provide any services. Moreover, co-publishing provisions transfer to the record labels fifty percent of the ownership in the copyright of applicable musical compositions.²³⁸ As a result, despite lack of success or inadequate support during the term of the agreement, labels are able to financially exploit a recording long after the contractual relationship with an artist has ended.

Despite the fact that record labels are not engaged in the business of concert promotion,²³⁹ touring provisions found in 360 deals require artists to share these revenues with their labels. The major labels have justified such an interest on the grounds that they should be entitled to share in the profits that are created, at least in part, by the distribution and marketing of records funded

WIRED, Mar. 26, 2008, available at <http://blog.wired.com/music/2008/03/sonybmgsupport.html>.

²³² See Leeds, *supra* note 9.

²³³ Under Atlantic's contract, the label's interest is equal to thirty percent. *Id.*

²³⁴ See *id.*

²³⁵ See *id.*

²³⁶ See Knopper, *supra* note 230, at 14; Susan Butler, *Music Biz Lawyers Wary of Label's New Grab*, REUTERS UK, Dec. 29, 2007, <http://uk.reuters.com/article/industryNews/idUKN2849012220071229> (last visited Dec. 3, 2008).

²³⁷ Leeds, *supra* note 9.

²³⁸ See BRABEC, *supra* note 82, at 65.

²³⁹ See Butler, *supra* note 236 (quoting Elliot Groffman, an attorney who represents large touring acts such as the Dave Matthews Band and Pearl Jam).

by the companies.²⁴⁰ However, major labels are able to profit from an act’s live performance success²⁴¹ despite the possibility that the recording, for which the labels actually provide their services, does not sell well. Alternatively, prior to having a hit record, many artists’ tours are minimally profitable.²⁴² Since artists often earn nothing from record sales,²⁴³ permitting the record label to share in potentially miniscule profits significantly reduces what is likely to represent the new artists’ only source of income.²⁴⁴ Therefore, the addition of a touring interest into the standard major label recording agreement favors the record label sufficiently to satisfy the unreasonable standard set forth in *Gillman*.

Likewise, the one-sidedness of the provisions comprising the 360 deal arguably “shocks the conscience.” The exigencies of the concert industry, being far different from those of the recording industry, require those commercially involved in it to remain closely informed about their consumers.²⁴⁵ However, despite retaining final decision-making rights on all touring issues under the current 360 deal, at present, major labels do not employ adequate personnel with expertise in the concert industry.²⁴⁶ Equally troubling, there have also been serious concerns about the major labels’ ability to understand the nuances of merchandising.²⁴⁷

Whereas in the past, the major record labels were able to define popular music, the advent of digital technology has empowered consumers to dictate success in the music industry.²⁴⁸ The major labels’ retention of final-decision making rights on all re-

²⁴⁰ See, e.g., Knopper, *supra* note 230, at 13 (quoting RCA’s general manager, Tom Corson).

²⁴¹ Many artists can profit from touring due to word-of-mouth buzz either prior to a major record release or despite continuously poor sales of such. See, e.g., David Carr, *A Qualified ‘Yeah’ to Fame*, N.Y. TIMES, Dec. 30, 2005, available at <http://www.nytimes.com/2005/12/30/arts/music/30clap.html>; Mim Udovitch, *Music; The Final Word on Phish*, N.Y. TIMES, June 13, 2004, available at <http://query.nytimes.com/gst/fullpage.html?res=9B0DE6DD1630F930A25755C0A9629C8B63>.

²⁴² See Butler, *supra* note 236.

²⁴³ See *supra* Part III(B)(2).

²⁴⁴ See Regis Behe, *Recording Industry Wants a Bigger Share of the Pie*, PITTSBURGH TRIBUNE-REVIEW, Jan. 20, 2008, available at http://www.pittsburghlive.com/x/pittsburghtrib/living/s_547967.html (arguing that merchandising and touring represent the majority of most artists’ incomes, therefore, sharing even a small amount of those profits can be extremely damaging to their finances).

²⁴⁵ See KUSEK & LEONHARD, *supra* note 180, at 116 (distinguishing the nature of the concert and recording industries).

²⁴⁶ See Butler, *supra* note 236 (quoting Elliot Groffman).

²⁴⁷ See *id.* (quoting Gary Gilbert, entertainment partner at Manatt, Phelps, & Phillips, giving an example of how business affairs personnel were uneducated on merchandising issues).

²⁴⁸ See KUSEK & LEONHARD, *supra* note 180, at 26-27 (arguing that whereas in the past radio stations mass-marketed recordings to the public, consumers are able to use the Internet as a more convenient way to discover new music on their own).

ording, touring, merchandising, and publishing activities forces artists, and ultimately their creative endeavors, to be subject to the complete control of their record label. This micromanagement is disadvantageous because it gives record label executives the power, rather than those more familiar with the particular demands of their respective industries, to affect numerous matters that have historically influenced artists' relationships with their fans.²⁴⁹

Additionally, the notion that 360 deals benefit the artists by forming a true partnership²⁵⁰ can prove to be illusory. While it is true that the resulting relationship satisfies the traditional definition of a partnership,²⁵¹ under this new type of agreement, the complete sacrifice of control to one party violates an important principle of partnership law.²⁵² Such unilateral control is rendered more significant when one considers the different incentives of the parties to the agreement.²⁵³ Major record labels are large corporations whose agents most likely have other incentives such as maximizing profits and shareholder value. On the other hand, artists might be more concerned with their reputation or artistic credibility. Each party's right to control is still subject to contrary agreement;²⁵⁴ thus, 360 deals are not in violation of partnership law. However, the lack of mutual control over artists' careers is evidence of the one-sidedness of 360 deals that should "shock the conscience."

²⁴⁹ Eliot Van Buskirk, *Radiohead Makes Business Plans the New Punk Rock*, WIRED.COM, Dec. 12, 2007, http://www.wired.com/entertainment/music/commentary/listeningpost/2007/12/listeningpost_1210 (last visited Feb. 3, 2009) (quoting Nate Krenkel, partner at Team Love, an independent record label).

²⁵⁰ See Gil Kaufman, *If the Old Music Business is Dead, What's Next?*, MTV.COM, Dec. 19, 2007, <http://www.mtv.com/news/articles/1576838/20071219/paramore.jhtml> (last visited Feb. 3, 2009).

²⁵¹ "A partnership is the association of two or more persons to carry-on as co-owners a business for profit." Revised Unif. P'ship Act § 101(6) (2007).

²⁵² Joint participation in the management and control of the subject matter is central to the formation of a partnership. See 1 ALAN R. BROMBERG & LARRY E. RIBSTEIN, *BROMBERG & RIBSTEIN ON PARTNERSHIP* § 2.07(c)(1) (1988). See, e.g., *Tuxedo Beach Club Corp. v. City Sav. Bank*, 749 F. Supp. 635, 646-47 (N.J. 1990) (holding control over the subject matter as an element of a partnership); *Chariton Feed & Grain, Inc. v. Harder*, 369 N.W.2d 777, 786 (Iowa 1985) (holding co-ownership of control to be a "key element in determining the existence of a partnership"); *Weingart v. C. & W Taylor P'ship*, 809 P.2d 576, 578-79 (Mont. 1991) (holding that, in order for a partnership to exist, "each party must have a right of mutual control over the subject matter of the enterprise").

²⁵³ Agencies that have traditionally handled the aspects of an artist's career now encompassed by a 360-degree deal are considered to have more respect for artists' interests than major record labels. See *A Change of Tune*, THE ECONOMIST, July 5, 2007, available at http://www.economist.com/business/displaystory.cfm?story_id=9443082.

²⁵⁴ See BROMBERG, *supra* note 252, at § 2.07(c)(2).

V. CONCLUSION

A wave of fear and uncertainty has gripped the recording industry. Many involved are concerned with the possibility that societal perception may be shifting towards a view of recorded music as a free commodity. The major record labels, through the R.I.A.A., have been engaged in a lengthy and costly battle to prevent such a shift but have yet to see many tangible improvements. Furthermore, instead of focusing their efforts on the development of new business models, the major record labels have been touting the new 360 deal as a means to offset declining profit margins and jump-start artists’ careers in the process.²⁵⁵

Despite advances in technology that make it substantially easier to utilize an independent or do-it-yourself approach,²⁵⁶ the likelihood of new artists achieving widespread commercial success remains much higher when supported by a major record label.²⁵⁷ Therefore, an absence of meaningful choice is still present in the music industry today. The incorporation of the 360-degree model into the standard major record label recording agreement only produces a more substantively unconscionable result for recording artists. While financial and career constraints prevent recording artists from judicially challenging these contracts, universal adoption of the 360 deal could eliminate the insulation enjoyed by the “Big Four.” The major record labels should reconsider the inclusion of new artists’ ancillary rights into the standard recording agreement or risk legal invalidation of their contracts.

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²⁵⁵ See Knopper, *supra* note 230, at 13-14; Leeds, *supra* note 9.

²⁵⁶ See BURKART & MCCOURT, *supra* note 76, at 131-32.

²⁵⁷ See *id.* See also Sloan, *supra* note 97; Veiga, *supra* note 97.

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