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DECISION OF NOTE

'Purchaser' Didn't Include Disney Subsidiaries

The California Court of Appeal, Second District, decided that the term "Purchaser" in an agreement for "Walt Disney Productions" to purchase rights in the novel "Who Censored Roger Rabbit?" and its characters didn't apply to Disney's subsidiaries. *Wolf v. Walt Disney Pictures and Television*, BC251199.

Book author Gary Wolf sued Disney, claiming underpayment of royalties from merchandising uses of characters from the movie "Who Framed Roger Rabbit," which was based on Wolf's novel. A jury determined in part that Disney owed Wolf monies earned from merchandising sales by Disney subsidiaries.

But the Court of Appeal found that the trial court erred in allowing the jury to interpret the meaning of "purchaser." "Absent a conflict in the evidence, the interpretation of the contract remains a matter of law," the court noted. "Here, the meaning of the term 'Purchaser' was not dependent on the credibility of conflicting extrinsic evidence."

The court then noted that the clause in the rights-purchase agreement that addressed Wolf's royalties from character exploitations and licenses specifically gave him payment from three different sources, one of which was from Disney subsidiaries. The court explained: "When the parties intended to identify 'subsidiaries,' they knew how to do so.

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Commentary

Favored-Nation Clauses: Live Nation's Expansion Into 360-Degree Deals with Artists

By Paul Menes

Like a lot of you, I've been watching the major record labels try unsuccessfully for some time to replace the CD and revamp their business model. Napster launched and didn't go away, instead chipping away at — and eventually crumbling — the labels' foundations. Many artists and employees, some friends and colleagues among them, lost their jobs in a shrinking industry.

QUICKER RETURN

Artist development, always a major component of a label's value (and eventually, a valuable catalogue), became almost non-existent. The major labels are no longer run by true music men and women, the kind of visionaries, mavericks and dreamers — like Sam Phillips, Jerry Wexler, Berry Gordy, Chris Blackwell, the Ertegun brothers and Clive Davis, among others — who built an industry from scratch into an innovative and creative cultural force.

The majors' current deals reflect their need to find new and much quicker sources of revenue, by taking portions of artists' touring and merchandising monies as a condition of signing them, and consolidating or merging with other record companies to achieve "economies of scale" in their back-office activities. The labels' financial reports and share prices show a lack of success so far.

On the other hand, I think the 10-year deal that concert-industry giant Live Nation just closed with Jay-Z is brilliant. It builds on Live Nation's groundbreaking deal with Madonna and reinforces its unique position to make these deals profitable. Madonna's reported $120 million deal with Live Nation caught my attention when announced — not because of the huge number, not because it was yet another try to create a viable "360-degree" deal model, and not because I thought CEO Michael Rapino was trying to put his stamp on Live Nation with a big, splashy deal and quickly justify the huge employment deal he received. What got my attention was that Live

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Motion for its own benefit and that the Debtor might resist paying Windels based upon the deferral agreement," the judge wrote. "By not advising its client, and not disclosing this to the Court, Windels was able to use the Interim Comp Order to try to override its agreement to defer compensation."

The judge said Windels Marx's desire to be paid may have influenced the proceeding in other ways. Noting that the firm had taken no steps to include affiliated entities of Source in the bankruptcy, Gonzalez said he found it compelling that Windels Marx was a creditor of at least one of these affiliates, whose debt it intended to pursue.

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Nation had something no record company or any other entertainment company doing 360-type deals had: ownership and control over most of the revenue-generating elements in this deal, and the consequent ability to package, cross-promote, cross-collateralize and otherwise leverage them off one another in an unprecedented fashion to maximum effect. Live Nation's whole was far more valuable then the sum of its parts.

Jay-Z Ideal for 360 Deal

Jay-Z and Live Nation are a perfect match for each other. They have both done well in myriad similar businesses. Live Nation's ownership, expertise and financial clout in the areas of touring, concert promotion, merchandising and ticketing, to name a few, give Jay-Z a larger canvas to paint on where he's already been extremely successful. Jay-Z got more (a reported $30 million more) than Madonna. But it seems justified for many reasons.

Jay-Z's entrepreneurial efforts have been far broader and arguably more successful than Madonna's. It was reported that Madonna's fashion line earned more than $20 million in its first year. Madonna turned Maverick, her Warner Bros.-financed "vanity" label, into a very successful one for her and Warners. Jay-Z started his Roc-A-Fella empire from scratch and out of his own pocket, initially as a record label to distribute his recordings. He grew it into a hugely successful conglomerate. Roc-A-Fella Records became a viable label. His Rocawear clothing line practically defined hip-hop style; he reportedly sold it for $204 million. He reinvigorated Def Jam Records when he took over as President/CEO. He's discovered new and important talent, such as Kanye West, Young Jeezy and Rihanna. He's expanded into nightclubs ("40/40"), sports (as co-owner of the New Jersey Nets) and spirits distribution.

These achievements surely formed the basis for Live Nation's reported $50 million commitment ($5 million per year for five years and another $25 million for acquisitions) to fund Roc Nation, a new joint venture with Jay-Z for his outside projects — and from which Live Nation will supposedly split profits. As the saying goes, "past performance is no guarantee of future success." However, Jay-Z's track record as an entrepreneur should make this investment as close to a sure thing for Live Nation as there is.

Live Nation is to pay Jay-Z an additional $10-million advance per album, to record three albums during his deal's 10 years. While less than the three-million U.S. units sold of his previous "Black Album," "American Gangster," released last year, has sold more than one-million U.S. units to date — a significant accomplishment in these days of plummeting CD sales and rampant piracy.

The structure of the Live Nation/Jay-Z deal makes it clear Live Nation believes that Jay-Z, like Madonna, will generate far more revenue from touring, merchandising, endorsements, clothing and other activities than from record sales. In fact, Michael Cohl — Live Nation's chairman and CEO of its Live Nation Artist — stated that an increase in Jay-Z's record sales is not necessary for this deal to be profitable.

Paying Jay-Z a reported separate $25 million advance for touring may also seem high. After all, Jay-Z, like most hip-hop artists, has a reputation for not being a very frequent or successful touring artist. However, he's indicated an intention to tour more. Reports from his current tour with Mary J. Blige put revenues as of May at $9.1 million, with projected revenue of $33 million. The tour's reviews have been as sterling as its income. Of course, this won't recoup Live Nation's $25 million advance, but it doesn't have to. Just on the touring side, Live Nation is the tour's promoter and owns many of the venues (giving them additional revenue ranging from parking to concessions), a lot of the ticketing and Jay-Z's merchandising. Moreover, Live Nation is also acquiring a portion of Jay-Z's publishing, licensing and other so-far unnamed rights as part of this deal, to further hedge its calculated bet on him.

Critics Missing Point

Critics have had much to say about these Live Nation deals. The deals have been characterized as expensive retirement packages for over-the-hill artists. This obviously ignores the multifaceted successes of artists like Jay-Z and Madonna, and their viability as touring artists and cultural icons, none of which appears to be waning. The critics have highlighted the approximately $12 million loss suffered by Live Nation last year as an indication that these types of deals don't work. However, start-up businesses and established ones using different systems or formulas are expense-heavy at the beginning. Considering the money Live Nation has spent to date, and the progress it continues to make towards profitability, $12 million isn't high, nor does the loss seem to predict the future.

Critics have also said that Live Nation's model can only work, if at all, with superstar-level artists. While this may be correct given the

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Focusing on Issues In Artist/Label 360-Degree Deals

By Paul Menes

One could argue that the concept of the "360-degree deal" harkens back to the record business of the 1950s and 1960s. Then, labels would commonly provide integrated A&R, publishing, management and promotional services to their artists, as well as put them out on tours with their label mates. But today's 360 deals are substantially different. Generally, a 360 deal has a label participating in revenue streams outside of its traditional business of manufacturing and distributing recordings. These deals now include some label financial participation — with or without business participation — in an artist's touring, merchandise, publishing, Internet/fan club and non-music digital content revenues such as wallpaper and voicetones.

Major considerations in artist/label 360 deals include:

- **The Nature of the Deal.** These deals can vary from a traditional record company structure based on a per-unit artist royalty, to formation of a new partnership or joint venture-type entity between label and artist with various degrees of ownership, control, approvals, and/or reversion of rights to the recordings, merchandise, publishing and other deal elements. Revenues are usually split on a "net" basis between the artist and label. These revenue splits can change at certain sales or revenue benchmarks overall, or per revenue stream. Another consideration is how actively the label will participate in the deal. Will the label be only a "passive" partner, merely insisting on multiple revenue-stream participation as a condition of entry into the deal with the artist? Or will the label be providing material input into the artist's merchandise, touring and sponsorship endeavors? Will the label serve any type of personal-management function? Does the label have any experience or abilities in any of these areas?
- **Cross-Collateralization.** The relationship between the various revenue streams, their advances and how the artist and label split these revenue streams needs to be addressed. For example, how do the various revenue streams' advances and expenses get recouped? Are some or all revenue streams cross-collateralized?
- **Handling "Traditional" Label Deal Concepts**. These include such items as mechanical royalties, record and release commitments, tour support, videos, album/master cycles, recording commitments and recording procedures.
- **Label "Commission."** Some labels want a management-type commission on one or more of the 360-deal revenue streams, such as publishing, touring and sponsorships. This is in addition to the label's other revenue participation in these streams. These commissions can be based on either a "gross" or a "net" calculation, after deduction of certain costs and expenses "off the top."
- **Artist's Existing Deals**. The parties need to address whether the artist already has merchandise, sponsorship, publishing/administration, personal-management and/or tour-promotion deals already in place.
- **Artist Cash Flow and Living Expenses.** Because the label is getting portions of advances and revenues that traditionally go to the artist, the parties need to address how the artist's cash-flow and living-expense needs will be accommodated under the 360 deal. Will the artist be receiving a monthly or weekly "salary"? Is all or a part of it considered an advance against one or more of the artist's revenue-stream splits? Is it derived from certain revenue splits or from a "pot" of all revenues? Is it paid "off the

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financials of the Jay-Z and Madonna deals and the finite number of current, multi-faceted superstar artists, it completely misses the point of the positive effect these deals can have in attracting younger artists to Live Nation. Younger artists today tend to be far more entrepreneurial and business-savvy than their predecessors, largely because of their ability to manage and further their careers via the Internet and social-networking sites. Live Nation's deals with Jay-Z and Madonna can show younger artists how they should think about plotting their careers going forward. Given a choice between ceding a portion of touring, merchandise and likely other revenue streams to a record company with no experience or direct involvement in these areas (the latter may be a benefit for artists) and to a company like Live Nation that both owns successful companies in these areas and has the expertise and incentive to back it up, a company like Live Nation seems the obvious choice.

Moreover, promoting tours in which a young artist can open for more established acts and owning so many venues of different sizes gives Live Nation a unique ability to break a new artist in the most effective manner: allowing an artist to build an audience by playing live. Deals with young artists would obviously be far less expensive and the new recordings component more valuable. A young artist's potential for selling records should only increase over time, to Live Nation's direct benefit.

And the major record companies? They can't replicate this without many expensive acquisitions or mergers; nor, at least to date, have they come up with another model with the potential financial success of these Live Nation deals. However, the dust seems to be starting to settle and labels appear more willing to try and embrace new ways of doing business. Ironically, Live Nation signing established artists like Jay-Z and Madonna can help the majors — by making their catalogs more valuable and giving them an opportunity to prove that the "long tail" works and helps their bottom lines.

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360-Degree Deals

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top" or on some type of "net" basis? Does it come out of any of the label's revenues? Is all or part of it recoupable? If so, when and by whom?

- **Artist and Label Strengths and Weaknesses**. These overriding factors can greatly influence how various revenue streams are split between the parties. An artist with proven strength in certain areas (*e.g.*, touring, merchandise, Web site sales) and/or an existing quantifiable fan base can govern the value of certain revenue streams and foster an argument for disproportionate treatment between revenue streams. So can a label's expertise and ability to add value, or the lack thereof, in certain revenue-stream-related areas.

There are also several issues to consider that are specific to certain revenue streams:

- **Merchandise**. These rights are usually exclusive to the label or venture. The rights could distinguish between tour and other, retail merchandise, have different splits for each, or exclude one or more types of merchandise from the deal. They can also be limited to certain specific designs that currently exist and/or are later created. Some deals can designate the record label as the artist's exclusive licensing agent for the artist's various trademarks, both related and unrelated to recordings made under the deal. Some deals only include a split of this revenue, and some exclude any licensing component or revenue participation.
- **Publishing.** Some labels, indies and majors both, have traditionally required artists to part with some of their publishing, to sign with the label's affiliated publishing company and/or to grant the label exclusive administration rights, primarily for compositions recorded during the term and for a defined period of time. These publishing components are also a desired standard in a 360 deal. Considerations here involve: whether the label obtains a part-ownership interest in the artist's existing and/or new musical compositions written during the deal's term; if so, is there any reversion of same and/or the label's portion of its income and if so, when; the handling of administration obligations and fees; how mechanical and controlled composition rates and "caps" are set or changed based on the level of label involvement on the business component attached to these; whether the artist accounts to the label for some or all publishing-derived revenues, if the label's more of a passive revenue participant; and the handling of the artist's new-composition delivery requirements and its affect on the artist's "recorded and released" obligations. Revenue splits may also vary based on certain circumstances, such as whether the label or the artist procures a synchronization license. Certain categories of placements can also be excluded from label participation.
- **Touring**. A tour-support commitment should still exist in a 360 deal. But the nature and amount of the tour-support commitment can be based on different criteria than in a traditional artist/label deal. For example, a label's participation and tour revenue can begin and/or end at certain revenue benchmarks. It can also vary or change depending on sponsorship procurement and/or financial participation in the tour and whether one or more of these sponsorships was procured by the label or the artist.
- **Sponsorship.** Many of these issues are similar to those involved in merchandising, such as who procures a sponsor, whether the sponsorship is tour-related or tour-exclusive, and whether it stems from a song placement.

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'Purchaser'

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Moreover, if 'Walt Disney Productions' includes subsidiaries, ... it would include a subsidiary 'licensing' itself to utilize the Roger Rabbit characters, a meaningless concept. ... On remand the trial court must reassess the damages awarded to Cry Wolf to the extent they were dependent on the erroneous interpretation of that contract term."

Among the other appellate findings in the case, the court upheld a directed verdict for Disney on Wolf's cause of action of breach of implied covenant of good faith and fair dealing. A clause in the rights-purchase agreement stated: "Purchaser shall not be under any obligation to exercise any of the rights granted to Purchaser hereunder; and any and all said rights may be assigned by Purchaser, and/or licenses may be granted by Purchaser with respect thereto, as Purchaser may see fit."

The court of appeal emphasized: "At trial, Cry Wolf [Gary Wolf's company] argued that, if the term 'gross receipts' [in the rights-purchase agreement] was intended to mean only monetized benefits received by Disney in exchange for licensing the Roger Rabbit franchise, then Disney breached the implied covenant of good faith and fair dealing by purposefully orchestrating promotional agreements for which it received no monetary consideration. ... Contrary to Cry Wolf's contention, there were no disputed factual issues for the jury to decide. The question was not what Disney did, but whether it was authorized by the parties' agreements to do it. In light of Disney's unfettered discretion under the 1983 Agreement to license or not license the Roger Rabbit franchise as it 'saw fit,' Cry Wolf's attempt to limit that discretion by use of an implied covenant, a pure legal question of contract interpretation, is improper."

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