

## Breaking Up is Hard to Do



The California Labor Code contains a “Seven-Year Statute” that restricts most service contracts to a maximum of seven years. It is the only state that sets a time limit on labor contracts.<sup>1</sup> In a famous 1944 case, *De Haviland v. Warner Brothers*, the California Supreme Court decided that the California Labor Code prohibited the enforcement of any clauses in labor contracts that effectively extended service obligations beyond seven calendar years. In 1987 the recording industry lobbied for and obtained a specific exemption for recording contracts. It is contained in Section 2855, paragraph B, of the California Labor code. Paragraph B allows recording companies to sue an artist for lost profits on any undelivered albums specified in the contract.<sup>2</sup> Since recording contracts typically specify a number of albums rather than years of service, this special right given recording companies effectively extends the artist’s obligation beyond the seven-year limit. This exemption is specifically restricted to contracts covering recording artists; the exemption is not available to any other class of workers.

The Recording Industry Association of America (RIAA), a trade association for recording companies, argues that long-term contracts are necessary for the efficient functioning of the recording industry. The RIAA claims that its members lose money on 90% of the contracts they sign.<sup>3</sup> New groups require hefty investments in promotional investments. Only by making an adequate return on the few artists that become successful, can they afford to promote new and emerging artists. If contracts are limited to seven years, successful artists could postpone delivering new albums until after the contract has expired. The RIAA claims that the additional financial risk accompanying term limited contracts would force companies to cut back on the number of new artists they sign and to limit promotional investments in new artists.

The Recording Artists Coalition (RAC), an organization consisting of several prominent recording artists has mounted a campaign to eliminate the special exemption for recording contracts. They argue that powerful recording companies force naïve young artist into long term contracts. Unknown new artist have little leverage when negotiating their first contracts with recording companies. The contracts typically hold these artists to multi-album deals. Later when these artists are successful they find themselves locked into highly unfavorable contracts. They are forced to deliver albums for lower royalties than they could earn in an unconstrained market. It is common for these contracts to require the delivery of six to eight albums. This usually takes far more than seven years

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<sup>1</sup> Jennifer Ordoñez, “Artists Seek to Ease Recording-Pact Law,” *Wall Street Journal*, (February 25, 2002).

<sup>2</sup> It is unclear whether damages are based upon investment in the artist or speculative profits on the undelivered albums. The speculative profits on the undelivered album would exceed the royalties paid to the artist.

<sup>3</sup> For an interesting article on failed investments in the recording industry see Jennifer Ordoñez, “Pop Singer Fails to Strike a Chord Despite the Millions Spent by MCA,” *Wall Street Journal*, (February 26, 2002).

to deliver, since it is typically not possible to produce and promote more than one album a year.

Don Henley, songwriter for the Eagles, is a prominent spokesman for the RAC. He claims that under present law artists are no more than “indentured servants” to the powerful media conglomerate. Efforts to amend changes in the law with SB 1246 have so far been successfully defeated by the California Music Coalition, an anti-amendment lobbying group formed in 2001. In August 2004 the bill was withdrawn from consideration by its author, Senator Murray.

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## Questions

1. Is there an economic rationale for limiting the duration of labor contracts? If so, why should recording contracts be exempt as they are under present law?
2. Does the proposed law increase rights or decrease rights? Can a limit on your ability to contract enhance social welfare? What rights are expanded and what rights are contracted?
3. How do the proposed changes in the law redistribute welfare? Consider the redistributive effects between recording companies and artists, and between beginning artists and established artists?
4. The incentive to invest will depend on risk and expected return. How does the proposed seven year limit affect the incentive to invest in new artists? Would this have an impact on the demand for established artists? Are established artists and new artists substitute inputs?
5. There is a related question of optimal timing. When does a new artist sign a recording contract? A new artist may delay signing a recording contract if he or she expects a better offer in the future. Would the seven year limit affect the optimal signing time?
6. Would you be more likely to favor a seven year limit on recording contracts if the recording industry were high concentrated in a few companies? Would the new law have any impact on competition in the recording industry?
7. Suppose that California was the only state to limit recording contracts to seven years? What impact would this have on the recording industry in California?
8. Supposed you signed a contract with a college to pay for your education, the college took a certain percentage of you future income. Would that be a fair or efficient contract? How would this differ from a long-term recording contract?

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## Related Articles

“Note: California Labor Code Section 2855 And Recording Artists' Contracts,” Harvard Law Review, Jun2003, Vol. 116 Issue 8, p2632, 22p

## **California Labor Code, Section 2855.**

- (a) Except as otherwise provided in subdivision (b), a contract to render personal service, other than a contract of apprenticeship as provided in Chapter 4 (commencing with Section 3070), may not be enforced against the employee beyond seven years from the commencement of service under it. Any contract, otherwise valid, to perform or render service of a special, unique, unusual, extraordinary, or intellectual character, which gives it peculiar value and the loss of which can not be reasonably or adequately compensated in damages in an action at law, may nevertheless be enforced against the person contracting to render the service, for a term not to exceed seven years from the commencement of service under it. If the employee voluntarily continues to serve under it beyond that time, the contract may be referred to as affording a presumptive measure of the compensation.
- (b) Notwithstanding subdivision (a):
- (1) Any employee who is a party to a contract to render personal service in the production of phonorecords in which sounds are first fixed, as defined in Section 101 of Title 17 of the United States Code, may not invoke the provisions of subdivision (a) without first giving written notice to the employer in accordance with Section 1020 of the Code of Civil Procedure, specifying that the employee from and after a future date certain specified in the notice will no longer render service under the contract by reason of subdivision (a).
  - (2) Any party to such a contract shall have the right to recover damages for a breach of the contract occurring during its term in an action commenced during or after its term, but within the applicable period prescribed by law.
  - (3) In the event a party to such a contract is, or could contractually be, required to render personal service in the production of a specified quantity of the phonorecords and fails to render all of the required service prior to the date specified in the notice provided in paragraph (1), the party damaged by the failure shall have the right to recover damages for each phonorecord as to which that party has failed to render service in an action which, notwithstanding paragraph (2), shall be commenced within 45 days after the date specified in the notice.