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The Strong Getting Stronger: Record Labels Benefit from Proposed Changes to the Bankruptcy Code

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THE STRONG GETTING STRONGER: RECORD LABELS BENEFIT FROM PROPOSED CHANGES TO THE BANKRUPTCY CODE

I. INTRODUCTION

On January 23, 1998, recording artist Toni Braxton filed for Chapter 7 Bankruptcy and rattled the recording industry. In the five years prior to her bankruptcy petition, her albums sold an estimated fifteen million copies worldwide. Based on her album sales, it was not apparent that she needed bankruptcy protection.

However, the recording industry’s interest in Braxton’s bankruptcy did not focus on her financial difficulties. Under current bankruptcy law, recording artists such as Braxton are able to terminate their recording contracts after filing for bankruptcy in good faith. As a result, suspicious industry insiders have suggested that Braxton intended to escape what she believed to be an inequitable contract with LaFace and Arista Records. Braxton’s supporters, however, cite her claimed 2.8 million dollars of debt as proof that her filing was legitimate and in good faith.

Bankruptcy law has historically provided a “safe harbor” for the indigent and financially destitute. For some, however, bankruptcy has evolved into an integral part of doing business. For example, bankruptcy is commonly used as a means for quickly settling controversies, a method

1. Toni Braxton, a five time Grammy winner, is a renowned pop music singer whose hits include “Breathe Again” and “Unbreak My Heart.” Degen Pener, A Star is Broke, ENT. WKLY., Feb. 20–27, 1998, at 72, 74.
3. See supra note 2, at 80.
5. See supra note 1.
6. See supra note 4, at 375.
7. See supra note 2, at 80.
8. See supra note 3.

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of acquiring leverage in negotiations, and even as an alternative to litigation.\(^9\)

Similar to other businesses, the recording industry has felt the impact of increased bankruptcy filings.\(^0\) Recording artists have increasingly used bankruptcy to escape their obligations under their recording contracts.\(^1\) These recording artists allege that in initial negotiations, they often lack the leverage necessary to alter the recording contract provisions demanded by record labels.\(^2\) Moreover, due to these unfavorable contract terms, artists argue they are unable to sufficiently reap the benefits of increased popularity.\(^3\) Therefore, recording artists believe bankruptcy is a just and proper means to relieve the financial difficulties resulting from these unfavorable agreements.\(^4\)

After the increase in artist bankruptcies, recording labels realized that artists had an effective means to escape their recording contracts.\(^5\) Record labels contend that it is unfair for recording artists to terminate their contractual obligations by merely filing for bankruptcy.\(^6\) Consequently, the concerns of the record labels set in motion a congressional lobbying effort to prevent recording artists from rejecting their contracts through bankruptcy.\(^7\)

The proposed Consumer Bankruptcy Reform Act\(^8\) drafted by the 104th Congress contained a specifically targeted provision effectively eliminating recording artists' ability to relieve themselves of recording

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10. See Morris, supra note 2, at 80.
13. See Pener, supra note 1, at 74–75. Braxton's management claims that her initial recording contract yielded a mere three percent of her $170 million gross record sales after all of the record company's expenses were recouped. Id.
14. See Collins, supra note 11, at 5. While bankruptcy may sound like a relatively simple solution to an unfair contract, it is important to understand that filing for bankruptcy can have repercussions. See Morris, supra note 2, at 80. As one music industry attorney noted: "It's the last thing I, as a lawyer would recommend someone to do . . . . You go into bankruptcy court, it's goodbye to you having any say about what to do with your money and your life." Id. (quoting Los Angeles attorney Neville Johnson).
16. See id.
17. See id.
contracts through filing bankruptcy. While the proposed version of the bill did not pass, a modified version containing the same provision will likely be reintroduced next term.

This Comment examines and criticizes the proposed change to the treatment of recording contracts in bankruptcy. Part II briefly explains the Bankruptcy Code and how it affects contractual relations such as record contracts. Part III explains how the music industry functions and compensates artists. Part IV reconciles a split in current bankruptcy case law. This Part also explains why bankruptcy courts allow recording artists to reject their record contracts, while other entertainers may remain bound to their obligations. Part V discusses the history of the proposed change to the Bankruptcy Code, the arguments that have followed it through the legislative process, and how the new relevant provisions would operate. Part V also argues that the proposed legislation is too severe for recording artists. Part VI concludes that the proposed changes to the Bankruptcy Code unjustifiably elevate record companies' rights above the rights of recording artists. This Part also contains suggestions that would better balance the interests of artists against the interests of record companies.

II. GENERAL OVERVIEW OF BANKRUPTCY LAW

Article I of the United States Constitution grants Congress the power to establish uniform bankruptcy laws. The Bankruptcy Code (“the Code”) is the statutory system Congress implemented to provide a single forum of law for debtors to utilize in order to liquidate or discharge their

21. See Melissa Kozlowski, Senate OKs Changes to Bankruptcy Criteria (visited Sept. 25, 1998) <http://www.ljx.com/LJXfiles/bankruptcyreform.html>; see also Electronic Mail from American Bankruptcy Institute (Nov. 5, 1998) (on file with the Loyola of Los Angeles Entertainment Law Journal); Telephone Interview with Dina Ellis, who drafted the Bankruptcy Reform Act for Congressman Gekas (Nov. 13, 1998) (indicating Congressman Gekas's intent to reintroduce the Bankruptcy Reform Act); Telephone Interview with Cary Sherman, General Counsel of the RIAA (Nov. 20, 1998) (indicating the RIAA's intent to reintroduce the compromised language).
liabilities. The Code balances debtors' interests in discharging liabilities against creditors' interests in attempting to satisfy their claims.

The original purpose behind bankruptcy is to allow a debtor to obtain a "fresh start" by ending creditor harassment and the worries and pressures of too much debt. As the Supreme Court noted, "[t]he most important consideration . . . of the Bankruptcy [Code is] to give the debtor a 'new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.' In order to help the debtor obtain this fresh start, Congress has allowed almost all of the debtors' liabilities to be discharged, no matter how remote or contingent the obligation might be.

However, federal and state statutes contain some limitations as to what liabilities the debtor may discharge. The debtor will remain liable for the full amount of these non-dischargeable liabilities outside bankruptcy proceedings, regardless of the debtor's petition. Some examples of these debts include income tax liability, fraud claims, alimony, educational loans, and claims for willful and malicious injuries.

Three forms of bankruptcy are available to individual debtors, including recording artists: Chapter 7, Chapter 11, and Chapter 13. Under all three methods, debtors can discharge, or effectively terminate, any debt that gives rise to a right of payment, such as past due bills. The three methods also allow the discharge of equitable remedies for breach if

26. See id.
29. See H.R. REP. NO. 95-595, at 180, 309; 6 COLLIER ON BANKRUPTCY ¶ 727.13, at 727-58 to 727-59 (Lawrence P. King ed., 1998); see generally Rowan v. Morgan, 747 F.2d 1052 (6th Cir. 1984) (holding that an obligation to repay social security benefits that were overpaid may be discharged).
31. See 11 U.S.C. § 523(a) (1998); 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [2][d][v], at 1-29 to 1-30.
32. See 11 U.S.C. § 523(a)(1)-(18); 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [2][d][v], at 1-29 to 1-30; 4 COLLIER ON BANKRUPTCY, supra note 29, ¶¶ 523.07-523.24, at 523-22 to 523-109.
33. See 11 U.S.C. §§ 109(e), 701, 1101. There are also two other forms of bankruptcy not relevant to most recording artists. Chapter 9 is the section of the bankruptcy code which municipalities must file under. See 11 U.S.C. § 109(c). Chapter 12 deals with bankruptcy of individual family farmers. See 11 U.S.C. § 109(f); 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [5], at 1-47 to 1-49.
the remedy also gives rise to a right of payment, like injunctions arising from breaches of contracts. The remedy also gives rise to a right of payment, like injunctions arising from breaches of contracts. The remedy also gives rise to a right of payment, like injunctions arising from breaches of contracts. 35

Chapter 7 is the liquidation chapter of the Bankruptcy Code. 36 After a debtor files for Chapter 7, a court appoints a trustee who immediately takes control of all the debtor's assets that are not exempted. 37 The trustee then liquidates these assets and distributes them in accordance with the statutory priorities. 38 Chapter 7 is available to both individuals and businesses. 39

Chapter 11 is the reorganization chapter of the Code. 40 While available to some individuals, it is primarily used by partnerships and corporations. 41 Chapter 11 allows the debtor to retain possession of its business and continue to operate while an agreement is reached with the creditors. 42 For this reorganization plan to be completed, a requisite majority of creditors must agree to the debt restructuring. 43 However, the overseeing court may approve a reorganization if it finds the plan to be fair and equitable. 44

35. Id. But see 11 U.S.C. § 522 (providing exemptions for those exceptions made under applicable state or federal law). Dischargeable equitable remedies include negative injunctions enforcing covenants not to compete. See In re Brown, 211 B.R. 183 (Bankr. E.D. Pa. 1997); Wald, supra note 25, at 3.

36. 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [2][a], at 1-21.
37. 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [2][c][ii], at 1-26.
38. See infra Part II.A.
39. Id.

40. The Code establishes a complex hierarchy which controls the order in which creditors receive proceeds. See 11 U.S.C. § 507. The Code allocates liabilities into specific categories based on who is owed or how the liability arose. Id. Then, each category is arranged by priorities. See 11 U.S.C. §§ 507, 726. Finally, creditors attempt to satisfy their claims against the estate's assets in order of priority group. See 11 U.S.C. § 726. However, if the estate is exhausted before the next priority class, their claims may remain unpaid. See id. For a more thorough discussion, see 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [2][d][xi], at 1-35 to 1-36-1.

41. See 11 U.S.C. § 109(b). However, Chapter 7 relief is not available to banks, insurance companies or railroads. Id. Chapter 7 is also the only chapter that stockbrokers and commodity brokers may file under. See 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [2][a], at 1-22.

42. See 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [4], at 1-37.
43. See id.

44. See 11 U.S.C. §§ 1107, 1108, 1121; 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [4][b]–[c], at 1-40 to 1-41.
45. See 11 U.S.C. § 1129(a); 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [4][c], at 1-43.

46. See 11 U.S.C. § 1129(b); 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [4][c], at 1-44 to 1-45.
Chapter 13 is the analogous chapter for individual debt reorganization. Chapter 13 is restricted to individuals or sole proprietorships with regular income whose unsecured debts do not exceed $250,000 and whose secured debts do not exceed $750,000. Chapter 13 allows debtors to keep their assets if the court approves a reorganization plan that repays the creditors over the course of three to five years. Once the debtor has made all the payments, the debtor will receive a discharge.

A. The Estate

The filing of a bankruptcy petition creates an “estate” under Section 541 of the Bankruptcy Code, which is a legal entity separate and apart from the debtor. Virtually all the property owned by the debtor at the time the petition is filed becomes property of the estate, subject to several exemptions. The property of the estate is then administered to creditors in a bankruptcy proceeding.

B. Executory Contracts

Perhaps one of the most powerful tools of bankruptcy is the debtor’s ability to escape performance of some pre-petition contracts. These types of contracts are deemed “executory” and may be rejectable after the debtor enters bankruptcy proceedings.

47. See 11 U.S.C. § 109(e); 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [6], at 1-49.
49. See 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [6], at 1-50.
51. See 1 COLLIER ON BANKRUPTCY, supra note 29, ¶ 1.03 [6], at 1-51.
52. 11 U.S.C. § 541.
53. See id. The Supreme Court has reasoned that the policy of the Bankruptcy Code allows for the bankruptcy estate to contain anything connected to the debtor’s pre-bankruptcy past and not needed to make a fresh start. See Segal v. Rochelle, 382 U.S. 375, 380 (1966).
54. Id.
55. See 11 U.S.C. § 522. For example, the individual debtor is allowed to keep earnings for services performed after declaring bankruptcy, which permits salaried employees to retain the money they earn after filing bankruptcy so that they can continue supporting themselves. See 11 U.S.C. § 541(a)(6). But see 11 U.S.C. § 1306(a)(2) (providing that under Chapter 13 bankruptcies, earnings from service contracts performed up to the closure of the case can become part of the estate). Debtors are also allowed to keep other necessities such as interest in their home (provided the interest is worth less than $16,150), a car worth less than $2,575, household furnishings worth less than an aggregate of $8,625, and governmental benefits such as social security payments and veterans benefits. See 11 U.S.C. § 522(d)(1)–(10).
56. See Wald, supra note 25.
57. See Wald, supra note 25, at 4.
58. See 11 U.S.C. § 365; In re Chi-Feng Huang, 23 B.R. 798, 800 (B.A.P. 9th Cir. 1982)
An executory contract is "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." There are three possible types of executory contracts: (1) contracts that the debtor has performed and the non-debtor has not, (2) contracts that the non-debtor has performed and the debtor has not, and (3) contracts that neither party has substantially performed. This broad definition allows the bankruptcy estate to include many of a debtor's existing contracts.

Once it is established that a contract is executory, it may be rejected, or effectively terminated, if it withstands the "business judgment" rule. In the bankruptcy context, the rule may prohibit the debtor from rejecting the contract if "the party whose contract is to be rejected would be damaged disproportionately to any benefit to be derived by the general creditors of the estate." This formulation allows courts to equitably balance the interests of the debtor against the creditors' claims.

The business judgment rule also allows courts to consider the debtor's viewpoint. Courts have authorized rejection when the contract at issue would be particularly burdensome to the debtor. Conversely, courts may not allow rejection when the contract is beneficial to the debtor. For example, when a debtor is solvent and a contract is not particularly burdensome, courts commonly refuse to reject an executory contract. Because the debtor would suffer relatively little harm as compared to the non-debtor party in the contract, the business judgment rule would prohibit the debtor from rejecting the contract.
Courts have held that a variety of contracts are rejectable, such as partnership and partnership dissolution agreements, contracts to sell real property, and licensing agreements. However, there is a split in authority as to whether personal service contracts, such as recording contracts, are rejectable.

Time is integral to determining whether a contract is eligible for rejection. Executory contracts are included in the estate as long as they were formed prior to the bankruptcy filing. However, if the contracts were formed after the bankruptcy filing, the court does not consider them for rejection. Also, contracts that have expired by the terms of the contract may be exempted from the estate and bankruptcy.

If the contract is rejected, it is equivalent to a breach by the debtor on the day before the petition for bankruptcy was filed and both parties are subsequently excused from performance. The estate is then liable for damages to the non-debtor party.

It is also important to note that the rejection process for Chapter 7 differs from Chapters 11 and 13. In a Chapter 7 bankruptcy, all executory contracts are automatically deemed rejected sixty days after filing for bankruptcy unless the debtor moves to reject or keep the contract before that date. On the other hand, under Chapters 11 and 13, the debtor must move for rejection of a contract; the contracts are not rejected as a matter of law. The Chapter 11 or 13 debtor must also request rejection before the court confirms its reorganization plan.

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75. See Lubrizol Enters., 756 F.2d at 1047 (involving nonexclusive license agreements); Fenix Cattle Co. v. Silver, 625 F.2d 290, 293 (9th Cir. 1980) (involving exclusive license agreements).
76. See infra Part IV.
77. See Cohen & Neale, supra note 4, at 380.
78. Id. at 380-83.
79. Id.
80. See, e.g., In re Waterkist, 775 F.2d 1089 (9th Cir. 1985).
82. See id.; In re IML Freight, Inc., 37 B.R. 556, 559 (Bankr. D. Utah 1984) (noting that parties are excused from performance only under certain circumstances); Wald, supra note 25, at 4.
83. Wald, supra note 25, at 4.
84. 11 U.S.C. § 365(d)(1). The statute also allows for the debtor to request an extension upon proof of "cause." Id.
85. Id.
86. Id. § 303(h).
87. Id.
The preceding material provides an essential background to the Bankruptcy Code so that the reader can understand how recording artists proceed in rejecting recording contracts. Moreover, the provision affecting recording artists is part of a complete overhaul of the Bankruptcy Code. Therefore, it is helpful to know how bankruptcy and rejection works under current law in order to understand the impact this overhaul may have on recording artists.

III. RECORDING ARTISTS’ FINANCES OFTEN PRESENT BANKRUPTCY PROBLEMS

Without knowledge of how recording artists are paid for their labor, the notion of a bankrupt “star” might seem absurd. Contrary to popular belief, most recording artists are not tremendously wealthy, nor do they necessarily possess business savvy. Many recording artists are primarily concerned with developing and creating music, and are not inclined to properly manage their finances. Thus, it is not uncommon for artists to suffer the effects of poor financial judgment. Famous artists who are or have been in dire financial straits include Toni Braxton, TLC, Issac Hayes, the lead singer of Kool & the Gang, Willie Nile, MC Hammer (now known as Hammer), Meat Loaf, actress Tia Carrere, and Chaka Kahn.

88. Id.
90. See id.
92. See Pendleton, supra note 89, (quoting Garry Harris, former senior director of A&R Records).
93. See Pener, supra note 1, at 72.
97. See In re Noonan, 17 B.R. 793, 794 (Bankr. S.D.N.Y. 1982). Willie Nile was a singer/songwriter who had signed a recording contract with Arista Records. Id. at 795.
98. Pendleton, supra note 89.
100. See In re Carrere, 64 B.R. 156 (Bankr. C.D. Cal. 1986).
A. The Structure of an Artist’s Earnings and Payment

To further understand why recording artists may file for bankruptcy, it is necessary to understand how recording artists are paid. Typically, when an artist begins a relationship with a major record label, both parties agree to a lengthy contract that can govern their relationship for several years. This agreement could possibly encompass the artist’s entire career. Moreover, record labels typically organize the term of recording contracts by options exercisable at the company’s sole discretion. These options allow the label to unilaterally terminate the deal as they deem necessary, but do not afford the same right to artists.

The artist is bound to the payment terms of the contract for all albums released under the agreement. Typically, artists receive an advance when they begin working on a new album. It is usually a percentage of what the record label believes the artist will earn from record sales, or an amount sufficient to maintain a respectable lifestyle. Once the artist records and releases an album, the recording artist receives a percentage of the record’s sales. An average artist can expect to receive between eleven and sixteen percent of the suggested retail price of CDs, while a superstar may be able to demand a royalty of up to twenty percent.

This compensation structure is deceptively complicated. First, record companies deduct a substantial portion of the artist’s royalty income to reimburse the company for numerous costs such as recording expenses, packaging costs, promotional copies of records for radio stations and retail stores, records given to distributors as an incentive to purchase, portions of marketing and radio promotion, and anticipated returned copies. Thus, the label must sell enough copies of the artist’s album to repay itself for all of these deductions before the artist is entitled to any further royalty payments.

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103. See id. at 330–31.
104. Id. at 330.
105. Id.
107. Id. at 279.
108. See PASSMAN, supra note 12, at 89.
110. See PASSMAN, supra note 12, at 88–99. It is also important to note that these deductions are all determined by the terms of the contract. Id.
111. See PASSMAN, supra note 12, at 102.
Second, all of an artist’s albums under a single recording agreement are usually cross-collateralized. This means that the proceeds from a successful album must be used to recoup any losses the record label experienced on the artist’s earlier albums. However, the artist does not completely bear the ultimate risk of loss. For example, if the artist fails to sell enough records to repay the label for the previously mentioned deductions, the record label absorbs the loss, not the artist.

When record companies issue advances, they often provide the artist with funds for sustenance and recording costs. For a new artist, this sum may range between $125,000 and $200,000 per album. The artist must use this money to produce the album subject to the record company’s budgetary approval. Because albums are quite expensive to produce, the new artist may use a substantial portion of the fund to create the work, retaining little or no money for personal use. Although the recording fund is typically the largest bulk sum an emerging artist will receive, the recording artist may have other sources of income. These sources may include publishing royalties and advances, proceeds from live performances, merchandising profits and the use of their songs in audio visual works.

1. How Artists May Face Financial Woes

Artists who receive enormous up-front payments often do not worry about their finances or plan for when they will no longer receive such advances. This lack of business savvy and foresight can lead an artist into serious financial problems. For example, MC Hammer lived beyond his means by traveling with an entourage in excess of one hundred people,
and purchasing a seven million dollar home. Toni Braxton, also believing she could afford an extravagant lifestyle, is currently in over two million dollars debt.

Personal overspending is only one of the problems that an artist faces. Due to the large advances recording artists receive, they are often placed in the highest income tax bracket, losing almost 40 percent of their income to taxes. Artists often do not realize the financial impact that these taxes will have on their disposable income. Furthermore, artists usually owe a significant portion of their income to lawyers, managers, producers, and booking agents. For example, Toni Braxton's producers were paid approximately one-third of her royalties for their work.

Record labels often make a larger percentage of album sales than the recording artist. For example, Toni Braxton was a multi-platinum artist whose record label is estimated to have received net profits between sixty and seventy million dollars from her record sales. However, Braxton only received approximately five million dollars, or less than three percent of the gross. The gravity of these financial realities may often surprise the new star who has suddenly entered into a life of fame and fortune. Therefore, bankruptcy may be the only recourse for artists who have lived beyond their means.

To understand why record labels appear to make much more than the artist, it is important to note what risks record companies face. Statistics show that only twenty percent of all artists on a label will generate enough sales to recoup the money that the record label has spent on them. Of this twenty percent, only the top five percent of the artists will be profitable. The other eighty percent of artists will lose money for the record label. Thus, to stay in business with such a high level of risk, record companies have structured their deals to yield the maximum return.

126. Id.
127. Id.; Pener, supra note 1, at 74.
128. Nathan, supra note 91, at 40.
129. See Pendleton, supra note 89, at Y1.
130. See generally Pener, supra note 1, at 72 (discussing an interview with Toni Braxton about her reasons for filing for bankruptcy).
131. See Pener, supra note 1, at 76.
132. A platinum record must sell over one million copies in the United States. See Passman, supra note 12, at 108.
133. See Pener, supra note 1, at 75 (quoting estimates by Braxton's managers).
134. See Pener, supra note 1, at 74 (quoting estimates by Braxton's managers).
136. Id.
137. Id.
from the few artists who become successful. Furthermore, the five percent of artists who actually do generate profits end up subsidizing the artists whose albums were a loss, as well the record company's business costs. As record labels cannot predict which new artists will become successful, they structure all of their deals to earn large profits in the event that the artist will succeed against the odds.

IV. PRIOR TREATMENT BY COURTS OF RECORDING ARTISTS FILING FOR BANKRUPTCY

In considering whether there is a necessity for new laws pertaining to recording artists, it is imperative to consider the current state of the law. Currently, a recording artist who files for bankruptcy must meet two requirements in order to have his or her recording contract rejected: (1) the court must allow for the rejection of personal service contracts, and (2) the court must find that the artist did not act in bad faith.139

A. Personal Service Contracts Are Generally Treated as Rejectable

Generally, courts are liberal in permitting rejection of executory contracts, which often include personal service contracts, such as recording agreements.140 However, existing case law does not clearly dictate whether it is appropriate to reject personal service contracts.141 The confusion is largely attributed to In re Carrere,142 a Ninth Circuit Bankruptcy Court opinion.

In Carrere, actress Tia Carrere sought to reject a personal services contract to perform on the soap opera General Hospital in order to accept a more lucrative contract to perform on another television show, The A-Team.143 In making her motion to reject the General Hospital contract, Ms. Carrere stated that her primary motivation for filing bankruptcy was to reject her current obligations in order to be more prosperous.144 The court denied her motion on both equitable and legal grounds.145 The court based its equitable conclusion on the notion that it would be unfair to protect a

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138. See id. at 49.
139. See Wald, supra note 25, at 3-4.
140. See Cohen & Neale, supra note 4, at 385-87. Generally, if some performance is still due, a contract will be deemed executory. See supra Part II.B.
141. See Cohen & Neale, supra note 4, at 385-87.
142. 64 B.R. 156 (C.D. Cal. 1986).
143. Id. at 157.
144. See id.
145. Id. at 160.
debtor when the major motivation for the rejection is to avoid any substantive remedy for the breach.146 The bankruptcy system requires good faith, and Carrere demonstrated bad faith by attempting to use bankruptcy in lieu of seeking rescission.147 Thus, the court denied her motion to reject for lack of "cause."148 The equitable ground of the decision has not been criticized.149

However, the Carrere court also based its conclusion on legal grounds which have proven confusing to subsequent courts.150 The court interpreted 11 U.S.C. section 365(c)(1)(a) to forbid the rejection of personal service contracts by the trustee.151 This section states that the trustee in a bankruptcy case may not assume or assign to another party an executory contract if state law excuses the non-debtor from accepting performance.152 A common law rule is that personal service contracts are not assignable under state law because of the inherently unique quality of performance sought and therefore excuses the non-debtor from accepting performance.153 Moreover, courts have historically refused to compel performance of a breached personal service contract under bankruptcy law.154 Thus, under a combined reading of common law and section 365, bankruptcy courts have not been able to assume, assign or compel performance of personal service contracts.155

However, the court went far beyond this common understanding of section 365. The court interpreted sub-section 365(c)(1)(a) as a complete restriction on the trustee's ability to assume, assign, or reject personal service contracts.156 This additional restriction that denies the debtor the ability to reject a personal service contract did not exist either in the Code or case law interpreting it.

The court extended this questionable logic further when it concluded that because debtors are given the identical rights of a trustee in

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146. See id.
147. See id.
148. Carrere, 64 B.R. at 160.
149. See infra Part IV.B.
151. Carrere, 64 B.R. at 159. The court indicated that personal service contracts would not be rejectable under both Chapters 7 and 11 of the Code. Id. at 158.
153. See 3 COLLIER ON BANKRUPTCY, supra note 29, ¶ 365.06[1][b], at 365-56. Common law restricts the assignment of personal service contracts due to the performing party's special relationship to the subject of the contract. Id.
154. 4 JOHN POMEROY, A TREATISE IN EQUITY JURISPRUDENCE § 1343, at 943–44 (5th ed. 1941).
155. See 3 COLLIER ON BANKRUPTCY, supra note 29, ¶ 365.06[1][b], at 365-56.
156. See Carrere, 64 B.R. at 159.
bankruptcy,\textsuperscript{157} Carrere herself could not reject the contract.\textsuperscript{158} Therefore, no one could reject the contract, and Carrere would be liable for breach.\textsuperscript{159} This decision has been criticized as an inappropriate interpretation of section 365.\textsuperscript{160} Nevertheless, Carrere has not yet been overruled, and is still good law in the central district of California.\textsuperscript{161}

The most often cited and thorough reply to Carrere is In re Taylor.\textsuperscript{162} In Taylor, the lead singer of "Kool and the Gang," James Taylor, filed for bankruptcy and sought to reject his various entertainment contracts.\textsuperscript{163} Taylor reported assets totaling approximately seven hundred thousand dollars and liabilities in excess of four million dollars.\textsuperscript{164} Unlike Carrere, the court concluded that Taylor had not filed bankruptcy in bad faith.\textsuperscript{165}

The court then re-examined Carrere's conclusion that personal service contracts are not rejectable and read Carrere to stand only for the proposition that a rejection may be dismissed if filed in bad faith.\textsuperscript{166} The Taylor court then concluded that section 365 did allow the rejection of personal service contracts.\textsuperscript{167}

The Taylor court based its conclusion on a thorough reading of section 365. The court explained that, as a general rule, sub-section 365(a) provides that trustees may assume, assign or reject any executory contract.\textsuperscript{168} The Taylor court then noted that sub-section 365(c)(1)(a) restricts only the trustee's ability to assume or assign a personal service contract.\textsuperscript{169} Thus, section 365 does not restrict the trustee's ability to reject personal service contracts.\textsuperscript{170} The court explained, "This is not in the least

\textsuperscript{157} 11 U.S.C. § 323.
\textsuperscript{158} See Carrere, 64 B.R. at 159.
\textsuperscript{159} See id. at 160.
\textsuperscript{161} See Cohen & Neale, supra note 4, at 386–87. But see Cohen and Neale, supra note 4, at 386 (citing In re Aslan, 15 B.C.D. 136, 137 n.1 (Bankr. C.D. Cal. 1986)).
\textsuperscript{162} 913 F.2d 102.
\textsuperscript{163} Id. at 105–06. These contracts included his recording and publishing contracts. Id.
\textsuperscript{164} Id. at 105.
\textsuperscript{165} Id. at 108.
\textsuperscript{166} Id. at 107.
\textsuperscript{167} Id. at 106.
\textsuperscript{168} Taylor, 913 F.2d at 106; see also 11 U.S.C. § 365(a) (1998).
\textsuperscript{169} Taylor, 913 F.2d at 106.
\textsuperscript{170} Id.
surprising since . . . any contract which is not assumed . . . is automatically rejected [in a Chapter 7 case]."171

The Taylor court concluded that the trustee’s authority to reject extends to all executory contracts.172 Subsequent decisions by other courts have overwhelmingly followed the Taylor rationale and held personal service contracts rejectable.173

B. Dismissals for Bad Faith

Recording labels arguing against rejection have consistently claimed that recording artists file for bankruptcy in bad faith, solely to escape their record contracts.174 If the label succeeds on this contention, the artist will not be allowed to reject the contract and the case can be dismissed.175

The Code allows a court to dismiss a voluntary petition if the debtor fails to meet a good faith requirement, a prerequisite to bankruptcy.176 The Code explicitly requires evidence of good faith for approval of reorganization plans under Chapters 11 and 13.177 There is no explicit requirement of good faith in Chapter 7 cases. However, courts have the inherent power to reject cases filed in bad faith under section 707(a).178 In other words, section 707(a) implicitly requires debtors who seek equitable remedies in bankruptcy, such as rejection, to have “clean hands.”179

To establish bad faith, record labels must meet a high burden of proof. They are required to show by clear and convincing evidence that a debtor

171. Id.
172. Id. at 107; see All Blacks, 199 B.R. 970, 974–75; Brown, 211 B.R. 188; Sammons, 210 B.R. 197; Watkins, 210 B.R. 394.
173. See All Blacks, 199 B.R. 970, 974–75; Brown, 211 B.R. 188, Sammons, 210 B.R. 197; Watkins, 210 B.R. 394; Wald, supra note 25, at 3.
174. See Taylor, 913 F.2d 102, 106; All Blacks, 199 B.R. 970, 975–76, Watkins, 210 B.R. 394, 398–403; In re Bofil, 25 B.R. 550, 552 (Bankr. S.D.N.Y. 1982) (rejecting Arista Record’s argument that it was improper to allow rejection of an executory contract where the sole purpose of filing for bankruptcy was to have the contract rejected).
176. See 2 COLLIER ON BANKRUPTCY, supra note 29, ¶ 301.17[3], at 301-41.
178. See 2 COLLIER ON BANKRUPTCY, supra note 29, ¶ 301.17[3], at 301-41 (explaining that although 11 U.S.C. § 707(a) contains no mention of good faith, the list of grounds for dismissal contained in § 707(a) is merely an illustrative list which allows consideration of good or bad faith). A similar provision for Chapter 11 cases appears in 11 U.S.C. § 1112(b). See 11 U.S.C. § 1112(b). The analogous Chapter 13 provision is 11 U.S.C. § 1307(c). Legislative history indicates that Congress approved such a reading, allowing courts to use their equitable powers to reach the correct result. H.R. REP. NO. 95-595, at 406 (1977).
179. See id. The clean hands doctrine states that a party cannot seek equitable relief if that party has violated an equitable principle such as good faith. BLACK’S LAW DICTIONARY 250 (6th ed. 1990).
filed for bankruptcy solely to accomplish an unlawful purpose, such as breaching a contract. Thus, most entertainment related cases involving bad faith are based on arguments that the debtor filed bankruptcy solely to reject a recording contract. Currently, case law is split as to whether filing bankruptcy solely to avoid a personal service contract amounts to bad faith.

1. Cases Finding Bad Faith When Entertainers File Bankruptcy Solely To Reject Contracts

*Carrere* is the leading authority in support of dismissing an entertainer/debtor’s motion to reject an executory contract when rejection is found to be the major motivation in filing bankruptcy. There, the court found that Carrere’s primary motivation for filing bankruptcy was to reject her *General Hospital* contract so she could enter a more profitable contract to play a role in the TV show, *The A-Team*. The *Carrere* court also implied that Carrere’s listed debts seemed questionable and indicated abuse of the system. Because of these two facts, the court found that the bankruptcy was filed in bad faith. As a result, the court denied Carrere’s rejection.

Similarly, the court in *In re Sammons* held that an entertainer/debtor may not file for bankruptcy primarily to reject an unfavorable contract solely to accept a more lucrative one. *Sammons* involved a heavyweight boxer who sought to reject his current management agreement in order to enter into a different contract with his new training manager. Sammons filed for bankruptcy to reject his original contract because he did not want to endure the lengthy legal battle involved in seeking rescission. The court noted that Sammons’s only reported debt consisted of the damages that would result from the rejection of the

182. See *id*.
184. *Id*. at 157. It is important to note that Carrere was an actress, not a recording artist. *Id*.
185. *Id*.
186. *Id*.
187. *Id*. at 160 n.6.
188. *Id* at 160.
190. *Id*.
191. *Id*. at 198.
192. *Id*. at 199.
Based on these findings, the court held that Sammons demonstrated bad faith and dismissed his bankruptcy case. Consequently, Sammons and Carrere suggest that, in some jurisdictions, an entertainer/debtor cannot abuse the bankruptcy system solely to reject an unfavorable contract in favor of a more beneficial one.

2. Cases Involving Recording Artists That Did Not Result in Bad Faith Dismissals

As opposed to entertainers paid on a salary or lump sum basis, it is not as simple to show bad faith in cases involving recording artists. Unlike Carrere and Sammons, another line of cases suggests that it is improper to dismiss a bankruptcy case when a debtor merely has a strong motivation to reject an executory contract. Thus, merely taking advantage of one’s legal rights is not enough, on its own, to establish bad faith.

In re Watkins is the best example of this line of reasoning. That case involved the three members of the musical group known as “TLC.” Apparently, the groups’ attorney stated to their recording label’s representative that each of the group members was considering filing for bankruptcy during renegotiations of their recording contracts. After the negotiations reached an impasse, the members filed for bankruptcy and sought rejection of their existing contracts. The court noted that other courts had denied rejection of contracts simply because another more profitable contract was available. However, there was no direct evidence that the debtors intended to abuse the bankruptcy process for this purpose.

To determine whether the debtors filed for bankruptcy in bad faith, the court examined the following factors: (1) whether the debtors had

193. *Id.* If a contract is rejected, it is treated as a breach and the damages become part of the estate. See 11 U.S.C. § 502(g) (1998); *In re IML Freight, Inc.*, 37 B.R. 556 (1984).


196. See infra Part IV.C.


198. 6 *COLLIER ON BANKRUPTCY*, *supra* note 29, ¶ 707.03[2], at 707-10 to 707-11.


200. *Id.*

201. *Id.* at 402.

202. *Id.* at 398.

203. *Id.* at 397.

204. *Id.* at 403.
suggested that their sole purpose for filing bankruptcy was to reject their contract; (2) whether the debtors had adjusted their lifestyles; (3) whether the debtors' conduct changed after filing bankruptcy; (4) whether the debtors were solvent; (5) whether the debtors had deceptively reported their liabilities to the bankruptcy court; and (6) whether the debtors were actually in financial distress.\(^{205}\)

First, the *Watkins* court found no evidence that the debtors' stated an intent to abuse the bankruptcy system.\(^{206}\) Even though the debtors' attorney had stated his clients' intent to file for bankruptcy during negotiations (presumably to gain leverage), the court found these statements were insufficient to amount to bad faith.\(^{207}\) The court based this finding on the debtors' demeanor during the trial, which was not evident from the opinion.\(^{208}\) While the court did not fully explain its reasoning, the court's conclusion suggests that the artists were truly in financial distress.\(^{209}\) It appears that TLC's members would have legitimately needed bankruptcy relief if renegotiations did not result in more income.\(^{210}\)

Second, the court determined that the debtors' expenditures and lack of lifestyle adjustment were not an issue because all of the debtors' funds used to perpetuate their post-petition lifestyle were not subject to the bankruptcy proceeding.\(^{211}\) The funds were not available to the creditors because they were either exempt or were earned after the filing and outside the scope of the bankruptcy proceedings.\(^{212}\)

Third, the court determined that there was no evidence of post-petition conduct indicating bad faith.\(^{213}\) This was also based on the debtors' post-petition use of only exempt funds.\(^{214}\)

Fourth, the court examined the solvency of the debtors. While bankruptcy does not require that a debtor actually be insolvent to voluntarily file for bankruptcy,\(^{215}\) solvency may indicate bad faith. Even

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\(^{205}\) *In re Watkins*, 210 B.R. at 398. The *Watkins* court cited several cases that used such factors. See, e.g., *In re Dixie Broad.*, Inc. 871 F.2d 1023 (11th Cir. 1989); *In re Phoenix Piccadilly, Ltd.*, 849 F.2d 1393 (11th Cir. 1988); see also *In re Zick*, 931 F.2d 1124 (6th Cir. 1991); *All Blacks*, 199 B.R. at 975–76; 6 COLLIER ON BANKRUPTCY, supra note 29, ¶ 707.03[2], at 707-10 to 707-11.

\(^{206}\) See *Watkins*, 210 B.R. at 403.

\(^{207}\) *Id.* at 402.

\(^{208}\) *Id.*

\(^{209}\) *Id.* at 399.

\(^{210}\) *Id.* at 402.

\(^{211}\) See *id.*

\(^{212}\) See *Watkins*, 210 B.R. at 402.

\(^{213}\) *Id.* at 403.

\(^{214}\) See *id.*

\(^{215}\) See *id.* at 399; 2 COLLIER ON BANKRUPTCY, supra note 29, ¶ 109.02, at 109-7. But see
though the debtors became solvent after filing, each of the debtors was unable to pay her debts at the time she filed for bankruptcy.216 The debtors established that they were behind on car payments, insurance premiums, credit card bills, and even medical bills.217 In some cases, the debtors were more than three months delinquent.218 The court concluded that the relevant and dispositive fact was that the debtors had a good basis for believing they were insolvent when they filed for bankruptcy.219

Fifth, the court examined whether the members of TLC had disguised their financial condition.220 Full and fair disclosure in a bankruptcy proceeding requires the scheduling of many assets.221 The recording label argued that the group had some contracts and properties not listed in their bankruptcy schedules.222 The court examined each of these items in detail. The Watkins court excused some of those items as acquired post-petition and therefore exempt from the proceedings.223 The debtors had also fairly assumed that the other properties, such as an option contract with MTV that was never exercised, had no value.224 Thus, the omissions were not material, and were not intended to disguise their financial condition.225 Even if the assets had significant worth, the court noted that the bankruptcy code contains other remedies for intentional omissions and that dismissal was inappropriate in such cases.226

Perhaps, the most significant part of the court’s analysis is the discussion of the recording label’s recoupable expenses for TLC.227 TLC’s royalties had not generated enough funds to recoup the expenses the record label incurred on TLC’s behalf.228 In fact, just before TLC filed for bankruptcy, the record label’s latest statement indicated that TLC would need to generate $576,000 in royalties before any of the group’s members could receive royalty payments.229 The record label insisted that this was

216. See Watkins, 210 B.R. at 399.
217. See id. at 398.
218. See id.
219. See id. at 399.
220. See id. at 400.
221. See id.
222. See Watkins, 210 B.R. at 400.
223. See id. at 401.
224. See id.
225. See id. at 401.
226. See id. at 400.
227. See id. at 401. For an explanation of the recording label’s recoupable expenses see Part III.A.
228. See Watkins, 210 B.R. at 401.
229. See id.
not a true debt because the artists would not be accountable for the expenses outside of the recoupment through record royalties. Thus, this was not a traditional debt.

The court rejected this argument relying on Johnson v. Home State Bank. There, the Supreme Court found that a negative royalty balance was a claim against future property in the form of royalties. Thus, the $576,000 could properly be listed as a liability and viewed as part of TLC's total debt. This large debt greatly influenced the court in determining the solvency of the debtors.

The sixth and final factor was whether the debtors were truly financially distressed. The recording company argued that the majority of debt came from the negative royalty balances in their control. Because the label had not pressured the TLC members for payment, the group was not distressed.

The court rejected this argument because the debt was payable only from TLC's royalties that the record company could not contractually request. Moreover, the debtors had been pressured by unrelated parties to deliver payments for debt that their cash flow could not cover. Because the creditors "affected each [debtor's] daily life," the debtors were experiencing bona fide distress that warranted bankruptcy relief.

Although In re Watkins is the most thorough opinion involving record contracts and bad faith bankruptcy claims, there are other cases in this area

230. See id.
231. Id.
233. See Johnson, 501 U.S. 78. Johnson held that a claim against property of the debtor included all interests, including interests against property regardless of how they came about. Id. at 85. Because future royalties are property rights that can be bought and sold, the Watkins court concluded that they fit within the Court's interpretation of the Code's definition of a claim. See Watkins, 210 B.R. at 401.
234. See Watkins, 210 B.R. at 401. It is notable that, as a group, TLC was jointly and severally liable for the negative royalty balance. Therefore, each of the members could report the total $576,000 on their individual indebtedness. See id.
235. See id. at 399.
236. Id. at 398.
237. Id.
238. Id. The contract stated TLC's negative royalty balance could only be paid by record royalties and not by the artists' other income. Id. It is also important to note that any contract term modifying or terminating the contract in the event of bankruptcy is invalid. See 11 U.S.C. § 541(c) (1998); H.R. REP. NO. 95-595, at 348 (1977).
239. See Watkins, 210 B.R. at 398. Parties seeking payment included banks threatening foreclosure on property, credit card companies, and other non-entertainment related parties who had acquired judgments for damages in civil suits. Id.
240. Id. at 399.
that warrant discussion. In *All Blacks B.V. v. Gruntruck*, a "grunge band" sought bankruptcy relief after it failed to receive further funding from its recording company. The band members filed bankruptcy on the advice of their attorney while the attorney was seeking another record contract for the band. The record company challenged the bankruptcy case as being filed in bad faith.

However, the bankruptcy court rejected the bad faith argument. The record label appealed the decision to the jurisdiction's federal district court. The district court found no evidence that the debtors' intent or sole purpose in petitioning for bankruptcy was to avoid their contracts with the record label. Despite the fact that one of the band members had received an inheritance with a $50,000 future value that would not accrue until 2001, the *All Blacks* court rejected the record company's claim that the band was not experiencing genuine financial crisis. The court concluded that the income was not substantial enough to remedy the band's debt since they had a negative royalty balance of $130,000.

The *All Blacks* court also concluded that the band's negative royalty balance of $130,000 was properly included in the statement of the band's indebtedness. Unlike the *Watkins* court, which based its conclusion on Supreme Court case law, the *All Blacks* court relied on a simple reading of the governing statute, section 101(5). Under this section, a debt is a liability on a claim, and a claim includes a "right to payment, whether or not such right is ... contingent ..." The band's negative royalty balance was only payable from uncertain future royalties. Thus, the band's future income from their recording contract was contingent and threatened the band's ability to move forward financially. Therefore, the court held that it was proper to include the negative royalty balance in the

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242. Id. at 971–72.
243. Id. at 972.
244. Id.
245. Id. at 975.
246. Id.
247. *All Blacks*, 199 B.R. at 975.
248. Id.
249. Id.
250. Id.
251. See *Johnson*, 501 U.S. 78.
253. Id. § 101(12).
254. Id. § 101(5).
256. Id.
total indebtedness. Finally, the court found that the band did not seek to abuse the bankruptcy system and that it was improper to dismiss the bankruptcy petition. In sum, it appears that courts are more likely to find good faith in cases dealing with recording artists if the indebtedness is created by a negative royalty balance.

C. Reconciling These Two Lines of Cases

Watkins and similar cases are usually cited to oppose cases such as Carrere and Sammons. However, these two lines of cases are actually consistent with each other. First, both the Carrere and Sammons courts found that the debtors intended to abuse the bankruptcy process by filing for the sole purpose of rejecting their contracts. In both Watkins and Gruntruck, the courts found the record devoid of any such intent. These courts then looked for evidence indicating that the debtors intended to manipulate the bankruptcy system for an improper purpose.

These cases suggest that courts look first for direct evidence or testimony of intent to abuse the bankruptcy process. If no such evidence exists, the courts then search for other factors, such as the absence of financial distress, to determine if the debtors were manipulating the system.

These cases are consistent when viewed in their proper contexts. In Watkins, Gruntruck and the other similar cases, the debtors were all recording artists. These cases all assumed that the artists' negative royalty balances were debts properly included in the bankruptcy as a claim on future property.

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257. Id.
258. Id. Other courts have subscribed to this analysis either explicitly or implicitly. See Delightful Music, Ltd. v. Taylor (In re Taylor), 913 F.2d 102 (3d Cir. 1990); In re Bofill, 25 B.R. 550, 552 (Bankr. S.D.N.Y. 1982); In re Noonan 17 B.R. 793, 798 (Bankr. S.D.N.Y. 1982).
261. See supra Part IV.B.1.
262. Id.
263. See supra Part IV.B.2.
264. Id.
265. See Delightful Music, Ltd. v. Taylor (In re Taylor), 913 F.2d 102, 106 (3d Cir. 1990) (involving singer songwriter Willie Nile); All Blacks B.V. v. Gruntruck, 199 B.R. 970, 975–76 (W.D. Wash. 1996); In re Watkins, 210 B.R. 394, 398–403 (Bankr. N.D. Ga. 1997); In re Bofill, 25 B.R. 550, 552 (Bankr. S.D.N.Y. 1982) (rejecting Arista Record’s argument that it was improper to allow rejection of an executory contract where the sole purpose of filing for bankruptcy was to have the contract rejected).
266. See supra Part IV.B.2.
Record labels often incur substantial costs in developing artists, which are added to the artist's negative royalty balance. Therefore, the negative royalty balances tend to greatly exceed the assets of an artist/debtor who has yet to receive any income from his or her labors. Because the negative royalty balance is considered a debt in bankruptcy, the large amount of negative royalty balances can demonstrate that the artist is overburdened by debt.

Both Carrere and Sammons, while involving entertainment related contracts, did not involve recording artists or deals that were structured like record contracts. The contracts at issue were generally structured like most personal service contracts and involved salaries or lump sum payments. Contracts based on salary generally do not involve a negative royalty or recoupable sum of money. Also, the debtors in these two cases arguably had no substantial debt except for the damages resulting from a breach of the contracts at issue. However, in cases involving recording artists, the record company's claim to future royalties remains even if the contract is not rejected. Therefore, while salary based contract that are not rejected eliminate any future debt, recording contracts, if not rejected, would still allow for other debt in the form of negative royalty balances.

Both legal and factual considerations suggest that when the cases are read together and reconciled, recording companies have a higher burden when trying to establish that the debtor filed in bad faith. Absent the unlikely case where an artist has openly admitted an intent to abuse the bankruptcy system, a record company will not be able to establish bad faith. It appears that there must be extreme evidence (like the Watkins court was looking for) or the artist must have recouped all of their negative royalties.

While record labels may not be able to establish bad faith when an artist wishes to reject their recording contract, record labels still maintain the majority of control over their relationship with the artist. This control

267. See supra Part III.
268. See Taylor, 913 F.2d at 106; All Blacks, 199 B.R. at 975–76; Watkins, 210 B.R. at 398–403.
270. See supra Part IV.B.1.
272. See, e.g., Carrere, 64 B.R. at 156.
275. Moreover, exhaustive research revealed no cases where a recording artist was found to have filed in bad faith.
is largely created from the unproven artist's lack of leverage in initial recording contract negotiations.\textsuperscript{276} Bankruptcy provides the artist with a limited apparatus to redress the imbalance in negotiation strength.\textsuperscript{277} However, if the proposed legislation passes, recording artists will have virtually no remedy for one-sided contracts dictated by recording labels.

V. THE PROPOSED AMENDMENTS TO THE BANKRUPTCY CODE

A. The History of a Sordid Provision

On June 10, 1998, the House of Representatives passed\textsuperscript{278} the Bankruptcy Reform Act of 1998 ("the Act").\textsuperscript{279} This bill was the culmination of efforts to curb the rise in bankruptcy cases and the overall abuse of the system, especially in Chapter 7 cases that allow complete discharges.\textsuperscript{280} According to congressional records, the Act was a direct response to a twenty-five percent increase in filings in 1997 despite a strong economy and low unemployment.\textsuperscript{281} Congress determined that debtors who were able to settle their debts were increasingly abusing bankruptcy and the complete discharge process.\textsuperscript{282}

During the creation of the bill, the Recording Industry Association of America ("RIAA"), an organization representing record companies, successfully lobbied for a provision to be inserted into the Act to make it more difficult for artists to escape their recording contract by altering section 365.\textsuperscript{283} The proposed amendment was originally drafted as follows:

(5) Where the court finds that a personal services contract is property of the estate, the trustee may not reject an executory contract for personal services in which advances are paid for the creation of copyrighted sound recordings in the future if a material purpose for commencing a case under this title is to reject such contract, unless, absent such rejection, economic

\textsuperscript{276} See Pener, supra note 1, at 74–75.
\textsuperscript{277} See Collins, supra note 11, at 7.
\textsuperscript{278} 144 CONG. REC. H4442 (daily ed. June 10, 1988) (Roll No. 225).
\textsuperscript{280} See Kozlowski, supra note 20.
\textsuperscript{281} Id.
\textsuperscript{282} Id.
rehabilitation of the debtor’s finances, including such contract, cannot be achieved. 284

This relatively small provision received much attention. It was sharply criticized by Democrats, 285 the American Federation of Musicians ("AF of M"), the American Federation of Television and Radio Artists ("AFTRA"), 286 and the International Managers Forum ("IMF"). 287

The groups primarily protested on two grounds. The first argument was that recording contracts were singled out in relation to all other executory contracts. 288 The second argument was that the provision was duplicative of decisions like Carrere and Watkins. 289 By formally codifying such a specially targeted provision, recording artists were likely to be subjected to an indirect and unwarranted higher standard of scrutiny. 289 Such a higher standard of scrutiny in cases involving recording artists would give the recording companies even more economic control over an artist than their contracts can legally establish. 290

Politicians blasted the bill as “smell[ing] like a very, very special-interest” provision. 291 According to a spokesperson for Congressman Gekas, sponsor of the House of Representatives bill, this provision quickly became one of the five most controversial issues in the bill. 292 After issuing many passionate statements, the RIAA agreed to negotiate compromise language with the unions and politicians. 293

Meanwhile, the Senate passed its own less conservative, 294 more pro-debtor bill, 295 the Consumer Bankruptcy Reform Act of 1997. 296 The Senate bill did not contain any provision regarding recording artists. 297 After the Senate bill passed, a conference committee was created by the

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285. Seeley, supra note 283.
287. See Bergman, supra note 19.
288. See Holland, supra note 286.
289. Id.; Bergman, supra note 19.
290. See Holland, supra note 286.
291. Id. A contractual term that exempts an agreement from bankruptcy is void as a matter of law. See 11 U.S.C. § 541(c); H.R. REP. No. 95-595, at 348 (1977).
293. Telephone interview with Dina Ellis, supra note 21. She stated that a lot of support came from the Senate democrats who had strong ties to recording artists and their interests. Id.
294. See Holland, supra note 286.
295. See Kozlowski, supra note 21.
296. See id.
298. See id.; Seelye, supra note 286.
The compromise bill was passed by the House of Representatives on October 9, 1998.

Shortly before the compromise bill was completed, the RIAA, the unions, and a few members of Congress reached a final agreement on the provision relating to recording artists and their ability to reject their recording contracts. According to Carry Sherman, General Counsel for the RIAA, the revised provision would not be contested because it reflected a middle ground approved by both the recording industry and recording artists.

However, the bankruptcy bill negotiations did not result in such an equal compromise. Even though the final product of the committee was passed in the House of Representatives, the Senate let the bill expire by failing to vote on it before the end of the term. It has been speculated that this filibuster was prompted by the White House, through the Office of Management and Budget, which promised to veto the compromise. According to an unnamed White House representative, the compromised bill did not provide enough protection for low income debtors and more resembled the House of Representatives' strongly Republican bill.

Nevertheless, the conference committee bill containing the new provision which would allow courts more leeway in rejecting recording contracts may reappear in legislation proposed in the future. In fact, several politicians have indicated that the bill will be reintroduced in the 106th Congress. Moreover, it is likely that the RIAA and union compromise provision will be included when the Bankruptcy Reform Act is reintroduced.

302. Telephone Interview with Carry Sherman, supra note 21.
305. See id.
306. See id.
307. See id.; Telephone Interview with Dina Ellis, supra note 21 (indicating Congressman Gekas's intent to reintroduce the Bankruptcy Reform Act); Telephone Interview with Carry Sherman, supra note 21 (indicating the RIAA's intent to reintroduce the compromised language).
308. Telephone Interview with Carry Sherman, supra note 21 (indicating the RIAA's intent to reintroduce the compromised language).
B. Recording Contracts and the RIAA, AFTRA, AF of M, and IMF
Compromise Provision

1. The Addition of the "Needs Based" Bankruptcy Test

The final compromise of the RIAA, AFTRA, AF of M, and IMF was inserted into the proposed legislation on October 7, 1998. To understand how the new provision works, it is important to grasp how the proposed amendments to the Code would reduce the number of Chapter 7 voluntary bankruptcies.

Part of the overhaul of the Code was the establishment of a "needs based" bankruptcy test for Chapter 7 cases. First, the legislature created a rebuttable presumption of abuse if the debtor is able to pay either twenty-five percent of unsecured debts—which includes liabilities such as credit card debts and negative royalty balances—or five thousand dollars over five years.

To help determine whether the debtor can meet this minimum payment plan, the Act provides several guidelines to establish what expenses the debtor is allowed, including a monthly budget. The rebuttable presumption of abuse in Chapter 7 cases can be rebutted by establishing that the debtor's income would fail to cover the twenty-five percent or five thousand dollars over five years. The only other way for a debtor to rebut the "needs based" Chapter 7 test is to establish that extraordinary circumstances require additional monthly expenses, and that these expenses would make it impossible for the debtor to pay the twenty-five percent or five thousand dollars over five years. If the debtor is unable to rebut the presumption of abuse, his case is involuntarily converted into a Chapter 13 case.

Thus, an artist filing for Chapter 7 bankruptcy who fails to meet the new "needs based" test would not be able to take advantage of the Chapter

309. Telephone Interview with Dina Ellis, supra note 21.
7 automatic rejection. The debtor will then have to establish that the recording contract will be disadvantageous or onerous to him or her. This creates a higher burden for the recording artist/debtor filing for a Chapter 7 bankruptcy. However, it is imperative to note that the higher burden applies to everyone filing for a Chapter 7 bankruptcy.

The general provision of the conference report also provides that where the presumption of abuse has been rebutted or excused, the court can still consider whether the case has been filed in bad faith. The second portion of the needs based test lowers the standard used to prove bad faith violations of the bankruptcy process from a "substantial abuse" test to merely an "abuse test." However, this may not be a substantive change because no real definition of either term exists.

Therefore, even if an artist can satisfy the rebuttable presumption of bad faith, the court may still dismiss their case or involuntarily convert it to a Chapter 13 bankruptcy upon a finding of mere "abuse" (such as bad faith or lack of financial distress), instead of the former "substantial abuse" standard.

2. The Bill’s New Standard for Considering the Rejection of Personal Service Contracts

The compromise reached by the RIAA and the unions raises the bar even higher than the already substantial standard for debtors filing for Chapter 7. The revised provision reads that, even where the debtor has rebutted the presumption of abuse, the court can dismiss the case or convert it into a Chapter 13 case if the totality of the debtor’s financial circumstances demonstrates abuse. This is a far lower standard than required by current case law in bad faith filings.

The provision specifically directs the courts to examine whether the debtor "seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor" when considering the totality of

315. See supra Part II.
316. See supra Part II.B.
320. Id.
the circumstances. Generally, this seems to create a lower burden of proof to either dismiss or convert the case to Chapter 13. It also seems to direct the court to pay special attention to situations where there is a rejection of a personal service contract at issue.

3. How the Proposed Law Affects Current Law

While the proposed changes may seriously hamper artists’ efforts to effectively utilize bankruptcy for their needs, there are some comforting notions about the current state of the changes. First, because the 1998 bill did not become law and was strongly opposed by the White House, any reintroduced bill would likely be altered before it is enacted into law.

Second, the “needs based” bankruptcy test and the proposed test for personal service contracts only applies to cases filed under Chapter 7. If the court decides that a Chapter 7 case involving a recording contract does not meet these standards, the court may convert the case to a Chapter 13 case. This does not preclude the rejection of a recording contract. However, the court still has discretion to dismiss the case.

Next, as with any newly created law, the courts will have to struggle to interpret and determine how to apply the tests set forth by the legislature. This may allow courts to construe the revised provisions more moderately than they appear as drafted. As a spokesperson for the RIAA contended, because the proposed tests apply to all personal service contracts and not merely record contracts, these tests will generate more case law than a specific provision singling out recording artists.

Because the new standard for personal service contracts allows judges to look for more than bad faith, which is a heavy burden for record labels, perhaps the courts will be able to examine the facts of a given case more thoroughly. This suggests that a court could look beyond a recording artist’s negative royalty balance to determine if the artist’s other liabilities are enough, on their own, to determine bad faith.

322. See id.
323. See supra Part V.A.
325. See id. Converting a case to Chapter 13 does not allow automatic rejection of debt. See supra Part II.
326. See supra Part II.
328. Telephone Interview with Carry Sherman, supra note 21.
329. See supra Part IV.C.
330. Telephone Interview with Carry Sherman, supra note 21.
4. The Compromised Provisions Are Still Overprotective of Record Companies and Under-Protective of Recording Artists

The major concern for the record companies involved in bankruptcy disputes with recording artists is that they will lose contracts with artists on the verge of success, such as Toni Braxton. With respect to such artists, the "need based" bankruptcy changes are a sufficient remedy. Because record royalties often accumulate long before the artist’s royalty balance is adjusted, the record label can demonstrate that the artist is expected to generate at least the five thousand dollar minimum payment over five years prescribed by the "need based" bankruptcy test. This is especially true considering that the test also provides a standardized monthly budget for petitioners, alleviating the problem of the over-spending artist.

Because an artist who does not qualify for the "need based" test would either have his or her case dismissed or be forced into a Chapter 13 bankruptcy, the record companies’ worries would be resolved. A Chapter 13 bankruptcy requires that the debtor satisfy the "business judgment" test. Here again, if the record company could show that the artist was about to benefit from the recording contract, it would not be in the artist’s best interests to reject the contract. Thus, it would be proper for the court to refuse to grant a motion to reject the contract. While the new contract may better enable the artist to repay their debts, it would be inequitable to allow a greedy debtor to escape contractual obligations and leave the record company without substantial remedies.

However, the proposed provision goes further than this. It adds special requirements that appear to lower the standard for finding an unlawful abuse of the bankruptcy system. Because the provision specifically addresses personal service contracts, it appears to require a stricter standard to review the circumstances when contracts like recording agreements are at issue. For example, a poor and struggling recording artist might be able to pass the "need based" test, but would ultimately fail when the court notes that the artist was seeking to reject a recording contract that could yield some financial benefit. This seems counter to the

331. See Holland, supra note 286, at 8.
332. See supra Part III.C.
333. See supra Part III.C.
334. See supra Part III.A.1.
335. See supra Part II.B.
336. See supra Part V.B.2.
Code's promise for a "fresh start" for those in need of relief from financial distress.\textsuperscript{338}

\textit{Watkins} demonstrates that when there is alleged manipulation of the bankruptcy system, courts are willing to carefully examine all of the circumstances surrounding an artist's Chapter 7 petition.\textsuperscript{339} A bad faith analysis test like the test used in \textit{Watkins} would catch debtors who were truly free from financial distress. Moreover, if recording artists have no substantial chance of recouping their negative royalty balances, then the artists will only continue to accrue more negative royalties on future albums, if any. Therefore, such artists will not have the opportunity to make any money from their recordings beyond the advances they originally received, putting them in debt to the record company.

VI. CONCLUSION

As bankruptcy case law regarding the rejection of record contracts has developed, record companies should not fear that artists will file bankruptcy solely to reject their recording contracts. Generally cases involving explicitly illegitimate purposes and abuses of the bankruptcy system, like \textit{Carrere}, have been dismissed by a finding of bad faith. Bankruptcy law already grants record companies control against successful artists that feign the need for the help of bankruptcy. Adding more specific legislation to make the rejection of record contracts almost impossible for those truly in need is an unnecessarily harsh reaction to extreme cases.

Perhaps the best solution would be for the record companies to attack the root of the problem rather than the manifestation. It would be beneficial to all parties involved if record labels initiated financial training for their artists who do not understand how money flows in the recording business. Artists could then maximize the money they earn in the event that they are not the one out of a million superstar. Moreover, record labels could better ensure that they would not be faced with bankruptcy cases.

Finally, rejection of a recording contract does not necessarily preclude the enforceability of covenants not to compete or the availability of equitable remedies such as negative injunctions.\textsuperscript{340} However, the case law in this area is unsettled and unclear.\textsuperscript{341} While a negative injunction will not affect a record company's ability to capitalize on further works of the

\begin{itemize}
  \item \textsuperscript{338} See \textit{supra} Part I.
  \item \textsuperscript{339} See \textit{supra} Part IV.B.2.
  \item \textsuperscript{340} See \textit{In re} Brown, 211 B.R. 183 (Bankr. E.D. Pa. 1997).
  \item \textsuperscript{341} Wald, \textit{supra} note 25, at 3.
\end{itemize}
debtor, it will allow the record company to prevent other companies from benefiting at their expense.\footnote{342. For a more thorough discussion, see Wald, \textit{supra} note 25, at 3.}

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