"[A] bird that can sing and will not sing must be made to sing."[1]
What happens when that bird is a recording artist arguing his/her right to reject obligations under a recording contract in a bankruptcy proceeding?

BANKRUPTCY & ENTERTAINMENT LAW: THE CONTROVERSIAL REJECTION OF RECORDING CONTRACTS

INTRODUCTION

In 2002 the number of bankruptcy filings reached a record high of 1.58 million.[2] This figure constitutes a 5.7% increase over the previous year according to the Administrative Office of the U.S. Courts.[3] Over the past 20 years there has been a 415% increase in bankruptcy filings[4] and the entertainment arena has not been shielded from this trend.[5] This increase has been characterized as a "double-edged sword . . . [that] threatens to substantially disrupt the standards and practices of the record industry while it simultaneously levels the playing field and forces record companies to pay their artists more."[6]

This note will examine both the positive and negative aspects of bankruptcy in the entertainment industry, with a specific focus on its impact on the recording industry. Before delving into this topic it is important to first highlight the pertinent

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[1] *In re* Noonan, 17 B.R. 793, 798 (Bankr. S.D.N.Y. 1982) (quoting De Rivafinoli v. Corsetti, 4 Paige Ch. 263, 270 (N.Y. Ch. 1833)).

[2] *See* Joseph Anthony, *Why Bankruptcy Reform May Fail Again in 2003*, MONEY MATTERS [hereinafter Anthony] (listing five reasons why 2002 bankruptcy bill failed), *available at* http://www.bankruptcyfinder.com/article%20folder/failagain.html (last visited Oct. 21, 2003); Rali Mileva, *Bankruptcy Filings Hit Historic Highs*, ABI World (discussing how 2002 bankruptcies filed led to historic records), *at* http://www.abiworld.org/release/3Q02.html (last visited Oct. 21, 2003); Rali Mileva, *Record Breaking Bankruptcy Filings Reported in 2002*, [hereinafter *Record Breaking Bankruptcy Filings*] (stating total bankruptcies filed in 2002 broke record highs), *at* http://www.abiworld.org/release/4Q02.html (last visited October 21, 2003).

[3] *See* Anthony, *supra* note 2; *Record Breaking Bankruptcy Filings, supra* note 2.

[4] *See U.S. Bankruptcy Filings 1980-2002 (Business, Non-Business, Total)*, (listing business and non-business filings from 1980 to 2002), *at* http://www.abiworld.org/stats/1980annual.html (last visited October 21, 2003).

[5] *See* RICHARD STIM, MUSIC LAW: HOW TO RUN YOUR BAND'S BUSINESS (3d ed. 2003). An excerpt from Stim's book highlights some of the larger known recording artists that have succumbed to bankruptcy over the years.

> Meat Loaf, whose albums sold more than 20 million copies, filed for bankruptcy in 1983 . . . Singer Toni Braxton lost millions in bad business deals and filed for bankruptcy in 1998. Rap star Luther Campbell gave up his 36-hole golf course and other assets when he filed for bankruptcy in the 1990s. As a result of legal hassles with MCA Records, Tom Petty filed for bankruptcy in the 1970s, a half million dollars in debt . . . Faced with a breach of contract lawsuit, funk music superstar George Clinton was prohibited from recording and forced into bankruptcy in 1985 . . . Bankruptcy and tax debts forced Marvin Gaye to leave the U.S. in 1982. Ray Sawyer, aka Dr. Hook, had a monster hit with "The Cover of the Rolling Stone," but the band went broke due to financial mismanagement. The band's first album after merging from bankruptcy court was titled "Bankruptcy."

Id.

[6] Wallace Collins, Esq., *Bankruptcy: An Extreme Remedy for Unfair Contracts*, *at* http://www.outersound.com/osu/contracts/bankrupt.html (last visited October 21, 2003).

areas of both entertainment law and bankruptcy law. The recording contract is probably the most logical place to start, since chronologically this is where the conflict begins. Following a basic explanation of how recording agreements typically function, this note will explain the most common forms of bankruptcy filings used by entertainment artists; namely, chapter 7[7] and chapter 11[8] bankruptcy. This will be followed by a demonstration of how these two legal disciplines intertwine in the context of entertainment bankruptcies, particularly examining the consequences posed by the recording contract, defined as an executory contract and the consequences of using such a definition. This note will also examine the automatic rejection of executory contracts under chapter 7 bankruptcy proceedings, as well as, the judicial processes of rejecting the recording contract under a chapter 11 bankruptcy proceeding. The discussion will then forge into the requirements for artist-debtors under the current system and the dangers of abuse that accompany this system. Finally, there will be a short summary of the concerns of both record companies and individual artists with regard to the bankruptcy law system, and a discussion of recently proposed changes set out to combat potential abuse.

I. THE RECORDING CONTRACT

Often individual artists tend to see the recording contract in a different light than the record company. Generally, when artists first get signed by a record company, they are in a position where they enjoy far less bargaining power than the sophisticated record company when it comes to setting the terms of the recording contract. This results in contracts that artists claim are unconscionable or unfair at best. In a highly publicized speech to the Digital Hollywood conference, recording artist Courtney Love demonstrated the unbalanced nature of the recording contract.[9] In the speech, she presented the financial results for a hypothetical band that sells a million records with a 20% royalty deal.[10] According to her hypothetical, the band would just break even, with a net gain of zero, while the record company would have already made $7 million, while retaining ownership of the music in

[7] 11 U.S.C. § 701 (2002).

[8] 11 U.S.C. §§ 1101–14.

[9] *See* Neva Chonin, *Courtney's Love Note*, S.F. CHRON., Apr. 15, 2001, at 44 (discussing Love's Digital Hollywood speech and calling for unionizing musicians), *available at* http://sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2001/04/15/PK204452.DTL (last visited Oct. 27, 2003); Abigail Wild, *The Downloading Dilemma*, HERALD (Glasgow), Aug. 18, 2001, at 12 (highlighting excerpts from Love's May 2000 Digital Hollywood conference speech); *see also* Courtney Love, *Artists Rights and Record Companies*, (reprinting open letter to fellow recording artists asking them to join her battle to obtain more power for artists and additional rights protection), *at* http://www.therecordindustry.com/courtney_artist_rights.htm (last visited Oct. 27, 2003).

[10] *See* Courtney Love, *Courtney Love's Manifesto* [hereinafter *Courtney Love's Manifesto*] (demonstrating how recording contracts work and examining royalty payments to artists and copyright ownership issues), *at* http://www.ambrosiaproductions.net/docs/clm.pdf (last visited Oct. 26, 2003); *see also* Courtney Love, *The Internet Strikes Back*, COURIER MAIL (Queensland, Austl.), BAM, Aug. 12, 2000, at M8 (offering Courtney Love's speech in edited version) [hereinafter *Internet Strikes Back*]; Robert Wright, *The 'Hole' Truth in the MP3 Debate*, TORONTO STAR, 1st ed., June 22, 2000 (reporting on Love's speech and including excerpts).

perpetuity.[11] In reality, most artists' recording deals are worth a fraction of that royalty rate.[12]

Love's hypothetical may be a bit clearer after an explanation of how a recording contract typically functions. There are several factors that render the recording contract particularly complex, including the length of the term, production, recording and delivery requirements, and the form of compensation paid to the artist.[13] The complications increase considerably as a result of the royalty payments scheme, whereby the artist is paid royalties based on the sales of the records.[14]

The exclusive recording agreement includes terms by which individual artists are obligated to record and deliver recordings to their record label on an exclusive basis.[15] The agreement also specifies the terms by which the record company is bound to compensate the artist for his/her services.[16] A basic principle of the exclusive recording agreement is that the length of the agreement is linked to the recording of a specified number of albums by the artist,[17]followed by the delivery of such albums to the record company.[18] After a recording artist satisfies the delivery requirement, the record company has the option of renewing the contract for another term. The amount of options granted to the record company is another

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[11] *See Courtney Love's Manifesto*, *supra* note 10 (calculating posed hypothetical scenario's financial results), *at* http://www.ambrosiaproductions.net/docs/clm.pdf (last visited Oct. 26, 2003); Courtney Love, *Courtney Love Does the Math*, Salon, June 14, 2000 (running through recording hypothetical's financial implications), *at* http://dir.salon.com/tech/feature/2000/06/14/love/index.html (last visited Oct. 27, 2003); *Internet Strikes Back supra* note 10, at M8 (presenting Courtney Love's speech in edited version); Wright, *supra* note 10 (comparing record company and recording artist relationship to master and slave).

[12] *See* Greg Kot, *You Say You Want a Revolution; A New Artists' Coalition Puts the Record Industry's Billion-Dollar Business Model at the Crossroads: Shrink or Perish*, CHI. TRIB., Feb. 24, 2002, at C1 (discussing typically small royalty rates provided by major record labels), *available at* 2002 WL 2627541; Tim Wilson, *Who You Calling a Pirate?* ("Best-selling R&B trio TLC sold $175 million worth of records for royalties of less than TWO percent, and balladeer Toni Braxton, with sales of over $180 million, received less than 35 cents per album for her efforts."), *at* http://www.plugincentral.com/aHTM/Features/PluggedIn/Pirate/BettingOnTheNet1.htm (last visited Oct. 27, 2003).

[13] *See* Gary Stiffleman & Bonnie Greenberg, *A Guide to Understanding the "How's" and "Why's" of Recording Agreements*, *in* 8-159 ENTERTAINMENT INDUSTRY CONTRACTS § 159.05 (Matthew Bender & Co., Inc. 2002) (outlining difficult portions of recording agreements). *See generally* Lynn Morrow, *The Recording Artist Agreement: Does it Empower or Enslave?*, 3 VAND. J. ENT. L. & PRAC. 40, 43–8 (2001) [hereinafter *Understanding Recording Agreements*] (describing in detail provisions often found in recording contracts).

[14] *See* Morrow, *supra* note 13, at 45–48 (explaining artist royalties)*; see also* Thomas v. Lytle, 104 F.Supp.2d 906, 919–20 (M.D. Tenn. 2000) (utilizing two expert witnesses qualified specifically in music accounting and royalty accounting fields to translate the royalty scheme). *See generally* Jasper v. Bovina Music, Inc., 314 F.3d 42, 46–47 (2d Cir. 2002) (discussing complexity of interpreting royalty agreements).

[15] *See Understanding Recording Agreements*, *supra* note 13, at § 159.03.

[16] *See Termination Agreement Between Record Company and Artists with Commentary*, *in* 8 ENT. INDUSTRY CONTRACTS 162–03, at 162–42, (Donald Farber ed., 1986) (discussing effects of expired or terminated recording agreement).

[17] *See id*. (demonstrating agreements are based on number of records produced and delivered rather than fixed period of months or years).

[18] *See* Gary Stiffleman & Bonnie Greenberg, *Exclusive Recording Agreements Between An Artist and A Record Company, in* 8 ENTERTAINMENT INDUSTRY CONTRACTS ¶ 159.03, at 159–16 (Donald C. Farber ed., 1986) [hereinafter *Exclusive Recording Agreements*] (relating terms of options to date of delivery).

specific provision of the recording agreement.[19] Although there are a fixed number of options in the contract, the temporal length of the contract is difficult to determine. Since the life of the agreement is based on delivery requirements and the record company has the exclusive right to exercise options to renew, the length of a recording contract is generally undeterminable. This can lead to a recording artist being subject to a contract that extends over many years.[20]

Another basic core feature of the recording agreement is the contract's exclusive nature. Most recording agreements include exclusivity provisions, which require the artist to record solely for that record company throughout the term of the contract.[21] Additionally, all recordings made by the artist during such term are the property of the record company.[22]

Next, we turn to the contract's most important provisions with respect to the likelihood of problems in the bankruptcy context: the agreement's payment or compensation structure. Generally, the contract is structured as an advance/recoupment arrangement, where the record company advances money for the dual purposes of compensating the artist and supplying production funds for recordings.[23] These sums are recoupable by the record company from the artist's record royalties.[24] In addition to recording costs, these advances often include the cost of video production, tour support and independent promotion.[25]

Artist compensation is primarily from the payment of royalties, which are determined by applying a specified royalty rate to record sales.[26] The royalty rate is

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[19] *See id*. at 159–16 ("The use of options by the record company reduces the risk to the company of obligating itself to pay for the recording of records from an artist who is unsuccessful, while ensuring that the company can enjoy a stream of product from a successful artist.").

[20] *See id*. ("There is one exception to the term running so long and that is in the State of California, where the labor code prescribes a seven year limitation on the term of any exclusive employment agreement, i.e., no exclusive employment agreement can be enforceable after a term of seven years."); *see also* CAL. LAB. CODE § 2855 (Deering 1976) (describing "Seven Year Statute" which imposes seven year term limit on exclusive service agreements in California).

[21] *See* Kathryn Starshak, *It's the End of the World as Musicians Know It, Or Is It? Artists Battle the Record Industry and Congress to Restore Their Termination Rights in Sound Recordings*, 51 DEPAUL L. REV. 71, 103 (2001) (stating most recording contracts have exclusivity provisions); MARK HALLORAN, THE MUSICIAN'S BUSINESS & LEGAL GUIDE 326, 333 (2d ed. 1996).

[22] *See Exclusive Recording Agreements*, *supra* note 18 (stating exclusive recording contracts require artists to turn over all master recordings to record companies).

[23] *See generally* Waldschmidt v. C.B.S., Inc., 14 B.R. 309 (M.D. Tenn. 1981) (describing agreement between country musician and his record company where advances were made subject to repayment out of eventual royalties).

[24] *See Exclusive Recording Agreements*, *supra* note 18 ("Recoupment of royalties may be on a fully cross-collateralized basis . . . any unrecouped sums payable to a record company in connection with one project may be recouped from royalties earned by another project of the artist."); *see also In re* Creed Taylor, Inc., 10 B.R. 265, 266 (Bankr. S.D.N.Y. 1981) (demonstrating enforceability of royalty provisions).

[25] *See* Ryan S. Henriquez, *Facing the Music on the Internet: Identifying Divergent Strategies for Different Segments of the Music Industry in Approaching Digital Distribution*, 7 UCLA ENT. L. REV. 57, 111 ("The advance is intended to cover the artist's living expenses, recording/producing expenses, promotion expenses, equipment expenses, and album artwork expenses.").

[26] *See id*. (discussing breakdown of royalty rate and payment to recording artist); Sarah Luck Pearson, *The Suit: An Anonymous Executive Talks*, L.A. WEEKLY, Mar. 26, 1999, at 32, *available at*

based on a complex calculation involving numerous variables.[27] The royalties are not actually paid to the artist until after the recoupment by the record label of all advances.[28]

To summarize, recording contracts typically provide for a "recording fund" or "album fund" for each album, from which the artist pays all costs to produce the records and the artist gets to keep any remaining portion of the fund as pre-royalty compensation.[29] This type of arrangement can be seen as beneficial to both the record company and the artist. It is intended to motivate the artist to be more responsible in spending money on recording costs, while simultaneously giving the artist the ability to draw a salary from the leftover portion of the fund. The arrangement also benefits the record company by allowing a reduction in the payment to the artist by any amount that he/she exceeds a set budget of proposed expenses.[30]

Compared to many other employment contracts, the compensation method in recording agreements makes it easier for individual artists to file for bankruptcy. The advance/recoupment structure makes the recording contracts vulnerable to rejection in bankruptcy proceedings.[31] The substantially unrecouped balance of the artist is perceived as a bona fide debt in bankruptcy court, which renders the contract and the subsequent options exercisable solely at the record company's discretion, subject to termination by the court if the contract terms cannot be renegotiated in a manner favorable to both parties.[32] A new trend in contract renegotiation has emerged, whereby artists' threats of bankruptcy provide greater leverage at the bargaining table and consequently redress the imbalance of economic power in the record industry.[33] For this tactic to work, a debtor must demonstrate a degree of insolvency or some financial distress under the terms of the law, since courts are capable of dismissing bankruptcy filings that are made solely for the purpose of breaking a contract and may deny rejection of the contract.[34] This is a somewhat weak requirement, because if an artist is in a substantially unrecouped position with his/her record label, the artist can easily show that his/her

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http://www.laweekly.com/ink/99/18/music-pearson2.php (discussing how onerous record contracts can be to everyone but record companies).

[27] *See* Morrow, *supra* note 13, at 50–51 (providing sample royalty calculation).

[28] *See* Todd M. Murphy, *Crossroads: Modern Contract Dissatisfaction as Applied to Songwriter and Recording Agreements*, 35 J. MARSHALL L. REV. 795, 803–05 (2002) (discussing payment of royalties to artist in exchange for transfer of rights by artist).

[29] *See Exclusive Recording Agreements*, *supra* note 18, at 159-17 to 159-18 (discussing money advances to produce recordings).

[30] *Id*.

[31] Collins, *supra* note 6 (discussing advance/recoupment structure of record contracts).

[32] *Id*.

[33] *Id*.; *see also* Murphy, *supra* note 28, at 795 (discussing artists' use of bankruptcy).

[34] Collins, *supra* note 6; *see In re* Carerre, 64 B.R. 156, 160 (Bankr. C.D. Cal. 1986) (disallowing rejection of entertainment contract because debtor's motivation was solely to breach her contract and enter into more lucrative one).

debts exceed his/her income, which is enough to satisfy the requirement of financial distress and affords the debtor the protections of the Federal Bankruptcy Code.[35]

II. BANKRUPTCY

A. Bankruptcy Options for Recording Artists

For the purposes of this note, there will be an assumption that the debtor party to the contract is the recording artist and the non-debtor party is the record company, since this is the typical scenario where conflict arises. When recording artists file for bankruptcy they usually file a petition for bankruptcy under chapter 11[36] or chapter 7[37] of the Bankruptcy Code.[38] Chapter 13 may also be a viable option, particularly for smaller recording artists.[39] However, chapter 13 is generally reserved for small-scale debtors owing less than $290,525 in noncontingent, liquidated, unsecured debts and less than $871,550 in noncontingent, liquidated, secured debts.[40] The recording agreements between major record labels and individual artists tend to exceed these amounts and therefore disallow chapter 13 as an option. In order to file under chapter 13 the debtor must also be an "individual with regular income," which is defined as one whose income is sufficiently stable to make payments under a chapter 13 plan.[41] The nature of compensation whereby the recording artist does not typically draw a salary, but rather is paid in lump sum, often precludes artists from using chapter 13 as well. Since chapter 13 applies only to a small number of recording artists, this note will focus primarily on chapter 7 and chapter 11 filings.

There are subtle, but significant differences between the chapter 7 and chapter 11 provisions. Chapter 7 of the Bankruptcy Code is available to both individual and business debtors, and its purpose is to fairly distribute the debtor's available property to creditors.[42] Most debts, other than those that have been reaffirmed or assumed, are discharged, enabling the debtor to enjoy a fresh financial start.[43]

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[35] *See* John P. Musone, *Crystallizing the Intellectual Property Licenses in Bankruptcy Act: A Proposed Solution to Achieve Congress' Intent*, 13 BANKR. DEV. J. 509, 526–27 (1997) (citing several entertainers who utilized bankruptcy proceedings as method of renegotiating or even rejecting their contracts).

[36] 11 U.S.C. § 1101 (2002).

[37] 11 U.S.C. § 701.

[38] *See* 2 COLLIER ON BANKRUPTCY ¶ 301.01, at 3 (Lawrence P. King et al. eds., 15th ed. rev. 1997) (comparing chapter 7 and chapter 11).

[39] *See* 11 U.S.C. § 109 (setting forth debtor eligibility requirements for chapter 13 proceeding).

[40] *See* Tim A. Thomas, *Classification of Debt as Liquidated, Unsecured, or Contingent, for Purposes of Determining Debtor's Eligibility, Under § 109(e) of the 1978 Bankruptcy Code (11 USCS § 109(e)), for Chapter 13 Proceeding*, 95 A.L.R. FED. 793 (Supp. 2003) (discussing requirements for filing under chapter 13).

[41] *See* 8 COLLIER ON BANKRUPTCY ¶ 1300.40, at 64–71 (Lawrence P. King et al. eds., 15th ed. rev. 1997) (containing general analysis of chapter 13).

[42] *See generally* 6 COLLIER ON BANKRUPTCY ¶ 700.01, at 1–2 (Lawrence P. King et al. eds., 15th ed. rev. 1997) (providing overview of requirements and purpose of chapter 7).

[43] *Id.*

Because chapter 7 includes an automatic rejection of all executory contracts unless voluntarily assumed, which typically includes his/her recording agreement, a chapter 7 bankruptcy is more favorable to the artist.[44] Chapter 11 of the Bankruptcy Code is available for both business and consumer debtors and its purpose is to rehabilitate a business or reorganize an individual's finances utilizing a reorganization plan approved by the court.[45] Under these provisions in the Bankruptcy Code debtors/artists are free to reject unfavorable executory contracts, specifically their recording contract. Record companies have attempted to keep artists from exercising their right to reject these contracts under both chapter 7 and chapter 11 proceedings based on several different theories of law. One possible avenue is through the definitional discrepancies of identifying the recording contract as executory. Additionally, record companies often look to other provisions in the contract that may prevent the artist from rejecting the exclusivity provisions in the contracts.

B. Rejection of the "Executory Contract"

The rejection of executory contracts is governed by section 365 of the Bankruptcy Code.[46] Since the term "executory" is not specifically defined in the Code,[47] courts determine the term's meaning on an ad hoc, case-by-case basis.[48] Recent case law has asserted that Congress's purpose in leaving the term undefined was to avoid misinterpretation and confusion since Congress assumed the term was commonly understood.[49] Although, Congress's original intent in leaving the term undefined was to avoid misinterpretation in the courts, the effect has been to muddy up the waters in the context of bankruptcies resulting from recording contracts. Record companies have continuously attempted to use this lack of a definition of "executory" as an indication that the recording contract might not actually be such an agreement.[50]

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[44] *See generally In re* Noonan, 17 B.R. 793 (Bankr. S.D.N.Y. 1982) (demonstrating artist's preferences for chapter 7 over chapter 11, highlighting their differences).

[45] *See generally* 7 COLLIER ON BANKRUPTCY ¶ 1101.01, at 3–6 (Lawrence P. King et al. eds., 15th ed. rev. 1997) (providing overview of requirements and purpose of chapter 11).

[46] 11. U.S.C.S. § 365 (2002).

[47] *Id*. The House Judiciary Report states, "[t]hough there is no precise definition of what contracts are executory, it generally includes contracts on which performance remains due to some extent on both sides." *Id*.

[48] *See In re* Cloyd, 238 B.R. 328, 333 (Bankr. E.D. Mich. 1999) (determining whether contract is executory).

[49] *See id*. (stating Congress intentionally did not define term because it felt term's meaning was well understood); *In re* Cardinal Indus., Inc., 146 B.R. 720, 725 (Bankr. S.D. Ohio 1992) (reasoning more explicit statutory language could lead to unintended omissions or inclusions (citing *In re* Sun City Inv., Inc., 89 B.R. 245 (Bankr. M.D. Fla.1988))); H.R. DOC. NO. 93–137, at 199 (1973) (report on Commission Bankruptcy Laws) (stating explicit language would risk unintended omissions or inclusions).

[50] *See In re* Taylor, 91 B.R. 302, 311 (Bankr. D. N.J. 1988) (debating whether recording contract is executory and ultimately deciding it is); *In re* Monument Record Corp., 61 B.R. 866, 867–68 (Bankr. M.D. Tenn. 1986) (discussing whether recording contract was executory contract within meaning of Code).

Despite this tactic, most courts have found the recording contract to fall within the definition of an executory contract for personal services.[51] Based on the assumption that the recording contract is in fact executory, section 365 plays an important role in determining the consequences of having such executory contracts in the context of a bankruptcy proceeding. Section 365(a) provides, "[e]xcept as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."[52]

Subsection (d) of this section clarifies the significance of filing for a chapter 7 bankruptcy versus a chapter 11 bankruptcy. It states:

> (d)(1) In a case under *chapter 7* of this title, *if the trustee does not assume or reject an executory contract* or unexpired lease of residential property or of personal property of the debtor *within 60 days* after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then *such contract or lease is deemed rejected*.
> (2) In a case under *chapter* 9, *11*, 12, or 13 of this title, *the trustee may assume or reject an executory contract* or unexpired lease of residential real property or of personal property of the debtor *at any time before the confirmation of a plan but the court*, *on the request of any party* to such contract or lease, *may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease*.[53]

The distinctions between the two sections are clear. If filing under a chapter 7 bankruptcy, the contracts are automatically rejected unless some affirmative action is taken to assume them while under a chapter 11 proceeding the debtor must affirmatively seek to have the contract rejected or assumed.

C. Property of the Estate

Upon filing a petition for bankruptcy, an estate is created under section 541 of the Code.[54] This estate maintains an identity separate from the debtor,[55] and consists

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[51] *See In re* Taylor, 103 B.R. 511, 515 (Bankr. D. N.J. 1989) (holding executory personal service contracts, including recording agreement, can be rejected in a bankruptcy proceeding filed in good faith); *In re* Noonan, 17 B.R. 793, 798 (Bankr. S.D.N.Y. 1982) (stating recording contract is not asset that can be used for its benefit); Jessica L. Kotary & Nicole L. Inman, Note, *Eliminating "Executory" from section 365: The National Bankruptcy Review Commission's Panacea for an Ailing Statute*, 5 AM. BANKR. INST. L. REV. 513, 523–29 (1997) (citing various caselaw supporting proposition that recording contracts are executory personal services contracts).

[52] 11 U.S.C. § 365(a) (2002).

[53] 11 U.S.C. § 365(d)(1)–(2) (emphasis added).

[54] 11 U.S.C. § 541.

of property owned by the debtor on the date a petition for bankruptcy is filed.[56] The manner in which the property is administered to creditors in bankruptcy proceedings varies depending on whether the debtor filed under chapter 7, chapter 11, or chapter 13.[57] In chapter 7 proceedings, the property is administered with the aid of a court appointed trustee.[58] Conversely, a court-appointed trustee is rarely used in chapter 11 proceedings, while in chapter 13 proceedings a trustee is generally appointed, though the debtor, and not the court, assumes or rejects the contracts. If there is no trustee appointed the artist filing for bankruptcy becomes the debtor-in-possession.[59] Only those in the capacity of trustee or debtor-in-possession have the authority to assume or reject executory contracts.[60]

Often record companies assert that the contract is not part of the estate and therefore the obligations under the contract cannot be discharged.[61] Courts have differed in opinion as to whether an unassumable contract, or a contract that has not been assumed, may become property of the estate.[62] Record companies rely heavily on the wording of section 541(a)(6)[63] when arguing that the proceeds of the debtor's post-petition personal services are not property of the estate, thus rendering the personal contract itself not property of the estate.[64] If the record companies' contentions were correct, the recording contract would be unable to be rejected through bankruptcy proceedings. The courts seem to overwhelmingly find for the artist, or debtor, in these types of scenarios, contending that to do otherwise would

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[55] *See* David C. Norrell, Note & Comment, *The Strong Getting Stronger: Record Labels Benefit from Proposed Changes to the Bankruptcy Code*, 19 LOY. L.A. ENT. L.J. 445, 450 (1999) (discussing nature of estate in bankruptcy proceeding).

[56] *See* Fitzsimmons v. Walsh (*In re* Fitzsimmons), 20 B.R. 237, 239 (B.A.P. 9th Cir. 1982) (defining "estate" and stating section 541 applies to cases filed under chapters 7, 11, and 13).

[57] *Id.*

[58] *See* 11 U.S.C. § 704(1) (listing duties of trustee).

[59] *See In re* Carrere, 64 B.R. 156, 159 (Bankr. C.D. Cal. 1986) (discussing rights of trustee versus debtor-in-possession and concluding they are virtually identical).

[60] *See* 11 U.S.C. § 365 (2002) (giving trustees ability to reject onerous contracts); 11 U.S.C. § 1107 (allowing chapter 11 debtor-in-possession same ability to reject contracts as trustee is entitled to).

[61] *See, e.g., In re* Mitchell, 249 B.R. 55, 58 (Bankr. S.D.N.Y. 2000) (discussing split in courts, but not reaching conclusion on issue); *see also In re* Carrere, 64 B.R. at 158 (discussing issue of whether contract becomes part of estate).

[62] *In re Mitchell*, 249 B.R. at 58; *Compare* Computer Communications, Inc. v. Codex Corp. (*In re* Computer Communications, Inc.), 824 F.2d 725, 730 (9th Cir. 1987) (concluding contract rights become property of estate when case is commenced) *with* Tonry v. Herbert (*In re* Tonry), 724 F.2d 467, 469 (5th Cir. 1984) (stating contract rights become property of estate only when contract is assumed).

[63] 11 U.S.C. § 541(a)(6). This section states, "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, *except such as are earnings from services performed by an individual debtor after the commencement of the case*" shall be included as property of the estate. *Id.* (emphasis added).

[64] *See In re* Cloyd, 238 B.R. 328, 334 (Bankr. E.D. Mich. 1999) (stating *Taylor* court correctly held "appropriate question is not whether the contract is property of the estate but rather, whether or not there are rights and obligations owed by the parties after the petition is filed.") (citing *In re* Taylor, 91 B.R. 302 (Bankr. D. N.J. 1988) (discussing interpretation of section 541(a)(6)).

frustrate the purpose of the Bankruptcy Code, which is to afford debtors a "fresh start."[65]

III. EFFECT OF THE RECORDING CONTRACT ON BANKRUPTCY PROCEEDINGS

A. Restrictive Covenants in the Contract

Another issue that arises in cases dealing with bankruptcies in the entertainment industry is the idea that the covenants not to compete existing in the original recording contract actually survive rejection.[66] To distinguish this theory from the previous argument that the contracts are not property of the estate, here the record company argues that the original recording contract itself may be rejected, but the restrictive covenants, most commonly covenants not to compete, are not included in this rejection. In these types of arguments there are two predominant views that are in conflict.

The first view likens rejection to cancellation; thus deeming all contractual provisions, including the restrictive covenants contained in the contract, breached.[67] The theory is that the contract is rejected in its entirety or not at all.[68] Artists can rely on sufficient case law to support their position that when the artist or debtor rejects an executory contract, all obligations and burdens under the executory contract are also discharged.[69]

In *In re Cloyd,*[70] the record company argued that rejection of the executory contract did not eliminate the exclusivity provisions.[71] The Court disagreed and concluded that the exclusivity provisions were embodied within the contract and

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[65] *See In re Taylor*, 103 B.R. at 515 (stating purpose of Bankruptcy Code is to provide debtors with fresh start).

[66] *See In re Mitchell*, 249 B.R. at 59 (stating although specific performance will not be compelled for breach of contract, it may be appropriate to enforce non-compete provision); *In re Cloyd* 238 B.R. at 334 (discussing issue of whether "exclusivity provision" survives rejection). *See generally In re* Brown, 1997 U.S. Dist. LEXIS 19211, at *14–15 (E.D. Pa. Nov. 26, 1997) (No. 97-5425) (examining covenants not to compete in recording contract with regard to California law).

[67] Alison J. Winick, *Can Superstars Really Sing the Blues? An Argument for the Adoption of an Undue Hardship Standard When Considering Rejection of Executory Personal Services Contracts in Bankruptcy*, 63 BROOK. L. REV. 409, 420–22 (1997).

[68] Bruce H. White & William L. Medford, *Enforcing Covenants Not to Compete After Rejection*, AM. BANKR. INST. J., Sept 2001, at 26.

[69] *See In re Brown*, 1997 U.S. Dist. LEXIS 19211, at *18 (concluding debtor's rejection of the executory contract was a rejection in full); Sharon Steel Corp. v. Nat'l Fuel Gas Distribution, 872 F.2d 36, 40 (3d Cir. 1989) ("While we acknowledge the general principle that a debtor may not reject a contract but maintain its benefits . . . [a] trustee may not 'blow hot or cold'; he must either reject contract in full or assume contract in full, which includes both benefits and burdens.").

[70] 238 B.R. 328 (Bankr. E.D. Mich. 1999).

[71] *Id*. at 334 (citing *In re* Drexel Burnham Lambert Group, Inc.), 138 B.R. 687, 703 (Bankr. S.D.N.Y. 1992)); *In re* W. Chestnut Realty of Haverford, Inc., 177 B.R. 501, 506 (Bankr. E.D. Pa. 1998); Eastover Bank for Sav. v. Austin Dev. Co. (*In re* Austin Dev. Co.), 19 F.3d 1077, 1082–83 (5th Cir. 1994)); *In re* Kilpatrick, 160 B.R. 560, 567 (Bankr. E.D. Mich. 1993)).

could not be separated from the executory personal services contract, and were therefore rejected pursuant to section 365 of the Code.[72]

However, record companies might argue that the covenant not to compete was a detached agreement that required separate negotiation, and as such, different consideration was furnished for the purposes of avoiding rejection specifically to this restrictive covenant.[73] This reasoning exemplifies the second predominant view. In *American Broadcasting Cos., Inc. v. Wolf*[74] the court demonstrated its ability to restrain the rejection. It stated in pertinent part:

> If the employee refuses to perform during the period of employment, was furnishing unique services, has expressly or by clear implication agreed not to compete for the duration of the contract and the employer is exposed to irreparable injury, it may be appropriate to restrain the employee from competing until the agreement expires.[75]

This language has been employed to assert that enforcing the covenants not to compete may be proper in some circumstances.[76] When a debtor in bankruptcy rejects an agreement containing a covenant not to compete, that rejection might not preclude the covenant from being enforced.[77] "[M]ere rejection does not magically erase the contract and/or the covenant."[78] The Bankruptcy Court for the Eastern District of Pennsylvania is another venue that has followed the second approach demonstrated in *In re Brown*,[79] where the court held that the rejection of the contract does not mean that the debtor is free to enter into any other contracts or that the record company has no rights against him.[80]

The reason for the differing views is the concern that with the first and more commonly used approach rejection does not provide adequate redress to the non-debtor or record company and allows the artist to entirely avoid contractual obligations.[81] Under the second view, the covenant not compete is regarded as a

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[72] *In re Cloyd*, 238 B.R. at 334 ("The [d]ebtor's promise is memorialized in the recording contract as a future promise that remains unperformed and is deemed executory in nature and subject to rejection.").

[73] *See In re* Annabel, 263 B.R. 19, 23 (Bankr. N.D.N.Y. 2001) (deciding whether agreement not compete survived the rejection of contract); *In re* Mitchell, 249 B.R. 55, 59 (Bankr. S.D.N.Y. 2000) (stating if employee refuses to perform during period of employment and expressly agreed not to compete for duration of contract employee may be restrained from competing until contract expires).

[74] 52 N.Y.2d 394 (1981).

[75] *Id*. at 404.

[76] *See, e.g., In re Mitchell*, 249 B.R. at 59 (recognizing courts may restrain breach of covenants not to compete but declining to exercise its discretion to do so).

[77] White & Medford, *supra* note 68, at 27 (discussing avenues of relief available for enforcement of covenants not to compete after rejection).

[78] *Id*.

[79] 211 B.R. 183 (Bankr. E.D. Pa. 1997).

[80] *See* Winick, *supra* note 67 at 423–24 (discussing relevance of outcome in *In re* Brown, 1997 U.S. Dist. LEXIS 19211, at 15–19 (E.D. Pa. Nov. 26, 1997)).

[81] *Id*.

second contract. The independent covenant not to compete, by its nature, would not be considered an executory contract since the record company would have no performance due and thus would not be capable of rejection. The concern here is that this would enjoin the recording artists from the ability to earn a living and may be considered against public policy.[82] Even if not against public policy, the reasonableness of such covenants not to compete is questionable at best.[83] The above two restrictive covenant views are irreconcilable and diametrically oppose one another giving both record companies and recording artists a forceful argument in determining the viability of restrictive covenants within the recording contract.

B. Involuntary Servitude

In response to the arguments made by record companies calling for artists to be enjoined from complete contract rejection altogether or from attempting to enforce the covenants not to compete after rejection, individual artists have raised an interesting constitutional issue. It has been asserted that to prohibit individual recording artists from rejecting their contracts, would force them into involuntary servitude, since they would be compelled to perform. Such assertions rely on the fact that courts of equity have traditionally refused to mandate performance of a contract for personal services.[84]

In the case of *In re Noonan*,[85] the court cites case law that states that the long-founded principles underlying the traditional refusal to enforce contracts for personal services has been supplemented after the Civil War legislation was enacted.[86] The decision states:

> During the Civil War era, there emerged a more compelling reason for not directing the performance of personal services: the Thirteenth Amendment's prohibition of involuntary servitude. It has been strongly suggested that judicial compulsion of services would violate the express command of that amendment.[87]

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[82] *See In re Brown*, 1997 U.S. Dist. LEXIS 19211, at *15–19 (holding performer was not bound by covenant not to compete and such covenant was rejected along with entire recording contract).

[83] *See* John D. Ingram, *Covenants Not to Compete*, 36 AKRON L. REV. 49, 50 (2002) (stating courts generally will not enforce a covenant not to compete unless it is reasonable in terms of length of time, geographic scope, and type of business activities restricted).

[84] *See In re* Noonan, 17 B.R. 793, 798 (Bankr. S.D.N.Y. 1982) (stating courts of equity will not order specific performance of personal service contracts); *In re* Taylor, 91 B.R. 302, 312 (Bankr. D. N.J. 1988) (noting long standing tradition of equity courts to not grant specific performance of personal service contracts); *see also* 5A ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1204 (1964) (discussing contracts for personal services).

[85] 17 B.R. 793 (Bankr. S.D.N.Y 1982).

[86] *Id.* at 798 (referring to enactment of Thirteenth Amendment) (citing ABC v. Wolf, 52 N.Y.2d 394 (1981)).

[87] *Id.* at 798.

The *Noonan* case looked to the Congressional intent behind the Bankruptcy Code in order to further argue an issue related to the Thirteenth Amendment.[88] The Court did not specifically come to any conclusion with regard to the Thirteenth Amendment implications of involuntary servitude in this case, because it decided the merits of the claim based on alternative theories of law and allowed rejection of the executory contract under those theories.[89] Yet, the Court invited commentary on the issue, stating in a footnote that if the record company was successful and the chapter 11 bankruptcy process unfolded, the court would have had a difficult time confirming a reorganization plan that is "by any means forbidden by law."[90] The Court indicated that it would interpret such a ruling as prohibited by the Thirteenth Amendment.[91] At least one court has followed *Noonan's* lead by considering the Thirteenth Amendment implications. The subsequent case of *In re Taylor* quoted much of the same language from *In re Noonan*, but used this language to suggest that section 541 of the Code encompasses a built-in protection, for the benefit of debtors, from creditors forcing a debtor into servitude for the payment of debts.[92]

This line of cases suggests the theory of involuntary servitude may provide an additional avenue for contract rejection. While there has not yet been a case ruling for rejection on this basis, there is certainly clear language within the courts' decisions to suggest the theory as a viable option.[93]

C. Good Faith

Another potential obstacle to using bankruptcy to address a recording contract is the doctrine of good faith, which may prohibit a filing solely for the purpose of rejecting the specific recording contract. Good faith requirements in bankruptcy proceedings are both implied and express.[94] There is an implied requirement of good faith imposed upon the debtor when initiating a bankruptcy proceeding or filing for bankruptcy.[95] This appears to be required in chapter 7, chapter 11 and chapter 13 Bankruptcy filings. In addition to the implied good faith requirement

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[88] *Id*. at 800 (uncovering congressional intent behind enactment of chapter 13 bankruptcy provisions which stated concerns with Thirteenth Amendment implications, and applying this language to other chapters under Bankruptcy Code).

[89] *Id*. (concluding record company could not involuntarily convert debtor's chapter 7 filing back into chapter 11 proceeding and affect rejectability of executory contracts under these filings).

[90] *Id*. at 800 n.16; *see* 11 U.S.C. § 1129(a)(3) (2002) (providing requirement plain is not "by any means forbidden by law").

[91] *In re Noonan*, 17 B.R. at 800 n.16 (explaining court's limited holding).

[92] *In re* Taylor, 91 B.R. 302, 312 (Bankr. D. N.J. 1988) (suggesting section 541 of Code contains built-in protection for debtors).

[93] *See generally Id*. at 302 (holding recording contract to which debtor obligated himself to perform was executory contract subject to assumption or rejection by debtor); *In re Noonan*, 17 B.R. at 798 (providing language from previous cases suggesting rejection based on involuntary servitude).

[94] *See* Lawrence Ponoroff & F. Stephen Knippenberg, *Legal Theory: The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV 919, 971–72 n.170 (1991) (describing when good faith may be required in bankruptcy proceedings).

[95] *See id*. at 922–23 (discussing implied filing requirement).

upon filing, debtors using chapter 11 and chapter 13 will invariably face an express good faith requirement when offering a reorganization plan to the court.[96]

While there is no literal requirement that a bankruptcy petition be filed in good faith, a good faith requirement has been applied under virtually every bankruptcy law since 1898.[97] The Bankruptcy Code does not particularly define good faith, but many courts have held that a showing of honest intention is enough to satisfy the requirement.[98] Since the good faith requirement may be applied so broadly, courts commonly look to whether the debtor honestly requires the liberal protection of the Code.[99] Many factors are considered material in making a determination as to the debtor's good faith. Courts have recognized that such a determination can only be made on an ad hoc basis.[100]

This issue frequently comes up in the context of entertainment bankruptcies. With the increasing use of bankruptcy as a tool for renegotiation and the vulnerability of recording contracts to bankruptcy proceedings, a question as to the debtor's genuine intent and motive in filing for bankruptcy must be examined.[101] A case often cited in the context of the good faith requirement is *In re Carrere*.[102] In this case, the debtor made it clear that her primary motivation in filing a petition under chapter 11 was to reject her existing executory contract for personal services in order to obtain a more lucrative contract with another entertainment company.[103] The court held that "[i]t would be inequitable to allow a greedy debtor to seek the equitable protection of [the] Court when her major motivation is to cut off the equitable remedies of her employer."[104] It would seem as though this decision would greatly aid record companies in their efforts to keep individual artists from rejecting their contracts for the purpose of procuring other options, however, such a predicament has not necessarily followed.[105]

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[96] *See* 11 U.S.C. § 1129(a)(3) (2002) (requiring good faith for confirmation of reorganization plan under chapter 11); 11 U.S.C. § 1325(a)(3) (requiring good faith for confirmation of plan under chapter 13).

[97] *See In re Taylor*, 103 B.R. at 518 n.7 (stating good faith standard for commencement, prosecution and confirmation of bankruptcy proceedings has been consistently applied (citing *In re* Victory Constr. Co., 9 B.R. 549, 551–60 (Bankr. C.D. Cal. 1981) (setting forth historical survey)).

[98] *See In re* Setzer, 47 B.R. 340, 344–45 (Bankr. E.D.N.Y. 1985) (finding showing of honest intention is sufficient) (citing Johnson v. Vanguard Holding Corp., 708 F.2d 865,868 (2d. Cir. 1983)); Ponoroff & Knippenberg, *supra* note 94, at 925 (discussing history of good faith throughout American jurisprudence). "[T]he term continues to evoke an immediate and shared understanding that the actor's subjective honesty has been called into question." *Id*. at 972.

[99] *See In re Setzer*, 47 B.R. at 345 (stating inquiries into whether debtor is entitled to liberal protection of Code is necessary (citing *In re* Vlahakis, 11 B.R. 751, 753 (Bankr. M.D. Ga. 1981)); Ponoroff & Knippenberg, *supra* note 94, at 970 (noting courts have used different tests to determine good faith).

[100] *See In re Setzer*, 47 B.R. at 345 (stating there are many factors to be considered when determining whether there is good faith (citing *In re* Chase, 28 B.R. 814, 817–18 (Bankr. D. Md. 1983)).

[101] *See* Murphy, *supra* note 28 (discussing bankruptcy as tool for renegotiation).

[102] 64 B.R. 156 (Bankr. C.D. Cal. 1986).

[103] Carrere while under a contract with ABC, made a guest appearance on the show "A-Team" and was then offered a long-term contract to become a regular on the show for considerably more money than she would have made under her contract with ABC. *Id*. at 157.

[104] *Id*. at 160.

[105] *See* Musone, *supra* note 35, at 526–27 (demonstrating difficulty of characterizing filing for bankruptcy as abusive by highlighting recent activities of well-known recording artists).

There is an issue as to whether an additional requirement of good faith surfaces at the stage of rejecting the recording contract. As it currently stands, the recording contract can almost always be rejected at the sole option of the artist. Once a recording contract is deemed executory and the artist subsequently seeks its rejection pursuant to section 365, the record company has virtually no ability to prevent the rejection.[106] In general, a record company can prove either that the artist filed the bankruptcy petition or requested rejection of the executory contract in *bad faith* or that the artist did not exercise sound *business judgment* in the rejection of the agreement.[107] As stated above, proving bad faith is extremely difficult for the record company absent evidence equivalent to an express admission that the artist's only intention in rejecting the executory contract is to enable the artist to take advantage of a more profitable one.[108] Even if the artist files for bankruptcy for the sole purpose of voiding his/her executory contract, it is not automatically indicative of bad faith.[109]

In 1993, the members of the rap group Run-DMC filed for bankruptcy protection. At that time, DMC's proceeds exceeded ten million dollars. They sought rejection of their recording contract with Profile Records to secure a more lucrative contract. This filing was deemed nonabusive and the court granted rejection. In 1994, the members of the rhythm and blues group Silk similarly filed for bankruptcy protection, sought rejection of their contract and were successful. In 1995, the members of the group TLC filed for bankruptcy. The group sold an estimated fourteen million albums, was paid approximately $1.2 million, and is undisputedly owed an additional $2 million since 1992. Like Run-DMC and Silk, TLC sought a new recording contract with a higher royalty rate. The filing was again deemed not to be abusive and the court allowed the group to reject their recording contract.

Id. (interior citations omitted).

[106] Winick, *supra* note 67, at 427 (1997) (stating under current bankruptcy law there is insufficient protection against rejection against non-debtor party); *see* Anita M. Samuels & Diana B. Henriques, *Going Broke and Cutting Loose*, N.Y. TIMES, Feb. 5, 1996, at D1, D6 (stating Bankrutpcy Code allows court to free debtors from burdensome contracts to obtain fresh financial start).

[107] Winick, *supra* note 67, at 427–428.

[108] *Id*. at 428; *see* Chuck Philips, *Group Tops Charts but Claims Bankruptcy; Music: The Dispute over Profit Between TLC and Record Firm is Familiar Industry*, L.A. TIMES, May 28, 1996, at A1 (explaining profits and record sales of recording artist in contrast to amount taken by record company).

[109] *See In re* Taylor, 103 B.R. 511, 520–21 (Bankr. D. N.J. 1989) (finding reorganization petition was not dismissed due to bad faith because evidence indicated real purpose for filing was to reject contractual obligations); Musone, *supra* note 35, at 526–27 (listing several other entertainment bankruptcy cases where court did not find bad faith on part of artist). *See generally In re* Watkins, 210 B.R. 394 (Bankr. N.D. Ga. 1997) (discussing lack of evidence of bad intent or motive behind the filing petition for bankruptcy by members of TLC, bad faith is difficult to find).

D. Business Judgment Test

The business judgment test is the final hurdle for the artist to get over in attempting to reject the recording contract, and it is a short hurdle at that. Without a finding of bad faith, the court must determine whether the rejection is appropriate. This is where the language in section 365 calling for court approval is finally satisfied.[110] The test for whether the rejection is appropriate has been termed the business judgment standard, and again, is an easy standard for the artist to meet.[111] The artist only has to demonstrate that rejection of the contract would be likely to benefit the estate.[112] In addition to the low level of scrutiny in the business judgment standard, courts generally will not interfere with a debtor's business decision unless the decision to reject is so unreasonable that it could not be based on sound business judgment, but only on bad faith.[113] The two standards are circular in their application and interpretation by the court.[114] If there is bad faith, then the business judgment standard is not likely to be met and if the rejection benefits the estate, then the business judgment standard is met while good faith may also be found on the same principle.

To some extent, the business judgment rule has been interpreted differently and perhaps more favorably to record companies. 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."[115] This interpretation allows courts to equitably balance the interests of the parties to the contract. Courts can authorize rejection when the recording contract would be overly burdensome to the artist or can prohibit rejection when the contract could be construed as beneficial to the artist. This balancing is important in the context of rejection of a recording contract because the nature of the recording industry ultimately plays a pivotal role here. Since the record company is

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[110] 11 U.S.C. § 365(a) (2002); *see* Peter J. Lahny IV, *Asset Securitization: A Discussion of the Traditional Bankruptcy Attacks and an Analysis of the Next Potential Attack, Substantive Consolidation*, 9 AM. BANKR. INST. L. REV. 815, 819 (2001) ("Section 365 grants the bankruptcy trustee the power to assume or reject any executory contract that it deems beneficial or burdensome in its best business judgment.").

[111] *See In re* Cirillo, 121 B.R. 5, 6 (Bankr. D. N.J. 1990) (discussing business judgment in context of rejection of contract); *see also* Kotary & Inman, *supra* note 51, at 526 (discussing court's interpretation of business judgment in *In re Cirillo*).

[112] *See In re Cirillo*, 121 B.R. at 7 (stating since rejection of record contract was in artist's best interest it was within proper exercise of business judgment); *see also In re* At Home Corp., 292 B.R. 195, 199 (Bankr. N.D. Cal. 2003) ("Bankruptcy courts generally approve rejection if the debtor demonstrates that the rejection will benefit the estate under a 'business judgment' test."); *In re* HQ Global Holdings, Inc., 290 B.R. 507, 511 (Bankr. D. Del. 2003) ("Under the business judgment standard, the sole issue is whether the rejection benefits the estate.").

[113] *See* Ferrell v. Robinson Mann Creative Enter., Inc. (*In re* Brown), 211 B.R. 183, 188 (Bankr. E.D. Pa. 1997) (referring to "low threshold necessary" to show decision to reject was made with sound business judgment); *In re* III Enters., Inc., 163 B.R. 453, 469 (Bankr. E.D. Pa. 1994) (stating sound business judgment is standard which we have concluded many times is not difficult to meet).

[114] *See* Ponoroff & Knippenberg, *supra* note 94, at 919 n.172 (discussing flexibility of good faith requirement in light of business judgment rulings by courts).

[115] Norrell, *supra* note 55, at 451.

able to cross-collateralize and use the profits of one record to offset the negative balance on a previous unsuccessful album, the projected sales of future albums play a role in the outcome and satisfaction of the business judgment rule.[116] For example, if the first artist's record fails, while the second record is projected to be a huge success, it hardly seems fair to allow the artist to reject the contract only to profit from the second album's release under a different record label, since the first record company expended a substantial sum of money to promote the artist. If the second album is projected to be a only a moderate success, or another failure, then the artist would just be digging a deeper hole of debt and both the record company and the artist would benefit from rejection. This exemplifies how the business judgment standard may be applied to rejection.

It is also common in the recording industry for the record company to initially acquire several options to renew under the contract because it is likely that the first album will not be largely successful. It usually takes an artist a few albums to develop a marketable name and sound. This is pertinent to the business judgment rule since upon contracting with the artist, the record company is making somewhat of an investment.[117] To allow artists the ability to reject their contracts in bankruptcy court is virtually guaranteeing the record company that there will be no return on its investment.[118]

IV. RECENT DEVELOPMENTS

A. Problems with the Current System

To summarize the positions of the opposing sides, the record company would argue that it is too easy for recording artists to escape their recording agreement and to continue to allow this practice of abusing the bankruptcy system for personal

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[116] *See Exclusive Recording Agreements supra* note 18, at 159-17 to 159-18 ("Recoupment of royalties may be on a fully cross-collateralized basis . . . any unrecouped sums payable to a record company in connection with one project may be recouped from royalties earned by another project of the artist."); Morrow, *supra* note 13, at 44 (discussing cross-collateralization by record companies); Norrell *supra* note 55, at 451 ("[T]he 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.").

[117] *See Recording Industry's Accounting Slammed*, L.A. TIMES, July 24, 2002, at C2 ("The industry . . . released an economic analysis of its record contracts, noting that fewer than 5% of signed artists produce a hit record. Likewise, for every hit the industry has, it loses $6.3 million on albums that bomb . . . ."); Kathleen Sharp, *Recording Artists Sue, Aiming to Rock Industry Action Expected to Put Big Labels Under Scrutiny*, BOSTON GLOBE, Oct. 7, 2001, at A6 (stating only 5% of company's acts turn profit); Johnny Sharp, *Yours Unfaithfully: Courtney Love and the Dixie Chicks want out of their Record Deals. They Claim They're Slaves to Greedy Labels. Case Dismissed—Rock Stars are Spoilt and Contracts Should Be Tougher*, THE GUARDIAN (London), Sept. 15, 2001, at 12 (stating only 5% of major label signings ever make profit).

[118] *See* Justin Pritchard, *Hatch, Union in Harmony on Bankruptcy Reform Bill*, L.A. TIMES, June 23, 1999, at 1 ("If a record company invests heavily in developing potential stars-to-be, the RIAA argued, the companies should reap some of the reward when their efforts pay off.") [hereinafter Pritchard, *Union in Harmony*].

gain - either through contract renegotiation with a current record company or securing freedom to entertain more lucrative contracts - offends the nature of the recording industry and the public at large.[119] The signing of each new individual artist represents a large risk on the part of the record company, since the likelihood is that this new artist will fail.[120] If this process is allowed to continue, record companies will be forced to limit the amount of artists they employ and these few positions will in turn go to the mainstream no-risk artists, to ensure a profit for the record company. This substantially harms the industry and arguably the public.

Conversely, the recording artists would argue that bankruptcy is one of their only options to secure a fair agreement. Negotiation between the record company and the artist is so skewed toward the record company that artists completely lack bargaining power.[121] As a result, they are forced to sign record deals that entitle them to a small share of the eventual profits from their record sales, while record executives continue to "rake it in." The artists are left with nothing other than threats of litigation and bankruptcy filings to level the playing field.

The bankruptcy system is ill-prepared to deal with these types of maneuvers on the part of the recording artists. While the continual trend has been a staggering increase in the number of bankruptcy filings annually, the system still has many flaws. The good faith requirements are far less than clear in their apparent application, with respect to at which stages of the bankruptcy procedure the requirements are imposed and exactly what standard is to apply. Additionally, once a filing is instituted the test of business judgment in the rejection or assumption of contractual obligations has no clear ability to terminate these types of actions.

In an effort to remedy the current system and correct ongoing inequities of bankruptcy law, a movement for large-scale bankruptcy reform has been underway for a good portion of the last decade.[122]

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[119] *See* Justin Pritchard, *Striking a Chord with Congress; Music: Record Industry Found a Ready Audience When It Sought Changes in Bankruptcy Code. Critics Say Legislators Were Hasty*, L.A.TIMES, Aug. 19, 1998, at 8 (discussing record companies complaining about growing number of artists who leave record companies after companies had substantially invested to start up those artists) [hereinafter Pritchard, *Striking a Chord*].

[120] *See* Norrell, *supra* note 55, at 456 ("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.").

[121] *See* Pritchard–*Striking a Chord*, *supra* note 119, at 8 (narrating claim about record companies holding unequal bargaining power in contract negotiations).

[122] *See* Mary Kane, *Bill on Bankruptcy Stirs Hot Debate*, CHI. TRIB., May 21, 2002, at 5 [hereinafter Kane].

Since bankruptcy laws first were written in 1898, the country has gone back and forth on how sympathetically or punitively it views debtors. That seesaw has contributed to the long and tortured history of the current reform legislation: A 1994 commission that produced 172 recommendations and a 13,000-word report. Five years of legislative battles. A last-minute veto in the waning days of the Clinton administration.

Id.

B. The Recording Industry Enters the Bankruptcy Reform Debate

Drawn out debates in Congress year after year have led the bankruptcy reform bill to be characterized as an overwhelming failure.[123] With each attempt at Congressional passage and enactment into law, the reform bill changes moderately in its language, yet it remains permanently connected to its initial purpose of remedying the current system to prevent high income debtors from abusing the system, while leaving the protection of the Bankruptcy Code and favorable provisions available to those debtors truly in need of liquidation or reorganization of debts.[124] Bankruptcy reform has also been viewed as an arena where record companies can address some of the inequities in the ability of individual artists to easily reject their recording contracts.[125] Record companies, through an organization known as the Recording Industry Association of America ("RIAA"), approached Congress and lobbied for a specific provision dealing exclusively with recording artists and record companies.[126] The details of this controversial provision are outlined below.

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[123] *See* Carl Hulse, *House Votes to Make It Harder to Seek Bankruptcy*, N.Y.TIMES, Mar. 20, 2003, at A28 ("The bankruptcy measure has been circulating in Congress for years . . . ."); Kathleen Day & Jim VandeHei, *House Passes Revised Bankruptcy Bill; Abortion-Related Provision Dropped After Earlier Bill is Scuttled*, WASH. POST, Nov. 15, 2002, at A04 ("Twice in five years bankruptcy bills have passed both the House and Senate, only to face defeat . . . ."); Dan Morgan & & Juliet Eilperin, *Bankruptcy Reform Bill in Trouble Again*, WASH. POST, Feb. 25, 2002, at A21.

You have to admire the sheer stamina of some aides, lobbyists and members of Congress. Consider those who never give up hope that bankruptcy reform legislation will someday be signed into law.

"Bankruptcy," as it is known in Hill shorthand, has sprouted a few gray hairs by now. It has been passed by both chambers of Congress numerous times since its saga began in 1997. In December 2000, it made it all the way to the White House. But there -- perhaps to the delight of dozens of lobbyists who have made a good living off it -- it died by virtue of President Bill Clinton's pocket veto.

For a while it seemed 2001 would be its year. The Bankruptcy Abuse Prevention and Consumer Protection Act, which would make it more difficult for heavily indebted individuals to hide from creditors, has been a priority of financial service companies and is popular with business. There was a GOP businessman in the White House and a pro-business mood in Congress.

. . . .

But it is never that simple with bankruptcy.

Id.

[124] *See* Charles A. Jaffe, *Good Intentions Gone Away*, BOSTON GLOBE, Sept. 18, 2002, at F2 [hereinafter Jaffe] (characterizing bankruptcy reform as "long, twisting road to updating and upgrading bankruptcy laws").

[125] *See* Pritchard–*Union in Harmony supra* note 118, at 1 ("The bill also had become a battleground between recording artists and their record labels over the use of bankruptcy laws by stars seeking to cancel their long-term recording contracts.").

[126] *See id.* (discussing RIAA provision which singled out recording artists by insisting artists prove they filed bankruptcy strictly because they are broke); Pritchard, *Striking a Chord supra* note 119, at 8 (discussing record companies approaching Congress to aid in remedying what they perceived as abuse of bankruptcy system on part of recording artists).

C. The Controversial Section 212

In the late 1990s the RIAA gained recognition as a political force when it surfaced as a highly influential power behind the addition of a provision in the reform bill that would deal exclusively with the inequities of recording contracts and artists' ability to reject contracts under bankruptcy law.[127] The provision, section 212, was in fact added to the version of the Bankruptcy Reform Bill that was eventually approved by the House of Representatives in 1998.[128] The RIAA issued a statement saying that the change in the law was necessary to close the loophole being exploited by "increasing numbers of agents and lawyers for popular recording artists who have been misusing the bankruptcy process to get out of long-term contracts in order to sign alternative, more lucrative contracts."[129]

There was a huge backlash from recording artists after the provision was added to the reform bill.[130] Generally, recording artists and advocates for the interest of recording artists, namely the American Federation of Television and Radio Artists ("AFTRA") and the American Federation of Musicians ("AFM"), felt that the bill was unfair because it singled them out for uniquely severe treatment.[131] The proposed bill gave courts the authority to allow debtors in bankruptcy to void burdensome contracts in all cases *except* those involving recording artists.[132] "The bankruptcy-reform bill [made] it possible for authors, actors, beer wholesalers, and anyone else to be freed from contracts that would negatively affect their livelihood. But not recording artists."[133] Another criticism of the provision was that it was "racially charged" in that it would disproportionately impact black artists and musicians attempting to exit their record contracts.[134] Congressman, John Conyers

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[127] *See* Pritchard, *Union in Harmony*, *supra* note 118, at 1 (stating lobbyists for RIAA convinced House lawmakers artists were exploiting bankruptcy law).

[128] H.R. 3150, 105th Cong. § 212 (1998).

[129] Christopher Stern, *Bankruptcy Bill Racist, Foes Charge*, DAILY VARIETY, June 11, 1998, at 6 [hereinafter Stern] (quoting RIAA spokesperson).

[130] *See* Starshak, *supra* note 21, at 91 n.165 ("Artist representatives were concerned with the RIAA's ability to lobby for an amendment inserted without any Congressional hearings on the matter. In this instance, it was a Congressman who entered the provision into the bill, but that Congressman had received a $3,000 contribution from the RIAA's political action committee." (citing Justin Pritchard, *Striking a Chord with Congress*, L.A. TIMES, Aug. 19,1998, at 8D)).

[131] *See* Liz Murray Garrigan, *Clement Strikes a Sour Chord*, June 29, 1998 *available at* http://www.nashvillescene.com/cgi-bin/printer.cgi?story=Back_Issues:1998:June_25_199… (last visited Oct. 22, 2003) (stating Clement represents Tennessee's Fifth Congressional District and was supporter of bankruptcy reform passed by the U.S. House); *see also* Norrell, *supra* note 55, at 470 (describing efforts of AFTRA and AFM).

[132] *See* Garrigan, *supra* note 131 (stating anyone except for recording artists could potentially be freed from contracts that negatively affect their livelihood).

[133] Garrigan, *supra* note 131; *see also* Pritchard, *Striking a Chord supra* note 119, at D8 (commenting on bill singling out artists).

[134] *See* Stern, *supra* note 129, at 6 (discussing racial implications of reform act).

(D-Mich.) stated that the provision was targeted at "minority artists and entertainers."[135] The RIAA countered this argument by asserting that the amendment was narrowly tailored to apply only to artists filing a bankruptcy petition for the sole purpose of breaching their contractual obligations.[136]

Although section 212 received initial success in being approved by the House, the success was short-lived.[137] The two groups, the record labels and the recording artists, were instructed to reach a compromise.[138] While the original RIAA language singled out recording artists by insisting on proof that artists file bankruptcy solely due to financial constraints, the final compromise lets a bankruptcy judge consider "the financial need for such contract rejection" during the filing process.[139] A bankruptcy court would still have authority and discretion to allow for rejection, even if the rejection of a record contract was the primary motivation for the bankruptcy filing, if the artist's financial or economic status compelled as much.[140] Following the compromise, the RIAA and AFTRA released a joint statement stating their new position maintaining that both organizations seek to reform the "bad faith" provisions of the reform bill without creating a special rule for recording artists.[141]

D. Intermediate Versions of the Bankruptcy Reform Bill

The controversial elements of the bankruptcy reform bill did not disappear upon the striking of a compromise between the RIAA and AFTRA. Although that specific version of the bill died in Congress that year,[142] the Bankruptcy Reform legislation that is still pending in Congress will undeniably affect future relationships between recording artists and their record companies. The most significant proposal is the introduction of a new form of "means testing" for people filing a petition for bankruptcy.[143] This new standard's purpose is to keep debtors that are capable of paying off debts from taking advantage of bankruptcy to avoid

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[135] *Id*.

[136] *Id*.; *see* Pritchard–*Striking a Chord supra* note 119, at 8 (quoting advocate of section 212 as saying, "[s]ection 212 does not deny anyone access to bankruptcy. Section 212 does not deny debtors who are in genuine economic stress the powers that debtors have to rehabilitate their finances. Section 212 does not give record companies a preferred creditor position.").

[137] *See* Pritchard, *Striking a Chord supra* note 119, at 8 (noting passage of section 212 by the House in June of 1998).

[138] *See* Pritchard, *Union in* Harmony, *supra* note 118, at C1 (stating artists and recording industry to settle).

[139] *Id*.

[140] *See id*.

[141] *See id*. (stating compromise eliminated language suggested by RIAA singling out recording artists).

[142] *See* Pritchard–*Union in Harmony, supra* note 118, at C12. The compromise provision that was inserted into the Senate bill died at the end of that Congressional term and the following Spring, House and Senate committees chose to add to their respective bills (HR 833 and SB 625) which maintained much of the language from the compromise. *Id*.

[143] *See* Janet Hook, *Bankruptcy Bill Clears Impasse Over Abortion; Congress: House-Senate Negotiators Finally Reach Pact After Clinic Protest Issue is Resolved*, L.A. TIMES, July 26, 2002, at 1 (discussing test as tool to screen improper chapter 7 filings).

payment to creditors.[144] The manner that the amendments propose to accomplish this task is to restrain debtors from utilizing chapter 7 proceedings and instead funnel them into chapter 13 proceedings, where debt repayment is more common.[145] Under the Code now, a debtor can utilize chapter 7 unless a court finds evidence of "substantial abuse."[146] The amended provisions would substitute a means test for the current substantial abuse test. This substitution shifts the focus to whether the debtor has the ability, or means, to repay some of these debts.[147]

E. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2002

In general, H.R. 333, better known as the Bankruptcy Abuse Prevention and Consumer Protection Act of 2002, incorporates this new means test and aims to force more bankruptcy filers under chapter 13, which requires some repayment of debts over time, rather than chapter 7 liquidation.[148] The new means test appears in the amended version of section 707(b) of the Code. This section provides for dismissal of chapter 7 cases or (with the debtor's consent) conversion to chapter 13, upon a finding of abuse.[149]

"Abuse can be found in one of two ways; first, through an unrebutted presumption of abuse, arising under a new means test; and second, on general grounds, including bad faith, determined under the a totality of the circumstances."[150] Enactment of the amendments to section 707(b) of the Bankruptcy Code proposed as part of the Bankruptcy Abuse Prevention and Consumer Protection Act could effectively overrule most of the foregoing case law by providing that a chapter 7 bankruptcy case could be dismissed merely upon a showing that the debtor could repay at least a specified portion of his/her debts or

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[144] *See id*. (stating current law allows too many people to file under chapter 7 which entirely wipes out debt).

[145] *See id.* (stating bill would force more people to file under chapter 13); *see also Bankruptcy Reform*, BUFFALO NEWS, May 24, 2002, at C12 (discussing how new law would limit number of filers who could seek protection under chapter 7).

[146] *See Bankruptcy Reform*, BUFFALO NEWS, May 24, 2002, at C12.

[147] *See id*. (stating chapter 13 mandates court structured repayment plan); Kane, *supra* note 122, at N5 (discussing new means test and its application).

[148] *See* Jaffe, *supra* note 124, at F2 (stating purpose of Bankruptcy Abuse Prevention and Consumer Protection Act). "A central element in the bill would make personal bankruptcy more difficult to use, forcing debtors who earn more than the median income level in their state to file for [c]hapter 13 protection - which requires repayment - as opposed to [c]hapter 7, under which unsecured debts are erased." *Id*.

[149] *See* H.R. 975, 108th Cong. § 102 Dismissal or Conversion (amending section 707).

[150] The Honorable Eugene R. Wedoff, *Major Effects of the Consumer Bankruptcy Provisions of the 2002 Bankruptcy Legislation (H.R. 333 Conference Report)*. H.R. 333, introduced before the 107th Congress in 2002 was substantially similar to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, H.R. 975, currently before the 108th Congress; s*ee Bankruptcy Abuse Prevention And Consumer Protection Act of 2001: Hearing on H.R. 333 Before the House Comm. on the Judiciary*, 107th Cong., 133 (2001) (statement of George Wallace, Eckert, Seamans, Cherin & Mellot, The Coalition for Responsible Bankruptcy Laws) (discussing American consumer abuse); David P. Goch, *Obstacles to Reform Bill May Be Growing*, (Feb. 6, 2003), *at* http://www.bankrutpcyfinder.com/bankruptcyreformnews.html (last visited on October 24, 2003).

that the debtor filed the chapter 7 petition in bad faith.[151] Among the proposals is one that would create an income means test to force individual debtors away from chapter 7 Bankruptcy Code protection, which allows for a liquidation of assets and fresh start, and toward chapter 13, which requires repayment of debts over several years.[152]

The legislation began as Congress examined the reports worked out between the House and the Senate in the previous Congress. The end result of which was a pocket-veto by former President Clinton.[153] The bankruptcy reform bill encountered 3 successive failures, with similar versions of the bill failing after being introduced in the 105th, 106th and 107th Congresses.[154]

F. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2003

To the surprise of Washington, D.C. legislators, House Judiciary Committee Chairman James Sensenbrenner (R-Wis.) reintroduced bankruptcy reform legislation early in the 108th Congress with few changes from the version that failed to pass in the 107th Congress.[155] The bill's history of failure leads many to believe that the reform movement is predestined only to fail again.

However, on March 19, 2003 the House of Representatives voted to approve the Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, H.R. 975,

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[151] *See* The Honorable Carla E. Craig, updated by Karen A. Giannelli & David N. Crapo, *Step-By-Step Procedure in a Chapter 7 Case*, *in* UNDERSTANDING THE BASICS OF BANKRUPTCY & REORGANIZATION 2002, 173, 200 (Practising Law Inst. 2002), *available at* 842 PLI/Comm 173; *see also* Jack F. Williams, *Distrust: The Rhetoric And Reality of Means-Testing*, 7 AM. BANKR. L. REV. 105, 115–19 (1999) (outlining means testing under House and Senate versions); Thomas J. Yerbich, *The Coming Exodus of Consumer Counsel*, 2003 ABI JNL. LEXIS 124, at *15–17 (2003) ("The means test of [section] 707(b) creates a presumption of abuse if, after applying the test, the debtor could afford to pay as little as $100/month to unsecured creditors"); Harriet Thomas Ivy, Note, *Means Testing Under the Bankruptcy Reform Act: A Flawed Means to a Questionable End*, 17 BANKR. DEV. J. 221, 241–42 (discussing conflicting interpretation given to section 707(b) substantial abuse).

[152] *Congress Tries, Yet Again, to Reform the Law*, BOSTON BUSINESS JOURNAL, (Feb. 3, 2003), *available at* http://boston.bizjournals.com/boston/stories/2003/02/03/focus.html (last visited Oct. 24, 2003_; *see also* Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*, 18 BANKR. DEV. J. 1, 46–47 (2000) (discussing public opposition to prior bankruptcy reform bills); Anthony, *supra* note 2 (suggesting five reasons why 2003 reform bill may fail).

[153] *See* Day & VandeHei, *supra* note 123, at A4 (discussing President Clinton's veto of bill); *see also* Rebecca M. Burns, *Killing Them With Kindness: How Congress Imperils Women and Children In Bankruptcy Under the Facade of Protection*, 76 AM. BANKR. L.J. 203, 203 (arguing Bankruptcy Reform Act of 2001 if passed, would make women and children "pawns in a financial game of life or death that the Act guarantees they will lose").

[154] *See* Consumer Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. (1998); Bankruptcy Reform Act of 1999, H.R. 833, 106th Cong. (1999); Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. (2001).

[155] *Rep. Sensenbrenner to Reintroduce Reform Measure in 10 th Congress*, BNA BANKRUPTCY LAW DAILY, Dec. 16, 2002; *see also* Tabb, *supra* note 152, at 2–6 (discussing how ramifications of September 11, 2001 may effect passage bankruptcy reform bill and President George W. Bush's pledged support for bankruptcy legislation); *House Passes Bankruptcy Bill 306-108, Bush Supports Legislation*, (March 2, 2001), *at* http://www.abiworld.org/headlines/01march2.html (last visited on October 25, 2003) (reporting on Bush's statement of support and surrounding national economics).

with a final tally of 315-113.[156] The aim of the act is consistent with that of bills past, to make it more difficult for people to eliminate debts by filing for bankruptcy, heeding complaints from lenders and businesses that the system is being abused.[157] Generally, the bill is meant to prevent those who can afford to pay a portion of their debts from using bankruptcy law to escape payment, while continuing to protect those debtors who are sincerely in the financial position where rejection would be a necessity.[158] The bill has passed through the House of Representatives and the President has pledged to sign it, but the final obstacle remaining is passage by the Senate.[159]

As the bill heads to the floor of a Republican-controlled Senate for further debate it is accompanied by expectations of problems. The nature of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2003 would reshape much of the traditional bankruptcy law in this country and there is a large degree of resistance.[160] The reform bill itself has once again been heavily criticized, and perhaps now even more than ever. One criticism is that the bill is "flawed and ill-timed" because it would have a detrimental effect on people already struggling financially in a less than favorable economy.[161] The bill has also been subject to great resistance from Democrats and it has even been suggested that the Democrats might filibuster a distasteful bankruptcy reform bill, which would serve to impede the bill's progress.[162] In order for the bill to pass in the Senate a "Cloture Vote" is required. Supporters must gain 60 votes to end debate and bring legislation to a

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[156] Hulse, *supra* note 123, at A28 (discussing House passage of reform); *Bankruptcy Reform Clears First Hurdle, But Challenges Remain,* (Apr. 11, 2003) [hereinafter *Bankruptcy Reform*], *at* http://www.bankruptcyfinder.com/article%20folder/firsthurdle.html (last visited on Oct. 25, 2003).

[157] *See Id*. ("[The bankruptcy reform] was intended to prevent people who could afford to pay some of their debts from using the courts to escape payment while protecting those who were truly strapped."); *see also The Bankruptcy Abuse and Consumer Protection Act of 2003: Hearing on H.R. 975 Before the House Subcomm. on Commercial and Administrative Law*, 108th Cong. (2003) (statement of Lucile P. Beckwith, President/CEO, Palmetto Trust Federal Credit Union).

Concerns about the rising tide of bankruptcy filings and the ever-increasing number of abusive filings are shared across the country. A November 2002 nationwide voter study conducted by the Penn, Schoen firm found that 68 percent of voters agreed that it was 'too easy' to declare bankruptcy, while another 61 percent said that they support tightening bankruptcy laws.

Id.; Robert D. Manning, *American Households Swimming In Red Ink*, THE SUN, Febr. 26, 2001, at 9A (discussing how consumer credit indebts).

[158] *Hulse*, *supra* note 123, at A28 (referring to authors' motivation behind bill).

[159] *See* Hook, *supra* note 143, at 1 (stating President Bush has indicated he will sign the bill); *Senate Approves Bankruptcy Reform Bill*, ST. PETERSBERG TIMES, Mar. 16, 2001, at 1A (stating President Bush has signaled he will sign); Philip Shennon, *Bankruptcy Reform Poised for OK*, CHICAGO TRIBUNE, Feb. 13, 2001, at N6 (stating President Bush has pledged to sign).

[160] *See Bankruptcy Reform, supra* note 156 (stating although Senate is Republican-controlled, opposition to legislation is high among Democrat Senators).

[161] Hulse, *supra* note 123, at A28.

[162] *See id*. (illustrating Democrats have tied bankruptcy legislation to abortion issues, further holding up measure).

floor vote, which is unlikely given Democratic dissention.[163] Currently, Republicans hold a slim majority in the Senate[164] and to succeed with passage of the bankruptcy reform bill would require a considerable amount of convincing of Democrats, assuming that voting will be split along party lines. A possible motive behind the Democratic dissent could be the looming 2004 presidential election and the knowledge that voters tend to vote with their purse or wallet in mind. Dissention could make Democrats appear sympathetic to the woes of voters experiencing financial trouble, which represent a large portion of the national public, considering the present state of the economy.[165]

G. Effect on the Industry

Although the Bankruptcy Abuse Prevention and Consumer Protection Act of 2003 is by no means as clear in its possible effect on the recording industry as the once proposed section 212, the enactment of the bill into law would serve to alter the current relationship between record companies and individual artists entering into a recording contract. The most substantial effect would of course come up in the context of bankruptcy proceedings whereby the artist is seeking to reject his/her executory record agreement. The once protective measures for this type of debtor that existed in the past would be replaced with a series of hoops the artist would need to jump through in order to reject his/her contract. They would encounter the new means testing, and would have to show that they were incapable of repaying the debts. Courts have used implied good faith requirements upon filing for bankruptcy to weed out potential abusers in the past, but the new means testing would call for the court to affirmatively examine the resources available to the artist before allowing the artist to reject his/her contract outright. Generally, the recoupment of costs will only come from a percentage of royalties on the sale of the record, so the actual effect of the change remains to be seen as to whether the debtor may be required to pay back the record company through the artist's profits from external agreements. These external agreements that might be utilized to offset the debt to the record company may include advertising endorsements, appearance fees and merchandise sales. While it is unlikely that such a result would occur, it is not impossible.

As a result of means testing, the question of an artist's good faith in filing a petition for bankruptcy and subsequently attempting to reject the contract will be balanced toward the interests of the record company, altering the burden. Instead of the bankruptcy court denying such a request by the record company on a showing of

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[163] Hulse *supra* note 123, at A28; *see also Bankruptcy Reform: Congress Should Focus on the Central Issue, Not a Legislative Add-on*, BUFFALO NEWS, Dec. 2, 2002, at B8 (stating opponents have more sympathetic case due to "sad shape of the economy").

[164] *See Bankruptcy Reform: Congress Should Focus on the Central Issue, Not a Legislative Add-on*, BUFFALO NEWS, Dec. 2, 2002, at B8 (commenting on effect of Republican majority).

[165] *See Bankruptcy Reform, supra* note 156 (noting currently 300,000 people are laid off and national deficit is growing).

bad faith and "substantial abuse" by the artist, the record company would merely have to show abuse. Demonstrating that the artist/debtor's primary purpose in filing the petition was simply to reject their contract would create an inference of abuse. This is a major departure from current bankruptcy law, whereby such a motive is not necessarily indicative of bad faith and debtors enjoy a large degree of deference in their decision to file for bankruptcy.

As the law currently stands, prior to the possible impending reform, an artist merely has to demonstrate that he/she was experiencing financial difficulties or a degree of insolvency to use bankruptcy proceedings, while a record company has to either prove that the artist is not experiencing such insolvency or that the filing is in bad faith, and therefore, the artist is substantially abusing the system. The proposed reform turns the table a bit and allows record companies a greater chance to rebut the presumption that the debtor is acting in good faith through the imposition of the new means testing. The lower standard of abuse, rather than substantial abuse may bar an artist's rejection of his/her recording contract more frequently.

CONCLUSION

As the number of bankruptcy filings continues to increase annually, bankruptcy reform is needed to ensure that "abuse" of the system is reduced to a minimum and proper debtors truly in need of the protections of bankruptcy may be afforded protection. There remains the implicit question, "Is the manner in which recording artists utilize bankruptcy fairly considered an abuse?" The relaxed standard that would result from the proposed bankruptcy reform would most likely include an artist's manipulation of the law as a negotiation tactic.

The efforts of artists and advocates for their cause may be better served by focusing on the initial terms of negotiation and the standard recording agreement, rather than on any inequity arising as a result of the contractual relationship with the record company. However, until these aspects of securing a record contract change, bankruptcy law will inevitably play an important role in the negotiation between recording artists and record companies. The exact effect of bankruptcy reform in this area remains to be seen with the passage of Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, but it will undoubtedly alter the current relationship of entertainment law and bankruptcy law.

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