

The Implications of Record Label Bankruptcy on Musicians

By Adam Burnett

INTRODUCTION

Congratulations! Your band has just been offered a record contract with a major record label. A life of wealth and fame awaits you and your fellow band members. However, before signing on the dotted line there may be a few elements to consider. What are the most important things that your band bargains for in the record contract? The turbulent state of the music industry creates uncertainty in what the future holds for both bands and record labels. If a record label goes bankrupt, certain powers given by the Bankruptcy Code may have drastic effects on a musicians' ability to receive future royalty payments for the copyrights to their music. This paper examines the most common and important features of a record contract through the use of a hypothetical band appropriately named the Neophytes. Unfortunately, the Neophytes' record company, A.I.G. Records, goes bankrupt. The Neophytes' story is followed with a discussion of pertinent aspects of both copyright law and bankruptcy law. Finally, the paper examines possible solutions to the problem confronting the Neophytes, along with better ways to structure the record contract to avoid some of these problems. Now it is time to meet the Neophytes.

THE STORY OF THE NEOPHYTES

Bill and Ted were childhood friends. They were both musically gifted and enjoyed creating music together. After high-school Bill and Ted decided that they should combine their

musical talents and start a band. They enlisted two more of their friends with similar talents and ambitions. Thus spawned *The Neophytes*, an amateur heavy metal rock band. The band's dream was to make it big and sign a deal with a major record label.

For several years they played every venue available to them in Chicago. Their music continually improved along with their fan base. One evening after a show they were approached by a representative from AIG Records. The representative told them that AIG Records was interested in signing the Neophytes to its record label. This was a dream come true for the Band. With the help of AIG Records, the Neophytes' music could be heard all over the world. The band seemed to be on its way to stardom.

The band members took a few days and think about what they wanted to do. The Neophytes decided on two main goals for their band: to maximize their global exposure and to make a lot of money. The individual members of the Neophytes had little to no legal experience. This created their first problem with the decision: whether to hire an entertainment lawyer to help interpret the recording contract presented by AIG Records. The band members thought that they should hire an attorney to interpret the contract for them. After much discussion, they decided that even if they employed an attorney, AIG Records was probably their only chance at a record contract. The AIG representative expressed his willingness to negotiate the contract as, "take it or leave it." The Neophytes took it.

THE RECORD CONTRACT

The record contract states the responsibilities of AIG Records and the Neophytes. AIG Records promises to record the music, master it, produce the recording, market the album, and

sell it to records stores and on the internet. The contract is for five albums to be recorded over five years. The Neophytes assign the copyrights in the musical works and future sound recordings to AIG Records. In return, AIG Records will pay the Neophytes a ten percent royalty for each album sold (physical or digital). AIG Records will pay the Neophytes an advance against their royalty payments of \$200,000 (\$50,000 to each member). This advance will be recouped out of the Neophytes' royalty payments. There are various other expenses that also must be paid back before the Neophytes start receiving royalty payments. These expenses are known as recoupable expenses.¹ Recoupable expenses include the cost of recording the album, promotions, music videos, and touring.² AIG Records expects to spend about \$200,000 on recoupable expenses. If the Neophytes manage to sell 500,000 albums at \$10 per album, and after AIG Records recovers its expenses, the Neophytes will earn \$100,000.

This arrangement is not the recording contract that the members of the Neophytes had always dreamed of. However, they decided it was the best contract that they could get with the little bargaining power they had. Two years after signing the contract, the Neophytes have gathered a strong following and sell about 500,000 albums each year. Therefore, the band members make about \$300,000 per album after their first year with AIG Records.

Although the Neophytes are a profitable band, AIG Records is struggling due to some poor management decisions. AIG Records files for liquidation under Chapter 7 of the bankruptcy code.³ A trustee is appointed to manage AIG Records' assets through the bankruptcy proceedings. The recording contract between AIG Records and the Neophytes is determined to be an executory contract (more on this later). The trustee uses a power granted to him under

¹ Marshall Brain, *How Recording Contracts Work*, available at <http://entertainment.howstuffworks.com/recording-contract.htm/printable> (last visited December 20, 2009).

² *Id.*

³ 11 U.S.C. § 301 (2009).

section 365(a) of the bankruptcy code and chooses to reject the recording contract.⁴ The Neophytes members partially performed their part of the contract by recording the music and assigning the copyrights to AIG Records. This makes the Neophytes a general unsecured creditor in the bankruptcy proceeding with a claim for breach of contract. However, there is no money left over after the assets are distributed to the secured creditors in the bankruptcy proceedings. AIG Records keeps the copyrights in the music received from the Neophytes' partial performance even after rejecting the contract. The Neophytes keep the advance on royalty payments as partial performance by AIG Records. Because the contract was rejected, AIG Records no longer owes royalty payments to the Neophytes. The trustee then sells the copyrights to the Neophytes' albums to USA Records. USA Records can commercially exploit its copyrights to the Neophytes music without having to pay royalties because the Neophytes no longer have any rights to the copyrights nor are any royalty payments owed to them.

The Neophytes feel that this outcome is unfair to them and want to know how and why this has happened. They also want to know what they can do in the future to prevent this from happening to them again or to any other bands. Before discussing possible solutions it is necessary to explain some of the basics of copyright and bankruptcy law.

THE INTERPLAY OF COPYRIGHT LAW AND BANKRUPTCY LAW

The copyright law is authorized by the Constitution's Patents and Copyrights Clause "To Promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."⁵ In order to do this,

⁴ 11 U.S.C. § 365(a) (2009).

⁵ U.S. Const. art. I, § 8, cl. 8.

Congress may grant limited monopoly power to the author of the work and promote creativity.⁶ This in turn creates a benefit to the public when the works enter the public domain after the monopoly has expired.⁷

Artists can secure the ownership of their works through the use of copyrights. Copyrights in works created after January 1, 1978 endure for the lifetime of the author and 70 years after the author's death.⁸ The ownership of musical works and sound recordings are protected by copyrights.⁹ The owner of the copyright holds the exclusive power to reproduce the work, make derivative works, distribute copies, perform and display the work publicly, and to perform the sound recording publicly through a digital audio transmission.¹⁰ The ownership of a copyright may be transferred by an ordinary conveyance.¹¹ The conveyance in the Neophyte's story was the Record Contract. The exclusive rights of ownership may be transferred separately from the copyright.¹² The Neophytes however, transferred the ownership of the copyright along with all of the exclusive rights of ownership.

The purpose of the Bankruptcy Code is to preserve the value of the bankruptcy estate and to maximize the value of the estate to pay the creditors.¹³ During reorganization the trustee or debtor-in-possession can manage the property in order to help satisfy creditors' claims and help the owner create income.¹⁴ To maximize the value of the bankruptcy estate, the Bankruptcy Code promotes the transferability of assets.¹⁵ The Neophytes feel that the transfer of the copyrights from AIG Records to USA Records was unfair to them. A copyright entitles its

⁶ *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 428-29 (1984).

⁷ *Id.*

⁸ 17 U.S.C. § 302 (2009).

⁹ 17 U.S.C. § 102(a) (2009).

¹⁰ 17 U.S.C. § 106 (2009).

¹¹ 17 U.S.C. § 201 (2009).

¹² *Id.*

¹³ See generally H.R.Rep. No. 95-595, p. 220 (1977), U.S.Code Cong. & Admin.News 1978, p. 5787.

¹⁴ 11 U.S.C. § 1108 (2009).

¹⁵ Peter S. Menell, *Significance of Bankruptcy to Copyright Interests*. 4-19A Nimmer on Copyright § 19A.01 (2009).

owner to exclusive control and the right to exclude others from its use.¹⁶ The Neophytes do not have title to the copyrights and are excluded from using them. The bankruptcy trustee rejected the contract effectively extinguishing the Neophytes' claim for future royalties and creating an unsecured claim in the bankruptcy proceeding.

To better understand what happened, it will help to understand some of the basics of bankruptcy procedure. A debtor can file a voluntary petition with the bankruptcy court which leads to the commencement of a bankruptcy proceeding.¹⁷ Filing the petition creates the bankruptcy estate which contains all of the debtor's assets and assets he acquires during the bankruptcy proceedings.¹⁸ Filing also creates an automatic stay which prevents creditor actions against the estate property.¹⁹ Creditors must receive authorization from the court to take any action against the estate property.²⁰ The debtor may file a Chapter 7 (liquidation) or a Chapter 11 (reorganization) petition.²¹ In a Chapter 7 liquidation proceeding, the trustee sells all of the estate's non-exempt assets and distributes the assets according to each creditor's priority.²² Once the assets have been distributed, the bankruptcy court usually discharges the remaining debts to give the debtor a fresh-start.²³ In Chapter 11 reorganization proceedings, the trustee or the debtor-in-possession creates a plan to pay debts owed to creditors.²⁴ The trustee or debtor-in-possession has various powers to modify rights of some of the involved parties, manage the estate property, and distribute the proceeds to creditors.²⁵ The trustee or debtor-in-possession

¹⁶ 17 U.S.C. § 106 (2009).

¹⁷ 11 U.S.C. § 301 (2009).

¹⁸ 11 U.S.C. § 541 (2009).

¹⁹ 11 U.S.C. § 362 (2009).

²⁰ *Id.*

²¹ 11 U.S.C. § 301 (2009).

²² 11 U.S.C. § 507 (2009).

²³ 11 U.S.C. § 727 (2009).

²⁴ 11 U.S.C. § 1121 (2009).

²⁵ 11 U.S.C. § 1123 (2009).

may also impair a class of claims or assume, reject, or assign any executory contracts.²⁶ The creditors may accept the plan and then it may be confirmed by the bankruptcy court.²⁷ If a creditor rejects the plan, the plan will be confirmed if the creditor will receive as much value under the plan as it would under a chapter 7 liquidation proceeding.²⁸ The confirmation of the plan binds the debtor to the plan and frees the property from creditor claims.²⁹

The Bankruptcy Code groups certain types of creditors in order to distribute the assets of the estate equitably. If the creditor follows certain steps to perfect her collateral in the debtor's property then the creditor is secured.³⁰ The secured creditors are given greater priority to their claims than unsecured creditors.³¹ A secured creditor has a property interest in the secured collateral and must be paid or receive the collateral before the unsecured creditors are paid.³² The unsecured creditors are placed into classes and the classes are ranked in order of priority.³³ Typically, when the estate assets are distributed, creditors in the same priority group share the assets on a *pro rata* basis.³⁴ When there are not enough estate assets to pay all of the creditors' claims, the lower ranked creditors receive nothing. This provides an incentive for creditors to become secured creditors which are more likely to receive money from a bankruptcy distribution.

The purpose of bankruptcy is to maximize the value of the estate to pay the creditors what they are owed.³⁵ The Bankruptcy Code strives to treat similarly situated creditors the same

²⁶ *Id.*

²⁷ 11 U.S.C. §§ 1126, 1129 (2009).

²⁸ 11 U.S.C. § 1129(7) (2009).

²⁹ 11 U.S.C. § 1141 (2009).

³⁰ 11 U.S.C. § 506 (2009).

³¹ 11 U.S.C. § 507 (2009).

³² *Id.*

³³ 11 U.S.C. § 507 (2009).

³⁴ 11 U.S.C. § 726(b) (2009).

³⁵ See generally H.R.Rep. No. 95-595, p. 220 (1977), U.S.Code Cong. & Admin.News 1978, p. 5787.

through priority grouping.³⁶ One section of the Bankruptcy Code intended to help trustees and debtors-in-possession increase the value of the estate is § 365(a). This section allows the trustee or debtor-in-possession to assume or reject any executory contract, subject to the court's approval.³⁷ The power to reject has been described as, "vital to the basic purpose of a Chapter 11 reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization."³⁸

Executory contracts are not defined in the code and prior to an article in the Minnesota Law Review by Professor Vern Countryman the courts' approaches varied across jurisdictions.³⁹ Countryman created the "material breach" test: "[A] contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."⁴⁰ There are alternative definitions and tests for executory contracts but the Countryman definition is sufficient for the purposes here.⁴¹

The trustee or debtor-in-possession may assume the executory contract unless the debtor has already defaulted on it.⁴² If the debtor has defaulted on the executory contract then the trustee must cure or provide adequate assurance that any such default will be cured before accepting the contract.⁴³ An alternative to choosing to accept the executory contract is the Trustee choosing to reject the contract.⁴⁴ The trustee has wide discretion in choosing whether to accept or reject the contract. The court will typically respect the trustee's decision as long as the

³⁶ 11 U.S.C. § 507 (2009).

³⁷ 11 U.S.C. § 365(a) (2009).

³⁸ *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984).

³⁹ Carl N. Pickerill, *Executory Contracts Re-Revisited*, 83 Am. Bankr. L.J. 63, 65 (2009).

⁴⁰ *Id.* at 66 quoting Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1972).

⁴¹ *See generally id.* at 66 – 79.

⁴² 11 U.S.C. § 365(b)(1) (2009).

⁴³ *Id.*

⁴⁴ 11 U.S.C. § 365(g) (2009).

trustee uses sound business-judgment.⁴⁵ If the decision to accept or reject appears to enhance the estate then the court will not second-guess the trustee.⁴⁶ This rejection constitutes a breach of the contract on the date immediately preceding the filing of the bankruptcy petition.⁴⁷ Any damages arising from the breach of the contract are administered in bankruptcy court and the priority of a general unsecured creditor is given to the other party to the executory contract.⁴⁸ Any property interests created by an executory contract are not terminated by the rejection of the executory contract in bankruptcy, unless specifically provided for in the Bankruptcy Code.⁴⁹

Thompkins v. Lil' Joe Records, Inc. illustrates how the Bankruptcy Code treats record contracts that assign a musician's copyright ownership to a debtor who subsequently enters bankruptcy.⁵⁰ *Thompkins* was a member of a rap group named the Poison Clan.⁵¹ Poison Clan was party to an Exclusive Recording Agreement with Luke Records.⁵² *Thompkins* was required to record music and to transfer the copyrights to Luke Records.⁵³ In exchange for the copyrights, Luke Records agreed to pay *Thompkins* royalties at specified rates.⁵⁴

On March 28, 1995, Luke Records involuntarily became a debtor under a Chapter 7 bankruptcy proceeding filed by its creditors.⁵⁵ The bankruptcy case was successfully converted into a Chapter 11 reorganization proceeding.⁵⁶ A case may be converted from Chapter 7 to Chapter 11 at any time at the request of the debtor or of a party in interest with the court's

⁴⁵ *Group of Institutional Investors v. Chicago, M., S. P. & P. R. Co.*, 318 U.S. 523, at 550 (1943).

⁴⁶ *Allied Technology, Inc. v. R.B. Brunemann & Sons, Inc.*, 25 B.R. 484, at 495 (Bankr. S.D. Ohio 1982).

⁴⁷ 11 U.S.C. § 365(g)(1) (2009).

⁴⁸ *NLRB v. Bildisco & Bildisco*, 465 US 513, at 531 (1984)(superceded by statute).

⁴⁹ *CASC Corp. v. Milner (In re Locke)*, 180 B.R. 245, 260 (Bankr. C.D. Cal. 1995).

⁵⁰ *Thompkins v. Lil' Joe Records, Inc.*, 476 F.3d 1294 (11th Cir. Fla. 2007).

⁵¹ *Id.* at 1298.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* at 1299.

⁵⁶ *Id.*

discretion.⁵⁷ After conversion, the case is guided by Chapter 11 of the Bankruptcy Code rather than Chapter 7.

Under the reorganization plan, Luke Records transferred its executory contracts to Lil' Joe Records, Inc.⁵⁸ The plan stated that any executory contracts were to be deemed rejected.⁵⁹ The bankruptcy court approved and confirmed the plan and the rejection of the executory contracts.⁶⁰ The bankruptcy court also approved the sale of the property (the Poison Clan copyrights) to Lil' Joe Records, Inc.⁶¹ Thompkins did not participate in the bankruptcy proceedings.

Thompkins filed suit in the district court against Lil' Joe Records seeking damages, declaratory relief, and permanent injunctive relief alleging violations of the Copyright Act, Lanham Act, and state common law claims.⁶² Thompkins claims were dismissed by the district court at the summary judgment stage and Thompkins appealed. The focus of the dispute was over the ownership of the copyrights.⁶³ Thompkins argued that ownership of the copyrights reverted to his possession and in the alternative, that Lil' Joe Records, Inc. owed royalty payments for its use of the copyrights.⁶⁴

The Eleventh Circuit first discussed the effect of the bankruptcy on the ownership of the copyrights.⁶⁵ The court held that the copyrights did not revert back to Thompkins but instead passed into the bankruptcy estate and were later properly transferred to Lil' Joe Records.⁶⁶ The approval of the reorganization plan freed Luke Records from the burdens under the recording

⁵⁷ 11 U.S.C. § 706 (2009).

⁵⁸ *Thompkins v. Lil' Joe Records, Inc.*, 476 F.3d 1294, 1300 (11th Cir. Fla. 2007).

⁵⁹ *Id.*

⁶⁰ *Id.* at 1301.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 1303.

⁶⁴ *Id.*

⁶⁵ *Id.* at 1306.

⁶⁶ *Id.*

contract and gave Thompkins a pre-petition claim for breach of contract.⁶⁷ The transfer of the copyrights was an executed sale of property and Luke Records held full legal and equitable title.⁶⁸ The court discussed Thompkins claims and held that Thompkins held no ownership of the copyrights and Lil' Joe Records, Inc. owed him no royalty payments.⁶⁹

LEGAL THEORIES TO RECEIVE COMPENSATION

Thompkins presented a theory of unjust enrichment as an alternative to his breach of contract claim.⁷⁰ An unjust enrichment claim is controlled by state law. *Thompkins* was governed by Florida law requiring “circumstances such that it would be inequitable for the defendant to retain the benefit conferred by the plaintiff without paying for it.”⁷¹ The court explained that as a result of the bankruptcy proceedings and the confirmation of the reorganization plan, Lil' Joe Records, Inc. has become the owner of the copyrights.⁷² Lil' Joe Records, Inc. owns the copyrights and the exclusive right to exploit the copyright. The profit derived from this exploitation cannot be characterized as unjust and the unjust enrichment claim fails.⁷³ Unjust enrichment claim elements vary by state but without the musician being able to show that the new copyright owner has acted unjustly, this claim is likely to fail under any state

⁶⁷ *Id* at 1308.

⁶⁸ *Id.*

⁶⁹ *Id* at 1315.

⁷⁰ *Id* at 1314.

⁷¹ *Id* citing *Nova Info. Sys., Inc. v. Greenwich Ins. Co.*, 365 F3d 996, 1006-07 (11th Cir. 2004).

⁷² *Id.*

⁷³ *Id.*

law.⁷⁴ The Neophytes would not be awarded compensation under an unjust enrichment claim against USA Records.

Another possible theory for recovery is a claim for rescission. Thompkins presented a claim for rescission that was dismissed by the court. The *Thompkins* court states that rescission is not a possible function of Section 365.⁷⁵ The Bankruptcy Code already provides a remedy for creditors in this situation. Non-debtor parties to rejected executory contracts become general unsecured creditors with a pre-petition breach of contract claim.⁷⁶ The court goes on to say that an equitable imposition of royalty payments on the purchaser of a copyright from the bankruptcy estate does not serve the purpose of the Bankruptcy Code for the same reasons.⁷⁷ The only avenue available to a musician in this situation is to file a claim pre-petition claim against the debtor for breach of contract.⁷⁸ The musician will be treated as a general unsecured creditor in this instance. The Neophytes will not prevail with claims for rescission or an equitable imposition of royalty payments.

The Neophytes are unhappy because they no longer get the royalty payments that they were initially promised. They exchanged the ownership of their copyrights for the advance and future royalty payments. Now they have no right to receive the future royalty payments. Their only option is to file claims against A.I.G. Records' bankruptcy estate as general unsecured creditors. AIG Records' bankruptcy estate has \$12,500,000 in liabilities with only \$5,000,000 in assets. The business property is worth \$2,500,000 and the bank has a secured interest in the property for \$2,000,000. The bankruptcy trustee incurs \$100,000 of administrative expenses.

⁷⁴ See e.g. *Oil States Int'l, Inc. v. LTV Corp.*, 2006 U.S. Dist. LEXIS 77307 (N.D. Ohio Oct. 23, 2006) (holding rejection of executory contract is a pre-petition breach and appellant's claim is limited to breach of contract).

⁷⁵ *Thompkins v. Lil' Joe Records, Inc.*, 476 F.3d 1294, 1312 (11th Cir. Fla. 2007).

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

AIG Records also owes its employees \$400,000. AIG Records owes the Neophytes and other musicians a total of \$10,000,000 as unsecured creditors. The Neophytes have a claim for \$1,000,000; the present value of their future royalty payments.

The property is sold and the trustee pays the bank the \$2,000,000 owed to it. Next the trustee pays \$100,000 in administrative expenses.⁷⁹ The \$400,000 in employee wages are next in priority list.⁸⁰ This leaves \$2,500,000 in assets to pay the remaining \$10,000,000 in liabilities to the general unsecured creditors. The Neophytes' claim of \$1,000,000 is one tenth of the total liabilities. This entitles the Neophytes to one tenth of the \$2,500,000 in assets, totaling \$250,000. The Neophytes' present value of future royalty payments is \$1,000,000 creating a deficit of \$750,000. The Neophytes understand that they have no other legal recourse, but they want to know what they could do to prevent this situation from occurring in future record contracts.

FUTURE CONSIDERATIONS FOR RECORDING CONTRACTS

The first and most obvious approach to avoid the Neophytes' situation is to bargain for the right to retain the copyright. It is likely that all musicians already desire to do this. Due to the limited bargaining power that most musicians have, compared to record companies, this is not a viable option. Record companies have the power to make this a mandatory part of the agreement. Although the bands may refuse a contract mandating the assignment of copyrights, this contract may be the only one offered to the band. The Neophytes had no ability to retain ownership of the copyrights because A.I.G. Records told them that they could either take the

⁷⁹ 11 U.S.C. 507(a)(2) (2009).

⁸⁰ 11 U.S.C. 507(a)(4) (2009).

contract or leave it. Retaining ownership of the copyright is the ideal situation although it is unlikely to be achieved by most musicians.

The next logical approach is to simply insert a clause into the record contract providing that if the record company becomes insolvent or enters bankruptcy (voluntarily or involuntarily) then the copyright reverts back to the musicians. Bargaining for this clause seems more likely to succeed because the record company will not anticipate bankruptcy in its future. If enforceable, bargaining for the forfeiture of the copyrights upon an unlikely condition will cost the musicians much less than retaining ownership of the copyright.

Unfortunately, even if the musicians successfully bargain with the record company for this clause, the clause is unenforceable under the Bankruptcy Code. The Code prohibits the modification or termination of an executory contract upon the insolvency of the debtor or the commencement of a bankruptcy case.⁸¹ Furthermore, the Code provides that property interests of the debtor become property of the estate even if there is a provision in an agreement, transfer instrument, or applicable non-bankruptcy law that is conditioned upon the insolvency or the entrance into bankruptcy of the debtor.⁸² The property still enters the bankruptcy estate even if this provision “effects or gives an option to effect a forfeiture, modification, or termination of the debtor’s interest in property.”⁸³ Basically anything that changes the debtor’s interest in the property will not be given effect in bankruptcy. The debtor’s property is the copyrights to the musical works and the sound recordings. A provision conditioned upon insolvency or bankruptcy that would give ownership of these copyrights to the musicians would clearly violate the Code. Chief Judge Jones explained the purpose behind Section 514(c)(1) as,

⁸¹ 11 U.S.C. § 365(e)(1) (2009).

⁸² 11 U.S.C. § 541(c)(1) (2009).

⁸³ *Id.*

*Sweeping all of the debtor's property into the bankruptcy estate created at filing is the means by which the Code achieves effective and equitable bankruptcy administration. Only through a comprehensive administration of the debtor's property, wherever located and by whomever controlled, can the court shield the property from creditors' unauthorized grasp; prevent harassment of debtors; and ultimately ensure equal distribution among creditors.*⁸⁴

If the court is faced with uncertainty or ambiguity then it protects the property of the estate in order to realize the intent of the Code.⁸⁵ Even if a condition in the recording contract reverts ownership of the copyrights back to the musicians, it is not enforceable in a bankruptcy. The property would still be administered through the bankruptcy estate and the musicians would share in the pro rata distribution with other general unsecured creditors.

If retaining possession of the copyright is not practical and reversion of the copyright to the musicians is not possible under the Code, the Neophytes may desire to improve their position in the bankruptcy proceeding. The Neophytes want to secure their claim to get paid before the general unsecured creditors do.

To secure a claim a creditor must meet the requirements of Section 506.⁸⁶ The claim must be “allowed” meaning it is valid under non-bankruptcy law and not invalid under bankruptcy law.⁸⁷ The Neophytes become secured creditors by retaining a security interest in the copyrights assigned to AIG Records and complying with the requirements in the Bankruptcy Code. To be a secured party, the Neophytes must be a have a claim against the debtor, which is

⁸⁴ *Bonneville Power Admin. v. Mirant Corp. (In re Mirant Corp.)*, 440 F.3d 238, 251 (5th Cir. Tex. 2006) quoting *Burgess v. Sikes (In re Burgess)*, 438 F.3d 493, 509 (5th Cir. La. 2006) (Jones, C.J., dissenting).

⁸⁵ *Id* citing *Brown v. Chesnut (In re Chesnut)*, 422 F.3d 298, 303 (5th Cir. 2005).

⁸⁶ 11 U.S.C. § 506 (2009).

⁸⁷ 4-506 Collier on Bankruptcy P 506.03 (2009).

the definition of a creditor.⁸⁸ The Neophytes become a creditor upon the trustee's rejection of the executory contract. The secured claim must be secured by a piece of property in which the estate has an interest.⁸⁹ If the Neophytes and A.I.G. Records agree to a security interest in the copyrights and the Neophytes comply with the statutory requirements of perfection: the Neophytes will be secured up to the value of the copyrights.⁹⁰ Perfection is a recording process that provides notice to the public at large of the security interest.⁹¹

At the time of the bankruptcy the court determines the value of the secured claim.⁹² The Neophytes' claim is valued at \$1,000,000; the present day value of their future royalty payments. Then the Neophytes can petition the court for relief from the automatic stay if they are not adequately protected, the creditor has no equity in the property, or if the property is not necessary to an effective reorganization.⁹³ If the stay is lifted then the Neophytes would be free to sell the collateral to satisfy their claim and return any surplus received to the estate.⁹⁴ Even if the Neophytes are not entitled to relief from the automatic stay they will still receive greater priority than the general unsecured creditors.⁹⁵ Although they may not receive all of the royalty payments owed to them they will receive more than they would as general unsecured creditors. This may not be their ideal outcome for the band but it is the best outcome available under the current Bankruptcy Code.

⁸⁸ 11 U.S.C. § 101(10)(A) (2009).

⁸⁹ *Id.*

⁹⁰ 11 U.S.C. § 506(a)(1) (2009).

⁹¹ U.C.C. § 9-303 (2005).

⁹² 11 U.S.C. § 506(a)(1) (2009).

⁹³ 4-506 Collier on Bankruptcy P 506.03 (7)(b) (2009).

⁹⁴ 11 U.S.C. § 362 (2009).

⁹⁵ 11 U.S.C. §§ 506, 507 (2009).

CONCLUSION

A beginning band is faced with many difficulties when offered its first record contract. In most cases it would be advantageous to hire an attorney to give legal advice and to help negotiate the contract. If possible, retaining possession of the copyrights to the music would be a high priority. This would guarantee ownership and would not put the ability to receive future royalty payments in jeopardy. However, this is not possible for most musicians, especially those who are less famous. Inserting an ipso facto clause into the contract reverting ownership of the copyright back to the musician conditioned upon the record label entering bankruptcy is not a viable option. A later lawsuit claiming breach of contract is not ideal because the musician will be treated as a general unsecured creditor and will not receive the full amount owed. The courts have not been receptive to claims of unjust enrichment either, as the bankruptcy code already provides a remedy for the musician.

If the musician is unable to bargain for retaining ownership of the copyright, the next best situation may be to bargain for a security interest in the copyright. Following the procedure outlined in Article 9 of the Uniform Commercial Code could secure the claim. By becoming the holder of a secured claim, the musician could receive superior priority over the general unsecured creditors. The musician would receive compensation closer to what he is actually owed. The main problem is bargaining for this with the record company. The pros and cons must be weighed in each situation because the record company is unlikely to grant a security interest in its property without the musician giving up something additional. Whatever the musician decides to do, it is important to consider the implications that a bankruptcy will have on his ability to receive future royalty payments.