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Rejection of Songwriter Publishing Agreements in Bankruptcy

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The music industry is no stranger to artist and songwriter bankruptcies — TLC, Toni Braxton and James Taylor, to name just a few. A common need for bankruptcy in the music industry is to get out from under burdensome agreements with record labels and publishers.

Songwriters frequently enter into publishing agreements with music publishers. Typically, the songwriter writes a certain number of songs over a specified term, transfers a portion of the copyrights of those songs to the publisher, and the publisher exploits the songs.[1] The songs earn royalty income, which is apportioned between the publisher, which receives the "publisher's share," and the songwriter, who receives the "writer's share." The publisher collects the royalties, retains the publisher's share and remits the writer's share to the songwriter.

This article examines what happens to the writer's share when a songwriter files for bankruptcy and rejects his/her publishing agreement. If the songwriter is relieved of his/her future obligation to write and deliver songs, is the publisher relieved of its obligation to pay the writer's share for songs that were already delivered? Is the publisher then entitled to keep the writer's share for itself? As argued in this article, the answer to both of these questions is "no."

Section 365 of the Bankruptcy Code is one of the most powerful weapons in a debtor's arsenal.

Under § 365(a), a debtor may assume or reject any of its executory contracts and unexpired leases. It is well established that executory contracts must be assumed or rejected in their entirety.[2] A debtor may not "cherry-pick" and assume the executory obligations in a contract that he or she deems beneficial while rejecting those executory obligations within the same contract that the debtor deems

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burdensome.[3] If a debtor wishes to assume an executory contract that is in default, the debtor must cure existing defaults or provide adequate assurance that any defaults will be promptly cured, as well as compensate for damages and provide adequate assurance of future performance.[4] If an executory contract is rejected, the debtor can no longer be compelled to perform his or her remaining obligations under the contract.[5] Rejection is considered a pre-petition breach that relieves the counterparty of any further obligation under the rejected contract and entitles that counterparty to a rejection-damages claim.[6]

A single contract might contain multiple severable agreements, only some of which are executory and capable of rejection. This requires attorneys and courts to carefully analyze whether a single agreement actually contains multiple severable agreements, and which of those severable agreements are executory and capable of assumption or rejection.

While the Bankruptcy Code does not define "executory," Prof. Vern Countryman has articulated the most widely cited definition: " n agreement in which the obligation of both the bankrupt and the other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other."[7] Most circuits have approvingly cited Prof. Countryman's definition, at least as a starting point, in defining "executory."[8] The U.S. Supreme Court has stated that "Congress intended the term to mean a contract 'on which performance is due to some extent on both sides.'"[9] Another approach to determining whether a contract is executory is the "functional approach," which asks whether assumption or rejection of the contract would benefit the estate and creditors.[10]

Even if a contract is executory in some respects, that is not the end of the inquiry because "the issue of assumption or rejection of such contracts relates only to those aspects of the contract remain unfulfilled as of the date the petition is filed."[11] Thus, where a single agreement embraces multiple obligations, some of which are executory and some of which are fully or substantially performed, only the executory obligations are subject to rejection.[12]

A review of case law demonstrates this point well. In *Stewart Title Guaranty Co. v. Old Republic Nat'l Title Ins. Co.*,[13] the debtor, Dallas-Texas-National Title Company (DTNT), was the lessee under a personal property lease with Dallas Title Co.[14] The leased personal property included a number of records necessary to the title insurance business.[15] The lease provided that upon termination of the lease, the records would remain the property of Dallas Title, but that DTNT could copy the records for its own use (the "reproduction rights").[16] Thereafter, DTNT filed for bankruptcy and the trustee rejected the lease, but sold the reproduction rights to Stewart Title as potential assets of the estate.[17] Thereafter, Dallas Title's successor, Old Republic National Title Insurance Co. f/k/a Southwest Land Title Co. (collectively, Old Republic), refused to allow Stewart Title to exercise the reproduction rights, forcing Stewart Title to file suit against it seeking specific performance.[18] Old Republic argued that due to the trustee's rejection of the lease, Stewart Title could not enforce the reproduction rights.[19] In response, Stewart Title argued that the lease consisted of two severable agreements: (1) an executory agreement regarding the use of records (the "use rights") and (2) an already performed agreement (i.e., nonexecutory) regarding the copying of records (i.e., the reproduction rights), which vested in the lessee on the lease's effective date.[20] Stewart Title argued that because the reproduction rights required no further performance from the lessee, the bankruptcy trustee's rejection pertained only to the use rights, the executory portion of the lease, and the nonexecutory reproduction rights could not be rejected.[21]

The first question that the *Stewart Title* court addressed was whether the lease was "severable."[22] According to the court, a severable contract "includes two or more promises can be acted on separately, such that failure to perform one promise does not necessarily put the promisor in breach of the entire agreement."[23] The court determined that a contract is divisible, or severable, when one party's performance consists of more than one "distinct and separate item … and the price paid by the other party is apportioned to each item."[24] The court then concluded that the use rights and reproduction rights were distinct and separate obligations,[25] and found that where an executory contract contains multiple agreements, a debtor can only reject those that are executory.[26] The court agreed with Stewart Title that the reproduction rights agreement was substantially performed, not executory, and therefore enforceable notwithstanding the trustee's rejection of the lease.[27]

In *In re Cutters Inc.*,[28] the debtor moved to reject an executory contract with distinct obligations between the debtor and a purchaser of the debtor's assets. The contract contemplated two basic transactions: (1) a sale of current assets; and (2) the sale of additional inventory over time.[29] The contract also contained restrictive covenants not to compete and to hold harmless.[30] The court found that the restrictive covenants were not significant enough to render executory the otherwise fully completed agreement as to the sale of current assets, thus that agreement was not capable of being rejected, but the severable executory agreement to sell additional inventory over time could be rejected.[31]

Similarly, in *Matter of Taylor*,[32] in analyzing whether the debtor could reject a personal-services contract requiring future performance of writing and performing musical compositions, the Third Circuit held that "the issue of or rejection relates only to those aspects of the contract remained unfulfilled as of the date the petition was filed."[33] The court also noted that " o the extent that money is due the debtor for prepetition services under a personal services contract, the debtor's claim for those sums is undoubtedly an asset of the estate … regardless of whether the trustee later affirms or rejects the contract."[34] This statement is in line with case law concerning the executoriness of settlement agreements, in which courts have found that the right to collect money under a settlement agreement is not enough to make the agreement executory.[35] As noted by the Third Circuit in *In re Columbia Gas Systems*,[36] "if the debtor has fully performed, the performance owed by the nonbankrupt is an asset of the bankruptcy estate and should be analyzed as such, not as an executory contract."[37]

Rejection of an executory contract does not reverse or undo any transactions completed before the point of rejection,[38] nor does it terminate the contract. Thus, the effect of rejection remains "one of the great mysteries of bankruptcy law."[39] In the case of a rejected publishing agreement, some publishers might argue that because the songwriter is relieved of future performance under the agreement, the effect of rejection is relieving the publisher of the obligation to remit the writer's share to the songwriter, thus it is entitled to keep the writer's share for itself. However, that argument ignores the fact that a publishing agreement might contain multiple severable agreements, only some of which might be executory and capable of rejection.

In publishing agreements, clear boundaries often exist as to which portions of the agreement are executory and non-executory. The creation and delivery by the songwriter of each song is its own promise, and royalties are attributable to individual songs. Once a songwriter delivers a song to the publisher, there is nothing left for the songwriter to do with regard to that song. The only remaining obligation as to delivered songs is for the nondebtor publisher to collect royalties and remit the writer's share to the songwriter.For purposes of rejection, future performance obligations from both the parties are easily severable from the portion of the agreement, requiring nothing more than payment of the writer's share to the songwriter for past performance. Where the debtor songwriter has delivered songs to the publisher, the publisher has exploited the songs and is collecting royalties attributable to those songs, the right to the writer's share for those songs is an asset of the estate — not an executory contract. There is nothing to reject, because this portion of the agreement is simply not executory, and the publisher must continue to remit the writer's share to the songwriter or the bankruptcy estate.

If the result were not as argued in this article, and publishers were relieved of any obligations to remit the writer's share to the songwriter for past performance, the publisher could effectively receive a windfall in keeping the writer's share for itself — an asset for which it neither bargained nor paid. This result also ignores the remedy for rejection provided by the Bankruptcy Code: a rejection-damages claim.[40]

Moreover, the right to receive royalty income is routinely sold or assigned to third parties. If songwriters who have assigned their rights to receive royalties thereafter file for bankruptcy and reject future songwriting obligations under publishing agreements, and the result is that the publisher is no longer required to remit the writer's share attributable to past songs to the songwriter's assignee, the market for royalty streams would be severely chilled. No royalty-stream purchaser would take the risk of paying for a royalty stream that in an instant might evaporate as a result of the rejection of the publishing agreement. This result serves no purpose in giving the debtor a fresh start and is not the result intended by 11 U.S.C. § 365, and would only serve to provide a windfall to the publisher.

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