

## LEGAL AFFAIRS

### **Revising the "Jump Ship" Clause: How California Legislators and the Music Industry Raised the Ante for Record Companies Seeking Injunctions Against Defecting Artists**

**By William I. Hochberg**

In a case of shaky missteps followed by fancy legislative footwork, California lawmakers increased from \$6,000 to \$50,000 the annual minimum compensation required to enjoin artists from walking away from recording and other entertainment contracts, and then, following an intensive industry backlash, withdrew the original bill and passed a substantially scaled-down

version. (See Cal. Civ. Code section 3423; Cal. Code Civ. Proc. section 526.)

The previous incarnation of the bill, spearheaded by the Beverly Hills Bar Association, would have raised the annual guaranteed compensation figure to \$50,000 per artist. (See ELR 14:9:20 and 15:4:23). The bill was signed into law without objection by the entertainment industry, whose lobbyists had apparently been caught unawares.

"Through a quirk of process, no one contacted the recording or film or television industries and the [original] bill went through without any comment," said George Kieffer, of Manatt, Phelps & Phillips, representing the Recording Industry Association of America, Inc. (RIAA). Kieffer subsequently served on the legislative workgroup panel which changed the law.

The RIAA apparently did not realize the impact of the former bill until it was signed into law, but succeeded,

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with others in the industry, in persuading the Joint Committee on the Arts, headed by State Senator Henry J. Mello (D-Watsonville) to support the repeal of the original bill and the redrafting and passage of the new version. The workgroup panel, including representatives of entertainment companies, music attorneys and other entertainment constituents hammered out the compromise measure over a six-month period.

The new law

The final version of the bill provides that companies in California may seek injunctive relief for breaches of contracts entered into after January 1, 1994 only after complying with the so-called "\$9,000 PLUS" provision, as codified in newly amended Section 3423 of the California Civil Code and Section 526 of the California Code of Civil Procedure, signed into law in October by

Governor Pete Wilson. The new law does not affect a company's right to sue for damages even if it is precluded from seeking the injunction remedy because of a failure to pay the minimums.

As shown in the tables below, the law requires a company to contractually guarantee \$9,000 in annual income on the first contract year, with step-ups to \$12,000 on the second year and \$15,000 on years three to seven. Such monies must be guaranteed (i.e. advances) and not contingent (i.e. royalties). In addition, in years four and five, the company must have actually paid additional sums of \$15,000 per year, and in years six and seven additional sums of \$30,000 per year. This so-called "Plus" compensation may include contingent royalties, as long as the monies were actually paid. Payments of guaranteed or contingent monies in excess of a statutory minimum for any particular year may be carried forward to meet future years' minimums.

The bill also provides an alternative means of obtaining injunctive relief for companies which did not make the annual guaranteed payments to an artist who then becomes extraordinarily successful in a later year. The so-called "Superstar Insurance" clause would, for example, allow a company that did not make guaranteed payments in years 1-3 and which released an extremely successful album in year 4 to seek an injunction against the artist by making a lump sum payment on the courthouse steps which, when added to any previous payments, would total \$510,000. (See table below.)

### Impact of law

In its current and final form, the bill (SB 487) is seen as impacting the record industry more profoundly than the film and television industries, because film and television talent usually earn more annual income under

their contracts than is required under the law, whereas budding recording artists often do not. The exceptions are companies producing television pilots and low budget films, where relatively small up-front investments in talent are often involved.

Opponents of the original bill warned that it would have caused record companies to flee California or sign artists in other jurisdictions, thus depriving the state of tax revenues and jobs, not to mention lost business for California-based entertainment firms.

In order to seek injunctive relief against every member of a musical group, each member of that group must receive the specified sums. Record companies are expected to blunt the effect of this aspect of the provision by guaranteeing the statutory amounts only to key and leading members of a group. Arguably, such a tactic would effectively bind an entire band because essential

members would be bound while lesser members would probably not want to abandon the group.

Ironically, while one might expect the California law to make injunctive relief more difficult to obtain in California than in other jurisdictions, the opposite may be true. Without such a law, judges likely would adhere to their traditional reluctance to grant injunctions in the context of personal services contracts. Indeed in the other major music industry jurisdictions -- New York and Tennessee -- no laws similar to the California bill are in effect or even under consideration, according to Paul Minicucci, consultant to the Joint Committee on the Arts, and coordinator of the statutory renegotiation effort. On the other hand, companies subject to New York or Tennessee law could at least threaten to seek injunctions against jumping artists, even if the companies had failed to make any minimum annual payments, while the

California law prevents such legal posturing unless a company has paid its dues.

David Altschul, senior vice president of business and legal affairs at Warner Bros. Records, says the California law should not cause smaller record companies to flee the state. "The fact that there are statutory prerequisites in California probably gives you a somewhat better shot of getting an injunction in California than in New York," he says. This may be due to a broader judicial acceptance of the concept of injunctions to prevent breach of personal services contracts in California than elsewhere, because lawmakers in Sacramento have specifically addressed the issue and set forth a "bright line test."

Kieffer, of Manatt, Phelps & Phillips, also feels artists may escape injunctions more easily in New York than California. "In New York they go under common law and case law and in the end they have reached the same

or better conclusions than under the California law," Kieffer says. "Many feel New York law is better because there are no minimums and the court may be more apt to look at other factors than simply how much money was paid to the artist in determining whether an injunction may be appropriate."

It is also important to note that under the California law a judge might still impose additional bonding requirements over and above the minimum payments set forth in the statute, according to the circumstances of a particular case. Thus, the statutory minimums may actually represent a floor, not a ceiling, for obtaining injunctions.

What impact, if any, the \$9,000 Plus law will have remains unclear. The major record companies probably will not change their policies appreciably, although there may have been some pressure to close deals which were still pending before the end of 1993, when the new law

kicks in, according to Doug Mark, head of Business Affairs at Giant Records. "We're rushing to get our contracts done before the end of the year, so we have them under the \$6,000 provision," he says. While the new law may have prompted record companies to close existing deals before the end of the year, Mark and others say it did not cause a feeding frenzy at record labels who might have wished to find and sign new recording artists before the end of the year.

"There are going to be windows where record companies will review sales levels and make tough decisions as to whether to play it safe and guarantee money, or risk not enjoining an artist," Mark says. "For the new artists and superstar artists there will not be much of a difference. It's the mid-level artists in the 200,000 - 300,000 units category of most concern."

In the case of a musical group, the law requires that each member must be paid the minimum annual salaries

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to bind that member. This effect may cause record companies to choose more selectively who to guarantee income to, Altschul points out. "When we sign groups, it has always been our practice not to make guarantees to every member," says Altschul. "We identify key members. So, there will probably be more heightened scrutiny than before."

Smaller independent record companies may attempt to circumvent the California statute by employing choice of law and choice of forum provisions specific to jurisdictions outside of California.

Jim Cooperman, Senior Director of Business and Legal Affairs at Relativity Records, says his company has always favored entering into contracts with New York jurisdiction and choice of law clauses, even with bands whose members are from California. "Most small record companies may try to avoid the application of this law," Cooperman says. However, he acknowledges that a

contract with a California artist which is signed in California may become subject to California law if a judge determines that the locus of the contract is California notwithstanding the choice of New York law and jurisdiction provisions.

"I'm glad its not \$50,000, that was a cause of great concern," adds Cooperman. "A label like ours, which is able to spend a third to a tenth of what major labels pay [for talent] would be precluded from signing bands in California" under the earlier version of the law. However, the current version of the law, "while it does increase the stakes, does not make the numbers so large as to preclude us from doing deals with California-based artists."

Commenting on the legislative sea change, David Altschul, of Warner Bros. Records, said opposition to the original bill came from many quarters in the music industry, including attorneys and managers representing

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talent, who "had a fear that if the \$50,000 provision went into effect, it would have had a meaningful impact on the number of artists signed in California."

### Interpretations of prior law

The \$6,000 figure of the original incarnation of the law was arrived at in 1919, and the figure is equivalent to \$140,000 in 1992 dollars. The law was first intended to address circumstances existing at the birth of the film industry, when studios had actors under strict exclusive contracts. However, over time the provision came to be applied more to the recording industry than to film and television contracts, because in both the motion picture and television industries salaries are well in excess of \$6,000 per year.

Caselaw which interpreted the former \$6,000 provision appears to remain applicable to the revised version for the most part.

For example, the issue of how to determine what portion of a record company's total advances may be considered as "guaranteed payments" in order to satisfy the law was addressed in *MCA Records, Inc. v. Newton-John*, 90 Cal.App.3d 18, 153 Cal.Rptr. 153 (1979) (ELR 1:1:4). It is standard practice for major record companies to advance an artist a so-called "recording fund" including the reasonable costs of recording an album in addition to the guaranteed advance against royalties. Olivia Newton-John was given complete discretion over how to allocate the total funds. The Court of Appeal held that Newton-John could be enjoined by MCA from rendering personal services to others. MCA had paid her nonreturnable advances of \$250,000 per album for each of four albums received during the first two

years, and an additional \$200,000 nonreturnable advance for two additional albums. Newton-John failed to deliver the final two albums and both parties filed breach-of-contract actions against one another. Newton-John argued that MCA was denied injunctive relief because it failed to guarantee a minimum annual compensation of \$6,000. She argued that she expended in excess of \$194,000 in recording costs, and her "net" compensation was thus less than \$6,000 annually. However, the Court found that Newton-John's exclusive control of production costs left her "free to record in as tight-fisted or as open-handed a manner, costwise, as she chose." Thus, the Court held, the "minimum compensation" referred to in the statute does not mean "net profits" after exhaustion of a recording fund, but is calculated based on a "reasonableness" standard with respect to recording costs. In passing judgment, the Court

noted that MCA had paid Newton-John approximately \$2,500,000 in royalties and nonreturnable advances.

Caselaw also provides that a record company cannot meet its obligation by making an option to pay an artist the statutory annual minimums but not actually providing a contractual guarantee of such payments. In *Motown Record Corp. v Tina Marie Brockert*, 160 Cal.App.3d 123, 207 Cal.Rptr. 574 (1984) (ELR 6:5:5) ("Teena Marie"), the appellate court held that a contract provision granting such an option did not meet the statutory threshold for injunctive relief. The Court made three important rulings with regard to the availability of injunctive relief in entertainment personal services contracts: (1) that a guarantee of the minimum compensation set forth in Section 3423 must be an express term in the written contract between employer and employee; (2) that only performers of "star" quality could be enjoined under Section 3423 (i.e. the statute should apply

to the "prima donnas" but not the "spear carriers" *Id.* at 583); and (3) an option to meet the statutory minimum violated the concept of fundamental fairness embodied in section 3423, adding that adding that such options in effect give record companies the ability to purchase injunctive relief "on the courthouse steps" (*Id.* at 132, 207 Cal.Rptr. at 580). It appears that the "distinctive-in-the-field" requirement no longer applies under the new law. The requirement would seem to give new and less successful artists the ability to "walk" on a contract without fear of injunction, and it would appear to have a chilling effect upon record company investments in marketing and promotion of new and unknown artists. Although the Teena Marie case specifically interpreted the original legislative intent as making available injunctive relief only against performers who have achieved fame and success, many in the industry feel that the legislative

update of the law makes clear that the law applies across the board to artists at all levels of success.

Commenting on the overall process of arriving at the final bill, Kieffer says: "After a rocky start all the parties spent a tremendous amount of time over six months to work out a compromise aimed at meeting the needs of artists and small companies, as well as the large companies. Great credit goes to the Beverly Hills Bar Association for reconsidering the issue."

Clause A: "The Nine Thousand Plus Installment Plan"

Contract Year	Guaranteed Money	+	Contingent Money "Actually Paid"
1	\$ 9,000	PLUS	0
2	\$12,000	PLUS	0
3	\$15,000	PLUS	0
4	\$15,000	PLUS	\$15,000

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5	\$15,000	PLUS	\$15,000 (cumulative)
6	\$15,000	PLUS	\$30,000 (cumulative)
7	\$15,000	PLUS	\$30,000 (cumulative)

### Clause B: "Superstar Insurance"

Contract Year	Ten-fold Lump Sum	Prior year(s) Aggregate	Total Sum to be paid for injunction
1	\$ 90,000	PLUS 0	= \$ 90,000
2	\$120,000	PLUS \$ 90,000	= \$ 210,000
3	\$150,000	PLUS \$210,000	= \$360,000
4	\$150,000	PLUS \$360,000	= \$510,000
5	\$150,000	PLUS \$510,000	= \$660,000
6	\$150,000	PLUS \$660,000	= \$810,000
7	\$150,000	PLUS \$810,000	= \$960,000

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[ELR 15:8:3]

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## RECENT CASES

### **Court refuses to reinstate "Un Lugar En El Munda" Oscar nomination for Best Foreign Language Film; Motion Picture Academy changes guidelines for category**

In August 1992, the Academy of Motion Picture Arts and Sciences invited Uruguay, along with several other foreign countries, to submit films for consideration for the 1992 Oscar nomination for Best Foreign Language Film.