ANDREWS LITIGATION REPORTER

THOMSON WEST

# Bankruptcy

COMMENTARY

REPRINTED FROM VOLUME 4, ISSUE 4 / JUNE 18, 2007

## Losing JT's Money: How a Recording Contract And a Corporate Bankruptcy Ruined One Rapper's Fairy Tale

By Lisa Bittle Tancredi, Esq.*

Rap artist Jeffrey Thompkins aka JT Money lived a fairy-tale life. Discovered by 2 Live Crew during a Miami talent show, he was signed to a recording contract with what would later become Luke Records. JT Money recorded, and Luke Records distributed, three albums under this arrangement: "2 Low Life Muthas," "Poisonous Mentality" and "Rufftown Behavior."

Under the recording contract, JT Money sold the copyrights in his creative works to Luke Records, which agreed to pay royalties in return. Then Luke Records went bankrupt, and this chapter of JT Money's story has an unhappy ending.

During the bankruptcy proceedings, Luke Records sold the copyrights for JT Money's musical compositions to another recording company, Lil' Joe Records. The bankrupt Luke Records also used the powers of the Bankruptcy Code to "reject" its recording contract with JT Money. The sale of the copyrights and the rejection of the contract meant that Lil' Joe Records became the new owner of the musical compositions and copyrights, without any obligation to pay royalties to JT Money.

JT Money's remedy? Only a claim for breach-of-contract damages against the estate of the bankrupt company — at least that is what the U.S. Court of Appeals for the 11th Circuit ruled in February in *Thompkins v. Lil' Joe Records*, 476 F.3d 1294 (2007).

The unhappy ending to this chapter in JT Money's life was the result of the structure of his recording contract and the Bankruptcy Code's treatment of contracts. Part of JT Money's problem was caused by the structuring of his recording contract as a sale. Under the deal, JT Money sold all his rights to the copyrights in the sound recordings he recorded during a five-year term.

While Luke Records was supposed to pay him royalties, it owned outright all the rights to the creative material, whether it paid royalties or not. Several side agreements were made between JT Money and Luke Records, but it was the structure of the main contract (*i.e.*, the outright sale of the creative materials) that led to the result in bankruptcy.

The Bankruptcy Code can have unpleasant effects on contract rights, and two sections of the code played a role in JT Money's case. The first provision, 11 U.S.C. § 365, allows a debtor to "reject" unfavorable contracts. Contrary to popular belief, bankruptcy rejection does not "undo" the contract. Instead, rejection has the legal effect of a breach of the contract by the debtor, as of the bankruptcy petition date.

This means that the parties are left in place, but the non-debtor party is entitled to a claim for damages for the debtor's breach of the contract. A claim for rejection damages has the priority of a general unsecured claim against the bankruptcy estate, and recovery of such claims is often only cents on the dollar.

The second Bankruptcy Code provision that played a role in this case was 11 U.S.C. § 363, which governs bankruptcy sales. Section 363 enables debtors to sell property "free and clear" of other interests in the property. In essence, under Section 363 property interests are transferred from the property to the proceeds of sale.

For example, under Section 363 a debtor may sell mortgaged property "free and clear" of the mortgage lien. The lien is transferred from the property to the sale proceeds. The purchaser gets the property free of the mortgage, and the mortgage holder's claim is secured to the extent that there are sales proceeds to cover it.

Luke Records' rejection of JT Money's recording contract did not "undo" the contract. The copyrights and creative materials were not returned to JT Money. Instead, the court ruled that Luke Records continued to own the copyrights and creative materials. JT Money was left with a claim against the bankruptcy estate for breach-of-contract damages.

Luke Records, as the owner of the copyrights, was then able to sell them to Lil' Joe "free and clear" of all interests. Lil' Joe, by purchasing the copyrights, did not assume an obligation to pay royalties to JT Money. That obligation was left behind when Luke Records rejected the recording contract. Finally, because JT Money did not keep any interests in the intellectual property when he signed the recording agreement, he did not have a claim to the sales proceeds.

Artists can use various strategies to prevent this result in their own dealings. The most obvious measure is for the artist to keep title to the intellectual property rights. That, however, may not be feasible. Another strategy is for the artist to sell the intellectual property rights, but require the recording company to grant the artist a lien on the same intellectual property.

The artist should also make sure that his lien is legally perfected. A perfected lien should provide some protection, even outside of bankruptcy, in the event that the recording company does not perform.

For example, such a lien may enable the artist to take back ownership of the intellectual property if the recording company fails to promote the artist.

And, in the event that the recording company does file for bankruptcy, a perfected lien should enable the artist to make a claim to the proceeds of sale of the intellectual property.

The success of record labels can, like the popularity of an artist, be of limited duration. It is critical that recording deals and other contracts be structured to protect the interests of the artists in the event their marketability outlives that of the label on which they record.

** Lisa Bittle Tancredi is a bankruptcy and restructuring partner in the Baltimore office of national law firm Venable LLP. She can be reached at (410) 244-7402 and lbtancredi@venable.com*