RECENT CASES

"The Kingsmen" may rescind recording contracts and recover masters, including "Louie Louie," because of record company's failure to account and pay royalties; court rejects laches defense despite Kingsmen's unreasonable delay in bringing suit

A record company's contractual duty to account and pay royalties to recording artists should not be taken lightly, no matter how old the records are nor how out-of-touch the artists have become - not if the record company wants to continue making and selling records by those artists. This is the lesson to be learned from a recent decision by Judge William D. Keller, of the U.S. District Court in Los Angeles, in a case brought by "The Kingsmen."

Back in the 1960s, "The Kingsmen" entered into a series of contracts pursuant to which 102 master recordings were produced, including the master for "Louie Louie." After a number of transfers, a company known as G.M.L., Inc., became the owner of those masters, and it licensed the sale of recordings made from them. Despite those sales, G.M.L. stipulated that neither it nor its predecessors had issued accountings to "The Kingsmen" or made royalty payments to them. Judge Keller held that this failure amounted to a breach of contract that was sufficient to justify rescission by "The Kingsmen" under New York or California law.

G.M.L., however, argued that "The Kingsmen" had delayed so long in seeking rescission that they were barred from doing so by the doctrine of laches. Judge Keller agreed that "The Kingsmen" had delayed "unreasonably" in bringing their claim for rescission. But he

noted that laches requires two things: delay and prejudice from that delay.

G.M.L. argued that it had been prejudiced, but Judge Keller concluded otherwise. He therefore concluded that "The Kingsmen" were entitled to rescission and to possession of their masters.

Editor's note: Judge Keller's decision is largely an application of the specific facts of the case to undisputed principles of law. Perhaps for this reason, the decision has not been published. Nonetheless, because the decision is of significant interest to entertainment lawyers, it is reproduced in full text immediately below.

Peterson v. Highland Music, Inc., Case No. CV 93-4672 (C.D.Ca., June 20, 1995)

Richard Peterson v. Highland Music, Inc.
United States District Court

C.D.Cal. No. CV 93-4672-WDK

[Full Text]

The plaintiffs in this case seek to rescind several recording contracts entered into in the 1960's. After a bench trial, the matter was taken under submission so that the parties could prepare post-trial briefs in lieu of closing argument.1

FACTUAL BACKGROUND

The plaintiffs are members of a recording group called "The Kingsmen." Beginning in 1963, The Kingsmen entered into a series of recording contracts, pursuant to which 102 recordings (the "Masters") were produced. (Exhibit 48). The Masters are now owned by defendant G. M. L., Inc. ("G.M.L."). According to the

plaintiffs, G.M.L. and its predecessors have materially breached the recording contracts. In particular, the plaintiffs claim that the defendants have failed to account and pay royalties. The plaintiffs therefore seek to rescind the recording contracts and recover possession of the Masters.

DISCUSSION

A. Choice of Law.

Federal courts ordinarily apply the choice of law rules of the state in which they sit. See Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487 (1941); Consul Ltd. v. Solide Enterprises, Inc., 802 F.2d 1143, 1146 (9th Cir. 1986). In deciding choice of law issues generally, the California courts apply a "governmental interest" test. See Reich v. Purcell, 67 Cal.2d 551, 63

Cal.Rptr. 31 (1967); American Bank of Commerce v. Corondoni, 169 Cal.App.3d 368, 215 Cal.Rptr. 331, 333 (1985); Ashland Chemical Co. v. Provence, 129 Cal.App.3d 790, 181 Cal.Rptr. 340, 341 (1982). Where there is a contractual choice of law provision, California courts follow [section] 187 of the Restatement (Second) of Conflict of Laws (1971). Nedlloyed Lines B.V. v. Superior Court, 3 Cal.4th 459, 466, 11 Cal.Rptr. 2d 330, 334 (1992).

This lawsuit has generated considerable confusion among the parties regarding choice of law. Nevertheless, as noted below, the court finds that the law of the various states implicated by the parties is the same in all aspects relevant to the outcome of this case. Thus, no extensive choice of law analysis is necessary.

B. The Contracts.

The Masters were recorded pursuant to several contracts. The first four contracts were between The Kingsmen and Jerden Records ("Jerden"), a company owned by Jerry Dennon. (Exhibits 4, 14-16). Under those contracts, The Kingsmen produced recordings for Jerden in exchange for royalties. Jerden, in turn, entered into a series of contracts with Scepter Music, Inc. ("Scepter"), transferring the Masters to Scepter. (Exhibits 1-5). Pursuant to those contracts, Scepter owed Jerden a duty to account and pay royalties. Jerden, in turn, owed a duty to account and pay royalties to The Kingsmen. In 1968, The Kingsmen entered into the last contract at issue here, this time directly with Scepter. (Exhibit 6). This contract required Scepter to account and pay royalties to The Kingsmen.

Pursuant to the foregoing contracts, Scepter took title to the Masters. After a series of sales, the Masters were purchased by defendant G.M.L. As Scepter's

successor-in-interest, G.M.L. stands in Scepter's shoes. (R. T. , Vol. I, pg. l 11:7-9). By an assignment, plaintiffs stand in the shoes of Jerden and Jerry Dennon. (Exhibit 43). Asserting Jerden's rights, the plaintiffs seek to rescind the contracts through which Jerden transferred its rights to Scepter. (Exhibits 1-5).2 Asserting their own rights, plaintiffs wish to rescind the 1968 contract, in which the remaining Masters were sold directly to Scepter. (Exhibit 6).

C. The Parties.

Some of the original members of The Kingsmen who were parties to the various recording contract subsequently left the group, and are not plaintiffs in this action. The defendants argue that these former members are indispensable parties who must be joined under Fed. R. Civ.P. 19(a)(2).

Under the first set of contracts, the rights to the masters flowed from The Kingsmen to Jerden, and from Jerden to Scepter. Scepter owed a duty to account and pay royalties to Jerden, which in turn owed a duty to account and pay royalties to the plaintiffs. Thus, as to the songs recorded under the first set of contracts, plaintiffs are asserting Jerden's rights against G.M.L. As noted above, Dennon and Jerden assigned those rights to the plaintiffs in
1993. (Exhibit 43).3 As to the 1968 contract, between Scepter and The Kingsmen, all of the members of the group who were parties to the contract are parties to this lawsuit. Thus, they are clearly the proper parties to rescind the contract.

D. Grounds for Rescission.

1. Choice of Law.

As noted above, this lawsuit has generated a great deal of confusion regarding choice of law. As to plaintiffs' grounds for rescission, the parties have focused on New York and California law.4 This choice of law inquiry is simplified, however, by the fact that the law of California and New York is essentially the same with regard to the grounds for rescission.

In California, a party may unilaterally rescind a contract if there is a material breach by the other party. Cal. Civ. Code [section] 1689(b)(2).
A material breach is one that is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the undertaking. If a breach does not go to the root of the matter and can be readily compensated in damages, a party may not rescind.
Fantasy Inc. v. Fogerty, 984 F.2d 1524, 1530 (9th Cir. 1993) (citations and internal quotations omitted).

Under New York law, a party may rescind where he has suffered "breaches of so material and substantial a nature that they affect the very essence of the contract and serve to defeat the object of the parties." Affiliated Hosp. Prod., Inc. v. Merdel Game Mfg. Co., 513 F.2d 1183, 1186 (2d Cir. 1975) (quoting Nolan v. Williams Music Co., 300 F.Supp. 1311 (S.D.N.Y. 1969) aff'd sub. nom. Nolan v. Sam Fox Publishing Company, Inc., 499 F.2d 1394 (2nd Cir. 1974)). See also Canfield v. Reynolds, 631 F.2d 169, 178 (2nd Cir. 1980) (citing Nolan). Rescission is not available where the breach did not go to the "root of the contract." Id.

Given the similarity of the standards for rescission under New York and California law, the result in this case would be the same in either state.

2. Materiality of the Breach.

Pursuant to the relevant contracts (i.e., the contracts by which Scepter obtained the Masters), G.M.L. and its Predecessors owed a duty to account and pay royalties to Jerden (and, in some cases, directly to plaintiffs). At trial, defendants stipulated that no one in G.M.L.'s chain of title made any royalty payments. (R.T., Vol. I, pg. 14:7-8). 5 Defendants also stipulated that there have been numerous uses of the Masters since the 1960's, for which royalties would have been due. (R.T., Vol. I , pp. 12: 5-6; 14: 23-15: 2) . Finally, defendants admitted that G.M.L. had not rendered an accounting within the applicable statute of limitations, and that no royalty statements were sent for 30 years. (R.T., Vol. IV, pg. 471:18-25; Vol. 11, pg. 74:6-7).

In light of the stipulated facts, it is clear that there has been a breach sufficient to justify rescission under either New York or California law. G.M.L. and its predecessors had a duty to account and pay royalties;

they had no other duties. Defendants stipulated that royalties were due, no royalties were paid, and no accounting rendered. This amounts to a total breach of the contracts. Such a breach is clearly material enough to justify rescission. Cf. Nolan v. Sam Fox Publishing Co., Inc., 499 F.2d 1394, 1399 (2nd Cir. 1974) ("[A]n essential objective of a contract between a composer and publisher is the payment of royalties, and a complete failure to pay means this objective has not been achieved."); Fantasy, Inc. v. Fogerty, 984 F.2d 1524, 1530-31 (9th Cir. 1993) (no rescission where the defendant paid royalties into an escrow account pending litigation, and kept accurate records of the amounts due).6

E. Laches.

1. Choice of Law.

The parties have argued at various times that either New York or California law applies to the defendants' affirmative defense of laches. As with the grounds for rescission, the Court finds that the law of both states is the same.

Under California law, relief based on rescission "shall not be denied because of delay in giving notice of rescission unless such delay has been substantially prejudicial to the other party." Cal. Civ. Code [section] 1693 (emphasis added): Witkin, Summary of California Law, Contracts [section] 892, pg. 799 (9th ed. 1987).7 Similarly, New York law requires a defendant claiming laches to prove prejudice as well as delay. See Airco Alloys Div. v. Niagara Mohawk Power Corp., 76 A.D.2d 68, 82, 430 N.Y.S.2d 179, 187 (4th Dep't 1980) ("Laches bars recovery where a Plaintiff's inaction has prejudiced the defendant and rendered it inequitable to permit recovery."); Western Elec. Corp. v. New York

City Transit Auth., 735 F.Supp. 1205, 1224 at fn. 20 (S.D.N.Y. 1990). Thus, the law of both states is the same as to the elements of laches; prejudice as well as delay must be established.8

Unlike the California Civil Code, which explicitly requires "substantial prejudice," the New York cases cited by the parties, and those examined by the Court in the course of its own research, do not specify the degree of prejudice necessary to prove laches. Nevertheless, the New York courts repeatedly note that laches is an equitable defense, and that unreasonable delay by the plaintiff bars recovery where delay "render[s] it inequitable to permit such recovery." Airco, supra, 76 A.D.2d at 82, 430 N.Y.S.2d at 187. If the New York courts were to identify the degree of prejudice needed to prove laches defense, they would certainly require "substantial" prejudice. Insubstantial prejudice is not the kind of prejudice which would "render[] it inequitable to permit

recovery." Thus, the Court finds that the law of laches is essentially the same in New York and California.

2. Delay.

At trial, the Court found that plaintiffs delayed unreasonably in bringing their claim for rescission. (R.T., Vol. III, pp. 402:4-403:19). The defendants have therefore established the first prong of their laches defense.

3. Prejudice.

(a) The Value of the Kingsmen Masters.

G.M.L. obtained the Kingsmen Masters in 1984, when it bought a catalog of over 10,000 recordings from a company called Koala for $500,000. (R.T., Vol. IV,

pp. 513:17-25; 517:8-19; 519:11-13). Of the approximately 10,000 recordings in the Koala catalog, 200-250 were considered "valuable" by G.M.L. (R.T., Vol. IV, pg. 517:15-19). When asked how many of the Kingsmen Masters would be within the 200-250 "valuable" records, G.M.L. `s vice president, Stephen Kountzman, testified that "Louie Louie" "might" be one of them, but he would not say that all 102 Kingsmen Masters were "valuable." (R.T., Vol. IV, pg. 536:18-22) (emphasis added). In fact, counsel for the defendants asserted that "Louie Louie probably comprises 95 to 98 percent of the income here. The other [Kingsmen] songs didn't generate much money . . . ." (R.T. , Vol . IV, pg. 425:18-20). In light of the defendants' testimony and argument, it is clear that of the Kingsmen Masters, only "Louie Louie" had any real value to G.M.L. Assuming that the $500,000 purchase price reflects the value of the 200-250 "valuable" masters, the single "valuable"

Kingsmen Master accounted for approximately $2,000-$2,500 of the purchase price, if the Koala catalog is evaluated on a pro rata basis.9

The defendants object to the evaluation of the Masters on pro rata basis. (Defendants' Post-Trial Reply Brief, pp. 9-10). However, because the defendants did not produce any other evidence regarding the value of the Kingsmen Masters, nor any of the other recordings, the pro rata approach is the only method of evaluation available. For example, Kountzman testified that the evaluation of the purchase price for the Koala catalog was done "primarily" by Mo Lytle, the owner of G.M.L. (R.T. , Vol . IV, Pg. 519: 15-18). However, the defendants did not produce, by deposition or at trial, any testimony from Mr. Lytle regarding the value of the Kingsmen Masters. Moreover, when asked how G.M.L. arrived at the $500,000 purchase price, Kountzman testified that the recordings were not evaluated on an

individual basis. (R.T., Vol. IV, pp. 519:19-520:1). Thus, in assessing the value of the Kingsmen Masters, the only evidence before the Court is the overall purchase price of the Koala catalog, the number of masters considered valuable by G.M.L., and the number of Kingsmen Masters considered of value.

(b) The Purchase Price.

Before deciding to purchase the Koala catalog, G.M.L. examined Koala's files to determine whether there were any royalties due. (R.T., Vol. IV, pp. 514:1-520:9). According to the defendants, the purchase price of the catalog reflected several factors, including the amount of royalties due. (R. T. , Vol. IV, pp. 519: 15-520:5). After examining the file relating to the Kingsmen Masters, G.M.L. concluded that no royalties were due. (R.T., Vol. IV, pg. 521:2-10). Defendants argue

that G.M.L. has suffered prejudice because it purchased the Koala catalog at a price based in part upon its belief that no royalties were due in connection with the Masters.

As noted above, G.M.L. failed to establish that the Kingsmen Masters represented a significant portion of the $500,000 purchase price. Indeed, the evidence shows that the Masters reflect only $2,000-$2,500 of that price. The defendants stipulated that during the four years prior to the lawsuit, G.M.L. received about $20,000 in connection with the Kingsmen Masters. (R.T., Vol. IV, pp. 444: 23-445:2). Even if this were the only money earned by G.M.L. during ten years of ownership, G.M.L. earned a substantial return for a minimal investment in the Kingsmen Masters. Indeed, under the circumstances, G.M.L. actually benefited from the plaintiffs' delay, because they were permitted to exploit the Kingsmen Masters without paying royalties.10 See,

e.g., Field v. Bank of America, 100 Cal.App.2d 311 (1950) (in an action to annul a trust, trustee was not prejudiced, but actually benefited from the delay, because fees accrued for many years).

Even if G.M.L. had established prejudice, such prejudice must be a result of the plaintiffs' delay in order to support the laches defense. See Cal. Civ. Code [section] 1693 (relief "shall not be denied because of delay in giving notice of rescission unless such delay has been substantially prejudicial to the other party."); Airco, supra, 76 A.D.2d at 82 ("Laches bars recovery where a plaintiffs inaction has prejudiced the defendant and rendered it inequitable to permit recovery."). In the case at bar, any prejudice to G.M.L. was caused as much by its own negligence as it was the plaintiffs' delay. Such negligence should be balanced against the prejudice asserted by G.M.L. See, e.g., Merchant v. Lymon, 328 F.Supp. 1048, 1063 (S.D.N.Y. 1993) (prejudice is

counterbalanced by culpability of the defendant in creating the circumstances causing the prejudice).

As noted above, G.M.L. examined the seller's files before purchasing the Koala catalog. The Kingsmen file contained all of the relevant recording contracts, which provided that royalties were owed either to Jerden Records or to The Kingsmen. Nothing in the file indicated that the potential royalty recipients had been bought out, or were otherwise not entitled to royalties. G.M.L., recognizing the importance of determining whether any royalties were due, allegedly tried to locate Jerden, but was unsuccessful. According to Mr. Kountzman, G.M.L. ran a Dun & Bradstreet report, called directory assistance in Seattle, and inquired with either the Secretary of State or Attorney General of Washington State. (R.T., Vol. IV, pg. 516:13-23).

When asked by the Court whether there was a written record of G.M.L. inquiry into the potential

royalty obligations attached to the Kingsmen Masters, Mr. Kountzman testified that notes were kept at the time, and that he recently had reviewed the Kingsmen file. (R.T., Vol. IV, Pp. 518:6-519:1). In spite of the specific inquiry from the Court, however, G.M.L. failed to produce either the notes or the file. Moreover, defendants failed to produce Mo Lytle, who was primarily responsible for putting together the Koala purchase. G.M.L. thus produced very little evidence of its attempt to locate Jerden. Given this lack of evidence, and an obvious incentive not to find any potential royalty claimants, the Court is not convinced that such efforts were made.

However, even if they were, there is no evidence at all that G.M.L. attempted to locate Jerry Dennon, who signed the contracts on behalf of Jerden, and there is no evidence that G.M.L. attempted to locate The Kingsmen. If G.M.L. had conducted a more thorough

investigation, it could have found Dennon and/or The Kingsmen, and would have known that royalties were due on the Kingsmen Masters.11 G.M.L., which specializes in obtaining master recordings without royalty obligations attached, should know how to determine whether royalties are owed on a given master, and should know how to prove that reasonable efforts were made to make such a determination. (See R.T., Vol. IV, pp. 512:19-513:16). Despite its experience, G.M.L. failed to produce evidence of a reasonable investigation.

Because the investigation was inadequate, G.M.L. could not reasonably assume that the Kingsmen Masters were unencumbered by any royalty obligations, and any prejudice resulting from that assumption was caused as much by the defendants' negligence as it was by the plaintiffs' delay.

(c) The Re-Recordings.

When G.M.L. purchased the Masters, G.M.L. already owned a re-recording of three Kingsmen songs, including "Louie Louie." This re-recording was performed by two of the original members of The Kingsmen, including the lead singer. (R.T., Vol. IV, pp. 520:5-9; 522:5-523:3: 525:5-526:5; 529:1-4). Stephen Kountzman testified that because G.M.L. owned the re-recordings, G.M.L. probably would not have purchased the original Masters if there had been royalty obligations attached. Id.

Assuming that G.M.L. would not have purchased the Masters if it had known that royalties were due, the only prejudice to G.M.L. would be the portion of the purchase price attributable to the Kingsmen Masters. However, as noted above, the Kingsmen Masters represented just a fraction of the purchase price, from which G.M.L. has earned a substantial return. Moreover, G.M.L. still owns the re-recordings. If the plaintiffs

were to recover the Masters, G.M.L. would be in the same position as it was before, except for the profits earned during the years of its ownership. Therefore, G.M.L. has not established anything approaching substantial prejudice.

(d) Marketing Efforts.

Believing that no royalty payments were due, both G.M.L. and Highland undertook some efforts to market the Masters. (R.T., Vol. IV, pp, 526:24-527:22; 557:14-558:23). The defendants argue that they would suffer prejudice if the plaintiffs were permitted to rescind. As the Court noted at trial, the evidence of marketing efforts was slim.12 Thus, the defendants have failed to produce evidence of any substantial prejudice resulting from the marketing efforts.

(e) Pricing.

In an attempt to establish prejudice, the defendants offered the testimony of Mr. Stephen Hawkins, president of Highland Music, Inc. ("Highland"). (R.T., Vol. IV, pg. 459:5-6). Highland, which was initially a defendant in this case, holds an exclusive license from G.M.L. in connection with the Kingsmen Masters. (R.T., Vol. IV, pg. 460:23). Pursuant to that license, Highland marketed the Kingsmen Masters. Highland's decisions in pricing its products were based in part upon its assumption that no royalties were due. (R.T., Vol. IV, PP. 553:1-557:5). In light of Highland's low profit margin, even a small royalty obligation would be significant in its decision-making process. (R.T., Vol. IV, pg. 571:16-25). According to the defendants, Highland's reliance upon the lack of royalty obligation in pricing its

products establishes prejudice sufficient to sustain their laches defense.

To begin with, it is doubtful that prejudice to Highland constitutes a defense for G.M.L. Although Highland was initially a defendant, the action against Highland was stayed when Highland filed for bankruptcy protection. More importantly, G.M.L., rather than Highland, owns the Masters and is Scepter's successor-in-interest. (R.T., Vol. I, pg. 11:7-9). Plaintiffs are attempting to recover the Masters from G.M.L., not Highland.

Laches, however, requires prejudice to the other party, not some third party. See Cal. Civ. Code [section] 1693 (substantial prejudice to "the other party" required); Airco, supra, 76 A.D.2d at 82, 430 N.Y.S.2d at 187 ("Laches bars recovery where a plaintiff's inaction has prejudiced the defendant and rendered it inequitable to permit recovery.") (emphasis added). Therefore, any

purported prejudice to Highland is not relevant to G.M.L.'s laches defense.

Of course, one might argue that G.M.L. could not have licensed the Masters if there had been royalties due because Highland would not have licensed them from G.M.L. given Highland's low profit margin. However, G.M.L. did not make that argument, and did not offer any evidence that it could not have licensed the Kingsmen Masters to someone else.

In any event, even if prejudice to Highland somehow affects G.M.L., the Court does not perceive any prejudice resulting from Highlands pricing decisions. If the plaintiffs were seeking to recover past royalties, the prejudice to Highland would be clear. However, because the plaintiffs seek only to rescind, Highland's pricing decisions are irrelevant. Highland marketed the Masters and charged a price that did nor account for royalties. Highland did not pay any royalties on those

sales, and is not now being asked to do so. Therefore, Highland will retain all of the profits which it expected to make when it priced the products. Under the circumstances, Highland will not suffer any prejudice as a result of its pricing decisions.13

(f) Defense Prejudice.

The defendants also claim to be prejudiced because the passage of time has deprived them of evidence necessary to defend the case. In that regard, the defendants point out that "royalty statements which may have been rendered from Scepter to Jerden and from Jerden to The Kingsmen have all been lost." (Post-Trial Memorandum, pg. 37). According to the defendants, such statements might have shown that the Kingsmen Masters were "unrecouped," and thus no royalties due to the plaintiffs.14 The defendants argue that they could

have defeated the rescission claim by proving that, because no royalties were due, there was no material breach.

At trial, however, the defendants stipulated that no royalty statements were ever sent to the plaintiffs. (R.T., Vol. II, pg, 74:6-7). Moreover, defendants argued that the failure to account alone was a material breach, even if no royalties were due. (R.T., Vol. II, pp. 81:13-83:7). They cannot now argue defense prejudice resulting from the loss of royalty statements "which may have been rendered." By their own admissions, there were no statements, and the amount of royalties due is irrelevant to the materiality of the breach.

CONCLUSION

For the foregoing reasons, the Court finds that the plaintiffs are entitled to rescind the recording contracts. Thus, plaintiffs may recover possession of the Masters. IT IS SO ORDERED.

Dated: 6/20/95
Judge William D. Keller

[Footnotes]

1 In their post-trial briefs, the parties have addressed several issues (e.g., statute of limitations, adverse possession) on which the Court has already ruled. Except as modified by this order, the rulings made by the Court at trial shall stand.

2 One of those agreements, Exhibit 2, is a contract between Jerden and Scepter, pursuant to which Scepter obtained the rights to "Louie Louie" and

"Haunted Castle," two of The Kingsmen's most valuable songs. Defendants have argued that there is no contract between The Kingsmen and Jerden with regard to those songs, and thus there is no contract for plaintiffs to rescind. As noted above, Jerden has assigned its. rights to the plaintiffs. (Exhibit 43). Plaintiffs, asserting Jerden's rights, may rescind Exhibit 2, regardless of whether there was any contract between The Kingsmen and Jerden with regard to "Louie Louie" and "Haunted Castle."

3 The defendants argue that claims for rescission are not assignable. Soderberg v. Gens, 652 F.Supp. 560 (N.D.Ill. 1987). The case cited by the defendants in that regard is a district court case from Illinois, and therefore is not binding. In any event, that case addressed the assignability of the right to rescind a fraudulent securities sale under federal law. As such, it is not persuasive. In California, where plaintiffs brought their claim, a "chose in action," including a right arising out of a contractual

obligation, is assignable. See Cal. Civ. Code [sections] 954, 1458.

4 In that regard, the Court notes that the most important recording contract, pursuant to which Jerden transferred the rights to "Louie Louie" and "Haunted Castle" to Scepter, contains a choice of law provision implicating the law of New York. (Exhibit 2, [para.] x) . None of the remaining agreements contains a similar provision.

5 Counsel for the defendants later said: "The fact is no money was paid; it's undisputed. Not a single dime for 30 years." (R. T. , Vol. II, pg. 74 :2-4).

6 The defendants argue that only $270.00 in royalties were actually due. According to the defendants, the failure to pay such a small amount cannot be a "material" breach. This argument misses the point. Because the defendants failed to perform any of their duties under the contracts, the amount of royalties actually

due is irrelevant, the total failure of consideration on the part of the defendants frustrated the purpose the contract. Cf. Nolan, supra. This argument also contradicts defendants' position at trial that the failure to account was, by itself, a material breach, even if no royalties were due. (R.T., Vol. II, pp. 81:13-83:7).

7 Defendants argue that the prejudice requirement is part of an alternative test requiring either prejudice or acquiescence in the breach. See Conti v. Board of Civil Service Commissioners, 1 Cal.3d 351, 359, 82 Cal.Rptr. 337, 342 (1969); Asian Investment Co. Ltd. v. Borowski, 133 Cal.App.3d 832, 838, 184 Cal.Rptr. 317, 322 (1982); Chemical Specialties Manufacturers v. Deukmejian, 227 Cal.App.3d 663, 672, 278 Cal.Rptr. 128, 134 (1991); County of Fresno v. Fair Employment and Housing Commission, 226 Cal.App.3d 1541, 1556, 277 Cal.Rptr. 557, 567 (1991). None of the cases cited by the defendants involves rescission.

Rather, those cases discuss laches in different contexts. In spite of the defendants' argument to the contrary, [section] 1693, which specifically applies to rescission, controls. Cases which discuss laches in different contexts are not applicable.

8 The defendants argue that delay creates a presumption of prejudice. The cases cited by the defendants in that regard are inapplicable, because they involve federal rather than state law causes of action. Jackson v. Axton, 25 F.3d 884 (9th Cir. 1994) (copyright); International T. & T. Corp. v. General T. & E. Corp., 518 F.2d 913 (9th Cir. 1975) (Clayton Act); Boone v. Mechanical Specialties, 609 F.2d 956 (9th Cir. 1979) (Title VII); Lemmon v. Santa Cruz County, Cal., 686 F.Supp. 797 (N.D.Cal. 1983) (Veterans Reemployment Rights Act). The case at bar, involving a state law contract claim, is not governed by the law of laches relating to federal causes of action.

9 This range of figures represents the total purchase price of $500,000 divided by the range of "valuable" recordings, 200-250. The Court recognizes the many limitations inherent in this pro rata method of evaluation. For example, it does not take into account potential differences between the 200-250 "valuable recordings," and it ascribes no value at all to the remaining 9,750 - 9,800 songs. However, lacking any more reliable benchmark, see supra, the court adopts the pro rata evaluation as a rough estimate. The only other alternative is to find that there is not enough evidence regarding the value of the Masters, and that G.M.L. has not met its burden of showing prejudice because it has failed to quantify prejudice with any specificity. In adopting the pro rata approach, rather than simply finding a lack of evidence, therefore, the Court is actually giving the benefit of the doubt to the defendants.

10 G.M.L. will not be deprived of these profits in any future proceeding. Any new claim by the plaintiffs against G.M.L. for past royalties would be barred by claim preclusion. See Fund for Animals, Inc. v. Lujan, 962 F.2d 1391, 1398 (9th Cir. 1992) (claim preclusion bars the assertion of any theory of recovery that could have been asserted in the first action).

11 For example, Dennon testified that he was listed in the Seattle phone book during the 1970's and 1980's. (R.T., Vol. 111, pg. 330:11-17). When asked by the Court, Kountzman testified that he remembered Jerry Dennon's name from the contracts, but that he did not try to contact Dennon personally, and could not provide a reason for failing to do so. (R.T., Vol. IV, pp. 545:7-546;15). As for The Kingsmen, the group began performing again in the early 1980's, and continued throughout the decade. (R.T., Vol. IV, pp. 582:10-586:12). If G.M.L.'s investigation had been

reasonably thorough, G.M.L. could have located both Dennon and The Kingsmen.

12 See statement by the court at R.T., Vol. IV, pg. 581:20-22: "I, frankly, have heard very little effort on their part, very little testimony regarding effort by the defense to merchandise these materials. Very little."

13 To the extent that it purchased an exclusive license from G.M.L., Highland could argue that it will suffer prejudice because the price of the license reflected Highland's belief that royalties were not due. Unlike the pricing decisions, this kind of prejudice would extend to sales that Highland expected to make in the future. However, the defendants did not offer any evidence as to the price of the license from G.M.L., and did not argue that Highland would suffer prejudice on this basis. Therefore, the defendants have not established such prejudice.

14 Under the recording contracts, the costs of producing and promoting the Masters were advanced by the record companies. Until the advance costs were recovered, the Masters were "unrecouped" and the plaintiffs were not entitled to any royalties.
[ELR 17:5:3]

Injunction barring rapper Willie D. from breaching contract with Rap-A-Lot Records is vacated by Texas appeals court, because contract period was indefinite and record company could terminate at any time

Rap artist Willie J. Dennis - known to his fans as "Willie D." - has successfully challenged the enforceability of his contract with Rap-A-Lot Records, and thus appears free to pursue his career recording for another

company. The term of the contract between Dennis and Rap-A-Lot was for a defined "Contract Period," during which Dennis promised to record and deliver masters for an album. The contract also gave the record company options to extend its term for additional "Contract Periods." Long before the contract expired, Dennis became dissatisfied with Rap-A-Lot, and recorded two albums for Ichiban Records. A lawsuit predictably ensued.

Dennis was not successful at first. A Texas trial court issued a temporary injunction prohibiting Dennis and Ichiban from engaging in conduct prohibited by the exclusivity clause of Dennis' contract with Rap-A-Lot.

On appeal, however, the case turned around, because the Texas Court of Appeals has reversed and vacated the injunction. In an opinion by Chief Justice Alice Oliver-Parrott, the appeals court ruled that Dennis' contract with Rap-A-Lot was indefinite in duration,

because the contract's "term has no time limitation." Therefore, the appeals court held that the contract could be terminated by Dennis, because contracts without a definite term may be terminated at will by either party. Moreover, the contract permitted the record company to terminate it at any time, and thus was a "contract for employment at will" which Dennis could terminate at will.

Justice Tim Taft dissented. As he read the contract, it had a definite duration, and while Rap-A-Lot could choose not to exercise its options, neither Rap-A-Lot nor Dennis could terminate the contract at will.

Editor's note: The Rap-A-Lot contract provisions at issue in this case appear to be those commonly used in the record industry since at least 1979. That was the year the California Court of Appeal decided the Olivia Newton-John case and held that the duration of an injunction may not exceed the term of a recording

contract, even if the recording artist refuses to perform during that term. (MCA Records, Inc. v. Newton-John, 90 Cal.App.3d 18 (1979) (ELR 1:1:4)) Since the Rap-A-Lot contract is industry-typical, this decision is of significance to the entire recording industry. Apparently, however, the Texas Court of Appeals failed to appreciate the importance of its decision, because it ordered it not to be published (in the official Texas reports). Though the decision is significant, it may not have any immediate impact for two reasons. First, because the decision has not been published in the official Texas reports, it may not (by rule) be cited in other cases, even in Texas. Second, the decision applies Texas law only. While the general principles appear to be principles of common law that are likely to be found in the laws of most if not all other states, some states have statutory provisions that may make this case distinguishable even if it otherwise were good precedent. California, for

example, has a statute that automatically imposes a seven-year cap on the duration of personal services contracts (Calif. Labor Code sec. 2855) and another statute that requires employers to pay employees specified minimum amounts per year in order for employment contracts to be enforced by injunction (Calif. Civil Code sec. 3423 & Calif. Code of Civil Proc. sec. 526) (ELR 15:8:3, 15:9:9). Thus, California recording contracts are not indefinite in duration, even if they appear to be, nor are they enforceable by injunction unless employees are paid certain amounts each year. Moreover, it is likely that at least some record companies have avoided using indefinite-duration contracts (or now will begin to avoid them) simply by inserting a clause stating that the contract shall not last longer than a specified period of years, even if the recording artist has not fully performed by then.

Ichiban Records, Inc. v. Rap-A-Lot Records, Inc., 1995 Tex.App.LEXIS 1739 (Tex.App. 1995) [ELR 17:5:9]

Sony Music obtains injunction prohibiting reproduction and distribution of pre-1972 tapes of rehearsal performances of The Byrds, Johnny Cash and other recording artists, even though tapes had been lawfully obtained by defendant

A quarter century ago, Columbia Records had a recording studio in Nashville and recording agreements with many of that era's biggest artists. The Byrds, Johnny Cash, Marty Robbins, The Statler Brothers, Bobby Vinton and others used Columbia's studio to rehearse, and at least some of their rehearsal sessions were taped. Some of the taped sessions were good enough to release on albums and they were, while others

remained what they started out to be - rehearsal session tapes.

At the time, the tapes had no perceived value, and eventually Columbia disposed of them by giving or selling them to an employee. Now, all these years later, those tapes do have value, and thus have become the object of an interesting case concerning who is entitled to exploit the tapes (by reproducing and distributing them) and who is entitled to physical possession of them. The result: Sony Music Entertainment, as the successor to Columbia Records, is the only one entitled to exploit the tapes. But Clark Entertainment Group, as the successor to the former Columbia Records employee, is entitled to physical possession of them (and is entitled to sell the tapes themselves). Chief Judge William H. Gindin of the U.S. Bankruptcy Court for the District of New Jersey has issued this ruling in an "adversary proceeding" in the bankruptcy of Clark Entertainment.

The rehearsal tapes were made before February 15, 1972 - when sound recordings first became protected by federal copyright law - and thus Judge Gindin applied New Jersey's common law of unfair competition which was New Jersey's version of common law copyright. He ruled that by virtue of Columbia's agreements with the recording artists in question, Sony owns exclusive rights in their recorded performances, and thus it would "be a violation of unfair competition principles" for Clark Entertainment or others to exploit those performances.

On the other hand, Judge Gindin ruled that Clark rather than Sony is entitled to possession of the tapes. Sony had argued that Columbia had transferred possession of the tapes in the mistaken belief that they had been erased, and that this mistake of fact made the transfer invalid. The judge disagreed, however, on the grounds that Columbia was responsible for erasing the

tapes and it should have known that if it failed to do so properly, it would be transferring potentially valuable material.

Editor's note: This case properly applies the well-settled doctrine (of both statutory and common law copyright) that there is an important distinction between the physical embodiment of a work and its copyright, and that the transfer of one does not by itself transfer the other. Thus, Columbia's transfer of the tapes did not transfer their common law copyrights; and Columbia's retention of their copyrights did not entitle Sony to regain possession of the tapes themselves. As a consequence of Judge Gindin's ruling, only Sony has the right to make and sell recordings of the tapes, but Clark Entertainment has possession of the tapes so Sony doesn't have the tapes it needs to make those recordings. And while Clark has the original tapes and can sell them, those tapes have no commercial value to Clark or any

buyer - other than Sony - because no one other than Sony can exploit them. It is of course possible that Judge Gindin's Solomon-like decision ultimately will benefit Clark's creditors, because Sony will have some incentive to buy the tapes in order to make and sell recordings from them.

In re the Clark Entertainment Group, Inc., 183 Bankr. 73, 1995 Bankr. LEXIS 792 (D.N.J. 1995) [ELR 17:5:10]

BMG Music and Russian record company Melodiya win preliminary injunction barring ZYX Music from distributing Russian classical music recordings in United States; District Court finds that ZYX's license was based on a forged document, and thus its

distribution of recordings infringed trademarks and common law copyrights

"This is an intricate case of international intrigue, involving players from the United States, Germany, Australia and the former Soviet Union as well as allegations of forgery, fraud and deception." That is how Federal District Judge Denny Chin described the lawsuit, and the facts recited in his decision support this unusually blunt assessment.

At issue in the case are U.S. distribution rights to classical music recordings made in the former Soviet Union by the USSR Symphony and Leningrad Philharmonic Orchestras, and by Olega Kagan and Mstislav Rostropovich, performing compositions by Tchaikovsky, Rachmaninov, Stravinsky and Prokofiev.

Legal rights in these recordings are owned by the Russian record company Firma Melodiya, a state

enterprise under the law of the Russian Federation, and by BMG Music as Melodiya's licensee. BMG claims that its license from Melodiya for the U.S. is exclusive, and Melodiya agrees. But copies of these recordings also have been distributed in the U.S. by ZYX Music - a well-established German record company - pursuant to a license from an Australian record company which claims that it acquired the right to distribute the recordings in the U.S. (as well as Australia and elsewhere) from Melodiya's proper representatives in 1988 - six years before Melodiya granted BMG an exclusive license for the U.S. in 1994.

At first glance, it appears as though this dispute involved nothing more than careless record-keeping within Melodiya concerning what licenses it had granted. Even American companies sometimes issue conflicting licenses by mistake, and it hardly would have been surprising if a Soviet/Russian company did so in

1988 and 1994. Those years are significant, because midway between them, the Soviet Union dissolved and countless changes were made in the way Russian companies do business with others. Indeed, in this very case, Melodiya acknowledged that prior to 1989, it was represented by MezhKniga, an agency of the USSR Ministry of Foreign Trade, for the purpose of licensing the distribution of its recordings outside the Soviet Union. The Australian company (from which ZYX Music obtained its U.S. license) claimed that it got a signed license to distribute Melodiya recordings from MezhKniga officials in 1988, the year before the Soviet government authorized Melodiya to represent itself for foreign licensing purposes. Who could have been surprised if by 1994, Melodiya had lost, forgotten about, or never been informed of the license granted by MezhKniga in 1988 to an Australian company?

Apparently, however, careless record-keeping does not explain the origins of the conflicting licenses issued to BMG and ZYX. As a result of evidence submitted in support of BMG's and Melodiya's motion for a preliminary injunction - including testimony and sworn statements by the MezhKniga officials who purportedly signed the license to the Australian company, and testimony by handwriting experts - Judge Chin concluded that the signatures of the MezhKniga officials had been forged, and thus were of no effect. Since ZYX had obtained a license from a company that did not have the right to grant one, its distribution of the recordings in the United States was unauthorized. And since ZYX's recordings were marked with Melodiya's registered trademarks - the words "Melodiya, Melodiya" in Cyrillic letters and a stylized "M" set on concentric circles - ZYX's distribution of those recordings constituted trademark infringement. Judge Chin also found that ZYX's

distribution of those recordings constituted common law copyright infringement and unfair competition under state law. (It did not amount to federal copyright infringement, because the recordings at issue all were made before 1972 when federal copyright protection was first extended to sound recordings.)

ZYX also sought dismissal of the case on the grounds that New York City was not a convenient forum, and argued that Australia was an adequate alternate. Judge Chin denied this motion.

During the preliminary injunction hearing, ZYX expressed concern that an injunction against it would brand ZYX a "music pirate." Judge Chin understood this concern and specifically noted in his opinion: "I believe that ZYX initially acted in good faith under the mistaken belief that it had purchased the right to distribute the Melodiya Recordings, and that it is a victim of deceit and fraud." Though it was a victim, Judge Chin also

added this: "Nonetheless, by continuing to sell the Melodiya Recordings after it suspected that the U.S. [license] was a forgery, ZYX exercised questionable judgment."

Judge Chin has issued a preliminary injunction barring ZYX from making, copying or distributing Melodiya classical music recordings and from using Melodiya's name in Cyrillic letters or its "M" design.

Editor's note: ZYX's concern about being branded a "music pirate" is certainly understandable. It actively protects its own copyrights in litigation against others it considers to be infringers. See, e.g., ZYX Music v. King, a case it brought in the U.K. reported in the International Cases section of this issue. (ELR 17:5:19) Also, this is not the only case brought in federal court here in the United States concerning the unauthorized distribution of recordings by Mstislav Rostropovich. Another

such case is Rostropovich v. Koch Int'l, 1995 U.S.Dist.LEXIS 2785 (S.D.N.Y. 1995) (ELR 17:4:21).

Firma Melodiya v. ZYX Music GmbH, 882 F.Supp. 1306, 1995 U.S.Dist.LEXIS 3292 (S.D.N.Y. 1995) [ELR 17:5:11]

Playboy wins partial reversal in case involving ownership of copyrights to artworks created by Patrick Nagel; Court of Appeals rules that some artworks were made-for-hire and copyrights to those are owned by Playboy, some artworks were not for-hire and their copyrights were owned by Nagel, and further proceedings are necessary to determine ownership of copyrights to remaining artworks

When artist Patrick Nagel died in 1984, he left behind a two-fold legacy. He left hundreds of beautiful and commercially valuable works or art, many of which are still available for purchase throughout the country in books and as posters. He also left an ambiguous copyright relationship with Playboy magazine - a relationship that has complicated the work-made-for-hire doctrine in a way that deserves clarification by the Supreme Court or Congress.

For almost eleven years, from 1974 until his death in 1984, Nagel created some 285 works of art that were published in Playboy. He did so as a freelance artist, not as an employee. Playboy paid with checks made payable to Nagel, or to his Studio, accountants or artist's representative. These checks were stamped with legends above the endorsement space, and these endorsements were the only writings signed by Nagel or his

representatives relating to the ownership of the copyrights to the Playboy artworks.

Following Nagel's death, his widow Jennifer Dumas became the owner of his copyrights; and she granted reproduction rights to the Playboy artworks to an unrelated company. Playboy too began marketing reproductions of some of the Nagel works it had published. A lawsuit was the result: Playboy sought a declaratory judgment that it was the owner of the copyrights to those Nagel artworks it had published; and Dumas counterclaimed for copyright infringement.

Dumas won the first round. In 1993, District Judge Charles H. Tenney ruled that Dumas was the owner of all of the copyrights to the Nagel artworks published by Playboy, because none of them was a work-made-for-hire and Nagel had not assigned any of their copyrights to Playboy. (ELR 15:12:21) However, Playboy has won a portion of the second round, on

appeal; and unless Playboy's partial victory is reversed by the Supreme Court, a third round will be necessary to determine who wins the rest of the case.

In an opinion by Judge James L. Oakes (joined by Judges Richard J. Cardamone and Ralph K. Winter), the Second Circuit Court of Appeals has ruled that:

- the artworks created by Nagel from 1974 through 1976 were works-made-for-hire whose copyrights are owned by Playboy;
- the artworks created by Nagel during 1977 may have been works-made-for-hire, and that further proceedings are necessary to determine whether those works were created at Playboy's "instance" in which case they were works-made-for-hire whose copyrights are owned by Playboy, and if not, their copyrights are owned by Dumas;
- the artworks created by Nagel from 1978 to July of 1979 were not works-made-for-hire, and their

copyrights are owned by Dumas because Nagel never transferred those copyrights; and

- the artworks paid for by Playboy from September 1979 to 1984 may have been works-made-for hire, and that further proceedings are necessary to determine: whether those works were created at Playboy's "instance" and whether those checks were endorsed by agents who could enter into work-made-for-hire agreements on Nagel's behalf, in which case those artworks were works-made-for-hire whose copyrights are owned by Playboy, and if not, whether Nagel transferred their copyrights to Playboy by means of the check endorsements, because if not, Dumas owns their copyrights.

The reason that the appellate court classified Nagel's artworks into four separate groups is that over the years that Playboy published his work, three important things changed at three separate times. In 1977, Playboy changed the nature and amount of direction it

gave Nagel concerning the content of his artworks. In 1978, a new Copyright Act took effect which changed the definition of works-made-for-hire. And in 1979, Playboy changed the language of the endorsements it stamped on the checks it used to pay Nagel. It was the changing combination of these factors that produced the four groupings perceived by the Court of Appeals, and the different conclusions it came to with respect to each.

The works created by Nagel from 1974 through 1976 are governed by the Copyright Act of 1909. Under that Act, works-made-for-hire created by independent contractors are those that were created at the "instance and expense" of the hiring party who had the right to control the manner in which those works were made. Nagel's works during this period were created at Playboy's "instance," at Playboy's "expense" (in the sense that Nagel was paid a sum certain for each artwork, not a royalty), and Playboy had the right to control the way

in which the artworks were created. This created a presumption that these artworks were for-hire. The presumption could have been overcome by evidence that Nagel and Playboy had a contrary agreement, either written or oral. But there was no evidence of any such agreement, because the appellate court concluded that the check endorsement used by Playboy during those years neither proved nor disproved they intended something other than a work-for-hire relationship.

The artworks created by Nagel during 1977 also were governed by the 1909 Act. By that year, however, Playboy had stopped asking Nagel to create specific works, and thus the evidence did not show whether Playboy actually had induced the creation of the artworks it purchased from Nagel that year. The appellate court therefore remanded the case to the District Court for further proceedings to determine whether those works were created at Playboy's "instance." If they

were, they would be works-made-for-hire whose copyrights are owned by Playboy; otherwise their copyrights are owned by Dumas.

The artworks created by Nagel from 1978 to July of 1979 were governed by the Copyright Act of 1976 (which is the current copyright statute). Under that Act, works created by independent contractors are works-made-for-hire only if (among other things) the parties agree in writing that they are such works. Here, there was no such writing, because the check endorsement used by Playboy during those years provided for an "assignment" to Playboy; it said nothing about works-made-for-hire. Thus, the "author" of those artworks was Nagel, not Playboy, and Nagel never transferred their copyrights to Playboy, because although the endorsement did refer to an "assignment," it was not clear whether this referred to an assignment of one-time publication rights or an assignment of the entire

copyright. The appellate court therefore upheld the District Court's decision that the copyrights to those works are owned by Dumas.

The artworks paid for by Playboy from September 1979 to 1984 also were governed by the 1976 Act. In order for works created by independent contractors to be works-made-for-hire under that Act, the Court of Appeals held that (1) the work must be of a certain type, (2) the parties must explicitly or implicitly agree before the work is created that the work will be for-hire, their agreement must be reduced to writing (eventually), and the written instrument must be signed by both parties, though it is acceptable if they sign it after the work is created, and (3) the work must be created at the "instance and expense" of the hiring party. In this case, Nagel's paintings were contributions to collective works and thus were a proper type. The appellate court found Nagel and Playboy had agreed that all of the September

1979 to 1984 artworks (except perhaps the first of these) were to be works-made-for-hire before those works were created, because Playboy had been using work-for-hire legends on the checks it issued during that period, and Nagel had not objected. The court also found that the check legends were a sufficient writing. But the appellate court could not say whether the signatures of Nagel's representatives were sufficient, because the evidence did not show whether they had authority to enter into work-for-hire contracts on his behalf. Moreover, the evidence was not sufficient to show whether the artworks created during that period were created at Playboy's "instance." The appellate court therefore remanded the case to the District Court so it could consider these two factual issues. If the signatures are sufficient, and the works were created at Playboy's instance, they are works-for-hire whose copyrights are owned by Playboy. If not (on either count), the works

are not works-for-hire; and in that case, the District Court also will have to consider whether the check legend used during that time was sufficient to transfer the copyrights from Nagel to Playboy.

Editor's note: The most significant legal issue in this case concerns the September 1979 to 1984 artworks. That issue is whether the writing required by the 1976 Act must be signed before the works were created - which is what the District Court had ruled, relying on an earlier decision by Judge Richard Posner in a Seventh Circuit case (ELR 15:3:9) - or whether the pre-creation agreement may be oral or even implied, so long as a written agreement is eventually signed, even if it is signed after the works were created - which is what the Second Circuit ruled in this case. Playboy's position was that a written agreement is sufficient whenever it is reached - before or after the works were created - even if there was no pre-creation agreement of any kind.

Playboy's position was rejected by the District and Second Circuit courts, just as that position was rejected by Judge Posner in the earlier Seventh Circuit case. Judge Posner had ruled that a written agreement must be signed before the work is created, because that is the only way the parties and others can be certain whether or not a particular work is a work-made-for-hire. In this case, the Second Circuit agreed that certainty is important. But the Second Circuit's decision will not provide such certainty. Instead, because the Second Circuit would permit the pre-creation agreement to be "implicit," disputes and litigation are inevitable because facts that imply something to one party do not always imply the same thing to other parties. The positions of both Judge Posner and Playboy are more likely to provide certainty than the Second Circuit's ruling that implicit pre-creation agreements are sufficient (so long as they are eventually confirmed in signed writings). There

is now a split between the Second and Seventh Circuits on this issue. Dumas has filed a petition for certiorari with the Supreme Court. The issue is of enormous practical importance and industry-wide interest. Indeed, amicus briefs were filed with the Second Circuit by the Magazine Publishers of America, The American Society of Media Photographers, the Graphic Artists Guild, the Committee for Literary Property Studies, the National Writers Union, and Volunteer Lawyers for the Arts. There thus appears to be a better than average chance the Supreme Court will agree to hear the case. Should the Supreme Court deny Dumas' petition, Congress ought to be asked to amend the Copyright Act to make clear whether the written agreement must be signed before the work is created or whether a post-creation agreement is sufficient.

Playboy Enterprises, Inc. v. Dumas, 53 F.3d 549, 1995 U.S.App.LEXIS 10191 (2d Cir. 1995) [ELR 17:5:12]

Tax Court rules that all compensation paid by NBA's Houston Rockets to personal service corporation of player Allen Leavell constituted income to Leavell himself rather than to his corporation

Back in 1985, Allen Leavell was the point guard for the NBA Houston Rockets. He'd been with the team since 1979 and was doing well financially - so well, in fact, that he had formed a personal service corporation to reduce the amount of income tax he otherwise would have had to pay. And reduce his taxes it did, at least at first. For 1985, the Rockets paid Leavell's personal service corporation $204,333 in "nonemployee" compensation from which the Rockets withheld no payroll taxes;

and the personal service corporation paid Leavell himself only $111,400, from which payroll taxes were withheld. The corporation contributed money to a pension plan for Leavell's retirement years. And all was right with the world, as far as Allen Leavell was concerned. Not so, however, as far as the IRS was concerned.

The IRS contended that Leavell's income for 1985 was actually $94,933 greater than he reported on his personal income tax return, that being the difference between the amount the Rockets had paid his personal service corporation and the amount the corporation had paid him. As a result, the IRS assessed a deficiency of $66,897 in Leavell's taxes and demanded that he pay it. Leavell took the matter to Tax Court, but he hasn't done as well in that court as he usually did on basketball courts. In a decision by Judge Robert P. Ruwe, the Tax Court has ruled in favor of the IRS and has sustained its assessment.

In the eyes of the Tax Court, the fault with Leavell's corporation was not with its form, but with its substance. On paper, Leavell was an employee of his personal service corporation rather than the Rockets. His personal service corporation had an agreement with the Rockets to provide Leavell's services as a player for the team. And Leavell signed a Personal Guarantee with the Rockets in which he agreed to perform all of the services his corporation had agreed to supply to the team. In substance, however, the Tax Court concluded that Leavell was the employee of the Rockets. It reached this conclusion by looking at whether the Rockets had the right to control the manner and means by which Leavell would supply his services as a player. This is the same test used in tax law for distinguishing between an employee and an independent contractor. And applying this test, the court concluded that the

Rockets did have the right to control the manner and means by which Leavell's services would be supplied.

As a result, the money paid by the Rockets to Leavell's corporation was money that was really paid - at least for tax purposes - to Leavell individually. And thus all $204,333 paid by the Rockets in 1985 should have been reported by Leavell on his personal income tax return for that year.

Editor's note: In reaching the ruling that it did in this case, the Tax Court expressly followed its earlier decision in a factually identical case involving professional hockey players, Sargent v. Commissioner, 93 T.C. 572 (1989) (ELR 11:11:3), in which the Tax Court also had disregarded the players' personal service corporations and ruled that all of the money paid by their NHL teams to their corporations was income to them individually. In that case, however, the players appealed to the 8th Circuit Court of Appeals, and that court

reversed the Tax Court and ruled in favor of the players. (ELR 13:6:16) Although the 8th Circuit is a higher court than the Tax Court, the Tax Court considers itself bound by Circuit Court decisions only in cases that are subject to appeal to the particular circuit whose decision is said to be applicable. Allen Leavell's case is subject to appeal to the Court of Appeals for the 5th Circuit rather than to the 8th Circuit; and for that reason, the Tax Court declined to follow the 8th Circuit's decision in the Sargent case. One aspect of this case is puzzling. In 1982 - three years before the tax year at issue in Leavell's case - Congress amended the Internal Revenue Code by adding a new section 269A which provides that if substantially all of the services of a personal service corporation are performed for one other company, and the principal purpose for forming the corporation was to obtain tax benefits, the IRS may allocate income between the corporation and its owners to clearly reflect

income. In other words, Congress seems to have done in section 269A exactly what the IRS did in this case, but the Tax Court's opinion does not rely on section 269A and in fact reveals (in footnote 6) that the IRS did not argue and actually "disavowed reliance" on that section. Leavell's corporation had income from endorsements and personal appearances by Leavell, in addition to what it received from the Rockets for his playing services. And perhaps that income was sufficient so that the IRS decided that it couldn't argue that substantially all of the services rendered by the corporation were performed for the Rockets only. If that is so, however, then the IRS and the Tax Court were really stretching when they reallocated income from Leavell's corporation to him personally under circumstances where section 269A did not sanction the reallocation, and in the face of the 8th Circuit's contrary ruling in Sargent.

Leavell v. Commissioner of Internal Revenue, 104 T.C. 140, 1995 U.S. Tax Court LEXIS 8 (1995) [ELR 17:5:14]

Seller of minor league baseball team breached sale agreement non-competition clause by employing team's general manager as consultant to seller's new team; as a result, buyer does not have to pay $650,000 balance of purchase price

In the world of professional baseball, most of the news - and most of the litigation - involves major league players. Minor league activities are just that: minor league. But recently, the Prince William Cannons, a minor league team in Virginia, sued its former owner for hiring the team's general manager as a consultant to the owner's newly-purchased team, the Wilmington Blue

Rocks. The amount of money at stake in the suit was significant, even by major league standards: $650,000, which was the balance due on the purchase price.

The central issue in the case involved the interpretation and enforceability of a non-competition clause in the agreement by which Francis Boulton sold the Cannons to their current owner. The clause prohibited Boulton from entering into any employment or consulting arrangement with anyone who had been employed by the Cannons during the previous year. This provision was important to the Cannons' buyer, because the buyer knew that Boulton was selling the Cannons in order to buy another team in the same league, and because the buyer wanted to "protect the value of the Cannons by protecting the management team which had been in place."

A portion of the purchase price - $650,000 - was deferred, and payment was made conditional on

Boulton's compliance with the non-competition clause. When the Cannons learned their general manager was serving as a consultant to the Blue Rocks, they sought a judicial declaration that they were not required to pay that $650,000. Judge Joseph J. Farnan, Jr. - of the Federal District Court in Wilmington, Delaware - has ruled against the owner of his hometown Blue Rocks and has granted the Cannons' motion for partial summary judgment.

Judge Farnan rejected Boulton's contention that the non-competition clause was really an installment sale agreement, drafted to appear to be a non-competition provision solely to give the buyer a favorable tax result. Judge Farnan also rejected Boulton's argument that he had not really breached the non-competition clause, because the Cannons and Blue Rocks do not actually compete with one another. As to both of these points, the judge ruled that the clause

clearly prohibited Boulton from hiring Cannon employees under any circumstances, for a prescribed period of time. Finally, Judge Farnan rejected the contention that the $650,000 holdback was a liquidated damages clause and as such an illegal penalty provision. Instead, the judge found the provision to be a enforceable provision of the sale agreement.

Prince William Professional Baseball Club, Inc. v. Boulton, 882 F.Supp. 1446, 1995 U.S.Dist.LEXIS 5647 (D.Del. 1995) [ELR 17:5:15]

Order referring "Son of Sam" claims to Referee is affirmed; appellate court rejects argument that

royalties from "Dog Day Afternoon" should be returned to their source

The United States Supreme Court declared New York's original "Son of Sam" law unconstitutional on sweeping First Amendment grounds, and left it to New York state courts to deal with the particular consequences of that ruling. Among the consequences left unresolved by the Supreme Court: what to do with money then being held by the New York State Crime Victims Board?This question arose because the New York State Crime Victims Board was holding funds in escrow under the provisions of the 1977 "Son of Sam" law when the United States Supreme Court declared that the law violated the First Amendment right of free speech. After the Court's decision in Simon & Schuster, Inc. v. New York State Crime Victims Board, 112 S.Ct. 501 (199) (ELR 13:8:3), New York amended the statute

concerning the compensation of crime victims by criminals. (ELR 14:11:18) But the amended statute did not indicate what should be done with funds held under the prior statute.

As a result, the Crime Victims Board brought an interpleader action in New York state court in which it asked the court to allocate the escrowed funds among various claimants who included victims, judgment creditors and the criminals themselves. At the time the interpleader was filed, the Board had escrow accounts for five convicted criminals: Jack Henry Abbott, concerning option payments for his book "In the Belly of the Beast"; Mark David Chapman (John Lennon's killer) concerning payment for an article written for "People" magazine; Henry Hill, concerning proceeds from a television interview, the book "Wiseguys" and the film "Goodfellas"; John S. Wojtowicz, concerning royalties from the film "Dog Day Afternoon"; and Marco

Sindona, concerning royalties from the book "Power on Earth."

In 1993, a New York trial court referred all of the claims to these funds to a special referee. (ELR 15:3:15) Only one party appealed the court's decision - George Heath, a fellow prisoner of John Wojtowicz, who had "acted zealously as Wojtowicz' jailhouse lawyer for many years."

In the early 1970s, Wojtowicz had sold the rights to his story in return for one percent of the profits from any film that might be made. Warner Bros.' "Dog Day Afternoon" was that film, and after a series of transactions, Heath obtained an interest in its profits. But before Warner Bros. could distribute the funds, the state enacted its "Son of Sam" law, and Warner Bros. turned the funds over to the Board.

Heath brought several unsuccessful state and federal actions seeking to collect his share of the movie's

profits. Among these was a third party complaint in the interpleader action, in which he contended that funds escrowed under the unconstitutional statute should be returned to their source (presumably so he could continue to pursue Warner Bros. for his claimed share). The trial court rejected that claim, deciding instead to refer Heath's claim (as well as the others) to a special referee.

That decision has now been affirmed by the Appellate Division. It ruled that returning the escrowed funds to their sources would "not serve a legitimate purpose" and would be "contrary to the intended goal of the trial courts to expeditiously and expediently resolve litigations and to avoid delay and multiplicity of lawsuits whenever possible."

New York State Crime Victims Board v. Abbott, 212 A.D.2d 22, 627 N.Y.S.2d 629, 1995 N.Y.App.Div. LEXIS 5875 (1995) [ELR 17:5:16]

Briefly Noted:

Times Square New Year's Eve marketing dispute.

The Times Square New Year's Eve ball-drop ceremony has become a world-famous ceremony, and the millennium ceremony at the start of the year 2000 is certain to be a special event. Indeed, a proposal for that ceremony already has been prepared. Entitled "Count-down 2000," the proposal was created by live media event producers Robin Ellis and Robert Morrison, and they have registered it for copyright. The ball-drop ceremony takes place at a building known as One Times Square, the owner of which once agreed to permit Jeffrey H. Sado to lease office space in the building and to sell signage on its exterior, working as an independent

contractor. Sado sued Ellis and Morrison, as well as the owners of One Times Square, claiming that he had been denied co-authorship credit on the copyright registration for "Countdown 2000," that he had been fraudulently induced to agree to lease office space and sell signage, and that Ellis, Morrison and the building owners had entered into a civil conspiracy with one another. But District Judge Richard Owen has granted a motion by all of the defendants for summary judgment, and has dismissed Sado's complaint. Judge Owen has ruled that Sado failed to offer any evidence that he had co-authored the "Countdown 2000" proposal, or that he had been fraudulently induced to work as a leasing or signage broker for the building. The civil conspiracy claim was dismissed, because under New York law, a civil conspiracy to commit a tort is not itself the basis for a claim; there must be an independent tort. And while Sado had accused Ellis and Morrison of a tort, and the

building owners of another tort, he never alleged any connection between the two, and thus never alleged a jointly committed tort which could be the basis for a civil conspiracy claim.

Sado v. Ellis, 882 F.Supp. 1401, 1995 U.S.Dist.LEXIS 5097 (S.D.N.Y. 1995) [ELR 17:5:17]

Gambling.

"Luck was not a lady" to Texas-resident gambler George Aubin. The law, on the other hand, has been. Aubin lost $25,000 playing blackjack at a casino in the Bahamas using chips he had obtained by signing casino "markers." But when the casino presented the markers for payment to Aubin's bank in Texas, it found that he had stopped payment on them. The bank sued in a

federal court in Texas, but in an earlier decision in this eight-year old case, the Court of Appeals ruled that gambling debts are unenforceable in Texas because gambling on credit is against the state's public policy. (ELR 13:8:18) On remand, however, the casino played a different hand: it bet that a claim based on "fraud" would be enforceable, even if a straight collection claim were not. The casino has lost again, however. The Court of Appeals has ruled for Aubin a second time. It explained: "For us to allow recovery against Aubin on an otherwise unenforceable gambling debt under a theory of fraud, when in fact the only real allegation of misrepresentation was that Aubin signed the markers knowing they were unenforceable in his home state (by operation of law), would require that we recognize an exception to Texas public policy that does not exist."

Carnival Leisure Industries, Ltd. v. Aubin, 53 F.3d 716, 1995 U.S.App.LEXIS 13543 (5th Cir. 1995) [ELR 17:5:17]

Labor law.

A federal appellate court has enforced a National Labor Relations Board ruling that Retlaw Broadcasting Co., the owner of television station KJEO-TV, violated federal labor law by offering to reinstate a weekend on-air anchor it had fired only if he waived his right to grievance procedures and union representation were he to be terminated again. KJEO-TV - a station in Fresno, California - fired the anchor in 1991 because of "incompetence and insubordination" in connection with his reports about that year's fire in Oakland, California. The anchor was covered by a collective bargaining

agreement between KJEO-TV and AFTRA; and that collective bargaining agreement provided that an on-air artist could be terminated without arbitration for "unsuitability" if he or she were paid severance, but disciplinary discharges were subject to grievance and arbitration. The anchor was offered a choice between immediate termination with severance pay or four additional weeks of paid work. In response to that offer, the anchor asked whether there was any chance he might be rehired after the four weeks had passed; and he was told that the station might consider rehiring him, but only if he waived his grievance and arbitration rights should he be fired again. AFTRA responded to this offer by filing a charge against Retlaw with the NLRB. An Administrative Law Judge decided that Retlaw had violated the National Labor Relations Act by conditioning the anchor's reinstatement on his waiving rights under the collective bargaining agreement; and the NLRB affirmed

the ALJ's decision. Retlaw then petitioned the Court of Appeals for review of the NLRB order, and the NLRB petitioned for enforcement of its order. The appellate court has denied Retlaw's petition and has granted enforcement of the NLRB's order. The court held that Retlaw had violated section 8(a)(1) of the National Labor Relations Act, because its reinstatement offer interfered with the anchor's protected right to assert his collectively-bargained-for grievance and arbitration rights.

Retlaw Broadcasting Co. v. National Labor Relations Board, 53 F.3d 1002, 1995 U.S.App.LEXIS 9497 (9th Cir. 1995) [ELR 17:5:17]

Disability access laws/attorneys fees.

A federal court of appeals has ruled that attorneys fees should have been awarded to a quadriplegic sports announcer who sued to enjoin use of the renovated press box at the Rose Bowl in Pasadena, California, because the case was settled on terms sought by the announcer shortly after the case was filed. Federal District Judge Stephen V. Wilson had denied the announcer's request for fees on the grounds that the California Attorney General had already demanded even more significant modifications be made to the press box, and thus the announcer was not the prevailing party because he was not a "significant catalyst" in bringing about the settlement. Judge Wilson also ruled that there were special circumstances that justified denying fees, because the matter would have been settled by the Attorney General without the lawsuit having been filed. The Court of Appeals has reversed, however. In an opinion by Judge Samuel P. King, the appellate court has ruled that the announcer

was the prevailing party because the announcer - rather than the California Attorney General - has the right to enforce the settlement, and thus it was unnecessary and improper to apply the "significant catalyst" test at all. Moreover, the appellate court ruled that there were no special circumstances justifying the denial of fees, because the timing of the announcer's lawsuit - at the beginning of the UCLA football season and just months before the 1993 Rose Bowl and Super Bowl games - "triggered settlement."

Kilgour v. City of Pasadena, 53 F.3d 1007, 1995 U.S.App.LEXIS 9583 (9th Cir. 1995) [ELR 17:5:18]

Previously Reported:

The Ninth Circuit Court of Appeals has rejected a petition for rehearing and a suggestion for rehearing en banc in the case of La Cienega Music Co. v. ZZ Top (ELR 16:10:13). The court amended its previously published opinion; and as amended, the opinion now has been republished at 53 F.3d 950, 1995 U.S.App.LEXIS 8131 (9th Cir. 1995). In this case, the Ninth Circuit ruled that the release of a recording of an otherwise unpublished song "publishes" that song, and thus starts the initial 28-year term of copyright with respect to pre-1978 releases. As noted in the ELR report on the Ninth Circuit's original decision in this case, the court expressly disagreed with a contrary ruling by the Second Circuit Court of Appeals in the case of Rosette v. Rainbo Record Mfg. Corp., 354 F.Supp. 1183 (S.D.N.Y. 1973), aff'd per curiam, 546 F.2d 461 (2d Cir. 1976). Thus, there is now a conflict among the circuits on this important issue. La Cienega Music has filed

a petition for certiorari with the United States Supreme Court. [ELR 17:5:18]

INTERNATIONAL CASES

British court rules that KWS' recording of "Please Don't Go" infringed valid copyright to disco arrangement composed by Roberto Zanetti, and that Pinnacle Records distributed records in U.K. with knowledge they were infringements so that additional damages are justified

In 1979, Wayne Casey and Richard Finch wrote a dreamy ballad titled "Please Don't Go" which was recorded by KC and the Sunshine Band. Thirteen years later, Italian record producer Roberto Zanetti composed a disco version of the song which was recorded by

Double You. The Double You record did well, especially in Italy where it "immediately became a hit" when it was released there in January 1992. But it didn't do as well as it might have in the United Kingdom, because shortly before it was released in that country, Pinnacle Records (the largest independent record distributor in the U.K.) released a disco version of the song recorded by KWS for Network Records. The KWS record was number 1 on the British charts for several weeks in 1992, generating sales that produced gross proceeds for Pinnacle that "are likely to have well exceeded" 700,000 British pounds. By contrast, the Double You recording "languished" on the British charts, reportedly topping out at number 41.

The Zanetti-composed version of "Please Don't Go" - the one recorded by Double You - was "dramatically different" from the original song written by Casey and Finch, while the KWS recording of the song was

"an almost precise copy of the Double You arrangement in virtually every respect and a virtually identical copy in every point of musical and lyrical substance." These facts meant two things. First, they meant that Zanetti could and did claim a copyright in his arrangement. And second, they meant that the company to which Zanetti had assigned his copyright, ZYX Music GmbH, could and did claim that the KWS recording infringed that copyright.

ZYX Music made these claims in two separate lawsuits, one in Germany (where the KWS recording also was being sold) and another in the U.K. An injunction was granted in 1992 by a German court restraining Pinnacle's German subsidiary, Rough Trade Records, from exploiting the KWS recording in that country. Now, a British court has issued a similar injunction in the U.K., because it found that the copyright to the Zanetti arrangement of the song is valid and was

infringed. It also found that when Pinnacle distributed the KWS record in the U.K., Pinnacle did so with knowledge that it infringed copyright, and therefore the court has ruled that "additional damages" are justified beyond the actual damages caused by the KWS record.

The court rejected Pinnacle and Network's argument that Zanetti did not compose his version of "Please Don't Go" alone, and that since there were other co-authors of the arrangement, Zanetti's assignment of the copyright to ZYX Music was insufficient to give it the necessary title to bring the lawsuit. This was a purely factual contention, and the court ruled that the facts proved at trial showed that Zanetti had composed his arrangement alone.

More significantly, Pinnacle and Network contended that Zanetti had not obtained a proper license from the owner of the copyright of the original Casey and Finch version of the song, and thus Zanetti's

arrangement was itself an infringement and not eligible for copyright. Zanetti had obtained a license; the question was whether he had obtained it from the correct company. The court found that while the company from which Zanetti had obtained his license was the correct company for a German license, it was not the correct company from which to obtain a U.K. license, and thus Zanetti's arrangement was a "technical" infringement as a matter of U.K. copyright law. On the other hand, the company from which Zanetti should have obtained a U.K. license was well aware of his arrangement, of Double You's recording of it, and of the U.K. lawsuit against Pinnacle and Network. And that company had never objected to Zanetti's claim of copyright, or ZYX's attempts to enforce it in the U.K. Thus, the issue was whether Zanetti's arrangement should be denied U.K. copyright protection because is was a "technical" infringement, and the court decided that it should not. It

decided, in other words, that under the circumstances, the U.K. copyright to the Zanetti arrangement is valid.

Since the similarity between the KWS recording and the Zanetti arrangement was not disputed, Network Records was found primarily liable for infringement. (The case had been settled against KWS.) Pinnacle was found liable for "secondary infringement" under U.K. law, because its German subsidiary had been enjoined from distributing the KWS record in that country, and thus Pinnacle knew or had reason to believe that the record was an infringement. For the same reason, the court found that this case was an appropriate one in which to award additional damages against Pinnacle, which under U.K. copyright law may be awarded when "the flagrancy of the infringement" justifies such damages.

Editor's note: This case is significant, and has been newsworthy, for two reasons. First, as a legal

matter, it establishes that under U.K. copyright law, an arrangement of a song may be entitled to a copyright of its own, if the arrangement is sufficiently different from the original version. Second, as a factual matter, the court's decision is unusually critical of the witnesses who testified on Pinnacle's behalf, saying they were "evasive and totally unreliable witnesses, willing to sacrifice the truth to achieve their ends and advantage to Pinnacle." The witnesses in question are quite well known in the British music business. One is a member of the Committee of the British Phonographic Industry, one of whose functions is to conduct anti-record-piracy operations in the U.K. The court's criticism was thus particularly stinging. According to press reports, the witnesses have "utterly rejected" the court's critical comments, and Pinnacle and Network intend to appeal.

ZYX Music GmbH v. King, [1995] 3 All ER 1 (U.K. Chanc. Div. 1995) (available in the LEXIS Enggen Library, Cases File) [ELR 17:5:19]

British Sky Broadcasting wins summary judgment against importer of German "smart cards" that permitted unauthorized decoding of encrypted satellite TV signals; British court rejects "Euro defense"

It is likely that David Lyons thinks of himself as an import-export entrepreneur. He probably would say that he scours the European marketplace for products the British might like to buy, and he imports them into the U.K. for sale to customers who live there. Others would describe Mr. Lyons differently, though. How exactly British Sky Broadcasting would describe him is unclear. But a judge of the United Kingdom Chancery

Division has called him a "parasite," in a case brought by BSkyB against Lyons as a result of one product he imported from Germany.

BSkyB owns and operates a satellite television service. Its signals are encrypted at its premises in Britain from which they are transmitted to the Astra satellite and then to viewers in the U.K., Ireland, the Channel Islands and the Isle of Man. Viewers who wish to watch BSkyB's programs subscribe to its service. Subscribers purchase decoders which they connect to their television sets. They also pay for "smart cards" that must be inserted into the decoders in order to enable them to decode the encrypted signals for those programs subscribers choose to watch.

Lyons purchased smart cards in Germany which also enable decoders to decode BSkyB signals. He sold them to customers in the U.K. who bought them from him in order to avoid purchasing them from BSkyB itself

(which presumably charged more for them than Lyons did). All of this was done without BSkyB's consent. It also was done in apparent violation of British law. Section 298 of the U.K. Copyright, Designs and Patents Act gives pay-TV, cable and other companies who provide "encrypted transmissions" "from a place in the United Kingdom" the same rights that copyright owners would have against those who make, import, sell or rent devices that enable people to receive programs "when they are not entitled to do so."

Lyons claimed that his activities did not actually violate section 298, and that even if they did, the section was invalid because it violates the European Union treaty which is known as the Treaty of Rome. Both of these arguments have been rejected by the Chancery Division, and summary judgment has been entered in favor of BSkyB with respect to these issues.

Lyons argued that his activities did not violate section 298, because the smart cards he sold did not enable his customers to do anything different from those who bought smart cards from BSkyB, and thus his customers could not use them to do anything "when they are not entitled to do so." The court rejected this argument as "untenable," because the purpose of section 298 "is to enable persons who provide a service, such as that provided by [BSkyB], to obtain recompense by giving them the right to supply apparatus designed or adapted to receive such service." It was in this connection the court described Lyons as a "parasite," saying that the smart cards he sold enabled his customers to receive BSkyB programs when they were not authorized to do so.

Lyons' "Euro defense" was based on Articles 7 and 30 of the Treaty of Rome (the treaty that created what is now called the European Union). Those sections

prohibit discrimination on the grounds of nationality and restrictions on imports. He contended that section 298 of the U.K. Copyright, Designs and Patents Act prohibited the importation of smart cards, and did so only to protect transmissions that originated in the U.K. but not to protect transmissions that originated elsewhere in Europe. The court rejected this argument too. It acknowledged that the U.K. act only provides protection for transmissions that originate in the U.K. But the court said that it does not discriminate on the basis of nationality, because all transmissions from the U.K. are protected, regardless of the nationality of the company that originates those transmissions. Moreover, said the court, even if the British act discriminated on the basis of nationality, that would not provide Lyons with a defense to BSkyB's lawsuit, because Lyons would not be one of those discriminated against. The court explained that if British law discriminates against broadcast, cable or

satellite companies whose transmissions originate from other European countries, they - and only they - would be able to complain. And the likely result of their complaints would be that British law would have to protect their transmissions too, not that Lyons would get to sell smart cards permitting the unauthorized decoding of encrypted transmissions.

Editor's note: Lyon's "Euro defense" has been successful in other types of European copyright cases. The defense appears to date back to 1971 when the European Community Court of Justice decided Deutsche Grammophon v. Metro, 2 IIC 429 (E.C.Ct.Jus. 1971). In that case, a German record company had sold and delivered records manufactured in Germany to its French subsidiary, and those records eventually were imported back into Germany where they were sold for less than the German company was selling them for in Germany. The court held that the Treaty of Rome

prohibited the German company from seeking to enforce its exclusive distribution rights in Germany, because doing so would interfere with free trade in recordings between France and Germany. Similarly, in Musik-Vertrieb v. GEMA, 12 IIC 526 (E.C.Ct.Jus. 1981), the European Community Court of Justice held that the German mechanical rights collecting society could not recover the difference between the British mechanical license fees and the greater German mechanical license fees on records purchased in Great Britain by a German distributor for resale in Germany, because doing so would interfere with the free movement of records between those two EEC countries. On the other hand, the "Euro defense" has been rejected before. In Warner Bros. v. Christiansen, CCH Eur.Com.Cases 33 (E.C.Ct.Jus. 1988), the court held that the unauthorized rental in Denmark of videocassettes of the Warner Bros. movie "Never Say Never Again" infringed the exclusive

rights of Warner Bros.' Danish licensee as a matter of Danish copyright law; and the court held that the Treaty of Rome did not bar enforcement of those exclusive rights in Denmark under Danish copyright law, even though cassettes rented by the defendant had been legally purchased by London and had been legally imported into Denmark, and even though under British law, sale of cassettes "exhausted" the copyright owner's distribution rights so that resales and rentals of cassettes in England was legal as a matter of British law.

British Sky Broadcasting Group v. Lyons, [1995] FSR 357 (available in LEXIS Enggen Library, Cases File) [ELR 17:5:20]

WASHINGTON MONITOR

FCC repeals remaining Financial Interest and Syndication Rules; ABC, CBS and NBC now permitted to acquire financial interests in prime time programs and to syndicate them domestically

The Federal Communications Commission has repealed all remaining provisions of its Financial Interest and Syndication Rules, thus permitting the Big Three networks - ABC, CBS and NBC - to acquire financial interests in the prime time programs they carry and permitting them to syndicate programs domestically (as well as abroad). The quarter-century-old Fin/Syn Rules already were scheduled to expire on November 10, 1995, unless their supporters persuaded the FCC that the Rules should have been retained. But the Rules' supporters - program producers and independent television

stations - were unable to persuade the FCC to keep the Rules on the books.

The Fin/Syn Rules have had a long and convoluted history. They were first adopted by the FCC in 1970 to limit network control over television programming. As originally adopted they prohibited ABC, CBS and NBC from owning and syndicating television programming. In 1978 and 1980, similar prohibitions were incorporated into Consent Decrees in antitrust suits brought by the Justice Department against the networks (ELR 2:11:1). Ironically, at about the same time these Consent Decrees were entered against the networks, an FCC staff report concluded the Fin/Syn Rules should be eliminated altogether. As a result, in 1983 the FCC issued a Notice of Proposed Rulemaking in which it indicated that it was considering the elimination of the Rules. (ELR 4:11:3) And later that year, it voted "tentatively" to do so. (ELR 5:4:20) Further proceedings were

"delayed" however. (ELR 5:7:13) Nothing further occurred until 1991, when the FCC "relaxed" but did not entirely eliminate the Rules. (ELR 13:10:6). That 1991 order was vacated by the Court of Appeals, on the grounds that the FCC had not adequately justified its decision to relax, rather than repeal, the Rules. (ELR 15:4:4) In 1993, the FCC did repeal significant portions - though not all - of the Rules; and that order was upheld by the appellate court. (ELR 16:8:11)

The portion of the Fin/Syn Rules that remained on the books after 1993 were those that prohibited ABC, CBS and NBC from domestically syndicating prime-time network programming or first-run non-network programs, from acquiring financial interests or syndication rights in any first-run non-network programs distributed in the U.S. (unless produced by the network), and from withholding prime time programs from the syndication market. The remaining Rules also required

the Big Three networks to file certain reports twice-yearly. (Fox was not subject to the Rules, either because it supplied no more than 15 hours per week of programming and thus was not a "network" as defined by the Rules, or because it obtained a waiver from the Rules for a one-year period. (ELR 12:1:21))

At the time the FCC repealed a portion of the Rules in 1993, it ruled that the remaining provisions would automatically be repealed two years after the antitrust Consent Decrees were removed, unless supporters of the Rules could affirmatively show they should be retained. The Consent Decrees were removed on November 10, 1993; and thus the remaining provisions were set to be repealed as of November 10, 1995, unless the FCC could be persuaded to extend them.

Earlier this year, the FCC gave supporters of the Rules an opportunity to justify their extension. But the FCC has determined that the Rules' supporters "have

failed to carry their burden of proof that earlier relaxation of these rules has threatened diversity in the television program production and distribution markets, or enabled the established networks to engage in anticompetitive activities to the detriment of the public interest; or that the current conditions of the production and distribution markets warrant retention of the rules." According to the FCC, supporters of the Rules did not provide "persuasive evidence" that the networks favor their affiliates to the detriment of non-network stations; that the networks make programming decisions because they have financial interests in or syndication rights to that programming; or that the networks have reduced the pool of program producers through anticompetitive practices. "Moreover," said the FCC, "there is persuasive evidence that the established broadcast television networks have faced increased competition for the acquisition of television programming from broadcast and

non-broadcast television distributors since 1993, and there is evidence which suggests that the market power of the established networks, as determined by their prime time audience share, has decreased since 1993."

The FCC therefore concluded there was no reason for strengthening the remaining rules, as program producers and independent stations had urged it to do, and the FCC declined to retain the remaining Rules in existence in their current form. Finally, the FCC decided that "no public interest would be served by allowing the rules to remain in effect until November 10, 1995." And thus it concluded by repealing all of the remaining Fin/Syn rules "immediately upon publication of this Order in the Federal Register" which occurred on September 21, 1995 (60 Fed.Regis. 48907).

Editor's note: The repeal of the Fin/Syn Rules would have been an enormously significant - and very pro-network - development all by itself. In fact,

however, this is only one of several regulatory developments that should have a positive impact on the fortunes of the Big Three networks, and ultimately on the Fox, UPN and WB networks as well. The FCC also has repealed its Prime Time Access Rule (see the following story). It is considering changes in its rules governing network/affiliate programming practices. (ELR 17:4:31) And it is considering whether to modify or repeal rules that forbid networks from influencing their affiliates' advertising rates during non-network broadcast time and that forbid networks from acting as advertising representatives on behalf of their affiliates for the sale of non-network time. Taken together, all of these changes will permit vertical coordination by networks over their activities and those of their suppliers and affiliates to a much greater extent than has been permitted for the last quarter-century or more. Those companies whose activities are coordinated by the networks may not appreciate

it. But if the coordination is done well, it should strengthen the network television business in ways that eventually will benefit all of those who are a part of it.

In re Review of the Syndication and Financial Interest Rules, Federal Communications Commission, MM Docket No. 95-39, 1995 FCC LEXIS 5912 (1995) [ELR 17:5:22]

FCC repeals Prime Time Access Rule so that ABC, CBS and NBC affiliates will be able to broadcast network programming during prime time viewing hours

The Federal Communications Commission has voted to bring down the curtain on a significant era in television history. It has decided to repeal its quarter-

century old Prime Time Access Rule - a rule that fostered the birth and growth of independent television production and syndication companies, and also contributed to the plethora of game shows, reality shows and tabloid news programs that came to dominate the 7 to 8 p.m. time slot.

The Prime Time Access Rule prohibits ABC, CBS and NBC affiliated stations in the top 50 markets from broadcasting more than three hours of network or former network programs during the four prime time viewing hours between 7 and 11 p.m. Eastern and Pacific times, 6 and 10 p.m. Central and Mountain times. Certain types of programs have been exempt from the Rule (including special news sports programs, documentary and children's programs, and runovers of live sporting events). But by and large, the Rule has required the big three networks to release one of the four prime time hours to their affiliates each evening - an hour which

their affiliates have filled with programs acquired from non-network sources. (Fox, UPN and the WB networks have not been subject to the Rule, because none of them yet offers 15 hours of prime time programming per week which is a prerequisite for being a "network" as defined by the Rule.)

The Prime Time Access Rule was adopted by the FCC in 1970 because of its concern that ABC, CBS and NBC dominated the program production business, controlled too much of the programming that was presented to the public, and inhibited the development of competing program sources. The FCC believed that the Rule would increase competition in program production, reduce the networks' control over their affiliates' programming decisions, and thereby increase the diversity of programs broadcast to the public. The FCC also thought the Rule would promote the growth of independent stations, because they would not have to compete with

network affiliates (in the top 50 markets) in acquiring broadcast rights to former network programs.

Much has changed in the television business since 1970. So last year, the FCC initiated a proceeding designed to review whether there is a continuing need for the Prime Time Access Rule, in light of those changes. Almost two dozen formal comments were filed by interested parties, including the networks, broadcasters, program producers and government agencies; and these comments generated more than a dozen formal replies. On the basis of this very substantial administrative record, the FCC has determined that the Rule "should be extinguished."

The FCC found that the three major networks no longer dominate the television business. Today, there are many buyers and sellers of programming. "Entry, even by small businesses, is relatively easy." There are many more broadcast outlets today than when the Rule

was adopted, because of an increase in the number of independent stations now on the air. "In addition, non-broadcast media have proliferated. Viewers can choose from program offerings on cable, so-called `wireless' cable, satellite television systems, and VCRs." The FCC therefore concluded that the Prime Time Access Rule is no longer needed to promote the development of non-network sources of television programming. The FCC also found that the Rule is "not warranted as a means of promoting the growth of independent stations and new networks, or of safeguarding affiliate autonomy."

The FCC decided that eliminating the Prime Time Access Rule is a sufficiently significant development that a "transition period" would be appropriate to give those in the television business "time to adjust their programming strategies and business arrangements." Thus, the effective date of the repeal will be August 30, 1996.

In re Review of the Prime Time Access Rule, Federal Communications Commission, MM Docket No. 94-123, 1995 FCC LEXIS 5110 (1995) [ELR 17:5:23]

NLRB rules that KIRO-TV violated federal labor law by refusing to bargain with AFTRA about effects of its decision to produce additional weekday news program to be broadcast by another station and by failing to provide AFTRA with requested information

Federal labor law makes important distinctions between mandatory subjects of collective bargaining on the one hand and management decisions that do not require collective bargaining on the other. As a general rule, issues that settle some aspect of the employer/employee relationship must be bargained

about, while those that have only "an indirect or attenuated impact" on that relationship do not. In practice of course this distinction is sometimes difficult to apply. This difficulty resulted in an NLRB proceeding between AFTRA and Seattle television station KIRO-TV when the station decided to produce an additional half-hour weekday news broadcast but refused to bargain with AFTRA concerning the station's decision to produce the broadcast or its effects on AFTRA members involved in the new program.

The disagreement between AFTRA and KIRO arose in part because although the new program was produced by KIRO employees at KIRO's own facilities, the program was not broadcast by KIRO itself. Instead, it was broadcast by another Seattle area station, KTZZ-TV. This was done because the program was to be broadcast at 10 p.m., but KIRO-TV is a CBS affiliate and as such was committed to broadcasting CBS

programming from 10 p.m. to 11 p.m. The practice of one station producing a news program that is broadcast by another station is a practice that is "relatively new in the industry" and "novel."

When AFTRA learned of KIRO's plans to produce a news program for broadcast by KTZZ, the union requested copies of the documents between the two stations. KIRO however refused to provide copies of the documents and refused to bargain about its decision to produce the program or about its effects on the program's on-air personnel even though they were AFTRA members. AFTRA initiated a proceeding before the NLRB, and Administrative Law Judge Joan Wieder ruled in its favor. Now, the NLRB has affirmed part of that decision, though not all of it.

NLRB Members James M. Stephens and John C. Truesdale have ruled that KIRO did not commit an unfair labor practice by refusing to bargain about its

decision to produce the new program, but did commit an unfair labor practice by refusing to bargain about the program's effects on AFTRA members and by refusing to give AFTRA copies of the documents it requested.

The Supreme Court has ruled that management decisions that do not require collective bargaining include those that involve "choice of advertising and promotion, product type and design, and financing arrangements." According to NLRB Members Stephens and Truesdale, KIRO's "decision to produce the 10 p.m. news on KTZZ is comparable to [these types] of management decisions. It involved a choice of product type and method of product distribution. . . . These matters are essentially unrelated to the employment relationship, and have only a limited, indirect impact on employment."

On the other hand, Stephens and Truesdale ruled that "An employer has an obligation to give a union

notice and an opportunity to bargain about the effects on unit employees of a managerial decision even if it has no obligation to bargain about the decision itself. . . . In this case, the credited evidence shows that the production of the 10 p.m. news on KTZZ resulted in increased hours, increased workloads, split shifts, and greater productivity demands for certain unit employees. . . . [T]hese changes in working conditions were material, substantial, and significant. Consequently, they were mandatory subjects of bargaining."

AFTRA was entitled to the requested documents because it "reasonably believed that the documents relating to the agreement between KIRO and KTZZ would not only address financial matters but would also discuss substantive details about the content of the 10 p.m. show and the manner in which unit employees would be used in the production of this show. This information would be clearly relevant to the Union's interests in

effects bargaining and in determining whether the new production entailed any breach of the collective-bargaining agreement."

NLRB Chairman William B. Gould IV agreed with the Administrative Law Judge that KIRO was under an obligation to bargain about the decision to produce the new program itself, and therefore he dissented from the majority's decision that KIRO had not violated labor law by refusing to do so. Chairman Gould concurred with the majority that KIRO was obligated to bargain about the effects of the decision and was obligated to give AFTRA copies of the requested documents.

The NLRB has ordered KIRO to give AFTRA an opportunity to bargain about the effects of the decision to produce a news program for broadcast by KTZZ and to provide the union with information relevant to those effects.

KIRO, Inc. and American Federation of Television and Radio Artists, 317 NLRB No. 186, 1995 NLRB LEXIS 717 (1995) [ELR 17:5:24]

DEPARTMENTS

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