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COPYRIGHT TERMINATION RIGHTS

IN THE “LOANOUT” CORPORATION’S

CONTEXT

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INTRODUCTION

A number of issues have been raised regarding termination rights by recent decisions and legislative developments. This year, 2003, is the first year that licenses granted under the 1976 Copyright Act can begin to have their authorization terminated by service of notices of intent to terminate.

Some performers create wholly owned corporations to which they exclusively license their services to insulate themselves from liability or privity of contract and to take advantage of possible favorable tax consequences. If these arrangements create work for hire status for the artist because she has become an employee of the wholly owned corporation, then the artist would lose her termination rights. Could "reverse piercing of the corporate veil" be used to restore termination rights? This paper will attempt to resolve the tension between the use of "Loan-Out" companies for tax and other related reasons by artists, and the problems this might create for the exercise of their termination rights. The use of reverse piercing may resolve this tension. This Article will identify the business justifications for using "loanout" corporations, weigh these against the disadvantages created for the exercise of termination rights, and suggest alternative solutions.

IV) I. Benefits Of "Loanout" Corporations

a. Background

The "loanout" company is a "Hollywood" term for a device that has received wide acceptance among doctors and lawyers, the personal service corporation. The following is a typical example: Performer forms a "loanout" corporation, which is fully owned by Performer. The "loanout" corporation enters into an employment agreement with Performer, pursuant to which Performer agrees to render services for her corporation and to third parties as the corporation may lend Performer's services. Producer enters into an agreement with the corporation, which requires the corporation to provide the services of Performer for a specified job. The employment agreement between Performer and her "loanout" corporation may call for Performer to render services exclusively to her corporation; more commonly, the agreement will provide only for Performer's domestic services to be exclusive. Performer might be an actor, director, writer, producer, songwriter, singer, comedian, athlete, or other Performer.

b. *Benefits of Incorporation*

Depending on the artist's success, a variety of forms of doing business might be considered. Generally, the non-tax advantages of incorporation are limited liability for the shareholders, access to capital, centralized management, transferability of ownership, and continuity of the business. The most important of these non-tax advantages for the artist will probably be limited liability. Another important advantage of the arrangement is that the "loanout" corporation is permitted to adopt a pension or profit-sharing plan for the benefit of Performer.

Moreover, the "loanout" corporation can establish a fiscal year (such as January

31), which overlaps the artist's taxable year. This allows the corporation to defer income by delaying the payment of salary reflecting income earned in one year to a subsequent year, so long as the salary payment occurs before the end of the corporation's fiscal year. Second, the corporation can provide fringe benefits such as a self-insured medical payment plan, term life insurance, and health insurance. These deductions may provide tax benefits in excess of the cost of incorporating. In addition, a "loanout" corporation can be used to avoid tax by the payment of a salary to the artist, which is deducted as an expense by corporation. Moreover, corporations are less likely to be audited than sole proprietorships. Some of the disadvantages of incorporation are mainly related to maintaining corporate formalities such as, record keeping, meetings, and paperwork, as well as expenses both for the initial incorporation and for any eventual dissolution. In addition, artists and performers may form one "loanout" corporation or several "loanout" corporations to handle the different segments of the industry in which the artist is involved. These related companies may be used to transfer income between entities to get the most beneficial tax treatment.

In summary, "loanout" corporations provide tax benefits such as: the ability to take deductions without limitations applicable to normal employee business expenses, the ability to obtain certain pension benefits that would otherwise be unavailable to employees, medical reimbursement plans, and insurance benefits.

II. WORK MADE FOR HIRE & TERMINATION RIGHTS

When an artist, whether performer, director, producer, writer, or other talent, uses a "loanout" corporation to provide her services to the production company, the "loanout" company contracts directly with the production company, and the artist will need an employment agreement with her own corporation. The employment agreement allows the "loanout" company to provide the artist's services and enter lending agreements with production companies. The artist becomes the employee of the "loanout" company, and it is the "loanout" company, which then contracts with the production company to provide the artist's services. Consequently, the employee's/performer's works of authorship are works made for hire, in which the authorship is held by her "loanout" corporation because under copyright law, A "work made for hire" is: (1) a work prepared by an employee within the scope of his or her employment; or (2) a work specially ordered or commissioned for use as a contribution to a collective…"

Section 203 of the 1976 Copyright Act states that, "In the case of any work other than a work made for hire, the exclusive or nonexclusive grant of a transfer or license of copyright or of any right under a copyright, executed by the author on or after January 1, 1978, otherwise than by will, is subject to termination" under some conditions. The purpose of the termination procedures under the current Copyright Act is to protect authors because of their unequal bargaining position. Like the other legislative history on section 203, the House Report refers to the unequal bargaining position of authors. Because authors are generally in a poor bargaining position, and the value of their copyright is difficult to quantify, section 203 was made to permit the artists to renegotiate their transfers, which do not provide them with an adequate and just share of the monetary return from their creations. Section 203 vests in authors a right to terminate their prior copyright transfers thirty-five years after their execution. Because section 203 excludes authors of works made for hire from exercising their termination rights, our performer who formed a "loanout" corporation would lose her termination rights because her “loanout” agreement states that she is an employee of her “loanout”.

IV) III. REVERSE PIERCING OF THE CORPORATE VEIL

If this arrangement creates work for hire status for the artist because she has become an employee of the wholly owned corporation, then the artist would lose her termination rights. Could “reverse piercing of the corporate veil” be used to restore termination rights?

a. ***Background***

Piercing the corporate veil is generally used by creditors to reach an individual who has used her corporation as an instrument to defraud the creditors. Here, the concern is with a different application of the theory, an application characterized as a reverse pierce. It is not a case in which a creditor attempts to pierce the corporate veil to hold a corporate insider liable; instead it is the shareholder corporate insider who attempts to pierce the corporate veil from within the corporation. “Because of this difference, reverse pierce claims implicate different policies and require a different analytical framework from the more routine corporate creditor veil-piercing attempts.”

> The classic, early statement of the principles governing corporate disregard was set forth by Judge Sanborn in 1905: ‘If any general rule can be laid down in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.’

Moreover, “the corporate fiction is but a matter of commercial convenience; the concept is not to be extended beyond reason and policy.” Since copyright law is federal law, this paper will first examine reverse piercing in the context of federal cases. A choice of law concern may arise in federal reverse piercing cases. Generally, the federal courts, defer to state regulation of corporate law. However, when federal courts interpret federal statutes, they have emphasized that federal common law may be used in such reverse piercing cases**.** Nevertheless, federal courts will often use state law for guidance.

a. Important Federal Reverse Piercing Cases Applying State Corporate Law

Floyd v. Internal Revenue Service

In *Floyd v. Internal Revenue Service*, the United States Court of Appeals for the Tenth Circuit addressed reverse piercing in an alter ego context. In *Floyd*, creditors sought to use corporate assets to satisfy a corporate shareholder's debt. The debtor, Thomas Bridges, owned three companies, Network Billing Centers, Inc., Med-Net Technologies, Inc., and Thomas Marketing, Inc. Bridges was the sole shareholder and director of all three companies. Three creditors, one of which was the IRS, obtained judgments against Bridges and fought for priority over the companies' assets. "The IRS sought to establish that Med-Net acted as an alter ego of Bridges in order to hold Med-Net liable for Bridges' personal debt, and thereby allow utilization of corporate assets to satisfy Bridges' debt."

The Appeals Court did not accept the IRS's alter ego argument. For reverse piercing, the court applied Kansas state law to determine whether Med-Net acted as Bridges' alter ego. Kansas courts, however, had not yet spoken on reverse piercing, and the court found significant reasons to resist the claim. The court reasoned that, reverse pierce posed several problems as applied to the facts of this case. First, it by-passed "normal judgment-collection procedures." Second, unfair prejudice may result to third parties if a creditor (the IRS) was able to attach a corporation's assets. Third, it could unsettle corporate creditors' expectations when securing loans with corporate assets. Fourth, it could reduce the corporate forms' effectiveness in raising credit. Fifth, only where a subsidiary dominated its parent, should courts find outside reverse piercing appropriate. Sixth, disregarding the corporate form required the unavailability of adequate remedies at law.

However, the court in *Floyd* stated that it recognized that "the problems associated with reverse-piercing may be viewed as less serious in cases where a corporation is controlled by a single shareholder--there are, for instance, no third-party shareholders to be unfairly prejudiced by disregarding the corporate form." Distinguishing *Floyd* to apply the reverse piercing principles of the court to our artist and her "loanout" corporation, our artist unlike in *Floyd*, is a single shareholder and there are no third party shareholders to be unfairly prejudice by disregarding the corporate form for the artist to maintain her termination rights. In addition, most musicians and artists operate out of California, which unlike Kansas courts, had spoken on reverse piercing and applied the alter ego doctrine. Therefore, the alter ego argument would be more favored towards our artist.

SEC v. Hickey

In *SEC v. Hickey*, the Ninth Circuit in a Federal securities law case, applied California corporate law for its decision. John Hickey was found guilty of securities fraud, and was ordered by the district court to disgorge over $ 1 million. When Mr. Hickey failed to disgorge his unlawful gains, the district court ordered that the assets of a brokerage firm owned by Hickey's mother be frozen. The Court applied the law of the forum state, California, in determining whether a corporation is an alter ego of an individual and stated that “California law recognizes an alter ego relationship, such that a corporation's liabilities may be imposed on an individual, when: (1) "there is such a unity of interest and ownership that the individuality, or separateness, of the said person and corporation has ceased, and (2) an adherence to the fiction of the separate existence of the corporation would . . . sanction a fraud or promote injustice.” Because an individual must own at least a portion of a corporation before an alter ego relationship exists under California law, the Court held that the Brokerage was not Hickey's alter ego. However, the Court held that the lack of an alter ego relationship between Hickey and the Brokerage did not mean that the Brokerage's assets could not be frozen. The existence of an alter ego relationship is necessary only when some type of piercing is sought and the court did not pierce the Brokerage when it froze its assets.

Applying the reverse piercing principals of California law, used in the federal court in *Hickey*, to our artist and her “loanout” corporation, there is a definite unity of interest between the artist and her corporation because the artist owns 100% of the corporation’s stock. Second, adherence to the fiction of the separate existence of the corporation would sanction a fraud or promote injustice because the artist would otherwise loose her termination rights to the production company just because she chose to incorporate.

Zahra Spiritual Trust v. U.S.

In *Zahra Spiritual Trust v. U.S.*, two corporations, Dar Al-Hikmah N.V., Inc., Mudin, Inc., and a trust, Zahra Spiritual Trust, sued the IRS to quiet title to certain real property and to discharge federal tax liens on the property. The dispute arose out of a tax jeopardy assessment by the IRS against Fadhlalla and Muneera Haeri for tax liability. The IRS sought to apply the alter ego doctrine to hold the corporation's assets accountable for the liability of the individuals who treated the corporation as their alter ego. The Fifth Circuit in its reverse piercing analysis used Texas law in an alter ego context. The factors used by the court were:

"1) the total dealings of the corporation and the individual, including the degree to which corporate formalities have been followed and corporate and individual property have been kept separately, 2) the amount of financial interest, ownership and control the individual maintains over the corporation, and 3) whether the corporation has been used for personal purposes."

Applying the reverse piercing principals of Texas law, used in the federal court in

Zahra, to our artist and her "loanout" corporation, since the artist is the sole owner of the corporation, she would most likely not follow corporate formalities and there would not be any directors and shareholders meetings. In addition, she would probably not keep the corporation's property separately because her property would be limited to: her mind, which creates the works of authorship, recording equipment, and musical instruments, which is most likely kept in her house. Second, the artist maintains complete financial interest, ownership and control over the corporation because she owns 100% of the stock and is the director and manager. Third, the corporation is being used for personal purposes, to maximize gain and benefit to the sole shareholder, the artist. Therefore, after distinguishing *Zahra* to our artist's scenario, *Zahra*'s alter ego elements favor our artist.

c. **Federal Reverse Piercing Cases using the**

Federal Common Law Test

When the veil piercing claim stems from an area of federal preeminence, as in copyright law, the courts may apply the federal common law test for piercing, rather than state law. Courts used the federal common law test in violations of federal labor laws cases. In *NLRB v. Greater Kansas City Roofing*, the Tenth Circuit characterized the alter ego theory as a two-part test. First, "was there such unity of interest and lack of respect given to the separate identity of the corporation by its shareholders that the personalities and assets of the corporation and the individual are indistinct. Second, would adherence to the corporate fiction sanction a fraud, promote injustice, or lead to an evasion of legal obligations."

Applying the reverse piercing principals of the federal common law test as applied in *NLRB v. Greater Kansas City Roofing*, to our artist and her "loanout" corporation; first, there is a definite unity of interest between the artist and her corporation and there is no separation between the properties of the artist and her corporation (both are explained above in the analysis of *Hickey*). Second, as also explained in this paper's analysis of *Hickey*, adherence to the corporate fiction would promote injustice because the artist would loose her termination rights.

d. ***Landmark State Reverse Piercing Cases***

As demonstrated in the federal reverse piercing cases, most federal reverse piercing cases apply the state law of the forum state. Moreover, the federal common law two part test is somewhat similar to the one used by federal cases deferring to state law. The court in *Floyd*, cited the hornbook landmark Minnesota case, *Cargill v. Hedge* as a guideline for one of its alter ego elements applied. Examining *Cargill* and applying its principals to our artist and her “loanout” corporation is therefore essential.

In *Cargill*, after purchasing a 160-acre farm, the Hedges incorporated their family farm as Hedge Farm, Inc. While the Hedges maintained some of the corporate formalities, they operated the farm as their own. Annette Hedge owned all the stock. All directors and officers were family members, with none of the officers receiving any salary. Sam Hedge purchased farm supplies on credit from Cargill. Cargill filed suit to collect the debt owed to him, and judgment was entered in his favor. Shortly before the expiration of the redemption period, Annette was allowed to join the proceedings as an intervenor. The *Cargill* court stated that the degree of identity between the individual and his corporation is important for reverse piercing the corporate veil. The court also stated that it is important whether others, such as creditors or other shareholders, would be harmed by a pierce. After conceding that the defendant and his wife had maintained some of the corporate formalities, such as keeping corporate minutes, filing corporate tax returns, and dealing with the Production Credit Association as a corporation, the Court nevertheless held that, because of the close family connections with the corporation's operations, the corporation was an alter ego for the defendant and his wife. The court reasoned that realistically, they operated the farm as their own and that they had no lease with the corporation and paid no rent.

The court determined that the purpose of the homestead exemption provided strong policy reasons for allowing reverse piercing. *Cargill* stands for the proposition that, if disregarding the corporate entity would advance important state policies, an insider reverse piercing claim will be sustained. This is true even if some corporate formalities have been observed.

e. Applying Reverse Piercing To The "loanout" Case

The court in *Cargill*, to reverse pierce the corporate veil considered: 1) whether the corporation was the alter ego of the major shareholder, 2) whether no shareholder or creditor would be harmed by a pierce, and 3) whether reverse piercing the corporate veil would further an important policy; in Cargill's case it was the homestead exemption.

1. *Alter Ego*

In our performer's "loanout" corporation case, the corporation is the alter ego of the performer. As in *Cargill*, there is a close identity between the artist and his corporation because the artist owns 100% of the stock in the "loanout", is the treasurer, and the president. Moreover, the "loanout" corporation is operated for the sole benefit of the artist and managed as her own. The artist can use, perform, display, or copy freely any song, script, or other creation which owned by the corporation because it is the artist herself who authored those copyrighted works and is the sole decision maker as to their use in the "loanout" corporation.

2. *No shareholder or creditor would be harmed by a pierce*

Since the artist is the sole shareholder of the "loanout" corporation, the artist will not be harmed by his decision; on the contrary the artist will gain back her termination rights and therefore will benefit by reverse piercing the corporate veil. Moreover, There are no creditors involved in piercing the corporate veil for the limited purpose of the artist claiming authorship of the copyrighted work and gaining her termination rights. Although a third party such as a record company, movie studio, or publishing company, may not be able to further exploit the artist's copyrighted work once termination is activated, however, such third party is not a creditor of the corporation.

3. Further The Policies Of Termination Rights

As in *Cargill*, in which the court determined that the purpose of the homestead exemption provided strong policy reasons for allowing reverse piercing, in the case of our artist, there is a strong policy to further the policy purposes of termination rights. Congress deemed those termination rights so important as to legislate that the right of termination of transfer cannot be waived in advance or contracted away. Section 203 (a) (5) states that, "Termination of the grant may be effected notwithstanding any agreement to the contrary, including an agreement to make a will or to make any future grant." Legislative history of section 203 states that the policy behind termination rights and "the provisions of section 203 are needed because of the unequal bargaining position of authors, resulting in part from the impossibility of determining a work's value until it has been exploited."

Moreover, "copyright, unlike real property and other forms of personal property, is by its very nature incapable of accurate monetary evaluation prior to its exploitation." In these circumstances, an author must necessarily find herself in a poor bargaining position when she initially negotiates the sale of her copyright. For this reason, a "second chance" is necessary for authors at a time when the economic worth of her work has been proven. This reasoning is somewhat less persuasive when the original sale is on a percentage royalty basis. Even in such a case, however, the nature of the royalty formula (*e.g.*, whether based on gross receipts, or "net profits" defined in such manner as to leave virtually nothing after deduction of "costs"), and the numerical amount of the percentage may vary depending on the author's bargaining position. These circumstances offer sufficient grounds for a "second chance" for authors without justifying an invidious comparison to other forms of property.

The court in *Cargill* reversed pierced the corporate veil to further the policy of the homestead exemption, a real property right. Similarly, termination right, an intellectual property right, is deemed by Congress to be important and reverse piercing of the loanout's veil will further Congress' policy.

f. Analogy of "loanout" problem to IP Holding Company Problem

1. Background on IP holding company

"An IP holding company is established by exchanging a parent company's intellectual property assets for stock in a newly-formed subsidiary corporation, which can be incorporated in certain states having favorable state tax laws." The exchange of stock in the subsidiary for intellectual property is a non-recognition transfer under Internal Revenue Code section 351, and is not taxed. When the assets are transferred, the parties enter into licensing agreements, with the parent agreeing to pay a royalty to the subsidiary for the right to use the intellectual property. The royalty payments paid by the parent are an expense, and therefore not included in its net taxable income. By choosing a state that excludes royalty income from taxation as the state of incorporation for the IP holding company, this company's income from the royalty payments is also untaxed. Consequently, the outcome is a decrease in the total tax obligation of the corporate enterprise.

These are substantial advantages to a corporate enterprise. "For trademarks, however, there is a potentially greater risk: the loss of the right to use the trademarks." When a trademark is abandoned, under the Lanham Act, the former owner loses all rights in it. A firm that has licensed others to operate under its trademarks must supervise the licensees. If no quality control is exercised, the mark may be deemed abandoned.

A court could decide that the existence of the parent-subsidiary relationship demonstrates adequate control by the subsidiary. If, however, a court finds that a subsidiary has no adequate control of the parent, to avoid trademark abandonment the parent must prove that the parent and its subsidiary are in reality one entity controlling the mark and the quality of goods affixed to the mark. The parent may claim that it is the alter ego of the subsidiary, and therefore the separate existence of the subsidiary should be ignored for purposes of trademark ownership. This is a similar situation to the situation of our artist who owns her "loanout" corporation, who can claim that she is the alter ego of the "loanout" for the purposes of: copyright ownership, copyright authorship, and termination rights.

However, "this standard for Lanham Act veil piercing has been criticized as the purest dicta." It may nevertheless be argued that the Lanham Act's policy considerations dictate that a revised approach to traditional veil piercing should occur in Lanham Act cases.

The legislative purpose of the Lanham Act is to protect the public and to protect the investment of the trademark owner from pirates and cheats. Abandonment of a trademark occurs when the words or design used no longer indicate to consumers a unique source. However, in the IP holding company context, where the subsidiary licenses back exclusively or primarily to its parent, and the parent uses the mark in interstate commerce, the source-indicating ability of the mark is not diminished. Arguably, then, it is against the legislative purpose where an infringer is allowed to continue to infringe simply by asserting that the trademark was abandoned solely by virtue of the corporate structure. In the IP holding company arrangement, there is no question that either the parent or the subsidiary is the party actually in control of the mark. No public purpose is served by allowing an infringer to escape liability because of a formalistic application of corporate law without reaching the merits of the infringement claim.

2. *Analogizing the legislative purposes of IP holding company and the "loanout"*

In the same manner, veil piercing is required in the case of artists owning their "loanout" corporations to further the policy of Section 203 of the Copyright Act. Allowing a third party, like a record company, publisher, or movie studio, to which the artist is providing her artistic services, to invalidate the artist's termination rights, and therefore benefit by virtue of the artist's choice of corporate structure, would violate the legislative purpose of section 203. In addition, no public purpose is served by allowing third parties to invalidate the artist's termination rights because of a formalistic application of the "work for hire" provision of the Copyright Act.

IV. ENTERTAINMENT CONTRACTS

a. *Parties' Contracting For The Services Of The Artist Treatment of artist and "loanout" In Entertainment Industry Contracts*

The following entertainment industry practices, as demonstrated in entertainment contracts, demonstrate that parties contracting for the services of the artist owning the "loanout" such as production companies, record companies, music publishers, or concert promoters, in actuality treat the "loanout" as the alter ego of the corporation.

Many artists utilize the corporation as their form of business organization. When an artist uses a “loanout corporation,” the attorney will prepare an agreement referred to as a “Loan-Out Employment Agreement.” This agreement allows the corporation to employ the artist, usually on an exclusive basis. In the case of an individual artist, one attorney will invariably represent both the artist and her corporation. The party contracting for the services of the artist (e.g., a production company, record company, music publisher, or a concert promoter) will enter into its agreement not with the artist, but with her “loanout” corporation. For that reason, the agreement is referred to as "Lending Agreement." This third party will require that the artist also execute another agreement referred to as an "Inducement Agreement" or "Inducement Letter," which will protect such party by binding the artist to the Lending Agreement if the Loan-Out Employment agreement, the contract between the artist and her “loanout”, should be breached.

The inducement agreement is generally a letter from the Artist to the production company requesting or "inducing" the production company to enter the lending agreement. The reason for the inducement agreement is simple. Since the lending agreement is between two corporations, the production company needs assurance that the individual Artist will be bound to perform the services being provided by the loan-out company if something happens to the loan-out company or to the agreement between artist and the loan-out company. Such typical clause states the following:

> SUBSTITUTION FOR LENDER: If Lender should be dissolved or should otherwise cease to exist or for any reason whatsoever should fail, neglect, refuse or be unable to perform and observe each and all of the terms or conditions of the Lending Agreement requiring performance or compliance by Lender, Artist shall, at the election of Borrower, be deemed substituted as a direct party to said Lending Agreement in the place and stead of Lender.

Since there is no guarantee that the corporation will not dissolve, become insolvent, or the artist's employment agreement with the corporation will not expire, the contracting party will want to be protected, and the Inducement Letter accomplishes this purpose. Even if the artist is incorporated, third parties may name the artist, not the corporation, as responsible for performing the contract. In such instance, the artist may be unwilling to sign the agreement and insist on contracting through her “loanout.” Consequently, it is customary to include along with the services agreement and Inducement Letter a third agreement that converts the services agreement into a Lending Agreement. This third agreement is referred to as a "Loan-out Rider" or "Loan-out Agreement,” which clarifies that the artist's services are being rendered through the corporation even though the agreement itself is drafted between the employer and artist.

Therefore, this use of inducement agreement shows that parties contracting with the artist and her “loanout” are seeking personal assurance as to artist’s performance of her services. It also demonstrates that although this inducement agreement is made for the purpose of providing personal assurance to third parties, the industry treats the “loanout” and the artist as one entity. This evidence of industry custom should also be used to strengthen an argument made by the artist for reverse piercing her “loanout’s veil to regain her termination rights.

b. ***Protection Measures Parties Contracting For Artist’s Services Use***

Record companies and other parties contracting for the artist’s services do not include in their recording contracts a specific clause which is directly related to the fact that an artist can lose her termination rights because she incorporated in a “loanout” arrangement. However, the following contract clauses and their explanations illustrate other protection measures taken by record companies and similar parties.

An example of such protection measure is demonstrated by the following clause in a typical Master Recording Agreements:

> Each Master made pursuant this Agreement or during its term, from the inception of its recording, will be considered a "work made for hire" for Label; if, for any reason, any such Master fails to qualify in any jurisdiction as a work made for hire, then all right, title, and interest in and to the copyright to any such Master shall be deemed transferred, on an exclusive basis, in perpetuity, to Label by this Agreement.

The following excerpt from a clause entitled "*Grant of Rights,*" is taken from an "Employment Agreement Between Recording Artist And His Corporation, " which is a "loanout" agreement.

> *Acknowledgments:* Employee hereby acknowledges and agrees that all services rendered by him hereunder shall be rendered as the "Employee-for- hire" of Employer as such term is defined in the Copyright Act of the United States, and that all results and proceeds of Employee's services hereunder shall be and at all times remain the sole and exclusive property of Employer, forever free and clear of any claims of Employee, his heirs, successors, representatives or assigns. Without limiting the foregoing, Employee acknowledges that if at any time hereafter the copyright law of the United States or any other country is amended so as to provide for payments by reason of ownership of copyright in a particular performance of a musical composition, all of such rights with respect to Employee's recorded performances hereunder shall also be and remain the sole property of Employer. Employee shall execute and deliver to Employer, from time to time as Employer shall request, all instruments and documents as Employer may request in order the better to evidence the relationship between Employee and Employer set forth in this paragraph.

In the motion picture industry, although artistic work done for movies is work specially ordered or commissioned for use as a contribution to a collective, as with directors and producers, it is not uncommon for a performer to form a "loanout" company to provide her services. Generally, such performer/production company contract states that "the rights that are acquired by the production company in the results and proceeds of the performer's performance must vest immediately in the production company in order for the production company to maintain its 'chain-of-title' in the motion picture." The following clause protects the production company against the potential exercise by the artist of her termination rights. This clause is intended to allow the production company to extend its rights by using a *right of first negotiation* or *first refusal*.

> All of the rights granted or agreed to be granted hereunder shall vest in Production Company immediately and shall remain vested whether this Agreement expires in normal course or is terminated for any cause or reason. All of the rights granted herein, including, without limitation, all material created, composed, submitted, added or interpolated by Performer hereunder shall automatically become Production Company's property, and Production Company, for this purpose, shall be deemed author thereof with Performer acting entirely as Production Company's employee. [Lender and] Performer do [es] hereby assign and transfer to Production Company all of the rights herein granted without reservation, condition or limitation, and no right of any kind, nature or description is reserved by [Lender and] Performer. Notwithstanding the foregoing, if any of the rights herein granted are hereafter subject to termination under Section 203 of the Copyright Act, or any similar provisions of this Act or subsequent revision thereof, then [Lender and] Performer agree not to make any further grant without giving Production Company *the first opportunity to acquire such rights* pursuant to a customary *right of first negotiation/first refusal.*

The above clauses are used by record companies, production companies, and similar parties to protect themselves. However, Section 203 states that the right of termination of transfer cannot be waived in advance or contracted away. Moreover, "termination of the grant may be effected notwithstanding any agreement to the contrary, including an agreement to make a will or to make any future grant." As previously demonstrated, the best protection for record companies is the "right of first refusal" clause. Therefore, the "right of first refusal" clause is the best tool used by record companies to protect themselves against artists claiming their termination rights.

IV. OTHER SOLUTIONS FOR THE INCORPORATING ARTIST

A typical artist's "Loan-Out Employment Agreement" states that the artist will be an employee of the loan-out company. Such arrangement can create a work made for hire relationship and the artist may lose her termination rights. As discussed in Section III of this article, our artist may argue that the "loanout" corporation's veil should be pierced to allow her to regain her termination rights. However, It is not clear if the reverse piercing doctrine will be extended outside of the somewhat unique homestead exemption context. Moreover, since copyright law is federal law, it is not clear, based on the federal reverse piercing cases presented above, that the federal courts will favor such alter ego arguments made by our artist. In such a case, the artist may argue that although her loan agreement states that she is an employee of the "loanout", for the purpose of termination rights, there was no valid employment relationship and therefore no work for hire arrangement between herself to the "loanout" corporation in the first place.

a. Reexamination of The Validity of Artist's Employment Relationship by The "Loanout" for The Purpose of Termination Rights.

Classification of a work as a work made for hire has profound implications, affecting both the initial ownership rights and termination rights. If a work becomes a work made for hire, the commissioned party loses all copyright rights. If the work is not a work made for hire, then the commissioned creator may retain, or recapture, important substantive rights.

"At the center of the controversy is the word "employee," which is not defined in the 1976 Act." Four judicial definitions of work made for hire developed in the federal courts, ranging from works prepared by "formal, salaried employees," which is the most pro-artist position, to works commissioned by hiring parties who retained the “right to direct and supervise” the creation of the product, which is the position least favorable to artists.

In light of the Supreme Court's decision in *Community for Creative Non-Violence v. Reid*, an “employee,” for purpose of work made for hire, is an agent, as defined by the Restatement of Agency § 220. The actual supervision and control test for *Aldon Accessories Ltd. v. Spiegel, Inc*. is no longer good law. Therefore, merely calling a creative party an “employee” in a “work made for hire” agreement will probably no longer grant the employer ownership of the work. Such work for hire agreement may be the equivalent of a transfer of copyright from the employee to the employer, but will not trigger other legal rights that flow from the "for hire" status such as termination rights. In *Community for Creative Non-Violence v. Reid*, the Supreme Court decided the case using the Fifth Circuit's “agency law” standard.

1. Community for Creative Non-Violence v. Reid

The Community for Creative Non-Violence (“CCNV”) was a nonprofit organization dedicated to advocacy for the cause of the homeless. It negotiated with Reid, a sculptor, to create a variation on the classic nativity scene, depicting homeless individuals. Agreement was made, and Reid created the bronze sculpture. Reid did the work in his studio, with minimal direction from CCNV. After the presentation, Reid registered a copyright on the work. Subsequently, Reid took custody of the sculpture and a disagreement arose between him and CCNV over future exhibitions. CCNV sued to obtain possession of the work. The Supreme Court held that the definition of employee is determined under common-law agency principles. The Court further held that the factors to be considered are: the level of skill required, tax treatment of the putative employee, the singleness of the assignment, and the source of the instrumentalities of the labor. Applying those factors to Reid's case, the Court held that: the work was highly skilled; Reid was retained only for this single assignment; supplied his own tools and work area; and was not treated as an employee for tax purposes. The Court concluded that Reid was and independent contractor and not an employee of CCNV. Therefore, the § 101(1) exception to § 201(a) did not apply, and the copyright belonged to Reid.

2. *Application of CCNV v. Reid factors*

The following will apply the common law agency factors mentioned in *CCNV v. Reid*, to the situation of the artist owning her "loanout" corporation:

i. The Level Of Skill Required

As in *CCNV v. Reid*, in which it was held that Reid's sculpting work required a high level of skill, An artist's work generally requires great level of skill, whether the artist is a musician, a painter, a sculptor, an actor, a producer, director or any type of artist. In the case of our "loanout" corporation, the artist is the only employee of the "loanout," and therefore, the fruits of the artist's labor depend solely on her. This factor favors the artist.

ii. *Tax Treatment Of The Putative Employee*

As mentioned in section I of this paper, "loanout" corporations are used to substantially avoid tax by the payment of a salary to the artist, which creates a deduction for the corporation. Such an arrangement can average the artist's income from year to year. In addition, the corporation is often used to provide other fringe benefits not otherwise available. However, the artist is not an employee in its traditional meaning. A typical clause appearing in Loanout Employment Agreements includes compensation to be paid by the “loanout” to the artist and is generally established after tax consultation to maximize benefits for the artist. Moreover, salaries may change each year, depending on how much money the corporation makes from loaning-out the artist's services. The lack of fixed income, as done in “loanout” corporations, was used as a factor in *Donaldson Publishing Co. v. Bregman, Vocco & Conn, Inc.,* although decided under the 1909 Copyright Act, to determine that Mr. Donaldson, a songwriter, was not an employee for hire of a corporation in which he held substantial percentage of stock. Donaldson was paid irregularly and his drawings from the corporation often exceeded by the amount of royalties he had earned. This factor therefore, is likely to favor the artist because as in Donaldson, our artist is customarily not paid in fixed income by her “loanout.”

iii. The Singleness Of The Assignment

Unlike *CCNV v. Reid,* in which Reid was retained only for a single assignment, the artist owning the “loanout” corporation is hired for many assignments as demonstrated in the following typical clause in a “loanout” employment agreement.

> Corporation further engages and employs Employee to render services exclusively for and as directed by Corporation as [*e.g., a director for theatrical motion pictures*] and in any other capacities designated by Corporation in all areas and fields throughout the entertainment and leisure time industries, upon and subject to the terms and conditions herein set forth. Employee hereby accepts such employment and agrees to keep and perform, diligently and conscientiously, all the duties, obligations and agreements assumed and entered into by (him) (her) hereunder.

The author of this treatise recommends that the nature of potential employment should be specified as broadly as possible to take into account the various types of services that an artist may perform during her career. For example, a writer or actor may later also become a director or producer. This element therefore, favors the “loanout”.

iv *The Source Of The Instrumentalities Of The Labor*

Most instrumentalities of labor used by artists, like musicians, are provided by the artists’ brain itself. Writing a song does not generally require special equipment. To write a song, an artist generally needs an idea, an instrument, and a piece of paper. Although the artist may use sound equipment, audio boards, music editing software, or other equipment purchased and deducted as an expense by the corporation, the main instrumentality necessary to write a song is the artist’s brain and sense of creativity. In addition, although recording artists usually record their albums in recording studios, the main space used to create and write their copyrightable songs is generally their home or any public place. Therefore, the space used for creation of musical works is also an instrumentality which is not funded or provided by the “loanout” but by the artist’s own personal resources. The same applies to movie directors, screen and book writers but does not favor artists who rely on equipment to produce their art such as, sound engineers and record producers, which expensive sound boards and other studio equipment are essential part of their creations. This element therefore generally favors the artist.

v. ***Hiring party's right to control the manner and means by which the product is accomplished.***

The traditional test for whether an individual's is an independent contractor or an employee arises out of common law agency and focuses primarily on the hiring party's right to control the manner and means by which the product is accomplished. Since our artist is the sole employee of the “loanout” corporation and is also the president and sole shareholder, the artist has full control over the manner her product is accomplished.

Although parties contracting for our artist's services such as, movie studios, record companies and publishers may have some control over the artist's works of authorship, those parties are not shareholders, employees or members of our artist's "loanout". This most important element therefore favors the artist.

Based on the common law agency elements presented in *CCNV v. Reid*, the artist is not an employee of his "loanout". Therefore, her creations are not work for hire, and the artist is still entitled to her termination rights.

The fact that an agreement between a "loanout" to the artist contains the phrase "we engage and employ you" or similar language does not necessarily create a for-hire relationship. Moreover, the use of the word "salary" in contracts does not necessarily make it an employment relationship.

3. *The Use Of Corporate Form*

Finally, *Frankel v. Bally, Inc.* although not a copyright case but did use *CCNV v. Reid* as precedent, held that the "corporate form under which a plaintiff did business was not dispositive in a determination of whether an individual was an employee or an independent contractor."

i. ***Frankel v. Bally***

In this case, the Plaintiff, Harold Frankel, worked as a shoe sales representative for defendant employer and was 61 years old. Under the terms of the parties' agreement, plaintiff was referred to as a commission salesman. The Plaintiff then incorporated. Later, the defendant asked all of its sales representatives to enter into a new contract under which they were labeled as independent contractors, but the Plaintiff's duties remained unchanged. The employee was terminated. The Plaintiff sued for age discrimination. The Court of Appeals for the Second Circuit held that whether an individual was an employee or an independent contractor within the meaning of ADEA, federal statute, was to be determined by applying common law agency principles. The court found that the corporate form under which the Plaintiff did business was not dispositive in whether an individual was an employee or an independent contractor.

Since the corporate form under which the artist does business is not dispositive in a determination of employment relationship between our artist to her "loanout", and since such relationship is determined by common law agency principles as mentioned in this paper in the previous section, even *Frankel v. Bally* favors our artist as not an employee, and she therefore, can still exercise her termination rights under section 203. Moreover, in the same way that Frankel did not lose his federal cause of action of age discrimination under the Age Discrimination in Employment Act of 1967 (ADEA), just because he incorporated, our artist should not lose her federal termination right claim under the Copyright Act just because she incorporated in a "loanout" arrangement.

CONCLUSION

Artists and their attorneys need to consider the benefits and risks involved in incorporating in a "loanout" arrangement. Such an arrangement, although beneficial for tax, pension, and other benefits, may cause the artist's works of authorship to be considered as work for hire and the artist may lose her termination rights. The artist may argue that the "loanout" corporation's veil should be pierced because the "loanout" is the artist's alter ego and/or that the relationship between the artist and the "loanout" is not of employer-employee within the meaning of *CCNV v. Reid* applying common law agency principals.