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The Honorable David D. Cortese, Chair
Senate Committee on Labor, Public Employment & Retirement
The Honorable Thomas J. Umberg, Chair
Senate Judiciary Committee
State Capitol
Sacramento, CA 95814

Re: AB 983 (Kalra) – OPPOSE

Dear Chairs Cortese and Umberg:

I write on behalf of the California Music Coalition to urge your Committees and the Legislature to reject California Assembly Bill No. 983 ("AB 983"). As I explain below, there is a significant risk that AB 983 would violate the Contracts Clause of the United States Constitution. The proponents of AB 983 have until recently included in that proposed legislation a provision that would expressly apply the statute not only to contracts entered into after the law's effective date, but also retroactively, to existing artist recording contracts. While the proponents recently amended the text of the draft bill to eliminate the express requirement of retroactive effect, to the extent the bill remains susceptible to being interpreted to apply retroactively, those constitutional defects remain.

Retroactive application of AB 983 would replace huge numbers of existing, heavily negotiated artist recording contracts in the recorded music industry with arbitrary and inflexible statutory provisions. In that scenario, AB 983's provisions would dictate the terms of existing contracts, substantially impair the record labels' rights under those contracts, and upend well-

established legal norms. The proponents of AB 983 have not identified, as they must to justify such retroactive effects, any permissible justification for these unprecedented results. AB 983's retroactive application would thus be unconstitutional. Given this significant constitutional infirmity, I urge the Committees to reject this proposed legislation.

I. INTRODUCTION

The Contracts Clause of the United States Constitution provides that "[n]o State shall … pass any … Law impairing the Obligation of Contracts." U.S. Const. art. I, § 10, cl. 1. It thus "restricts the power of States to disrupt contractual arrangements." *Sveen v. Melin*, 138 S. Ct. 1815, 1821 (2018).[1] "This prohibition is not absolute, but it imposes substantial limits on laws that would undermine existing contractual rights." *Elliott v. Bd. of Sch. Trustees of Madison Consol. Sch.*, 876 F.3d 926, 928 (7th Cir. 2017).

The Supreme Court has adopted a two-step test for determining whether a state law violates the Contracts Clause. *Sveen*, 138 S. Ct. at 1821. The Court first considers the "threshold issue" of "whether the state law has 'operated as a substantial impairment of a contractual relationship.'" *Id.* at 1821–22 (quoting *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978)). Whether an impairment is substantial depends on "the extent to which the law undermines the contractual bargain, interferes with a party's reasonable expectations, and prevents the party from safeguarding or reinstating his rights." *Id.* at 1822; *see also Spannaus*, 438 U.S. at 247 (a statute substantially interfered with existing contractual rights because it "nullifie[d] express terms of the company's contractual obligations and impose[d] a completely unexpected liability in potentially disabling amounts"). A substantial impairment is clear where, as here, the state law would "force[]" an affected party "to make all the retroactive changes in its contractual obligations at one time." *Spannaus*, 438 U.S. at 247.

If the state law substantially impairs an existing contractual relationship, the Court next examines whether the law "is drawn in an 'appropriate' and 'reasonable' way to advance 'a significant and legitimate public purpose.'" *Sveen*, 138 S. Ct. at 1822 (quoting *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 411–12 (1983)). "The State bears the burden of proof in showing a significant and legitimate public purpose underlying the Act." *Ass'n of Equip. Manufacturers v. Burgum*, 932 F.3d 727, 730 (8th Cir. 2019) (quoting *Equip. Mfrs. Inst. v. Janklow*, 300 F.3d 842, 859 (8th Cir. 2002)); *see Energy Reserves Grp.*, 459 U.S. at

[1] The California Constitution similarly provides that a "law impairing the obligation of contracts may not be passed." Cal. Const., art. I, § 9. The California Supreme Court uses the federal Contracts Clause analysis for determining whether a statute violates this parallel provision. *See, e.g.*, *Alameda Cnty. Deputy Sheriff's Ass'n v. Alameda Cnty. Employees' Ret. Ass'n*, 9 Cal. 5th 1032, 1074–75 (2020) (applying the federal doctrine to determine whether the California contract clause was violated).

411–12. "The requirement of a legitimate public purpose guarantees that the State is exercising its police power, rather than providing a benefit to special interests." *Energy Reserves Grp.*, 459 U.S. at 412; *see also Burgum*, 932 F.3d at 730 ("[S]pecial-interest legislation unsupported by a significant and legitimate public purpose" violated the Contracts Clause). The Supreme Court has recognized as legitimate such purposes as "protect[ing] consumers from the escalation of natural gas prices caused by deregulation," *Energy Reserves Grp.*, 459 U.S. at 417, and "[m]ass transportation, energy conservation, and environmental protection." *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1, 28 (1977).

If a state law that substantially impairs existing contract rights lacks a constitutionally permissible public purpose, that law necessarily violates the Contracts Clause. *Energy Reserves Grp.*, 459 U.S. at 412; *see Spannaus*, 438 U.S. at 247 (a state law violated the Contracts Clause where it was not "necessary to meet an important general social problem"). As is particularly relevant here, the Supreme Court for nearly a century has made clear and "reaffirmed that the Contract Clause prohibits special-interest redistributive laws, even if the legislation might have a conceivable or incidental public purpose." *Burgum*, 932 F.3d at 730; *see also Spannaus*, 438 U.S. at 248–49 (a state law violated the Contracts Clause where it could "hardly be characterized … as one enacted to protect a broad societal interest rather than a narrow class").

II. IF APPLIED RETROACTIVELY, AB 983 WOULD VIOLATE THE CONTRACTS CLAUSE OF THE UNITED STATES CONSTITUTION

While the proponents of AB 983 recently amended the bill to eliminate its express retroactivity clause, *see* AB 983 at p. 4, the bill remains susceptible to continued arguments for unconstitutional retroactive application. The surviving language of the bill states that "[a]ny provision in a contract that would deprive an employee or music talent of the protections of this section shall be void." *Id.* This language arguably could be read to suggest that AB 983 would apply to *all* personal services contracts within its terms—including existing recording contracts. But as explained below, applying AB 983 to such existing agreements would violate the Contracts Clause. AB 983 would constitute the kind of "special-interest legislation unsupported by a significant and legitimate public purpose" that violates the Contracts Clause. *Burgum*, 932 F.3d at 730.

A. AB 983's Retroactive Application Would Substantially Impair Record Labels' Existing Contractual Rights

AB 983 contains at least two provisions that, if applied retroactively, would substantially impair record labels' contractual relationships with recording artists.

1. Eliminating Record Labels' Ability to Seek Damages for Breach

First, applying AB 983 retroactively would substantially impair record labels' existing contractual rights by eliminating their right to recover damages when a recording artist breaches

a contract by failing to produce and deliver recordings they agreed to make. *See* A.B. 983 at pp. 1–3. At the same time, this provision would leave recording artists' right to damages untouched. *Id.*

It is a foundational principle of contract law that "[e]very breach of contract gives the injured party a right to damages against the party in breach." Restatement (Second) of Contracts § 346, cmt. a (1981); *see* 3 Samuel Williston, *The Law of Contracts* § 1338, at 2392 (1920) ("[T]he general purpose of the law is, and should be, to give compensation[]—that is, to put the plaintiff in as good a position as he would have been in had the defendant kept his contract."). AB 983 disregards this principle in favor of an indiscriminate rule that would effectively prohibit record labels from being made whole when a recording artist breaches a contract. And this rule is mandatory: AB 983 explicitly provides that any contrary contract "shall be void." AB 983 at p. 4.

Such retroactive elimination of record labels' existing rights to seek damages for contractual breaches would stand in stark contrast to state laws that the Supreme Court has held do not substantially impair existing contractual rights. For example, in *Sveen*, the Supreme Court held that a state law providing that dissolution of a marriage would revoke any designation of an individual's former spouse as the beneficiary of a life insurance policy did not substantially impair preexisting contract rights because (1) it was "designed to reflect a policyholder's intent" and thus "to support, rather than impair, the contractual scheme'; (2) it did "no more than a divorce court could always have done," so it was "unlikely to disturb any policyholder's expectations"; and (3) it supplied "a mere default rule, which [a] policyholder c[ould] undo in a moment." 138 S. Ct. at 1821–22. Here, in contrast, applying AB 983's damages provision to existing contracts would disregard the contracting parties' intent; upend their well-settled expectations; and supply a rigid default rule that the parties would be forbidden to alter. *See* AB 983 at pp. 3–4. It would thus substantially impair record labels' existing contractual relationships. *See Spannaus*, 438 U.S. at 247.

Applying AB 983's damages provision retroactively would wreak havoc on record labels' ability to safeguard their existing contractual rights. *See Sveen*, 138 S. Ct. at 1822 (a law substantially impairs a contractual relationship when it "prevents the party from safeguarding … his rights"). In the event of an artist's breach of the fundamental requirement to make and deliver recordings, a record label would have no way to recover for the expenses it has incurred investing in the artist's career. These expenses, which often are significant, include expenditures for, among other items, artist development, recording costs, and marketing and promotional efforts. Nor could the record label recover lost profits that the label would be able to prove that arise from undelivered albums the artist agreed to provide in exchange for the record label's investment. AB 983 would thus vastly diminish record labels' ability to effectuate their rights under existing recording contracts.

Applying AB 983's damages provision to existing contracts also would undermine the record labels' reasonable contractual expectations. *See Sveen*, 138 S. Ct. at 1822. "The Supreme

Court's decisions under the Contract Clause show that reliance interests are key" to assessing whether a state law substantially impairs existing contractual rights. *Elliott*, 876 F.3d at 934–35 (a state law that "substantially disrupted tenured teachers' expectations about job security" substantially interfered with the teachers' contractual rights). For example, in *Spannaus*, the Supreme Court held that a state law imposing different terms on existing collective bargaining agreements regarding pensions undermined existing contractual rights where the plaintiff "had no reason to anticipate that its employees' pension rights could become vested except in accordance with the terms of the plan" and "relied heavily, and reasonably, on this legitimate contractual expectation" in organizing its affairs. *Spannaus*, 438 U.S. at 245–46. Likewise, in *Burgum*, the Court of Appeals held that a law that required covered parties "to take certain actions, notwithstanding the terms of any contract," violated the Contracts Clause because it "render[ed] unenforceable obligations that that [the covered parties] previously accepted as part of freely negotiated contracts." *Burgum*, 932 F.3d at 730–31.

These and other cases would require the invalidation of AB 983 as applied to existing recording contracts. The record labels entered into their existing recording contracts with the expectation that, in the event of a breach, the labels would be able to seek and recover damages. The labels relied on those rights under existing law when they decided to make significant investments in the artists with whom they contracted. Retroactively limiting record labels' ability to recover damages in the event of a breach would thus interfere with their reasonable expectations and "undermine[] the contractual bargain" that they reached in reliance on the existing statutory scheme. *Sveen*, 138 S. Ct. at 1822.

AB 983's language requiring a breaching artist to return contractual advances for undelivered recordings would not ameliorate the harm retroactive application of its damages provision would create. AB 983 provides that a breaching artist need only repay advances "that are directly and solely related" to undelivered albums. AB 983 at p. 3. That limited partial repayment is not a meaningful substitute or replacement for a record labels' existing statutory ability to seek damages caused by failure to deliver recordings, which could include recovery of investments far beyond cash advances as well as lost profits.

In short, retroactive application of AB 983 would permit a recording artist to sign a recording contract, enjoy the benefits of the record label's investment in their careers, and then refuse to perform until the contractual seven-year period expires—leaving the record label with no meaningful remedy for the albums it was promised in exchange for its investment but did not receive. In so doing, AB 983 would "nullif[y] express terms of the [labels'] contractual obligations and impose[] a completely unexpected liability in potentially disabling amounts." *See Spannaus*, 438 U.S. at 245. It would thus substantially impair record labels' contractual rights within the meaning of the Contracts Clause. *See id.*

2. Requiring Subsequent Album Options to be Exercised Within 12 Months

If applied retroactively, AB 983 also would severely impair record labels' existing contractual rights by requiring a label to exercise a contractual option for additional albums in a multi-record deal within twelve months of an album's commercial release. *See* AB 983 at p. 3 ("A contract for the exclusive personal services of a music talent shall not contain a term that includes option periods that extend more than 12 months after the initial commercial release of the applicable music product.")

In contrast to the extensively negotiated option periods that exist under the current statutory regime, a universal 12-month option period would artificially hamstring record labels' ability to evaluate an artist's commercial performance before deciding whether to make the additional investments required to exercise an option for additional albums. This arbitrary and non-waivable time limit was not in place when the parties entered into their contracts. Yet, if given retroactive application, it would override any provisions to the contrary in existing agreements. *See id.* at p. 4. Thus, like the damages provision, AB 983's arbitrary 12-month option period would "interfere[] with [record labels'] reasonable expectations and "undermine[] the contractual bargain" to which the record labels already agreed. *See Sveen*, 138 S. Ct. at 1822. In so doing, it would substantially impair record labels' existing contractual rights in violation of the Contracts Clause.

B. AB 983 Is Not Appropriately and Reasonably Tailored to Serve Any Purpose, Much Less a Constitutionally Permissible Public Purpose

Because AB 983's retroactive application would substantially impair record labels' existing contractual rights, to pass muster under the Contracts Clause, the statute would have to be "drawn in an 'appropriate' and 'reasonable' way to advance 'a significant and legitimate public purpose.'" *Sveen*, 138 S. Ct. at 1822 (quoting *Energy Reserves Grp.*, 459 U.S. at 411–12). Yet neither the text of AB 983 nor the bill's supporters have identified *any* public purpose for the bill—much less a constitutionally permissible one. *See* AB 983.

What is more, the bill appears to target a small subset of the population: recording artists who wish to terminate their existing recording contracts. This limited focus further demonstrates that applying the bill to such existing contracts would be unconstitutional. AB 983 "can hardly be characterized … as [a bill] enacted to protect a broad societal interest rather than a narrow class." *Spannaus*, 438 U.S. at 248–49. Rather, like the unconstitutional law in *Spannaus*, AB 983 "was not even *purportedly* enacted to deal with a broad, generalized economic or social problem." *Id.* at 250 (emphasis added). Without such a public purpose to justify the bill's extreme effects, applying AB 983 to existing agreements would violate the Contracts Clause.

* * *

If applied retroactively, AB 983 would upend existing legal norms and eviscerate record labels' existing contractual rights—with no constitutionally acceptable justification. In so doing, it would violate the Contracts Clause of the United States Constitution. In view of AB 983's patent constitutional defects, I urge the Committees to reject this proposed legislation.

Very truly yours,

Donald B. Verrilli, Jr.

cc: Honorable Members, Senate Committee on Labor, Public Employment & Retirement
Honorable Members, Senate Judiciary Committee
Cory Botts, Morgan Branch/Senate Republican Caucus