ARTS ARBITRATION & MEDIATION SERVICES

In re

v.

Case No. 15-009

Statement of Decision of Arbitrator

This case arises out of a June 2001 distribution agreement whereby (NM) agreed to manage distribution services for (VRR)'s label. VRR is a rock label. NM in its contract with VRR agreed that Koch "shall" distribute the records of VRR pursuant to a distribution agreement that NM had with Koch. Koch is a major distributor of independent labels--in fact, it is the largest in this class. Koch has the ability to put salesman with product in major chains throughout the USA and Canada. NM was only recently formed before the NM-VRR contract. NM consisted of three experienced principals who had only then a small operation that represented a few music artists/labels. VRR was influenced significantly to go with NM because of NM's April 2001 distribution agreement with Koch. VRR insisted that Koch be mentioned in the NM-VRR agreement to make it clear that Koch was to be the actual "end" distributor, and not someone else.

One month approximately into the NM-VRR deal, Koch said it did not want to distribute VRR records. It informed NM that it did not think the genre of music represented by VRR could be sold. Koch was "adamant" that it did not want to distribute VRR's label. NM then cancelled the agreement it had with VRR in July 2001 on the ground that VRR had failed to disclose that it had been turned down by Koch on a prior occasion or occasions.

With regard to the foregoing facts, I find in favor of as follows, but on grounds other than it asserted for terminating the contract with

1. There was no material misrepresentation that justified rescinding/terminating the agreement with

2. The alleged material misrepresentation was, in effect, that although VRR said it had talked to Koch about distributing its product, VRR did not also disclose Koch turned down VRR. However, the prior rejections were due to the size of VRR, not its genre. The rejection by Koch under the NM-VRR deal was based on genre, not size--a totally different reason. So the failure, if any, of VRR to say it had been rejected earlier for its size would not have apprised NM of the risk that later under the NM-VRR deal Koch would reject VRR because of its genre. Thus, since there is no connection between Koch's earlier action to its later action, it could not be material whether VRR had told NM that it had been rejected by Koch previously.

3. Furthermore, I find there was adequate disclosure. VRR did disclose to NM that it made prior contact with Koch and had not been accepted. That was enough to put NM on notice that there might have been a rejection and it, NM, should investigate if it suspected this could materially affect their VRR-NM contract.

4. Putting that issue aside, we now must determine what is the nature of this music

distribution agreement, and whether the failure of Koch to distribute VRR's label was a failure of a condition or a breach of promise by NM.

4. The contract between NM and VRR provides in paragraph 2(c) that "Distributor [NM] and Company [VRR] agree that all Company's [VRR's] records, consisting of current catalogue .... **shall** be released through Distributor's [NM's] current distribution arrangement with Koch Entertainment Distribution."

5. The word *shall* is generally a word of promise. On its face, this promises that Koch shall distribute VRR's records pursuant to the Koch-NM agreement. Is that what the parties intended? That NM would in essence guarantee Koch's performance? And if Koch refused, that NM would have to pay damages as if Koch should have performed?

6. There is another way paragraph 2(c) could be read. In contracts, one's own performance can be conditioned on the performance of a third party. A condition may be something "to be done .. by a third party." *Murray on Contracts* (1974) § 134 at 273. Here, if despite the appearance of 2(c) as a promise ("shall"), it was actually a condition (namely, Koch would distribute VRR's records), then if that condition failed to occur, NM's duties to perform and support VRR's label would be discharged (excused), as long as NM did not encourage or cause Koch to fail to perform.

7. Is the fact the word "shall" is used in paragraph 2(c) sufficient to show this is a promise and not a condition?

8. A commentator notes that such promissory language is not determinative. In *Murray on Contracts* (1974) § 134 at 274, it states: "It is often a difficult question of interpretation to determine whether a provision in a contract is to be construed as embodying a condition or a promise or both. ***The mere fact that language only appropriate to one or the other type of stipulation has been used is not conclusive since a condition may be found to be implicit in language only appropriate to a promise*** and vice versa."

9. What are the factors to resolve whether paragraph 2(c) is a promise or a condition?

10. *Murray on Contracts* (1974) § 135 at 274-75 provides us an explanation, which in pertinent part reads:

"In distinguishing between promises on the one hand and conditions on the other, the following analysis has proved helpful:
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(2) the purpose of a promise is to create a duty in the promisor, whereas the purpose of a condition is to postpone a duty in the promisor;

(3) when a promise is performed, the duty is discharged; but where a condition occurs. the quiescent activity is activated; and

(4) when a promise is not performed, a breach of contract occurs and the promisee is entitled to damage."

11. So using these factors, the testimony and surrounding circumstances reveal that:

(a) NM was not intending to ***promise*** that Koch would be the distributor so that if Koch failed, NM was assuming the obligation to guarantee that performance. One reason why that is true is that NM could not promise Koch's performance because its own deal with Koch gave NM no right to insist that Koch distribute a particular label that NM represented. Also, had the contract really intended this "shall" as a guarantee of Koch's performance by a new small company like NM, we would expect to see some language to limit or qualify the guaranty in some way. The reason for this is that the contract was drafted by NM, and VRR made no changes other than to insist Koch be the end distributor, and it had a right to back out if Koch terminated with NM. The fact a small company like NM gave no importance to what VRR now is arguing to be a major promise suggests NM did not view this provision as a promise that it guaranteed Koch's performance. NM had all the leverage *vis-a-vis* VRR to limit or protect itself had it understood that it was assuming such a large obligation. The fact it did not do so indicates it did not view this provision as a guarantee that Koch would perform. Rather, it understood its duties to manage distribution would not begin in earnest until Koch distributed VRR's product. NM would then earn a commission for having introduced VRR to Koch, and in return handle accounting services. All those substantive duties depended on Koch's performance.

(b) The contract expressly contemplated that if Koch was not involved that VRR could terminate. The contract provides that in the event Koch terminated the deal with NM, VRR could opt out of the VRR-NM contract. While there was no similar clause expressed in NM's favor, this clause in favor of VRR proves that VRR was excused if Koch did not perform, so it follows that NM should be excused if Koch likewise did not perform;

(c) Applying test (3) above from *Murray on Contracts*, had Koch performed, then under the VRR-NM contract this did not operate to discharge NM's duties by itself. In other words, had Koch performed, then the major duties of NM would have just begun (*e..g.*, to manage the label, do accounting, etc.) Until Koch performed, NM had nothing of substance to perform under its VRR-NM contract. Thus, these facts tend to show Koch's performance was a condition to NM's substantive duties.

(d) Applying factor (4) from *Murray on Contracts*, the contract does not appear to provide that if Koch rejected a label and did not perform that NM is in breach. Rather, NM's duties were written in light of an assumption that Koch would perform. This tends to show it was just assumed that Koch would perform, and no language one way or the other was put in to handle the situation of who was responsible if Koch refused (except the termination clause for VRR's benefit, which likewise supports finding 2 (c) was a condition). Thus, optimism apparently explains why a contingency was omitted that discussed what would happen if Koch rejected a label. Contrary to Mr. Boyd's expert declaration, the omission of such a contingency provision does not somehow show NM must be responsible for Koch's unexpected decision. The contractual silence on this issue merely indicates that Koch's

performance was taken for granted, not that it was being guaranteed by NM.

Thus, the weight of all these factors indicates that Koch's performance was a condition of NM's substantive duties, and that NM did not assume the obligation to guarantee that Koch would perform.

12. Finding therefore that Koch's performance of distribution services under the NM-Koch contract was a condition of the NM-VRR contract, and since that condition failed, NM is excused from performing (absent circumstances discussed below). As *Murray on Contracts* states:

> "Thus, breach of a promise gives rise to a cause of action whereas failure or nonoccurence of a condition does not give rise to a cause of action." *Murray on Contracts* (1974) § 134 at 273.

13. NM could still be in breach if it did anything to encourage that condition to fail (*i.e.*, Koch to not distribute), or did not use good faith efforts to make the condition of Koch's performance occur. For example, if NM failed to ever submit VRR's label to Koch, then it could not use Koch's non-performance to post-pone its duties under the contract. NM would then be held liable for damages based on a duty to perform the contract as if Koch had received and *accepted* the contract, but only if there were a reasonable basis to believe Koch would have accepted the distribution. *See*, *Jacobs v. Tenneco West, Inc.* (1986) 186 Cal.App.3d 1413, 1416 (if third party's acceptance is condition precedent to duty, and defendant failed to even submit to third party to approve the contract, then the condition of approval is excused but the plaintiff must still show the third person would have approved had it been submitted to it).

14. *Restatement of Contracts* provides: "Where a party's breach by non-performance contributes materially to the non-occurrence of a condition of one of his duties, the non-occurrence is excused." *Rest.2d Contracts*, § 245, p. 259.)

15. However, the evidence here is that NM did make efforts to have Koch perform. It submitted VRR to Koch. This is amply proven by VRR's being actively engaged with Koch's staff prior to Koch backing off from distribution. Then after Koch made its decision, NM tried to find out more information but Koch was closed lip about the situation. And Koch's explanation was not so inherently weak that NM could foresee it could turn around Koch's decision by means of persistent negotiation. So when NM decided to send a termination letter, it appears NM had exhausted what reasonable and good faith steps were necessary to have the condition occur. Thus, it does not appear the failure of Koch to pick up this VRR label to distribute was due to any neglect or bad faith on NM's part.

16. In sum, the failure of Koch to distribute the VRR label was a failure of a condition precedent to NM's duties, and NM did not do anything to contribute to Koch's failure to distribute. Thus, NM's substantive duties under the NM-VRR contract never came into existence and no cause of action lies.

It is hereby found that take nothing from

The question of costs should be resolved by reference to the laws of

Dated: November 22, 2002

Douglas J. Del Tondo, Esq., Arbitrator