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Practical Considerations for Reviewing Entertainment Agreements in M&A Transactions

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With content distribution methods evolving rapidly, major players within the entertainment industry are looking to mergers and acquisitions (M&A) as a means to strengthen their position and maintain market share. Industry insiders predict a continued increase in M&A activity within the entertainment sector. In light of the likelihood that entertainment companies may be presented with an M&A opportunity, either as a buyer or as a seller, it would serve entertainment companies well to prepare for such an opportunity.

An essential part of any M&A transaction is the due diligence process, which allows a buyer to confirm key information about the seller. A buyer can use the information obtained during the due diligence process to make an informed decision whether to finalize the transaction and/or whether any modifications to the deal need to be made to address issues that may have been revealed. The seller can also benefit from the due diligence process, as the process can function as a way to confirm that the seller can agree to the representations, warranties and other deal terms required by the buyer.

Certain provisions in existing contracts are always closely scrutinized during the due diligence process and entertainment-related contracts are no exception. However, entertainment agreements often pose unique issues that buyers and sellers should be mindful of when reviewing agreements in connection with a proposed M&A transaction.

Party to the Agreement: While it may seem simple, the first question that should be answered when reviewing an agreement in the due diligence process is, “what entity is party to this agreement”? The answer to this question will assist in determining whether the rights to the assets a buyer intends to purchase (whether by way of a merger, stock purchase, asset sale, etc.) are actually owned by the entity being acquired or whose assets are being acquired.

If a transaction involves the acquisition of the assets or equity of a parent company, the fact that assets are held at a subsidiary level will likely not result in a material issue. However, if a subsidiary entity is the target, it is possible that certain rights might sit within a different entity that is not part of the transaction. A common scenario in which this may occur is when most of the rights to a specific piece of content are owned by one entity, but the distribution rights to such content are owned by another. If the rights that are to be acquired are owned by entities not part of the transaction, internal assignments of those rights should be included as a condition to closing the transaction.

Assignment: In the M&A context, an assignment of an agreement from a target company to a buyer is required to transfer such agreement to an entity other than the existing target company. An anti-assignment provision typically provides that a party may not assign the agreement without the consent of the other party. Assignment provisions may provide specific carve-outs to a counterparty's right to consent to the assignment of the agreement, such as a change of control transaction or an assignment to an affiliate. Typically in the event of a stock acquisition or merger, an anti-assignment provision will not be applicable, as the agreement will remain in the name of the existing target company. However, anti-assignment provisions may be drafted so that they also implicate a merger or equity transaction (i.e., by specifying that a merger is deemed an assignment).

Even if assignment is permitted under the terms of an agreement, frequently entertainment agreements will provide that following an assignment the assigning party will remain secondarily liable to the other party, unless such assignment is to a major studio, distribution platform, or similarly financially responsible third party that assumes the assigning party's obligations under the agreement in writing.

Change-of-Control: As with assignment provisions, there is also a wide range of provisions restricting change of control. Common examples of what constitutes change of control for such provisions include change of ownership, sale of all or substantially all of a target company's assets, or change in a majority of board members. These provisions provide counterparties with various rights upon the announcement or consummation of a proposed M&A transaction, including termination rights and consent rights. Of particular note for production services agreements (PSAs), a change of control of a target company is frequently included in the list of events that trigger a studio's production takeover rights.

Back-End Participations: As studios accelerate initially releasing content on their owned and operated platforms, agreements related to such content increasingly contain provisions pursuant to which key above-the-line talent receive adjusted compensation depending on whether the film opens in theaters, on platform or both. Typically this compensation is a "back-end buyout" of the talent's ongoing right to participate in revenue generated by the project. It is also not uncommon for a modified adjusted gross receipts, adjusted gross receipts or net proceeds definition to contemplate the ability to "buy-out" talent following an M&A transaction. In such a scenario, the "buy-out" amount will be a portion of the transaction purchase price, calculated in a variety of ways. The ability to buy-out a participant's back-end participation may be particularly attractive for a buyer that wants to limit ongoing obligations post-transaction.

Key Individuals: Often entertainment agreements, particularly PSAs, specifically require the services of a particular individual. If these services are not provided, the party that is obligated to provide such services may be in breach of the Agreement, or the party's attachment to the project could be impacted. If an individual's ongoing participation in a project has implications for the project going forward, the parties should discuss whether that individual will continue with target company post-transaction and, if not, whether consent or a waiver should be obtained from the counterparty to the agreement at issue.

Content Restrictions: It is not uncommon for PSAs with a network and/or streamer to contain a restriction on a production company's ability to create similar content while engaged by the network or streamer. These provisions are also often applicable to a production company's affiliates, which would include a buyer and their affiliates following a transaction. If a buyer has or plans to have projects that are similar to the projects of a target company, close consideration should be given to any restrictions that might impact the buyer’s existing and future projects.

While this note highlights selected key provisions to review in existing agreements during an M&A process, it can also serve as a road map for entertainment companies in negotiating agreements to avoid terms that may raise a red flag for potential buyers. In addition to the specific provisions discussed above, given the unique and industry-specific structure of entertainment agreements, any buyer pursuing entertainment M&A opportunities should be prepared to undertake a significant due diligence process and make modifications to the transaction to address the findings of such due diligence.

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