Coronavirus and Content: The Impact of COVID-19 on the Development, Financing, Production, and Exploitation of Media Content.

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Coronavirus and Content

Force Majeure

In connection with the development, production, financing and distribution of content, we find ourselves in uncharted territory where most of the foregoing has been impacted by the COVID-19 pandemic, "social distancing" measures and varying degrees of government-enforced quarantines. As a result, the entertainment community is turning to a customary provision found in industry agreements: "Force Majeure".

What is the principle of force majeure and does it relate to the current, global, COVID-19 pandemic? Force majeure refers to a situation where an unforeseen event, beyond the control of the impacted party, prevents the impacted party from performing its obligations under an agreement. In this memorandum, we will examine: (i) whether COVID-19 is likely to be covered under the scope of a contractual force majeure event, and, if it is covered, how you can invoke force majeure protections in connection with the development, production, financing and exploitation of content; (ii) what your fallback option is if you cannot rely on force majeure protections (either due to the fact that COVID-19 is not covered by the contractual scope of the force majeure definition or because the contract is silent as to force majeure); and (iii) what steps you should take to best protect yourself moving forward.

Development

If you currently have projects in development, first, you will need to check the terms of your underlying rights agreements, whether it be an option purchase agreement, writer agreement or attachment agreement, to see if you can extend your current option, attachment or writing periods in connection with the content in question due to a force majeure event. Ideally, your agreement will specify that the current option / attachment / writing period is automatically extended without notice for the duration of any force majeure events. It may, instead, say that you have the right to suspend or extend the option / attachment / writing period by written notice for the duration of the force majeure event (or a shorter time period, at the discretion of the affected party). Further, you should check whether your agreement gives you (or your counterparty) the option to terminate if the force majeure event lasts for a certain prolonged period of time as set out in the agreement (usually, in excess of six months).

If, for some reason, your agreement does not provide for force majeure extension, it would be advisable to paper an extension to the option /attachment / writing period with respect to the relevant content.

Production

The impact of COVID-19 on physical production of content is self-evident; the closure of public places and limitations on work and travel mean that production services providers are being forced to stop all activities. Further, talent risks either being incapacitated from the illness itself or physically limited in their ability to perform writing, acting or directing services. The following addresses both the impact on physical production and individual services.

Production Services

If you are a production company engaged to produce and deliver content, you will need to know whether you can suspend and/or terminate your production services for force majeure. In terms of suspension, you should check whether your production services agreement (PSA) provides you with the right to suspend the production services not just for the duration of the force majeure event but also any additional period of time that might be reasonably required to prepare to resume production (at the production company's discretion).

Conversely, if you are the entity hiring the production company, you will want to ensure that your payment obligations to the production company are likewise suspended (although you will still likely be liable for any outstanding payments that have accrued up to the date you suspend the production services). You will also want to ensure that your agreement requires the production company to immediately exercise all of its suspension rights under all of its third party contracts with production personnel unless you say otherwise; the entire web of production agreements needs to be suspended.

With the temporal impact of COVID-19 still uncertain, most PSAs provide that if a force majeure event continues for a period of four consecutive weeks or more, or an aggregate of six weeks or more, then you have the right to terminate the production services. Most PSAs will provide that a force majeure event will relieve a production company of a breach or default under the PSA due to its inability to perform its production services. This means that the production company is not automatically in breach if it fails to deliver the content it is obligated to deliver where events, outside of its control, have stopped it from doing so.

As a result, and similar to development agreements, parties will have to wait for any suspension period to expire before they can terminate. As the company engaging a production services company, you should ensure that the PSA makes it clear that, upon termination following a suspension period, you will be released and discharged from any further obligations to the production company, other than the obligation to pay the production company for its production services rendered and for any other costs set out in the budget

and cash flow schedule which were due and payable at the time services were suspended.

In connection with ancillary production agreements (location, licenses, usage, clearances, etc.), these agreements can vary significantly, and only rarely provide for force majeure event protection, so it's important to review each of these agreements with an attorney to determine whether the agreement contains appropriate protections.

Talent and Crew

If you are a content producer, whether or not you can suspend (and potentially terminate) the services of your cast and crew in light of the current COVID-19 crisis is of the utmost importance.

As to illness (caused by COVID-19 or otherwise), most agreements will provide that the relevant talent's services are suspended during any period of illness or incapacity (note that this also falls within the potential coverage of production and/or essential element insurance which should be explored with legal counsel, particularly regarding the insurability of losses caused by COVID-19). You will also need to verify that you have the right to terminate the applicable agreement if the talent fails to render material services because of such illness or incapacity for a prolonged period (e.g., if the person in question is ill or incapacitated for ten consecutive days or fourteen days or more in the aggregate) so that you may replace the actor before production is interrupted for too long a period, assuming that production is otherwise able to proceed as normal.

As for talent services more generally, you will need to look to the relevant services agreement to see whether you are entitled to suspend for the period of the force majeure event and/or terminate, if necessary, after a prolonged period of force majeure (typically eight weeks or more but this period may differ from agreement to agreement). Note that the right of termination is potentially a "two-way street"; talent may also have the right to terminate in the event of a prolonged period of force majeure to pursue other projects.

If talent is pay-or-play (meaning the talent's fixed fee is guaranteed regardless of whether or not you terminate his or her services), there should be a carve-out in the agreement providing that the artist's incapacity (for prolonged illness) or an event of force majeure nullifies a pay-or-play provision so that the artist is only paid for services actually rendered up to the date of the force majeure event or illness. You should also check whether principal cast or director agreements contain any stop dates beyond which the cast or director can no longer work on the production needing to move on to other commitments (even though those other commitments are likely also to be pushed). You may be able to negotiate an agreement with talent to keep themselves available later in the year to come back to your stalled project but this is obviously likely to come at a price.

Financing

Typically, the terms of a loan and security agreement require the content producer, as borrower, to notify a lender of a force majeure event interrupting production, post-production and/or delivery of the collateral in question (i.e., the underlying content). At such time, the lender will customarily have the right to require the borrower to enter into any agreement it requires to protect its funding and the collateral that secures its loan (i.e., the underlying content and its ability to earn revenues).

Ultimately, if the borrower (producer) has been forced to suspend production due to COVID-19, the suspension is likely to be an event of default under its loan agreement(s). It may be, however, that the event of default language is drafted in such a way that it is only an event of default if the suspension will materially and adversely affect the lender's ability to be repaid and its security interest in the content intellectual property.

With respect to COVID-19, if it were clear that the pandemic was set to peak and subside within a definitive period of time and that production could then resume unaffected, it is possible that the borrower would be able to persuade a content financier not to call on the event of default and demand repayment of its funding. That being said, any loan agreement is likely to also contain a more general event of default provision which triggers repayment where an event or condition exists which, in the good faith business judgment of the lender, is an event of default or could have a material adverse effect on the borrower's ability to complete and

deliver the content and repay the funding under the loan agreement.

The nature of the entertainment industry as a relationships-based business that should pick up when the virus subsides means that most lenders are aware that pulling the plug on an investment and demanding repayment from a borrower is not necessarily the best course of action; particularly since the borrower is unlikely to be able to repay the sums borrowed upon an event of default. As such, parties will most likely work together to determine the best path forward rather than force a foreclosure.

An equity investor who usually only has recourse to a project's revenues that are not hived off to repay debt financiers, will be heavily dependent on the project being completed and delivered and assumes the larger portion of the risk for the project being completed, particularly in connection with a force majeure event.

Where financiers have required a Completion Guarantee for a project, the terms of that guarantee will become relevant. As the Completion Guarantor is required to guarantee completion and delivery of the project to any sales agent or third party distributors, those delivery dates should be contractually subject to extension for events of force majeure. If any cast member on the project is also an essential element, there may also be an essential element force majeure event where that cast member is incapable of rendering services on the project before the completion of principal photography of the project. Most Completion Guarantors should have ensured at the time of contracting that there was sufficient cushion between the date the producer is required to complete and deliver the content to the Completion Guarantor and the outside delivery date by when the content is to be delivered to the sales agent and/or the distributors. The cushion should include a ninety-day extension for force majeure. If production is delayed by beyond three months, the agreements will need to be amended to reflect the additional delay.

In the worst-case scenario that a project has to be abandoned before it is completed, the financing documentation should provide that all unspent monies and insurance recoveries are returned to the investors in the project pro rata on the basis of their respective investment. A Completion Guarantor will have the right to elect to abandon the production by sending an abandonment notice to the beneficiaries under the Completion Guarantee. Subject to the terms of the relevant Completion Guarantee, the Completion Guarantor will be required to call on its insurance and refund the investments in the project to those investors who are beneficiaries under the Completion Guarantee. If there is no Completion Guarantee for the project or the Completion Guarantor is not yet on the hook because the financing paperwork has not yet been finalized, funders face the very real scenario that their bridge or pre-production funding spent to date will have to be written off. This is the case even if production is re-started later in the year, as duplicate funds will be needed to gear the production up again to the point it had reached when it was forced to stand down.

Distribution

As a content producer, you will need to ensure that if you have to stop or suspend production then you will not be in breach for failing to deliver on time (or at all) to third parties. Similarly, sales agents or distributors, awaiting delivery from content producers, who may have in turn entered into agreements with exhibitors, OTT platforms, broadcaster channels or any other distributor for the project will need to ensure that if the content producer fails to deliver to them that they are not automatically in breach of their agreements with those third parties down the chain. Again, it will depend on the scope of the force majeure provisions in the distribution agreements permitting the delivery date to be delayed by the period of any event of force majeure. The distribution agreements should also contain the mutual right to terminate in the event of a prolonged force majeure period, if, on the one hand, the producer knows it will never be able to deliver the project to the sales agent or distributor, or, on the other hand, the distributor wants to be released to be able to pursue distribution of other projects (and to have any minimum guarantee that it has paid for the project returned to it). As a distributor, you will want to know how long the force majeure event or delivery delay can go on for before you are able to terminate.

Is COVID-19 a "force majeure event"?

Assuming that you have the requisite contractual rights to suspend and/or terminate if a force majeure event occurs, the next question is whether COVID-19 qualifies as a "force majeure event". The first step is to analyze the force majeure

event definition in the relevant contract. A standard definition will include a litany of events outside of the contract parties' control that would prevent them from performing under the relevant contract such as labor strikes, acts of god, floods etc. We discuss below the treatment of force majeure event definitions by courts in New York and California.

New York

In New York, a force majeure event definition should specify the event preventing a party's performance expressly.[1] Courts interpret force majeure clauses narrowly and expect parties to delineate the scope of force majeure in their contracts.[2] If your force majeure event definition specifically includes "pandemic", "disease", "epidemics" or, "quarantines", for example, then as the non-performing, impacted party you should be excused from performance in connection with COVID-19.[3] To illustrate, a content producer that cannot complete and deliver its content on time (or at all) will bear the burden of proving that a force majeure event has occurred, that COVID-19 is covered by the term "pandemic" in the contract and that it has tried to perform the contract despite the occurrence of the force majeure event.[4]

If, however, your force majeure definition does not specify the above events expressly, then you might argue that COVID-19 is covered by certain other terms within the listed events such as an "act of god" or a "natural or public disaster" or "governmental mandate". Failing that, your definition may be open-ended including "other events beyond the control of the impacted party" which might capture COVID-19. If you are seeking to argue that COVID-19 was an event outside of the control of the impacted party, then it will all turn on whether or not the event was foreseeable.[5] It is a question of timing; hinging on whether you knew COVID-19 existed at the time you entered into the relevant contract. If it is determined that COVID-19 is not covered by your force majeure definition then, unless you can rely on the doctrines of frustration or impossibility (as discussed below), you will not be excused from performance and you will have to perform the contract (and will be in breach if you do not do so), even if COVID-19 renders it impossible or more challenging for you to perform. In those circumstances, if possible, negotiating a fair and equitable solution to share the loss that works for all parties impacted would be the best solution.

California

Similarly to New York, if the contract parties have specified the particular event in the force majeure definition then the party seeking to rely on the definition should be excused from performance and a court will not need to look into whether or not the event was foreseeable by the contracting parties. If the event has not been specifically set out, the event must be unforeseeable at the time of contracting to qualify[6]. The court will read a reasonable control component into all force majeure provisions in a contract; this means that you must act in good faith not to cause the force majeure event and you must be diligent in taking reasonable steps to ensure performance.[7] California courts, like New York courts, construe force majeure events narrowly; if you have not specifically listed "pandemic", "quarantine" or like terms, it is more difficult to rely on general, catch-all wording. The courts are likely to favor the party that is not claiming force majeure in that instance.

How should you invoke force majeure?

First, if you are able to show that COVID-19 was covered by the relevant force majeure definition, you will also need to show that despite the fact COVID-19 is inhibiting your capacity to perform, you could not have performed the agreement or overcome the issue through any alternative means. If you could have produced the content but for COVID-19, which is likely, then you may be able to rely on force majeure as an excuse for not performing under the relevant agreements. In California, for example, to invoke a force majeure clause you need to show that, in spite of skill, diligence and good faith on your part, performance became impossible or unreasonably expensive.[8]

Secondly, you will need to show that you complied with any notice requirements in the applicable contract i.e., that you notified the counterparty that a force majeure event had occurred and that you provided the level of detail required by the contract. A court is unlikely to excuse your failure to notify the counterparty even if all the other above elements for relying on a force majeure event to excuse non-performance are in place.

Thirdly, you will need to show that you have tried to mitigate the impact of the force majeure event (i.e., you have diligently tried to end the failure to perform or delay and to minimize the effects of COVID-19).

[1] *Phibro Energy, Inc. v. Empresa De Polimeros De Sines Sarl*, 720 F. Supp. 312, 318 (S.D.N.Y. 1989).
[2] *Reade v. Stoneybrook Realty, LLC,* 882 N.Y.S. 2d 8, 9 (1st Dep't 2009) and *Belgium v. Mateo Prods., Inc.*, 29 N.Y.S.3d 312, 315 (1st Dep't 2016).
[3] *One World Trade Ctr., LLC v. Cantor Fitzgerald Sec.,* 789 N.Y.S.2d 652, 655 (Sup. Ct. N.Y. Co. 2004).
[4] *Phillips P.R. Core, Inc. v. Tradax Petroleum Ltd.* 782, F.2d 314, 319 (2d Cir. 1985).
[5] *Rochester Gas and Elec. Corp. v. Delta Star, Inc.,* 2009 WL 368508, at *8-10 (W.D.N.Y. Feb. 13, 2019).
[6] *Free Range Content, Inc. v. Google Inc.,* 2016 WL 2902332, at *6 (N.D. Cal., May 13, 2016).
[7] *Oosten v. Hay Haulers Dairy Emp. & Helpers Union*, 45 Cal. 2d 784, 789-90.
[8] *Jin Rui Group, Inc. v Societe Kamel Bekdache & Fils S.A.L.*, 621 Fed Appx. 511 (9th Cir. 2015).

What if your contract is silent on force majeure?

New York

If your contract says nothing about force majeure, then a court would look to the common law. In New York, the common law defense of frustration of purpose might apply to COVID-19. Frustration of purpose can be invoked when it is still possible for a contract to be performed but the contract ceases to provide a party with the benefits that induced that party into making the bargain in the first place because of intervening, unforeseeable events.[9] Frustration of purpose requires the contract to lose its value to a party entirely. It is not enough that a contract is simply less profitable than contemplated or that performance might cause one party to incur a loss for the doctrine to apply.[10] The court should apply the frustration of purpose doctrine if the unforeseen event has frustrated the original purpose for entering into the contract so that it makes little or no sense to continue performing under the contract. This will depend on whether the purpose of your content-related agreements has become so frustrated that it is nonsensical to force the parties to continue to perform.

California

In California, the doctrine of frustration of purpose likewise applies where the performance of a contract no longer makes sense because of an intervening, unforeseeable event.[11] The doctrine of impossibility is also an option where performance of an obligation is prevented or delayed by an irresistible, superhuman cause (or an act of public enemies of California or the USA).[12] A court will apply either the impossibility or frustration doctrines on the conditions that the event in question has made the duties set out in the contract impossible or impracticable to perform (impossibility) or, as in New York, frustrated the purpose for entering the contract in the first place so that it makes little or no sense to continue performing under the contract (frustration).

Future steps to take

1. Review the relevant contracts (we can help you with this) to determine your rights, obligations and remedies in the event of diseases, epidemics, pandemics, quarantines, and international / national / state / local government ordinances or mandates. Establish any obligations you have to notify any relevant counterparties of a force majeure event.
2. Promptly provide notice of a force majeure event to your counterparties in accordance with the terms of the contracts. If any of the contracts does not specify how quickly you are to respond, then do so timely or promptly. If you fail to do so, this might negatively influence your ability to rely on the force majeure defense.
3. Take and document reasonable steps to mitigate the impact of COVID-19, this will strengthen your force majeure defense.
4. Review the force majeure provisions in any future agreements you enter into to ensure they specifically list diseases, epidemics, pandemics, public health emergency of international concern (as defined by the World Health Organization), national or regional emergency, delays and/or restrictions in travel and transportation, and international/national/state/local government ordinances or mandates.
5. Check your insurance policies to determine whether any force majeure events (including any specific types of force majeure events) are covered or excluded by your insurance policies.

[9] *Profile Publ'g & Mgmt. Corp. APS v. Musicmaker.com, Inc.*, 242 F. Supp. 2d 363, 365 (S.D.N.Y. 2003)).
[10] *Gander Mountain Co. v. Islip U-Slip LLC,* 923 F. Supp. 2d 351, 359 (N.D.N.Y. 2013)).
[11] *Glenn R. Sewell Sheet Metal, Inc. v. Loverde*, 70 Cal. 2d 666, 676 n.13 (1969).
[12] Cal. Civ. Code § 1511(2).

Assistance from Reed Smith Attorneys

As legal issues emerge across the film, TV and other content creation industries in connection with COVID-19, your Reed Smith key contacts can help you to find solutions.

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