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Finding Good Faith and Fair Dealing In Entertainment and Sports Relationships

By Sunny Brenner

Contractual interpretation can be a thorny business. Yet it pales in comparison to the treacherous waters that surround supposed duties nowhere to be found in the language of a contract — and that may never have been negotiated or discussed by the parties. For many entertainment and sports professionals, the most significant and far-reaching of these *implied* duties is the duty of good faith and fair dealing that courts read into every contract. As straightforward as the obligation sounds when described in general terms, it can be vexing to determine what particular conduct it may require in specific situations. What's more, the reported decisions construing the obligation tend to be highly fact-dependent, thus providing only limited guidance.

Promoting Parties' Goals

In theory, the covenant of good faith and fair dealing aims to promote the goals of the contracting parties, as opposed to loftier aspirations. "The covenant of good faith is read into contracts in order to protect the express covenants or promises of the contract, not to protect some general public policy interest not directly tied to the contract's purpose." *Foley v. Interactive Data Corp.*, 47 Cal.3d 654, 690 (1988). But as bland and organic as such descriptions of the doctrine may sound, its application is not always so restrained. Some courts have deployed the covenant to impose *affirmative* duties that the parties could have negotiated but didn't, on the theory that it "not only imposes upon each contracting party the duty to refrain from doing anything which would render performance of the contract impossible by his own act, but also the *duty to do everything that the contract presupposes that he will do to accomplish its purpose*." *Harm v. Frasher*, 181 Cal.App.2d 405, 417 (1960) (emphasis added). Moreover, adversarial proceedings convened to adjudicate claims of a breached covenant have been known to devolve into sweeping examinations of the reasonableness, fairness or decency of the combatants.

Breach-of-contract claims are commonly accompanied by claims of a breached duty of good faith and fair dealing, and it often can be difficult to distinguish between the factual underpinnings of the two causes of action. If properly construed, however, the covenant can play a discrete role in guiding parties' behavior and sorting out their occasional disputes. Indeed, several situations in which the covenant has been invoked in entertainment and sports disputes suggest both distinct rationales for its use and empirical evidence of its focus on issues separate from — though often related to — clashes focused narrowly on express contractual terms.

Entertainment Sees More Than Fair Share

That sports and entertainment transactions have been breeding grounds for claims of abysmal faith and unfair dealing may be traced in part to the proliferation in these industries of sketchy and informal agreements. Such deals — be they oral agreements, deal memos, letters of intent, "agreements in principle," written agreements that use but fail to define terms of art that people in the industry understand in different ways, partially executed agreements, or interlineated long-form agreements — not only tempt fate, they practically invite squabbles about the

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demands of the covenant of good faith and fair dealing. And courts and arbitrators, when presented with incomplete or enigmatic contractual provisions, may seek refuge in notions of good faith and fairness as a means to avoid addressing more daunting questions surrounding the parties' problematic contractual blueprint.

Consider the following example, which is based on a case in which I represented a film-production company against a visual-effects provider. The parties' written agreement required the effects provider to create and deliver "first class digital visual effects" for a major theatrical motion picture. Although the contract contained a fair amount of detail, it provided no guidance about what would constitute "first class digital visual effects" and specified no concrete steps that the effects provider — a novice in the entertainment business — would need to take to put itself in a position to discharge its obligations. The relationship quickly soured when the provider refused to invest in personnel and facilities upgrades; however, the production company didn't terminate the provider until, after chronic failures to deliver the required effects at the expected level of quality during the first phase of post-production, the provider refused to undertake testing that was integral to its ability to proceed with the second and more critical phase. At the ensuing arbitration hearing, much of the evidence centered on what constituted "first class digital visual effects." Reluctant to read into the contract a requirement that the effects provider invest in expensive upgrades, the arbitrators instead based their ruling for the production company on the duty of good faith and fair dealing. Most persuasive to the panel was the evidence that the effects provider, after failing to meet quality specifications, refused to proceed with tests that could have helped raise its performance level. Although, as the effects provider pointed out, the contract did not explicitly require this testing, the arbitrators found that the duty of good faith mandated it under the circumstances.

Another scenario that has provoked disputes about the duty of good faith and fair dealing arises when contracts vest in one party the discretion to act on the other party's behalf, or to approve the work or services of the other party. Decisions have required the party vested with such discretion to exercise it in good faith, even when the express language of the contract gives that party absolute and unfettered discretion. When approval rights are involved, the good-faith obligation typically doesn't open the door for the subjective taste of the party with discretionary authority to be challenged, provided that the party wielding the discretionary axe has been open-minded and decided the issues on the merits.

More stringent standards of review may come into play, however, when one party is empowered to negotiate arrangements with third parties that affect the economic value of the original deal. There have been cases, for example, in which television networks negotiated licensing fees for distribution or syndication rights in successful series' that they owned to affiliated entities, and the creators, executive producers or other profit participants to whom the companies were required to account complained that the deals were below market value and deprived them of the economic benefits that a good faith process would have yielded. In addition to claiming underpayment based on their contractual profit definitions, the participants asserted good-faith-and-fair-dealing claims that brought into play such other issues as the sincerity of any negotiations the network may have had with unaffiliated companies, the openness of its decision-making process and its economic relationships with other arms of the same conglomerate.

Parties in positions to control or heavily influence the benefits their contractual partners will receive may also be targeted with good-faith-and-fair-dealing claims based on allegations that they didn't try hard enough to maximize the economic potential for the dependent parties. An athlete locked into a long-term endorsement deal might complain that the failure of an apparel or shoe manufacturer to feature the athlete in advertising and marketing campaigns or to support products bearing the athlete's name undermined the economic potential of the deal for the athlete and was a product of bad faith. A composer or recording artist may assert that its music publisher has been insufficiently industrious in pursuing and maximizing available revenue streams in which the artist would share. Such claims would seem to push the limits of the concept of good faith and fair dealing, as they would require imposing on one party an affirmative obligation to exercise "best efforts" to maximize the profitability of deals for other parties. Such claims may have greater appeal, however, in instances in which particular contractual language or oral assurances had given rise to reasonable expectations of a high level of diligence.

Yet another species of good faith and fair dealing claim focuses on the period between the conclusion of a term sheet, letter of intent or other preliminary understanding — which may be "nonbinding" in the sense that

no agreement on the substantive terms being negotiated will become enforceable until a more formal contract is reached and/or due diligence is completed — and the closing of a transaction. During this interim period, some courts have suggested that the parties should be seen as having committed to proceed in good faith through the remainder of negotiations and/or the due diligence process. They may not be obligated to conclude the transaction, but they may be forced to defend any decision *not* to proceed with closing as having been reached in good faith.

These scenarios by no means exhaust the situations in which the duty of good faith and fair dealing may be relevant, but they do suggest some lessons for contractual advisors of entertainment and sports clients. Most basically, there should be an appreciation for the tacit requirements that parties deal with their contractual partners in a manner that would later be seen by an objective eye as having been evenhanded and sincere, and that they not take affirmative steps likely to undermine the economic benefits that other parties may reasonably expect to derive from their agreements. Beyond this, counselors should be alert for times when the duty of good faith and fair dealing may require their clients to take affirmative steps that are nowhere spelled out in their contracts.

Good-Faith Steps

The following rules of thumb may help to manage the risks associated with the difficulty of predicting how the covenant of good faith and fair dealing will be applied to particular sets of facts:

- Use the express language of the con-tract as your starting point. Remember that the purpose of the covenant of good faith and fair dealing is to promote the parties' expressly stated goals. But also keep in mind that many courts and arbitrators are likely to be disinclined to impose affirmative obligations — particularly onerous and expensive ones — that could have been spelled out in a contract but weren't.
- Be sufficiently familiar with the par-ties' negotiating history and course of dealing, as well as industry custom, to speak authoritatively to the types of measures that the parties may reasonably be presumed to have contemplated even though they didn't specifically spell them out in the four corners of the agreement.
- Bear in mind that the particular incident or factor that an adjudicator may consider decisive could differ from the events that the parties themselves think are most important or that cause a party to reach its breaking point. And don't assume that, when a trial or arbitration hearing is held several months or years down the road, the facts will seem as one-sided as they may appear at the time the events are unfolding. Contemporaneously document the other side's bad conduct and your client's expectations and understandings about what the contract requires.
- If your client decides to terminate a contract based on a default or repudiation by the other party, be satisfied that the record will enable your client to prove that this extreme step was taken as a last resort. If a party is thinking about terminating an agreement, it often is advisable first to demand performance in writing and seek adequate assurances of the other party's ability and willingness to perform in the future.
- Bear in mind that, irrespective of whether their ultimate decisions are based on a particular fact or a narrow point of law, some courts and arbitrators will conduct a thorough review of the parties' entire course of conduct and dealings with one another, with an eye toward forming an opinion as to which of the parties appears to have been acting more appropriately or in "good faith."
- Be aware that arbitrators often aren't required to follow the law and may base their decisions on considerations of equity and fairness. In those instances, consider such issues as whether the interpretation of the contract that your client is espousing would have obligated the other side to spend far more money than the parties originally contemplated. Although "a person may not escape a voluntarily assumed contractual obligation merely because performance would be more expensive than contemplated," *Ellison v. City of San Buenaventura*, 48 Cal.App.3d 952, 962 (1975), an arbitrator who is free to overlook this legal proposition may be swayed by such evidence.

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