

Alert

Technology & IP Transactions

Contract Drafting and Interpretation of “Affiliate”

By Jeffrey D. Osterman*

In an important ruling, the New York Court of Appeals recently held that use of the term “affiliates” in a contract includes only those affiliates in existence at the time the contract was executed, absent explicit language demonstrating that the parties intended to bind future affiliates of the contracting party to the contractual obligations. The Court’s decision in *Ellington v. EMI Music, Inc.*¹ (“*Ellington*”) is likely to have a significant impact on the way contracts under New York law should be drafted and interpreted. To avoid misinterpretation, contracts should be express as to whether future affiliates are intended or not intended to be captured in the term “affiliates.” Though it is still too early to tell how broadly the Court’s holding will be applied, including the extent to which it will apply to fact patterns that are not identical to those in the case, this majority holding should now be considered the law in New York.

The New York Court of Appeals Decision

The agreement at issue in *Ellington* was a 1961 United States copyright renewal agreement between Edward Kennedy “Duke” Ellington and Mills Music, Inc. (now EMI). The heir and grandson of Duke Ellington commenced a breach of contract action to recover royalties allegedly due under a royalty provision contained in the agreement. The preamble of the agreement defined the “Second Party” to the agreement as “American Academy of Music, Inc., Gotham Music Service, Inc., and their predecessors in interest, and any other affiliate of Mills Music, Inc.”² The agreement assigned the copyright interests in certain musical compositions by Duke Ellington to the Second Party, requiring that the Second Party renew the copyrights on behalf of Duke Ellington and make certain royalty payments. The royalty provision required that the Second Party remit 50% of net revenue actually received by the Second Party from foreign publication of the musical compositions. At the time the agreement was executed, there were no foreign subpublishers affiliated with EMI. However, EMI later became affiliated with multiple foreign subpublishers. Following an audit of EMI, plaintiff discovered that EMI’s affiliated foreign subpublishers were retaining 50% of the royalties generated from foreign sales of the Duke Ellington compositions and the remaining 50% was then being split between EMI and the Ellington heirs (such that the EMI group of companies was, collectively, retaining 75% of “at source” proceeds). Plaintiff filed suit for breach of contract and fraudulent concealment, claiming

that by using affiliated foreign subpublishers and accounting for royalties in this manner, EMI was “double-dipping” into the revenue generated from foreign sales and “diluting” plaintiff’s share of the royalties.³

The New York Supreme Court (the lower court) held that the contract’s use of the term “affiliates” included only those affiliates in existence at the time that the contract was executed.⁴ The Appellate Division affirmed, stating that the agreement’s definition of “Second Party” did not include foreign subpublishers that were not in existence or affiliates of Mills Music/EMI at the time of contract.⁵

The New York Court of Appeals evaluated whether the phrases (1) “net revenue actually received” in the royalty provision, and (2) “any other affiliate” in the definition of “Second Party,” were ambiguous. The Court held, “[a]bsent explicit language demonstrating the parties’ intent to bind future affiliates of the contracting parties, the term ‘affiliate’ includes only those affiliates in existence at the time that the contract was executed.”⁶ In analyzing the parties’ intent under the agreement, the Court stated that (i) the use of present tense language, and not forward looking language, in the agreement demonstrated the parties’ intent to bind only affiliates in existence at the time of the agreement, and (ii) the use, in a later clause, of the confirmation that “Mills Music, Inc., American Academy of Music, Inc., and Gotham Music Service, Inc., or any of their predecessors in interest or any other affiliated companies of [EMI] not specifically mentioned, *were and are now* possessed of and are entitled to the original copyright of the [relevant] musical compositions”⁷ was probative of an intent to limit application to then-current affiliates. The Court stated that “[a]s the affiliated foreign subpublishers do not acquire a United States copyright to the relevant compositions, the parties likely would not have intended them to be members of the Second Party.”⁸ Holding that the term was clear and unambiguous, as the intent of the parties could be found within the contract, the Court affirmed the lower court’s holding.

The New York Court of Appeals holding had the support of four of the seven justices. A fifth justice

concurred in the result but rejected the majority’s interpretation of the term “affiliate.” Justice Smith stated, “it seems wrong to me that, when a contract is written to bind ‘any ... affiliate’ of a party, its effect should be limited to affiliates in existence at the time of contracting. That invites parties to create new affiliates, and to have them do what the old affiliates are prohibited by the contract from doing.”⁹ The concurrence further stated, “if the facts of this case were a bit different, I very much doubt that the majority would give ‘affiliate’ such a restrictive reading.”¹⁰

Two justices dissented, stating that the contract contains “unclear and contradictory language which renders the term ‘affiliate’ ambiguous.”¹¹ Citing Black’s Law Dictionary, the dissenting opinion defined “affiliate” as a “corporation that is related to another corporation by shareholdings or other means of control; a subsidiary, parent, or sibling corporation”¹² and further stated that it should be considered an open question whether the parties intended to include foreign affiliates in the contractual arrangement since “the purpose of the Agreement, as well as the custom in the music industry, support [Ellington]’s interpretation.”¹³ Deciding that Ellington’s interpretation seemed at least as reasonable as EMI’s, the dissenting justices stated that the proper interpretation should not have been decided by the Court on a motion to dismiss.

In the final sentence of the dissenting opinion, the justices highlighted the potential for abuse of the majority’s interpretation of “affiliate” where a corporate party may creatively reconfigure to avoid the contractual understanding of the parties.

Holding Ramifications

The holding may surprise practitioners because many agreements do not define “affiliates” with forward looking language to expressly capture future affiliates and the potential for gamesmanship, given such a default interpretation seems dangerous. For example, when a contract includes a non-compete which applies to “affiliates” of a party, if not explicit, this non-compete may not bind future subsidiaries or parent companies of the party subject to the non-compete.

However such issues were clearly not lost on the concurrence and dissent.

This case impacts all contracts that use the term “affiliate,” including provisions related to releases, license grants, non-competes, and assignment/change of control. It is worth noting that the context of the term may play a role in a court’s interpretation. The use of the term “affiliates” appeared in the *Ellington* agreement in the preamble as defining the party to the agreement, which may imply a fixed universe of entities and did not necessarily lend itself to an expansive reading. However, this point was not highlighted by the Court so it should not be relied on as a distinguishing factor given the clear wording of the majority’s holding. The Court did demonstrate that it would engage in a fact-specific inquiry to determine the parties’ intent in drafting.

For newly drafted agreements under New York law, clients and drafters of such agreements should be thoughtful about whether “affiliate” is an explicitly defined term and how it is defined. Additionally, when reviewing existing agreements, they should remember the rule set out by the *Ellington* Court, its potential application, and the resulting implications of such an interpretation.

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1. *Ellington v. EMI Music, Inc.*, 24 N.Y.3d 239 (2014).
 2. *Id.* at 242.
 3. *Id.* at 243.

4. *Ellington v. EMI Music Inc.*, 33 Misc. 3d 1209(A), 939 N.Y.S.2d 740 (Sup. Ct. 2011) judgment entered, (N.Y. Sup. Ct. Dec. 7, 2011).
5. *Ellington v. EMI Music Inc.*, 106 A.D.3d 401, 964 N.Y.S.2d 141 (1st Dept. 2013).
6. *Ellington*, 24 N.Y.3d at 246. The New York Court of Appeals relied on a 2nd Circuit holding in *VKK Corp. v. Nat’l Football League*, which states that “affiliates,” as used in an agreement to release past, present, and future claims against Member Clubs of the National Football League, includes only present club members of the NFL and was not intended to release clubs that become new members after the date of the release. “Nothing in [the Black’s Law Dictionary] definition indicates the inclusion of future rather than present members.” 244 F.3d 114, 130 (2d Cir. 2001). The Court applied the doctrine of *expressio unius est exclusio alterius*—“to express or include one thing implies the exclusion of the other, or of the alternative,” stating that the NFL and its member clubs were sophisticated commercial actors who specifically referenced “past, present and future” claims in the release and could have explicitly included future member clubs but did not. *Id.* at n.12.
7. *Ellington*, 24 N.Y.3d at 247 (citing Agreement ¶¶ 5 [emphasis added]).
8. *Id.*
9. *Id.* at 248 (Smith, J., concurring).
10. *Id.*
11. *Id.* at 250 (Rivera, J., dissenting).
12. *Id.* at 251 (citing Black’s Law Dictionary [9th ed. 2009]).
13. *Id.* at 252.

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