

Endeavor IPO: Conflicts with Clients and Risk for Investors

Endeavor's Packaging Fees and Content Production Violate Fiduciary Duty and Threaten Its Representation Business

Client representation is a core component of Endeavor's operations; Endeavor purports to represent over 6,000 clients, and its "Representation" segment accounts for 36% of company revenues. However, Endeavor is engaged in several conflicted business practices which led more than 1,400 television and film writer clients to leave the agency in April and prompted the filing of a lawsuit now pending in federal court in Los Angeles.

- "Packaging fees" are payments Endeavor's talent agency negotiates for itself directly from the studios employing its clients. Endeavor leverages representation of its writer clients to negotiate its own compensation, which includes upfront fees, paid out of the production budget of each episode, and a percentage of the TV series' profits, rather than the traditional 10% commission on clients' earnings.

From the WGA lawsuit:

21 9. Packaging fees have created numerous conflicts of interest between
22 writers and WME and the other Agencies, wherein WME and the other Agencies
23 enrich themselves at their writer-clients' expense, in most cases without those
1 clients' knowledge and in all cases without their valid consent. Unlike in a
2 commission-based system, the economic interests of the agents at WME that
3 represent writers and other creative talent are no longer aligned with those of their
4 writer-clients. Rather than seeking to maximize how much writers are paid for their
5 work, WME is incentivized instead to maximize the packaging fee it will be paid for
6 a particular project or program. Further, WME has the incentive to, and does,
7 prioritize the studios' interests over those of its clients in order to protect its
8 continuing ability to negotiate new packaging fees from those studios. Moreover,
9 because WME's packaging fee is generally tied to a show's profits, WME has an
10 incentive to *reduce* the amount paid to writers and other talent for their work on a
11 show. Further, WME seeks to prevent the writers it represents from working with

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¹ Answer and Counterclaim, *William Morris Endeavor Entertainment, LLC v. Writers Guild of America, West, Inc., et al.*, Case No. 2:19-cv-05465 (C.D. Cal. 2019) at ¶ 9.

- The creation of Endeavor Content, which produces film and television projects, is a conflict of interest because it combines a talent agency with an employer of the talent agency's clients within the same company.

From Endeavor's S-1:

Our business involves potential internal conflicts of interest and includes our client representation businesses representing both talent and content rights holders and distributors while our content businesses produce content, which may create a conflict of interest.

Increasingly, we must manage actual and potential internal conflicts of interest in our business due to the breadth and scale of our platform. Different parts of our business may have actual or potential conflicts of interests with each other, including our client representation, media production, events production, sponsorship, and content development businesses. Although we attempt to manage these conflicts appropriately, any failure to adequately address or manage internal conflicts of interest could adversely affect our reputation and the willingness of clients and third parties to work with us may be affected if we fail, or appear to fail, to deal appropriately with actual or perceived internal conflicts of interest, which could have an adverse effect on our business, financial condition and results of operations.

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Endeavor Has Lost 1,400 Television and Film Writer Clients Since April 2019

Endeavor's own S-1 discloses its dependence on clients and exposure to disruption if it is unable to manage conflicts of interest. Its recent loss of 1,400 clients makes clear that these risks are real and are actively disrupting company operations.

From Endeavor's S-1:

Our failure to identify, sign and retain clients could adversely affect our business.

We derive substantial revenue from the engagements, sponsorships, licensing rights and distribution agreements entered into by the clients with whom we work. We depend on identifying, signing and retaining as clients those artists, athletes, models and key brands whose identities or brands are in high demand by the public and, as a result, are deemed to be favorable candidates for engagements. Our competitive position is dependent on our continuing ability to attract, develop and retain clients whose work is likely to achieve a high degree of value and recognition as well as our ability to provide such clients with sponsorships, endorsements, professional contracts, productions, events and other opportunities. Our failure to attract and retain these clients, an increase in the costs required to attract and retain such clients, or an untimely loss or retirement of these clients could adversely affect our financial results and growth prospects. We have not entered into written agreements with many of the clients we represent. These clients may decide to discontinue their relationship with us at any time and without notice. In addition, the clients with whom we have entered into written contracts may choose not to renew their contracts with us on reasonable terms or at all or they may breach or seek to terminate these contracts. If any of our clients decide to discontinue their relationships with us, whether they are under a contract or not, we may be unable to recoup costs expended to develop and promote them and our financial results may be adversely affected. Further, the loss of such clients could lead other of our clients to terminate their relationships with us.

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² Endeavor Group Holdings, Inc. Prospectus, Amendment No. 4 to Form S-1 (Prospectus), filed with the SEC on September 16, 2019, at 35.

³ Prospectus at 34.

Writers Guild of America (“WGA”), has recently terminated its existing franchise agreement, the Artists’ Manager Basic Agreement, with the ATA. The termination became effective April 6, 2019. In the absence of a new, negotiated agreement, the WGA unilaterally implemented a Code of Conduct (the “Code of Conduct”) that includes terms that effectively prohibit packaging deals by agencies and prohibit ATA members or their affiliated companies from producing content. WME has not signed the Code of Conduct. The WGA has instructed its members to terminate writing representation services of any agency (including WME) that has not signed the Code of Conduct and as a result, the agency has received termination letters from a majority of its writer clients for the commissioning of writing representation services (for clarity, notwithstanding such terminations, the Company continues to represent more than 6,000 clients as of the date of this prospectus). The duration of the dispute between WGA and the ATA (including WME) is unknown. Furthermore, the WGA and certain writers have recently filed a lawsuit in state court in California against WME and other talent agencies alleging, among other things, breach of fiduciary duty and unfair competition under California law based on the same issues underlying the WGA’s dispute with the ATA, including the use of packaging deals and connections to affiliate producers. In addition, on June 24, 2019, WME filed a lawsuit in federal court in California against the WGA alleging violations of Section 1 of the Sherman Act. In August 2019, the WGA voluntarily dismissed its state court lawsuit against WME and other talent agencies and instead refiled the claims in that lawsuit as counterclaims to the action brought against it by WME in federal court. The WGA asserts counterclaims of breach of fiduciary duty, unfair competition, violations of Section 1 of the Sherman Act, violations of the California Cartwright Act and RICO, among others. On September 13, 2019, the judge ordered the case to be consolidated with cases brought by United Talent Agency and Creative Artists Agency. The outcome of the dispute, including the commercial landscape that will exist in the future between writers and agents, could have an adverse effect on our business. As with the WGA dispute, any revocation, non-renewal or termination of our or our clients’ franchises or licenses, including but not limited to the Artists’ Manager Basic Agreement, any change in our client representation business’ ability to generate new future packaging revenues or its ability to affiliate with other Endeavor companies that produce content, or any disputed application of, or unexpected change in franchise or licensing requirements (whether applicable to us, our clients or otherwise), could have an adverse effect on our business, financial condition and results of operations.

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Endeavor Is Facing a Federal Lawsuit Over Alleged Illegal Packaging Fees, Price-Fixing Behavior

In August, WGA filed claims in federal court against Endeavor, charging that packaging fees violate fiduciary law, federal antitrust law, and the Racketeer Influenced and Corrupt Organizations (RICO) Act.

- Endeavor keeps updating its IPO prospectus with developments in the WGA’s lawsuit, which is now pending in federal court and alleges that packaging fees represent illegal kickbacks from an employer and racketeering, as well as illegal price fixing under antitrust law.

From the WGA lawsuit:

⁴ Prospectus at 46.

3 of these practices. First, as asserted in Counterclaimants' first through fourth claims
4 for relief, WME and the other Agencies have engaged in unlawful *per se* price fixing
5 and unlawful *per se* group boycotts in violation of the Sherman Act, 15 U.S.C. §1 *et*
6 *seq.*, and the Cartwright Act, California Business and Professions Code §16700 *et*
7 *seq.* Second, as asserted in Counterclaimants' fifth claim for relief, WME's
8 packaging fees violate the fiduciary duty that agents owe to their writer-clients and
9 deprive them of the conflict-free representation to which they are entitled. Third, as
10 asserted in Counterclaimants' sixth claim for relief, WME's breaches of its fiduciary
11 duty to its writer-clients also constitute constructive fraud under California Civil
12 Code §1573. Fourth, as set forth in Counterclaimants' seventh claim for relief, for
13 these reasons, and because the payments made from production companies to WME
14 as part of any package constitute unlawful kickbacks from an employer to a
15 "representative of any of his employees" prohibited by Section 302 of the federal
16 Labor-Management Relations Act, 29 U.S.C. §186(a)(1), packaging fees are an
17 unlawful or unfair business practice for the purposes of the California Unfair
18 Competition Law, Cal. Bus. & Prof. Code §17200 *et seq.* ("UCL"). Fifth, as set
19 forth in Counterclaimants' eighth through eleventh claims for relief, WME's
20 repeated Section 302 violations also constitute an unlawful "pattern of racketeering
21 activity" within the meaning of the Racketeer Influenced and Corrupt Organizations
22 Act, 18 U.S.C. §1962 *et seq.* ("RICO").

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"ESG [Environmental, Social, and Governance] investors need not apply":⁶ Endeavor's Stock Structure Disadvantage Investors

Endeavor's dual-class stock structure gives CEO Ariel Emanuel, Executive Chairman Patrick Whitesell, and affiliates of private equity owner Silver Lake Partners control of most of the company's 20-to-one super-voting shares.⁷

- Dual-class stock structures have been criticized by the Council of Institutional Investors (CII) and others for undermining accountability and increasing risk. CII wrote to Endeavor in July to suggest that Endeavor amend its IPO with a sunset date for its super-voting rights to "mitigate the adverse effects of misalignment between ownership and control."
 - [Letter from Kenneth A. Bertsch, CII Executive Director, to Egon Durban, Endeavor Chairman](#) (June 26, 2019).
 - Mary Leung, CFA and Rocky Tung, [Dual-Class Shares: The Good, The Bad, and The Ugly](#), CFA Institute (Aug. 2018).

⁵ Answer and Counterclaim, *William Morris Endeavor Entertainment, LLC v. Writers Guild of America, West, Inc., et al.*, Case No. 2:19-cv-05465 (C.D. Cal. 2019) at ¶ 17.

⁶ Bernstein Pre-IPO Research, *U.S. Media: Endeavor IPO – not for the faint of heart* (July 9, 2019) at 3.

⁷ Prospectus at 52-53.

- Many experts believe that dual-class stock does not generate long-term returns for public shareholders.
 - Robert J. Jackson Jr., [Perpetual Dual-Class Stock: The Case Against Corporate Royalty, speech given Feb. 15, 2018.](#)
 - Martijin Cremers, et al., [The Life-Cycle of Dual Class Firm Valuation](#) (Dec. 19, 2018).

- Endeavor’s dual-class structure will likely disqualify it from inclusion in FTSE Russell and S&P Dow Jones indices, which Endeavor notes could adversely affect the market price of its Class A common stock.⁸

Endeavor’s Anti-Takeover Provisions Will Ensure Perpetual Control By Current Management

Endeavor’s structure also includes several poison pill measures that are designed to give executives indefinite control over the company:

- The company will have a staggered board with three classes, and the board will have the ability to issue a new class of preferred stock without shareholder approval, the effect of which would likely preclude any attempts to acquire Endeavor that the board does not approve.
- The company will also require a two-thirds supermajority vote to remove directors and, in some cases, to change by-laws or provisions of the company’s incorporation.⁹

These provisions are particularly concerning as the company concedes that its top executives may have conflicts of interest with public investors.

From Endeavor’s S-1:

Messrs. Emanuel’s and Whitesell’s, Executive Holdcos’ and the Silver Lake Equityholders’ interests may not be fully aligned with yours, which could lead to actions that are not in your best interest. Because Messrs. Emanuel and Whitesell, Executive Holdcos and the Silver Lake Equityholders hold part of their economic interest in our business through Endeavor Operating Company, rather than through the public company, they may have conflicting interests with holders of shares of our Class A common stock. For example, Messrs. Emanuel and Whitesell, Executive Holdcos and the

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Articles:

- “Buyer beware: Endeavor IPO offers up a company with huge debt, volatile earnings, says Bernstein,” MarketWatch (July 15, 2019),

⁸ Prospectus at 50.

⁹ Prospectus at 60.

¹⁰ Prospectus at 49.

<https://www.marketwatch.com/story/buyer-beware-endeavor-ipo-offers-up-a-company-with-huge-debt-volatile-earnings-says-bernstein-2019-07-09>.

- “Entertainment Giant Endeavor is going public: 5 things to know ahead of its IPO,” MarketWatch (Sept. 16, 2019), <https://www.marketwatch.com/story/entertainment-giant-endeavor-is-going-public-5-things-to-know-ahead-of-its-ipo-2019-05-31>.
- “Endeavor’s IPO prospectus for dummies: Why the Hollywood player wants you to think it’s a tech company,” Fast Company (May 24, 2019), <https://www.fastcompany.com/90354904/endeavors-ipo-prospectus-for-dummies-why-the-hollywood-player-wants-you-to-think-its-a-tech-company>.
- “Why Endeavor’s IPO Numbers May Not Add Up (Guest Column),” Hollywood Reporter (June 24, 2019), <https://www.hollywoodreporter.com/news/why-endeavors-ipo-numbers-may-not-add-up-guest-column-1219501>.
- “As Endeavor Talent Agency Prepares To Go Public, Investors Are Wary,” NPR (July 4, 2019), <https://www.npr.org/2019/07/04/738791479/despite-internal-drama-talent-agency-endeavor-prepares-to-goes-public>.
- “‘The Numbers Are Fucked Up’: The Endeavor IPO Makes No Sense—Except As A Monument to Ari Emanuel’s Talent,” Vanity Fair (May 31, 2019), <https://www.vanityfair.com/news/2019/05/why-the-endeavor-ipo-makes-no-sense>.
- “WME Threatened to ‘blow up’ the ‘Good Doctor’ deal over packaging fees, showrunner says,” LA Times (July 20, 2019), <https://www.latimes.com/entertainment-arts/business/story/2019-07-20/wme-good-doctor-packaging-fees>.
- “Endeavor Group Holding IPO: What Investors Need to Know,” The Motley Fool (September 25, 2019), <https://www.fool.com/investing/2019/09/25/endeavor-group-holdings-ipo-what-investors-need-to.aspx>.