THE UNRESTRAINED POWER OF VERTICAL INTEGRATION IN THE FILM INDUSTRY AND ITS HARM TO CREATIVES: SHOULD COURTS PLACE LIMITS ON THE STUDIOS ONCE AGAIN?

Comment

I. INTRODUCTION

In 2017, the producers of *The Walking Dead* (*TWD*) filed a multimillion-dollar lawsuit against AMC Studios (AMC).[1] While this is certainly the most high-profile case in recent memory, it is not the first time creatives from a highly successful television show have sued a studio over profits relating to an alleged abuse of vertical integration.[2] Vertical integration has been an issue since the beginning of the film industry[3] and has remained an issue despite studio acquisitions and expansions creating a new industry landscape.[4] The prevailing vertical integration issue may force the industry to restructure once again.

This comment uses the pending *TWD* case as a lens to discuss the current state of vertical integration in the film industry, as well as predict not only how the court will decide the case, but also the repercussions of the decision to the film industry at large. Part II lays the groundwork for the discussion, providing the history of vertical integration in the film industry leading into the modern day. Part III details the background of the currently pending *TWD* suit, the case which forms the core of this analysis, and discusses its significance for the film industry and highlights potential issues that the court may address. Part IV, analyzes the case and predicts the court's decision based on prior film-related vertical integration cases. This article argues that the court should favor Robert Kirkman and the other creatives and explains why AMC should lose due to its arbitrary license fixing. Part IV also discusses the potential consequences of such a decision, which includes studio budget cuts and financial restructuring of the film industry. Part V includes various justifications for the prediction outlined in Part IV, such as the prevention of large studios from taking unfair advantage of creatives for profits that were not agreed upon. Finally, Part VI ends with a warning to read the proposed prediction narrowly in order to effectively balance both the studio and creative interests fairly.

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1. Eriq Gardner, *'Walking Dead' Producers Claim Massive AMC Profits Scam in New Lawsuit*, HOLLYWOOD REPORTER (Aug. 14, 2017, 3:37 PM), http://www.HollywoodReporter.com/thr-esq/Walking-Dead-Producers-Claim-Massive-AMC-Profits-Scam-New-Lawsuit-1029197.

2. *See* Josh Wolk, *David Duchovny Sues Fox Over "X-Files" Profits*, ENT. WKLY. (Aug. 13, 1999, 4:00 AM), http://EW.com/article/1999/08/13/David-Duchovny-Sues-Fox-Over-X-Files-Profits/.

3. *See* United States v. Paramount Pictures, Inc., 334 U.S. 131, 141 (1948).

4. *See generally* Peter Decherney et al., *Are Those Who Ignore History Doomed to Repeat It?*, 78 U. CHI. L. REV. 1627, 1655 (2011) (describing economic evolution and early combinations of film industry).

II. THE DEVELOPMENT OF VERTICAL INTEGRATION IN THE FILM INDUSTRY

A. The Rise of Vertical Integration

Since the birth of film in the late 1800s, vertical integration has had a large presence in the industry beginning with the dominance of Thomas Edison's patented Kinetograph, one of the world's first film cameras.[5] In 1908, as competition from various other film patentees began to threaten Edison's monopoly, he and nine of his competitors formed the Motion Picture Patents Company (MPPC), called the Edison Trust, to assure their control of the industry.[6] By pooling the patents of "film equipment manufacturers, producers, distributers, and theater owners[,]" the MPPC was able to "cut licensing costs" and effectively control the film market in all aspects of production, distribution, and exhibition.[7]

The tight grip of the Edison Trust motivated the disadvantaged independent producers and distributors to start anew in Los Angeles.[8] The intense rivalry between the Edison Trust and the young independent filmmakers in Los Angeles ended in 1915 with the decision in *United States v. Motion Picture Patents Co.*[9] In that case, the Pennsylvania District Court held that the MPPC violated the Sherman Act because Edison and his partners attempted to maintain a monopoly of the film industry through an unlawful restraint of trade.[10] Because the court forced a dissolution of the MPPC,[11] the independents were now able to participate in the first-ever open market of the American film industry.[12]

Yet, it was not long before history repeated itself. The small independents took advantage of the absence of competition in the wake of *Motion Picture Patents Co.* and formed their own studios, including Universal, Paramount, and Twentieth Century Fox.[13] The new studios asserted their dominance in the film industry with different methods than Edison and the MPPC.[14] Using the glitz and glamour of Hollywood to their advantage, the studios utilized the star power of famous actors

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5. Alexandra Gill, *Breaking the Studios: Antitrust and the Motion Picture Industry*, 3 N.Y.U. J.L. & LIBERTY 83, 89–90 (2008).

6. *Id.* at 91–92.

7. Decherney et al., *supra* note 4, at 1649; *see also* Gill, *supra* note 5, at 92.

8. *See* Decherney et al., *supra* note 4, at 1649–50.

9. United States v. Motion Picture Patents Co., 225 F. 800, 812 (E.D. Pa. 1915).

10. *Id.* at 811.

11. *Id.* at 801, 812.

12. Decherney et al., *supra* note 4, at 1650.

13. *Id.*

14. *Id.* at 1650–51.

to force exhibitors to submit to oppressive terms (called block booking) instead of the exclusive contracts Edison relied on.[15]

The system, or as Hollywood called it "the studio system," relied on three factors to maintain exclusive control of the film industry against outside competition: "(1) strong-willed individual leadership; (2) control of talent through exclusive contracts; and (3) merged film production, distribution, and exhibition capabilities."[16] The studio system went unchecked for nearly two decades thanks to the government's close relationship with the film industry.[17] It was not until the end of World War II, when the government no longer needed the film industry to make propaganda films to bolster support for the war effort, that the courts finally had a serious look at the legality of the vertically integrated studio system.[18]

B. The Fall of Vertical Integration

No longer struggling in the midst of the Great Depression but thriving after the economic growth spurred by World War II, the film industry lost the special, sympathetic treatment by the courts that it had previously enjoyed.[19] In *United States v. Paramount Pictures, Inc.*, the government sued the "Big Five" players of the studio system (comprised of Paramount Pictures, Loew's, RKO, Warner Bros., and Twentieth Century Fox) for violating §§ 1 and 2 of the Sherman Act.[20] Section 1 of the Sherman Act states that a contract or conspiracy to restrain trade is illegal,[21] while § 2 forbids monopolization of any part of a trade or commerce.[22]

Much to the studios' surprise, the Supreme Court held that they had illegally restrained trade through a variety of practices including "block booking, clearances, formula deals, franchises, master agreements, runs, pooling, and blind selling."[23] A key practice condemned by the Court, and the one most relevant for *TWD* case analysis, is price fixing.[24]

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15. *Id.*

16. Howard M. Frumes, *Surviving Titanic: Independent Production in an Increasingly Centralized Film Industry*, 19 LOY. L.A. ENT. L.J. 523, 525 (1999).

17. Decherney et al., *supra* note 4, at 1652.

18. *Id.*

19. Gill, *supra* note 5, at 105.

20. United States v. Paramount Pictures, Inc., 334 U.S. 131, 140 (1948).

21. 15 U.S.C.A. § 1 (Westlaw through Pub. L. No. 115-281).

22. *Id.* § 2.

23. Gill, *supra* note 5, at 107.

24. *Id.* at 109.

The Court emphasized that price fixing of any kind is per se illegal.[25] The studios were guilty of creating a vertically integrated price fixing license agreement between the distributor-defendants and exhibitors.[26] The intentions of this agreement were made clear by the words of the Paramount vice-president of distribution when he highlighted the importance of how much an exhibitor charged to exhibit a film: "Because the admission price that he charges determines the film rental that I can earn for my pictures."[27] By deliberately fixing a minimum rental fee to exhibitors, the distributors who made the agreement were getting a larger percentage of money from those rental fees.

The Court also analyzed a competitive bidding decree proposed by the district court to solve price fixing and deter illegal license agreements.[28] The district court's solution required all films to be licensed to exhibitors on a competitive bidding basis to ensure small independent exhibitors would have access to new films.[29] The Supreme Court ultimately rejected the remedy, finding that the test would put too much strain on the courts.[30] The *Paramount* decision required all the studios to divest their interests in exhibition, forever separating the production and exhibition aspects of the film industry and bringing the end of the widely successful studio system.[31]

Studios are still suffering from the nearly sixty-year-old *Paramount* decision. Though the essentials of the film industry, including the financial structure, remained the same, studios lost the guaranteed revenue from exhibition rental fees.[32] In the 1950s, studios began producing far fewer films than they did during the peak of the studio system era (300 per year in the 1950s compared to 750 per year in the 1930s).[33] To attract more filmgoers in the wake of declining ticket sales, studios "resorted to gimmicks like Cinemascope, Cinerama, and 3-D movies," but those methods proved to be ineffective.[34]

With dwindling ticket sales and no exhibition fees to rely on, the studios were forced to adapt; the limits of vertical integration power led

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25. *Paramount*, 334 U.S. at 143 (quoting United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); United States v. Masonite Corp., 316 U.S. 265, 274 (1942)).

26. United States v. Paramount Pictures, Inc., 66 F. Supp. 323, 334 (S.D.N.Y. 1946).

27. Gill, *supra* note 5, at 110.

28. *Paramount*, 334 U.S. at 161.

29. *Id.* at 161–62.

30. *Id.* at 162–63 (explaining that determining the highest bidder is too subjective and requires a thorough case by case analysis of each separate bid).

31. Gill, *supra* note 5, at 118. *See generally Paramount*, 334 U.S. 131.

32. *See* Gill, *supra* note 5, at 120.

33. *Id.* at 119.

34. *Id.* at 120.

to the development of the blockbuster.[35] The high-risk high-reward nature of the blockbuster allowed the production and exhibition sides of the industry to find a way to work together within the newfound limits of vertical integration set forth in *Paramount*.[36] The studios created blockbuster films that attracted large audiences, the exhibitors created multiplexes that were big enough to house the large amount of people that blockbusters attracted in a single showing, and both groups flourished through such relational contracts.[37] The success of blockbusters inspired studios to begin a strategy to reclaim the prosperity they had during the vertical integration dominated era of the industry.[38] This strategy is currently impacting the producers in the *TWD* case today.

C. The Rebirth of Vertical Integration

The late 1960s marked the beginning of Hollywood's transformation into media conglomerates.[39] Studios were either acquired by other companies or began acquiring companies themselves.[40] Going well beyond the vertical integration of film industry in the past, media conglomerates began absorbing many different types of industries because they could afford to hold dominance in multiple markets and interrelate its many strengths.[41] As long as distributors avoided acquiring exhibitors, as banned by *Paramount*,[42] they could acquire any other related entertainment industry. While technically legal, vertically integrated media conglomerates have been highly contested in the television and film industries.[43] For example, in the television industry, a vertically integrated conglomerate can "create and produce the program, broadcast the program on its affiliated network, and then license the syndication of the program to its own cable network."[44] The main benefit of a vertically integrated media conglomerate is that it can control the cost of distribution and

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35. Ryan Riegg, *Opportunism, Uncertainty, and Relational Contracting – Antitrust in the Film Industry*, 6 U. DENV. SPORTS & ENT. L.J. 107, 109 (2003).

36. *Id.* at 143.

37. *Id.*

38. *Id.*

39. Decherney et al., *supra* note 4, at 1655.

40. *Id.* Paramount was acquired by Gulf and Western. *Id.* Disney acquired radio stations, comic book publishers, and television networks. *Id.*

41. *See id.* at 1656.

42. United States v. Paramount Pictures, Inc., 334 U.S. 131, 178 (1948).

43. Matthew Belloni, *Why Do Studios Keep Losing Lawsuits?*, REUTERS (July 8, 2010, 2:50 AM), http://www.reuters.com/article/us-disney-lawsuits/why-do-studios-keep-losing-lawsuits-idUSTRE66715W20100708.

44. Stanton L. Stein & Marcia J. Harris, *Vertically Challenged: Repeal of the Fin-Syn Rules and Vertical Integration Led to a Barrage of Lawsuits by Profit Participants in Television Projects*, 26 L.A. LAW. 30, 30 (2003).

syndication by owning both the licensor and the licensee rights.[45] This allows a studio to charge itself below-market license fees in an effort to create less gross revenue; as a result, studios can pay creatives less (e.g., writers, directors, producers, and actors) based on the lower revenue amount.[46]

It was not until the late 1990s that creatives began suing the studios for lost profits over the self-dealing of vertically integrated media conglomerates.[47] Lawsuits involving the creators of *Home Improvement*, the producers of *Cops*, David Duchovny of *The X-Files*, and Alan Alda of *M.A.S.H.* all had one thing in common: their lawsuits settled before they could go to trial.[48] With no resolution of this relatively recent issue regarding the legality of self-dealing in vertically integrated media conglomerates, the high-profile *TWD* case is an opportunity for the courts to finally address vertical integration in its newest form.

III. *THE WALKING DEAD* 2017 LAWSUIT

A. Judicial Opportunity to Address Vertical Integration

1. *The Walking Dead* Lawsuit

AMC's *TWD* is a popular television show, based on a successful comic book series, that chronicles a sheriff and his motley crew's survival in the wake of a zombie apocalypse.[49] It is currently in its eighth season and continues to be a ratings juggernaut in the television landscape.[50] As with many profitable ventures, the players will eventually fight over how to share the pie.

Frank Darabont, *TWD*'s former showrunner filed a lawsuit in 2013, which laid the groundwork for contesting AMC's self-dealing practices.[51] Darabont's lawsuit, and the vertical integration cases that came before it, involve the same issue as the new *TWD* case: a disagreement over the

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45. *See id.*

46. *Id.*

47. *Id.* at 32. The article lists many lawsuits initiated by creatives including: Langley Prods., Inc. v. Fox Entm't Grp, Case No. BC233041 (Cal. App. Dep't Super. Ct. June 2017); Bochco v. Twentieth Century Fox Film Corp., Case No. BC216801 (Cal. App. Dep't Super. Ct. Sept. 1999); Duchovny v. Fox Entm't Grp, Case No. SC058329 Cal. App. Dep't Super. Ct. Aug. 1999); and Wind Dancer Prod. Grp v. Walt Disney Co., Case No. BC 166377 (Cal. App. Dep't Super. Ct. Mar. 1997).

48. Ross Johnson, *The Lawsuit of the Rings*, N.Y. TIMES (June 27, 2005), http://www.nytimes.com/2005/06/27/business/media/the-lawsuit-of-the-rings.html.

49. *The Walking Dead* [TV Series], ALLMOVIE, https://www.allmovie.com/movie/the-walking-dead-tv-series-v527037 (last visited Mar. 28, 2019).

50. Brandon Davis, *'The Walking Dead' Season 8 Premiere Set to Break a Ratings Record*, COMICBOOK (Aug. 22, 2017), http://comicbook.com/thewalkingdead/2017/08/22/the-walking-dead-season-8-ratings-record-.

51. Trial Order at 1, Darabont v. AMC Network Entm't, LLC, No. 654328/2013, 2018 WL 6448457, at *1–2 (N.Y. Sup. Ct. Dec. 10, 2018).

fair market value (FMV) of contractual profit participation.[52] Before the show began, AMC decided to "produce and broadcast the show in-house" effectively allowing the studio to charge itself whatever license fee it desired.[53] Concerned, Darabont asked AMC to detail the formula it would use to calculate the license fee, but AMC did not provide a calculation until it saw the success of the first season.[54] After realizing *TWD*'s growing popularity, AMC developed a fixed license fee formula, one that would not change based on *TWD*'s future popularity or the length of time *TWD* remains on the air.[55] The fixed fee AMC paid for *TWD* contrasts sharply with the increased licensing fee AMC paid for the less popular *Mad Men*.[56]

Darabont ended his complaint by alleging that AMC fired him before season two to avoid paying him increased profits according to an FMV calculation.[57] Four years later, Darabont and his team are inching closer to an actual trial. A hearing relating to a motion for summary judgement by AMC held in September 2017, by Justice Eileen Bransten, showed that neither side was assured victory.[58]

The $280 million lawsuit by Darabont was now bolstered by the potentially billion-dollar lawsuit brought by Robert Kirkman, the creator of *TWD* comic and a producer on the show, along with various other producers in August 2017.[59] The producers may have been keeping a watchful eye on Darabont's lawsuit because this new lawsuit appears to be ignited by the reveal of a previously unknown license fee formula agreement hidden in documents submitted to the court in July 2017, as part of the Darabont *TWD* lawsuit.[60] The legal documents revealed a modified agreement dealing with an increased percentage of the Adjusted Gross Receipts given to Executive Producer Greg Nicotero,

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52. *Id.* at *11.

53. *Id.* at *3.

54. *See id.* at *2–8.

55. *Id.* at *8.

56. Kim Masters & Matthew Belloni, *Fired 'Walking Dead' Creator Frank Darabont Sues AMC for Profits*, HOLLYWOOD REP. (Dec. 17, 2013, 11:27 AM), http://www.hollywoodreporter.com/thr-esq/fired-walking-dead-creator-frank-666176.

57. Trial Order at 5–6, Darabont v. AMC Network Entm't, LLC, No. 654328/2013, 2018 WL 6448457, at *9–10 (N.Y. Sup. Ct. Dec. 10, 2018).

58. Brian Sternberg, *Lawyers for Frank Darabont, AMC Square Off in Court Over 'Walking Dead' Lawsuit*, VARIETY (Sept. 15, 2017, 11:13 AM), http://variety.com/2017/tv/news/the-walking-dead-frank-darabont-lawsuit-amc-hearing-1202560283/. Justice Branston showed skepticism relating to an argument questioning which legal entity (the network or a separate production unit) was behind the calculation of the license fee. *Id.* She also suggested that both parties "start working on their appeals." *Id.*

59. Dominic Patten & Greg Evans, *'Walking Dead' Lawsuit: Frank Darabont Lawyers Compare AMC Series to Iconic 'ER' – Update*, DEADLINE (Sept. 15, 2017, 1:09 PM), http://deadline.com/2017/09/walking-dead-lawsuit-frank-darabont-amc-caa-profits-summary-judgment-hearing-1202170259/.

60. *Id.*

one of the few producers on the show who did not join either *TWD* lawsuit.[61]

The agreement unintentionally (or perhaps intentionally) gave Darabont and his agency an additional $3 million[62] and gave current *TWD* producers additional profits similar to the increased share Darabont received.[63] Displeased with the additional payout in the modified agreement, executive producers Robert Kirkman, Gale Ann Hurd, and David Alpert joined together with former producers Glen Mazzara and Charles Eglee to sue AMC for nearly one billion dollars.[64]

The current *TWD* lawsuit spearheaded by *TWD* co-creator Robert Kirkman is very similar to the suit filed by Darabont four years ago. The complaint filed with the Los Angeles Superior Court alleges that "defendant AMC Entities exploited their vertically integrated corporate structure to combine both the production and the exhibition of *TWD*, which allowed AMC to keep the lion's share of the series' enormous profits for itself and not share it with the Plaintiffs, as required by their contracts."[65] Similar to Darabont's lawsuit, the current case calls to question whether the cost of the license fee that "AMC Studio" charged "AMC Network" in broadcasting *TWD* is fair where AMC owns both companies and is essentially charging itself without any regulation controlling its discretion.[66]

In his complaint, Kirkman notes the vast difference in licensing fee costs between *TWD*, a show produced and distributed by AMC, and shows such as *Better Call Saul* and *Mad Men*, which are produced by Sony and Lionsgate and are only distributed by AMC.[67] Despite vastly superior ratings, *TWD*'s license fee for the first four seasons was a meager $1.45 million per episode,[68] compared to the first seasons of *Breaking Bad*, *Better Call Saul*, and *Mad Men*, which all started with a

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61. Dominic Patten, *'Walking Dead' Lawsuit: Frank Darabont & CAA Hit AMC Over New Profit Payments — Update*, DEADLINE (July 13, 2017, 12:46 AM), http://deadline.com/2017/07/walking-dead-lawsuit-frank-darabont-amc-caa-greg-nicotero-profit-payments-1202127831/.

62. *See id.* AMC's modified agreement, which gives Darabont and other producers increased profits, was seen by some as a "goodwill distraction." *Id.* AMC hopes the court will consider its newfound generosity to producers when analyzing whether the amount of profit participation is proper under a FMV standard. *Id.*

63. *Id.*

64. Patten & Evans, *supra* note 59. Kirkman filed a lawsuit against AMC three days after signing a lucrative deal with Amazon relating to his own entertainment company, Skybound Entertainment. *Id.* Interestingly, the deal came less than a month after AMC's modified agreement was revealed in the Darabont lawsuit. *Id.*

65. Complaint at 2, Kirkman v. AMC Film Holdings, LLC, BC672124 (Cal. App. Dep't Super. Ct. Aug. 14, 2017).

66. *Id.* at 3.

67. *Id.* at 4.

68. *Id.* at 39.

license fee upwards of $1.75 million per episode.[69] In addition to having a lower license fee than AMC's independently produced shows, AMC "unilaterally took for themselves the right to run an unlimited number of runs of *TWD* in perpetuity on all AMC platforms."[70] In contrast, independently produced shows are broadcast for a fixed number of times before expiring.[71]

Though Kirkman has not estimated how much *TWD*'s license fee will be, Darabont is currently arguing for a $30 million license per episode.[72] Kirkman will likely rely on the "related party provision" in his contract, which is meant to guarantee "that AMC's transactions with affiliated companies would be on monetary terms comparable to transactions with non-affiliated companies."[73] In other words, the license fee must be comparable to that of independently produced shows like *Mad Men* and *Breaking Bad*.[74] Kirkman and the other producers believe that AMC violated its contractual obligations by ignoring the self-dealing protection provision and instead choosing to abuse its vertically integrated conglomerate status.[75]

AMC has defended its actions by downplaying the significance of the lawsuit, claiming that vertical integration lawsuits "are fairly common in entertainment and they all have one thing in common—they follow success."[76] Regarding its substantive defense, AMC argues that the existing license fee is a result of fair negotiations that Kirkman had an opportunity to address prior to signing his contract.[77] Furthermore, using the same strategy it used in the Darabont summary judgement hearing, AMC is attempting to show its generous side to the court by

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69. *Id.* at 39–43; Bryn Elise Sandberg, *'Mad Men': Details of Matthew Weiner's Legendary $30M Deal Revealed in 'Walking Dead' Suit*, HOLLYWOOD REP. (July 14, 2017, 7:09 AM), http://www.hollywoodreporter.com/live-feed/mad-men-details-matthew-weiners-legendary-30m-deal-revealed-walking-dead-suit-1020935. Specifically, *Mad Men* (produced by Lionsgate) started at $1.85 million per episode, *Breaking Bad* (produced by Sony) started at $1.75 million per episode, and *Better Call Saul* (also produced by Sony) started at $2.5 million per episode. These license fees only increased with each subsequent season. *Id.* For example, the seventh and final season of *Mad Men* had a license fee of $4 million per episode. *Id.* Comparatively, the seventh season of the *Walking Dead* has a license fee of only $2.4 million per episode. Gardner, *supra* note 1.

70. Complaint, *supra* note 65, at 43; Gardner, *supra* note 1.

71. Complaint, *supra* note 65, at 43; Gardner, *supra* note 1.

72. Gardner, *supra* note 1. Darabont's attorney justified the large license fee by comparing the show to *ER*, a show that had a $30 million fee due to its immense popularity and high ratings. *Id.* Stressing the value of *TWD*'s record-breaking ratings, plaintiffs argue that the "meager ratings" attracted by shows like *Mad Men* means that the show is entitled to greater license fees than any of AMC's other shows. *See* Sandberg, *supra* note 69.

73. Gardner, supra note 1.

74. *Id.*

75. Complaint, *supra* note 65, at 3. *See generally* Gardner, *supra* note 1.

76. Gardner, *supra* note 1. It is also worth noting that AMC is attempting to treat this case as civilly as possible because Kirkman and a few other producers are still involved in the making of *TWD*. *Id.*

77. *Id.*

giving Kirkman, Darabont, and the other producers a larger share of the profits (though still much less than the multi-millions Kirkman is asking for).[78] And yet, if Justice Eileen Bransten's hearing over Darabont's lawsuit is any indication,[79] both Kirkman and AMC have a long road ahead before either side has victory in their sights.

B. The Significance of The Walking Dead Lawsuit

Vertical integration in the film industry has remained untouched since the Supreme Court's decision in *Paramount*.[80] Still, the industry has evolved since that earthshattering decision. Companies such as Redbox and Netflix have radically changed the state of the television and film industry.[81] The growing sophistication of the internet and the creation of numerous online streaming services has forced the entertainment market to adapt to this newly competitive climate.[82]

One solution for industry players, in the absence of vertical integration of exhibitors as banned by *Paramount*, is the creation of media conglomerates to enable cost cutting and power over multiple aspects of the entertainment industry.[83] This power to budget cut by conglomerates likely helped AMC thrive when it was still trying to gain dominance as a reputable network.[84]

Many creatives have sued media conglomerates for alleged lost profits as a result of self-dealing practices, but very few have actually made it to trial.[85] However, of the shows that have filed suit, none of them have had as wide an impact on popular culture as *TWD*.[86] Kirkman's lawsuit has the potential to bring to light an issue that

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78. Trial Order at 17, Darabont v. AMC Network Entm't, LLC, No. 654328/2013, 2018 WL 6448457, at *35 (N.Y. Sup. Ct. Dec. 10, 2018).

79. Patten & Evans, *supra* note 59.

80. United States v. Paramount Pictures, Inc., 334 U.S. 131, 178 (1948).

81. Ryan Sullivan, *The Rental Epidemic of the Twenty-First Century: A Look at How Netflix and Redbox are Damaging the Health of the Hollywood Film Industry and How to Stop it*, 30 LOY. L.A. ENT. L. REV. 327–28 (2010).

82. Megan Sieffert, *Conception to Distribution: Vertical Integration in the Television Production and ISP Industry*, 6 J. BUS. ENTREPRENEURSHIP & L. 157, 160 (2012).

83. *Id.*

84. James Poniewozik, *Walking Dead?; or Can AMC Afford to Budget-Cut Its Way to Success?*, TIME (Aug. 11, 2011), http://entertainment.time.com/2011/08/11/walking-dead-or-can-amc-afford-to-budget-cut-its-way-to-success/. Evidence that AMC attempted to cut the budget of not only *TWD* but also *Mad Men* and *Breaking Bad*, hints that AMC may not be able to produce as much high-quality content as it does without relying on the power of its media conglomerate. *Id.*

85. *See* Celador Int'l Ltd. v. Walt Disney Co., No. 2:04-cv-3541-FMC-RNFx, 2009 U.S. Dist. LEXIS 133688, at *62–63 (C.D. Cal. Mar. 6, 2009).

86. Jeremy Egner, *'The Walking Dead' at 100: Still a Hit, But for How Much Longer?*, N.Y. TIMES (Oct. 18, 2017), https://www.nytimes.com/2017/10/18/arts/television/the-walking-dead-season-season-8.html. Though the ratings for *TWD* dipped notably in season seven, it still doubles the ratings of its Sunday night competitors. *Id.*

Hollywood has kept hidden from the public spotlight for years.[87] The last major vertical integration case to go to trial was in 2004 and involved the television show *Who Wants to be a Millionaire*.[88] Because the film and television industry has changed so much in the last thirteen years, Kirkman's *TWD* lawsuit has the potential to pave the way for the courts to reevaluate vertical integration within the film industry with the same scrutiny as they did in *Paramount* several decades earlier.

IV. PREDICTING THE OUTCOME OF *THE WALKING DEAD* LAWSUIT

A. Major Issues and Potential Questions to Consider in Studio Vertical Integration

In order to predict how the Los Angeles Superior Court will decide Kirkman's *TWD* case, it is necessary to outline the major issues that are likely to be addressed by the court. It is also necessary to note that because there is minimal case law on vertical integration after *Paramount*, many of these issues have no clear answer and the *TWD* decision has the potential to reshape vertical integration and antitrust standards in the industry.[89]

Likely, the main issue in the case will question whether price-fixing licenses by media conglomerates that own both the production company and the network distributor violate the Sherman Act by illegally restraining trade through unfair contracting.[90] Related to this question is the issue of the standard of fairness that should be required in studio contracts concerning self-dealing practices. For example, are studios free to contract any license fee terms they wish so long as the creatives agree to it, or should studios be subject to standards of good faith to ensure they do not abuse their vast ownership powers to short change creators and producers? Determining what contractual duties studios owe to their employees will affect how the act of self-dealing is seen by the court.[91]

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87. David Ng, *Like a Zombie, Profit Dispute Over AMC's 'The Walking Dead' Refuses to Die*, L.A. TIMES (Sept. 21, 2017, 6:00 AM), http://www.latimes.com/business/hollywood/la-fi-ct-walking-dead-20170921-story.html. Studios attempt to deter creatives from bringing vertical integration cases by inserting arbitration clauses in their contracts, which prevent judicial resolution of the dispute. *Id.* Studios do not want a jury to know what self-dealing entails because it could lead to large judgments against them. *Id.*

88. *Celador*, 2009 U.S. Dist. LEXIS 133688, at *12. In that self-dealing case, the jury awarded $270 million in profits to a producer working for Disney. Andrew Clark, *Who Wants to Be a Millionaire? Producers Wait for Final Answer on $270m Battle with Disney*, GUARDIAN (July 6, 2010, 12:58 PM), https://www.theguardian.com/media/2010/jul/06/who-wants-to-be-a-millionaire-battle-disney.

89. *See* Sieffert, *supra* note 82, at 168–69.

90. *See* 15 U.S.C.A. § 1 (Westlaw through Pub. L. No. 115-281).

91. *See* Marc Simon, *Vertical Integration and Self-Dealing in the Television Industry: Should Profit Participants Be Owed a Fiduciary Duty?*, 19 CARDOZO ARTS & ENT. L.J. 433, 434–36 (2001).

Even if the main issue is solved, the most difficult part will be finding a remedy that will adequately consider the interests of both parties. Producers wish to be fairly compensated for their work, while the studio is interested in using its acquired assets to make projects at an affordable price.[92] Furthermore, while the producer may be disadvantaged by inadequate bargaining power, a remedy that is overreaching could cause an unreasonable strain on a studio that uses self-dealing to make quality programming at an affordable price.[93] Taking these disparate interests into account, how much should *TWD*'s license fee per episode be, and what standard should guide that conclusion?

The final, and arguably most important question the Los Angeles Superior Court needs to answer is: Should there be more limits on studios now that media conglomerates dominate every aspect of the film industry? More specifically, is studio ownership of the production *and* distribution aspects of a single project (effectively giving the studio the power to charge itself as little as it wishes) a strong enough conflict of interest that courts should compel the studio to split its power even further like in *Paramount*? Or is it a natural byproduct of a growing business that creative employees just must endure for the sake of growth and innovation?

These issues and questions will be addressed individually to formulate a potential prediction of the court, using the vertical integration and studio contract case law currently available.

B. Prediction One: The Court Will Rule in Favor of Kirkman

1. License-Fixing Should Not Be Permitted When an Agreement Requires Fair Dealing

The Los Angeles Superior Court will likely rule in favor of Kirkman, finding that license-fixing should not be permitted when the contract explicitly requires a FMV standard. Kirkman's initial complaint shows that his agreement with AMC required license fees to be subject to an FMV standard.[94] Unfortunately, FMV can be a difficult standard to define.[95] In the context of assigning value to license fees, *Celador International, Ltd. v. Walt Disney Co.* can help determine what is deemed "fair."[96]

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92. *See id.* at 434–35.

93. *See* Poniewozik, *supra* note 84.

94. Complaint, *supra* note 65, at 3–4.

95. 1-1 VALUATION HANDBOOK § 1.01 (2017). Kirkman describe FMV as "the result of an arm's length negotiation between unrelated entities." Complaint, *supra* note 65, at 20.

96. *See generally* Celador Int'l, Ltd. v. Walt Disney Co., 347 F. Supp. 2d 846, 846 (C.D. Cal. 2004).

Celador is comparable to the *TWD* lawsuit in that the plaintiff, a producer for *Who Wants to Be a Millionaire*, sued Disney over a contract dispute concerning the FMV of licensing fees.[97] While Disney agreed to license fees comparable to the FMV, it used an imputed per-episode license fee that "could never reach profits after production costs . . . [and] distribution fees were deducted from the gross receipts, thereby ensuring that plaintiff received no profits."[98] Similar to the facts of the *TWD* lawsuit where AMC took more than four seasons to increase the license fee,[99] Disney failed to renegotiate the license fee, despite the fact that the show became highly successful, running for several seasons.[100]

Like Kirkman, the plaintiff in *Celador* sued for breach of contract and breach of the covenant of good faith and fair dealing for the studio's self-dealing practice in relation to fixing license fees.[101] In addition, the plaintiff also asserted a breach of the fiduciary duty created by the existence of a joint venture.[102] A joint venture is formed where there is a common business, an understanding to share profits, and a right to joint control.[103]

The court denied defendant Disney's motion to dismiss plaintiff's claims of breach of fiduciary duty and breach of covenant of good faith and fair dealing.[104] According to the court, a deliberate act that "unfairly frustrates the agreed upon common purposes" of the contract or an act in bad faith constitutes a breach of the covenant of good faith and fair dealing.[105] After the district court denied Disney's motions, the case went to trial, where the jury found that Disney had "cheated" the plaintiff out of 50% of the participation profits.[106]

The appeals court in *Ladd v. Warner Bros. Entertainment, Inc.* upheld a $3.2 million jury verdict against Warner Bros. for disputes over licensee fee profits.[107] The plaintiff sued Warner Bros. for breach of contract and breach of the implied covenant of good faith and fair dealing for deliberately undervaluing plaintiff's films in a license fee

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97. *Id.* at 850.

98. *Id.*

99. Complaint, *supra* note 65, at 4; Gardner, *supra* note 1.

100. *Celador*, 347 F. Supp. 2d at 850–51. The plaintiff argued that it is industry custom to renegotiate if a show becomes more successful. *Id.*

101. *Id.*

102. *Id.*

103. *Id.* (citing Wolf v. Superior Court, 130 Cal. Rptr. 2d 860 (Cal Ct. App. 2003)).

104. *Id.* at 859.

105. *Id.* at 852 (quoting Careau & Co. v. Sec. Pac. Bus. Credit, Inc., 272 Cal. Rptr. 387, 387 (1990)). In *Celador*, the court found that a breach was likely because Disney took actions to prevent the plaintiff from receiving benefits guaranteed by the contract. *Id.*

106. Belloni, *supra* note 43. The jury believed Disney went against the parties' agreement to share profits when it changed the terms of the licensing fees in order to gain more profit. *Id.*

107. *Id.* Around the same time that *Ladd* was decided, a similar case brought by the creators of *Will and Grace* against NBC resulted in a jury verdict of $48.5 million for the creators. *Id.*

agreement.[108] Like the court in *Celador*, the California Court of Appeals found that Warner Bros. owed the plaintiff a duty to fairly allocate license fees based on their "relative value."[109]

The court held that "every contract in California contains an implied covenant of good faith and fair dealing that neither party will do anything which will injure the right of the other to receive the benefits of the agreement."[110] The court noted that the implied covenant is particularly applied when dealing with a party who has the "discretionary power affecting the rights of another."[111] In finding a breach of an implied covenant, the court based its decision on the fact that Warner Bros. assigned films of various quality the same fixed licensing fee, despite some films being more valuable based on their prestige from awards of popularity with the general public.[112]

Another reason the court may favor Kirkman is AMC's use of the notoriously vague practice known as "Hollywood Accounting" to calculate *TWD*'s profit participation agreement.[113] Hollywood Accounting is the method film and television studios use to determine the estimated budgets for film projects.[114] The estimated budgets are then used to judge whether films will make a profit and consequently affect how much writers and actors receive from their profit participation agreements.[115]

Labeling Hollywood Accounting a method is overzealous. The formulas used in Hollywood Accounting do not follow generally accepted accounting principles or reflect market realities; rather, they involve inflating costs to decrease revenue, which lowers the effective royalty rate from profits.[116] This accounting practice causes high-grossing films such as *Harry Potter and the Order of the Phoenix*, which made nearly a billion dollars in box office revenue, to end up accounted as a $167 million loss.[117]

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108. Ladd v. Warner Bros. Entm't, Inc., 110 Cal. Rptr. 3d 74, 78 (Cal. Ct. App. 2010).

109. *Id.* at 81.

110. *Id.* (quoting Kransco v. Am. Empire Surplus Lines Ins. Co., 23 Cal. 4th 390, 400 (Cal. Ct. App. 2000)).

111. *Id.*

112. *Id.* at 81–82.

113. Renee Howdeshell, *Hollywood Accounting: Another Good Reason to Read (and Audit) Your Contracts*, BETWEEN THE NUMBERS (Mar. 24, 2011), http://betweenthenumbers.net/2011/03/hollywood-accounting-another-good-reason-to-read-and-audit-your-contracts/.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

Courts generally do not favor profit participation agreements based on Hollywood Accounting.[118] In *Buchwald v. Paramount Pictures*, writer Art Buchwald sued Paramount for stealing his screenplay treatment to make the film *Coming to America* starring Eddie Murphy.[119] After determining that the stories were similar and that Paramount owed Buchwald damages, the court concluded that the net profit formula used to calculate Buchwald's royalties was unconscionable because the terms were "overly harsh" and "one-sided" resulting in the formula having no connection to "actual costs."[120]

In an effort to prevent "oppression and unfair surprise" where parties have unequal bargaining power, a court may find unconscionability, which will render the terms of the contract unenforceable.[121] This doctrine is especially relevant in studio contracts where a single creative is bargaining with a huge conglomerate.[122] Court rulings such as *Buchwald* and jury trials favoring creatives like *Celador* motivate studios to require mandatory arbitration clauses in actors' and writers' profit participation contracts to prevent their questionable Hollywood Accounting practices from reaching the courtroom.[123]

It is worth noting that the California courts have not always ruled in favor of creatives when it comes to potentially unconscionable contracts. In *Batfilm Productions v. Warner Bros.*, the California Superior Court held that two producers for the 1989 version of *Batman* did not have an unconscionable contract with Warner Bros.[124] However, the court's decision was based on the plaintiffs' failure to bring evidence that showed that overhead costs were arbitrary, rather than a failure to follow the industry standard.[125] As opposed to the producers in the *Batfilm* case, the *TWD* producers can provide evidence of arbitrary accounting inputs—that *TWD*'s profits are inconsistent with prior projects such as *Mad Men* and *Breaking Bad*. Thus, it is likely that Kirkman will prevail.

Using *Celador* and *Ladd* as precedent, the court will most likely view AMC's practices as a breach of the implied covenant of good faith and fair dealing. Kirkman, like the plaintiffs in *Celador*, attempted to contractually protect himself from unfair self-dealing by requiring AMC

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118. *See generally* Lee v. Marvel Enters., 386 F. Supp. 2d 235 (S.D.N.Y. 2005); Buchwald v. Paramount Pictures, Corp., No. 706083, 1992 WL 1462910, at *1 (Cal. Super. Ct. Mar. 16, 1992).

119. *Buchwald*, 1992 WL 1462910, at *1.

120. Ian Brereton, *Beginning of a New Age?: The Unconscionability of the "360-Degree" Deal*, 27 CARDOZO ARTS & ENT. L.J. 167, 187 (2009).

121. *Id.* at 171.

122. *See generally* Eric Strum, *Hollywood Accounting: Profit Participation and the Use of Mediation as a Mode of Resolving These Disputes*, 18 CARDOZO J. CONFLICT RESOL. 457 (2017).

123. *Id.* at 459.

124. Cal. App. LEXIS 1333, at *6 (Cal. Ct. App. Mar. 14, 1994).

125. *Id.* at *8–9.

to determine license fees based on an objective FMV.[126] Similar to the argument in *Ladd*, Kirkman will argue that the prestige and popularity of *TWD* warrants a higher license fees than less popular shows.[127] In addition, because some Hollywood Accounting practices are unconscionable, like in *Buchwald*,[128] Kirkman's argument that AMC's practices constitute unfair dealing that should not be enforced is bolstered. The license fixing made by AMC should be seen as breaching good faith, as the price chosen is arbitrary without a clear standard, and the studio is abusing its vast power to fix prices.

C. *Prediction Two: Kirkman Will Receive Royalties According to an FMV Assessment of The Walking Dead License Fee*

Because Kirkman's contract is silent as to the price of the license fees, the price point should be based on the FMV of the product as was consistently held in *Celador*[129] and *Ladd*.[130] The license fee AMC charged itself was not based on the value of the show, but rather an arbitrary number that has not changed to accommodate the show's increased popularity.[131] As argued by the producers, AMC shows like *Mad Men* and *Breaking Bad* (both of which had comparatively worse ratings than *TWD*) had higher license fees charged to them by independent distributors.[132] Therefore, the court should require AMC to determine *TWD*'s license fee using objective criteria such as the average television rating per episode and the economic value of the show as a whole. Using this objective standard, the license fees will be more representative of the show's success and will give the creators a fair piece of the total profits. This objective standard will also be fair to studios because they will only have to pay higher license fees if the show becomes highly profitable.

D. *Prediction Three: The Court Will Be Restrained in Its Decision, Narrowing the Holding to Apply Only to The Walking Dead Case*

The California Superior Court will most likely limit its final decision to apply only to the case at bar, leaving any industry changing precedent up to the United States Supreme Court. The *Paramount* decision created

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126. Complaint, *supra* note 65, at 4.

127. *Id.*

128. Buchwald v. Paramount Pictures, Corp., No. 706083, 1992 WL 1462910, at *1 (Cal. Super. Ct. Mar. 16, 1992).

129. *See* Celador Int'l, Ltd. v. Walt Disney Co., 347 F. Supp. 2d 846, 852 (C.D. Cal. 2004).

130. *See* Ladd v. Warner Bros. Entm't, Inc., 110 Cal. Rptr. 3d 74, 82 (Cal. Ct. App. 2010).

131. Complaint, *supra* note 65, at 39–40. *See generally* Sternberg, *supra* note 58.

132. Gardner, *supra* note 1.

a new era of business within the film industry,[133] but that decision was built on decades of prior case law.[134] Vertical integration, as reimagined by media conglomerates, is still a relatively new model[135] and will only continue to present new problems.[136] A decision affecting the entire industry—that is the source of two million jobs and $43 billion in revenue[137]—should not be taken lightly. By focusing on objective criteria, the Superior Court can avoid favoring one group (creatives) over the other (the film industry). Nevertheless, the California Superior Court's holding will be a valuable first step for the Supreme Court to reference whenever the issue of vertical integration in the film industry eventually resurfaces.

E. Potential Consequences of the Predictions

1. Potential Consequences for *The Walking Dead*

A ruling in favor of creatives will require AMC to pay millions of dollars in unpaid license fees according to a FMV standard. While creatives may be pleased with the result (and will be willing to continue working on the show), this result may negatively affect the show. Higher overhead costs could cause AMC to find that producing *TWD* outweighs the benefits of the show, which could lead to a significant budget cut or cancellation of the show entirely.[138]

However, a ruling in favor of the studios could have an equally negative effect. Many of the creatives instrumental to the show may resign, causing a creative restructuring of *TWD* with new showrunners. This restructuring will impact the creative and potentially quality of the program as a whole.

2. Potential Consequences for the Film Industry at Large

A victory for creatives could open the door for numerous other license fixing law suits. Studios like AMC and Disney that own both the

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133. Riegg, *supra* note 35, at 109.

134. *See, e.g.*, United States v. Motion Picture Patents Co., 225 F. 800, 811 (E.D. Pa. 1915); Fed. Trade Comm'n v. Paramount Famous-Lasky Corp., 57 F.2d 152, 159 (2d Cir. 1932); Glass v. Hoblitzelle, 83 S.W.2d 796, 797 (Tex. Civ. App. 1935); Hughes Tool Co. v. Motion Picture Ass'n of Am., Inc., 66 F. Supp. 1006, 1014 (S.D.N.Y. 1946).

135. *See* Ahmed E. Taha, *Controlling Conflicts of Interest: A Tale of Two Industries*, 37 LOY. U. CHI. L.J. 753, 756–57 (2006); *see also supra* Part II.C.

136. Josh Spiegel, *Why Disney Fans Should Be Concerned About the Fox Deal*, SLASH FILM (Dec. 18, 2017), http://www.slashfilm.com/disney-fox-deal-concerns/.

137. Jobs and the Economy, MOTION PICTURES ASS'N OF AMERICA, https://www.mpaa.org/jobs-economy/; *see also* David Robb, *U.S. Film Industry Topped $43 Billion in Revenue Last Year, Study Finds, But It's Not All Good News*, DEADLINE (July 13, 2018), https://deadline.com/2018/07/film-industry-revenue-2017-ibisworld-report-gloomy-box-office-1202425692/.

138. *See generally* Poniewozik, *supra* note 84 (illustrating the lengths AMC will go to cut budgets to save money).

producing and distribution aspects of a film may have to pay larger license fees to creatives. Consequently, studios may be less willing to take on riskier projects if they cannot offset those risks with lower license fees. If the type and quality of programming is negatively affected because studios are forced to reallocate their budget and resources, consumers will be disappointed and eventually disinterested in the films.

On the other hand, creatives would be more adequately protected in negotiations. They will have a concrete idea of the amount they should expect in license and royalty fees. This added protection will empower creatives and give them greater leverage against the media conglomerates, putting them in more equal bargaining positions.

3. Potential Consequences for the Legal World

If this outcome comes to fruition, the courts will have some guidelines on how to address the issue in future cases. A large influx of cases will be brought by other creatives, giving many courts the opportunity to shape their guidelines further and address other issues of vertical integration besides licensing fees. With more cases being tried, courts may be more willing to place greater limitations on studios to prevent abuses of power.

V. JUSTIFICATION FOR THE PREDICTIONS

While the results of the predictions may seem far-reaching, it is currently necessary to set boundaries on the film and media industry, like in *Paramount* all those years ago.[139] A ruling in favor of AMC would send the message to studios that they can keep monopolies in the media industry and continue to cut costs at the expense of creators.[140] Favoring creatives will give them added protection against the much larger studio conglomerates during negotiations. Conglomerates, unlike individual creators, have the resources to compensate adequately.[141] As integral players in film creations—a main source of studio revenue—creatives are entitled to a fair portion of the studio's profits.

The unjust actions of the studios, including intentionally fixing prices low to pay creators less than they contracted for, should not be endorsed. While smart business practices should be encouraged, they should remain fair to creatives. Public policy dictates that a business should not succeed by acting in bad faith.[142]

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139. *See* United States v. Paramount Pictures, Inc., 334 U.S. 131, 140 (1948).

140. *Id.* at 174.

141. Anup Shah, *Media Conglomerates, Mergers, Concentration of Ownership*, GLOBAL ISSUES (Jan. 2, 2009), http://www.globalissues.org/article/159/media-conglomerates-mergers-concentration-of-ownership.

142. Ladd v. Warner Bros. Entm't, Inc., 110 Cal. Rptr. 3d 74, 81 (Cal. Ct. App. 2010).

VI. CONCLUSION: A WARNING AGAINST OVERREACHING

The pending *TWD* case has the potential to change how film studios control their shows through vertical integration. The decision will have significant industry wide consequence no matter the outcome. But a ruling in favor of creatives is justified based on the studios' bad faith by intentionally fixing low prices below FMV. This ruling will set the parties in a more equal bargaining posture, rather than expand the already ballooning power of media conglomerates at the expense of the much weaker individual creator.

However, because of the impact such a ruling could have, the court should narrow its holding to encompass only the issue of license fixing. The new vertical integration structure accomplished by the creation of media conglomerates has resulted in a flourishing film industry. A complete dismantling of this structure could have vastly negative consequences, such as requiring a complete restructuring of finances and production work in the industry similar to what occurred after *Paramount*. Therefore, claims related to vertical integration should be addressed on a case by case basis, considering the interests of the parties and the industry at large. In some instances, a studio may have a greater interest concerning vertical integration where license fees play no part, which may warrant a ruling in favor of the studio. But as far as the *TWD* case is concerned, AMC should abandon its arbitrary license fixing method to adequately compensate the creatives to whom they owe so much of their studio's success.

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