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Client Alert: *The Walking Dead*: Is AMC’s License Fee “Improper” and “Outrageous”?

By Ezra Doner*

What is a fair deal between a captive TV production company and a network parent? That may depend on who you ask.

In a pending lawsuit, writer/director Frank Darabont, creator of mega TV series *The Walking Dead*, along with talent agency Creative Artists Agency, claim that AMC Entertainment and affiliates artificially lowballed license fees via a “sweetheart deal” between related companies. The alleged result of this arrangement was to shift profits from AMC Entertainment, which the plaintiffs would share, to AMC Networks, which they wouldn’t share, leaving the series hopelessly in deficit¹.

Darabont and CAA claim the related company license fees are “improper”, “outrageous”, “abusive” and “unconscionably low”.

Below, I analyze certain of Darabont and CAA’s related company claims. But first, a look at the customary TV production / distribution scenario.

Production Companies and Networks

In the typical scenario, a television production company (Prodco) contracts with a showrunner (a series originator such as Darabont) to create and produce a TV series. Compensation to the series creator typically includes fixed fees, paid from production budgets, plus contingent fees (a/k/a revenue participations) which are a percentage of series revenues.

If the TV production company is a standalone company, unaffiliated with the network or other end user of the series, then the participation interests of a series creator such as Darabont are aligned with those of the Prodco. A standalone Prodco would want to license the series to the highest bidder, because the more revenue the series generated, the more revenue for the creator and the Prodco to share.

¹ *Darabont et al v. AMC Network Ent. et al*, No. 654328 (NY Sup. Ct. 2013)

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Captive Production Company

But what if the TV production company isn't a standalone but, rather, is affiliated with and controlled by a TV network, so that the Prodco can't sell the series to the highest bidder? In other words, what if the Prodco is a captive production company? In that scenario, the Prodco is typically not a separate profit center but, instead, a stand-in for the network. In that case a creator such as Darabont or a packager such as CAA can find themselves directly in conflict with the network over calculation of network license fees.

That's what is alleged in this litigation.

Plaintiffs Frank Darabont and Creative Artists Agency

Plaintiff Frank Darabont, the creator of *The Walking Dead*, together with series packager CAA, claims just such a captive relationship and resulting misalignment of interests. The case is still in the discovery phase, the plaintiffs have not proven their claims, and the defendants have denied the truth of the claims. But a close reading of the complaint is a useful guide to the pitfalls of the production and licensing arrangement used by the AMC defendants for this series.

Darabont Develops *The Walking Dead*

The Walking Dead, which is set amidst a zombie apocalypse, started out as a black and white graphic novel by Robert Kirkham initially published in 2003. Frank Darabont, the acclaimed writer/director of such films as *The Shawshank Redemption* and *The Green Mile*, brought the property to NBC, which commissioned him to write a pilot episode but, ultimately, did not proceed to series. Darabont then took the project to AMC, the formerly sleepy classic movies channel originally known as American Movie Classics, which, thanks to *Mad Men* and *Breaking Bad* (both produced by independent TV companies), had become the hottest network on basic cable.

AMC and Darabont reached agreement in general terms and, while Darabont began revising the pilot script, AMC began preparing an agreement. The draft agreement provided for a revenue participation to Darabont of up to 12.5% of profits of an unaffiliated company that AMC would designate. But after receiving Darabont's new work, AMC decided instead to produce the series via an affiliated rather than an unaffiliated company.

Imputed License Fee

Because AMC's captive arrangements called for its affiliated production company to produce the series for the AMC Network, the Prodco would not be putting the project on the market to objectively establish a license fee. So how would the license fee be set?

Per allegations in the complaint, AMC was permitted to "impute" a license fee on "monetary terms comparable to the terms on which [AMC] enters into similar transactions with unrelated third party distributors for comparable programs." In other words, the license fee was to be set at fair market value.

The Profits Definition and Actual License Fee

The above language of the agreement established the principle of fairness, but lacked a mechanism to put it into effect. The net profits exhibit which AMC subsequently provided, however, set the related companies' license fee as a percentage of production cost at a level that Darabont and CAA allege is "unconscionably low" and has "no regard for what AMC or any network would pay in an arms' length agreement for the right to broadcast such a comparable highly successful series."

Multiple Choice Question

What is the percentage of production cost at which AMC allegedly set the imputed license fee?

- A. 90%
- B. 65%
- C. 33⅓%
- D. 10%

The Answer

The percentage is B – 65%. But, per the complaint, at the time the net profits exhibit, including the 65% license fee, was first circulated, the first season finale had already aired and the series was a certified hit. Moreover, the imputed license fee was capped at \$1,450,000 per episode (with 5% bumps in subsequent seasons), leading to an effective rate well below 65%. Finally, the fee arrangement was also perpetual, and didn't provide an opportunity for a re-set at the end of the fourth season which would have been customary in an arm's length license.

At the end of season two, AMC's accounting to Darabont showed no profits, but instead a loss on the series of \$55 million, rising to \$71 million when interest and overhead are factored in. The plaintiffs highlight these numbers to show the economic unreality of the related party arrangements.

The Future of This Lawsuit

To be clear, evidence has not yet been presented or tested in this case, by way of a motion for summary judgment or a trial. The plaintiffs have also made other claims, among them, that Darabont was wrongly fired as executive producer in the second season, to avoid the vesting of certain valuable contract rights. So I have no view as to the merits or the likely disposition of the dispute. But if the allegations are sustained, AMC may well want to change its practices (and indeed, may already have) so that it specifies related company license fees earlier in the contracting process. Because if you are the network and you're late, you may end up with a license fee or profit calculation set by a jury. See my Client Alert at <http://www.donerlaw.com/client-alerts/?p=18> regarding the profits of reality TV phenomenon *Who Wants To Be A Millionaire*. In that case, the jury did indeed make the plaintiffs millionaires – 320 times over!