Antitrust Argument – Lenhoff v. UTA – Economic Viewpoint

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I. Per Se Violation

The District Court argued that:

To state a claim for a per se violation of the Sherman Act, Plaintiff must sufficiently plead that Defendants (1) entered into an agreement (2) to fix prices or divide the market. *Id.* Here, Plaintiff alleges that the Big 4 Agencies "are engaged in horizontal price-fixing." (SAC ¶¶ 73, 84, 116.) However, Plaintiff provides no factual details other than this conclusory statement. (*Id.*) Without more facts, such as the parties who engaged in the price-fixing or when the parties entered into the agreement, Plaintiff fails to sufficiently plead a per se Sherman Act violation. *See Kendall v. Visa USA, Inc.*, 518 F.3d 1042, 1047 (9th Cir. 2008) ("[T]o allege an agreement between antitrust co-conspirators, the complaint must allege facts such as a 'specific time, place, or person involved in the alleged conspiracies' to give a defendant seeking to respond to allegations of a conspiracy an idea of where to begin."

Order on Motion to Dismiss at 7.

Response:

A) Ubers have market power

The Big 4 Agencies control over 95% of the market for scripted television shows. As of the 2015-2016 season, the Herfindahl-Hirschman Index (HHI), one of the metrics used to measure market concentration by the Department of Justice (DOJ), equaled approximately 2,711.[1] This figure is well above the 1,800 threshold where the DOJ states, *Where the post-merger HHI exceeds 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise*."[2]

By 2015-2016, the Big 4 Agencies ("Ubers"), packaged 434 of the 454 shows, for a total of 96% of total show packages. Of these, 121 shows were co-packaged. Every co-package included at least one Uber. Despite the fact that 43 agencies serve this market, not a single co-package was completed without the participation of at least one Uber agency in the last two television seasons. In other words, non-Uber agencies cannot participate in co-packaging independently of Uber Agencies because of the latter's market power.

B) Ubers charge a common price

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[1] Declaration of Ted Tatos at 5.

[2] https://www.justice.gov/atr/15-concentration-and-market-shares The DOJ also notes that "*The presumption may be overcome by a showing that factors set forth in Sections 2-5 of the Guidelines make it unlikely that the merger will create or enhance market power or facilitate its exercise, in light of market concentration and market shares*."

Uber Agencies not only charge a different price than non-Ubers, but they also use a different pricing system all to themselves. While most talent agencies operate on a commissions-based payment system, Uber agencies charge a packaging fee, which raises the price to the studios and reduces output by restricting the budget available to the talent to produce a television show. Both outcomes are anti-competitive. Uber agencies follow a standard package fee model of "3-3-10." The Uber agency receives 3% of the license fee of the show, 3% of the budget of the show, and 10% of the "back-end", the revenues when the show is sold into syndication. Uber Agencies all charge the same package fee with little or no divergence from the set price. The smaller agencies charge 10% commission of the talent's income, and can compete against each other on the percentage they charge. In other words, the Uber agencies charge a percentage of the total show's budget, both on the front end and the back-end, while the smaller agencies only charge a commission on the individual talent (writer, etc.)'s salary. The following shows an example.

Suppose we have the following scenario, based on Meredith Stiehm's arrangement for the show she wrote, Cold Case:

Front End		**Amount/Pct.**
Package Fee/Episode to CAA	A	$75,000
Percentage to CAA	B	3.0%
License Fee Amount	C=A/B	$2,500,000
License Fee Percentage	D	60.0%
Show Budget/Episode	E=C/D	$4,166,667
Stiehm Pay/Episode	F	$50,000
Commission % if no CAA Package	G	10%
Commission $ if no CAA Package	H=F*G	$5,000
Episodes	I	154
Total Stiehm Pay w/o Package	J=I*F	$7,700,000
Total Commission w/o Package	K=I*H	$770,000
Total Package Fee Paid by Studio	L=A*I	$11,550,000
Amount Studio would have paid w/o Package		$0
Deferred Payout		
Syndication $/Episode	M	$1,400,000
Total Syndication	N=M*I	$215,600,000
Deferred Payout Package Fee (3%)	O	$11,550,000
Amount to Stiehm	P	$0

Total Amount to CAA Thus Far	$23,100,000
Total Amount to Stiehm Thus Far	$7,700,000
Total Amount Studio Pays Under Package Fee	$23,100,000
Total Amount Studio Pays Under Commission Fee	$0

Under this scenario, which is the standard price, or "package fee" charged by Uber agencies, the studio pays the Agency $23,100,000 as a package fee, even before the "back-end" syndication is included. Stiehm, the talent, receives only $7,700,000. In other words, the Agency makes three times what the actual talent earns. Under a commissions-based system, which the smaller agencies use, the studio would pay nothing, while Stiehm's salary would remain the same, $50,000 per episode. The package fee system has thus raised the price to the studio by $23M over the commission-based compensation system. Because this fee impacts the studio's total budget for the television show, it can reduce the total output. The $23M fee to the Uber agency represents nearly 6 additional episodes that could have been produced, or extra money available to a) provide additional compensation to the talent (Stiehm), b) hire additional actors, or c) otherwise improve the quality of the show. This $23M would not have been paid to the Uber agencies in a competitive market. It is only paid because the Uber agencies have market power that they can leverage to obtain a higher price. The market power comes about because a) the Uber agencies control the vast majority of the talent and b) they do not compete against each other on price. This stands in stark contrast to the small agencies that charge a commission to the artist but very rarely any fees to the studio.

C) Uber Agencies Do Not Charge a Competitively-Set Price

As such, it is clear that the "dirty secret" of package fees, as TV week put it, serves to reduce output, raise price, and potentially decrease quality in the market for scripted television shows, all three of which are anti-competitive outcomes. The Plaintiff charges that such outcomes have come to pass because the Uber agencies collude with each other to fix prices at supra-competitive levels well above those charged by the smaller agencies, which outnumber the Ubers approximately ten-to-one, yet control less than 5% of the market to the Ubers' greater than 95% market share. The evidence presented to the District Court was that all Ubers charge the same 3-3-10 package fee to the studio, without competing against each other. They have done so consistently for well over a decade. Meanwhile, the smaller agencies charge nothing to the studio. The advantage, from an economic viewpoint, should be clearly with the smaller agencies, who charge the lower price. However, the ability of the Ubers to raise prices above the competitive level indicates that this is not a competitive market. In a competitive market, firms are "price-takers". In other words, each must accept the competitive price, and any attempt by one or more firms to raise the price

(“price-setting” at a higher level) will fail because customers will switch to the lower-priced competitors. Thus, the firms who attempted to raise price would be faced with the choice of either lowering their prices back to the competitive level or going out of business.

However, the Uber agencies successfully managed to become price-setters rather than price-takers. Rather than accepting the 10% commission fee, they raised the price such that they now obtain orders of magnitude more compensation than small agencies. This compensation comes directly from the studio, who pays the package fee, and indirectly from the artists themselves, who are worse off because their show has a smaller budget and package fees are non-negotiable. This arrangement only benefits the Ubers to the detriment of the consumers (artists and studios). Absent the package fees, the studios would have more money to compensate the artists and to put toward the show. Consider the Stiehm case above. The commission paid to Stiehm in the front end was $770,000. The studio could easily either raise Stiehm’s compensation so she would be better off by more than $770k or just cover the commission to the talent agency and still be millions of dollars better off than it is by paying the $23M package fee. As a matter of basic mathematics, the studio could pay Stiehm $200k per episode and be in the same financial position if it did not have to pay the package fee, even before the back-end revenues. To see why this is the case, consider that the studio pays $23.1M to the Uber plus $7.7M to Stiem, for a total of $30.8M. If the entire amount were paid to Stiehm instead of the Uber, Stiehm would obtain $30.8M/154 episodes, or $200k per episode. The smaller talent agency would obtain 10%, or approximately $3.1M. The artist would be better off by far, and so would the smaller talent agency. If the payment to Stiehm falls somewhere between $50k and $200k, the studio is better off by paying less, the artist (Stiehm) is better off because she receives more compensation, and the smaller talent agency is better off. The only party that would be worse off is the Uber agency, which would not receive the supra-competitive package fees, but rather have to “settle” for perhaps $3M. However, its client, Stiehm, whose best interest it claims to have, would be in a much better position.

Thus, the evidence shows that the Defendant Uber Agencies have established a pricing scheme that they all share, namely the 3-3-10 package fee, that is not shared by the smaller agencies, who charge a significantly lower fee based on a commission paid by the artist, not the studio. The evidence shows that the package fee charged by the Uber Agencies is many times more than they would have obtained under the commission arrangement, and exceeds the amount even paid to the artist, creating a conflict of interest where the amount paid to the Uber agency constrains the amount available to be paid to the artist both directly as salary and indirectly through increased funding for the show itself. This conflict of interest becomes even more apparent when a deal falls through because the agency demands a package fee instead of commissioning their client. As TVWeek notes, “Studio executives and agents can all recount stories of

deals that fell apart because the agency demanded a packaging fee instead of commissioning their client."[3] Zelenski, in the Southern California Law Review, notes[4],

> *Packaging, then, is a big exception to the general rules that prohibit agents from acting as producers and from charging commissions in excess of 10%. So long as they represent bankable artists, agents can package and so can circumvent franchise restrictions. But because these agents effectively act as their clients' employers, they necessarily face conflicts of interest. In particular, they might procure for their clients only the work that they can package.*
>
> *For example, suppose that an agent is considering whether to present a bankable client with two separate job opportunities. The first is a deal to star in a film for $20 million and the second is a deal to star in a film for $15 million. Suppose further that both films are budgeted at $100 million, that both are identical in terms of prestige, that casting for the first film has been completed except for the starring role, and that casting for the second film has not begun. Given this, the agent can package the second film. In other words, the agent can force the second film's producer to hire other clients in addition to the bankable client and can negotiate with that producer for a package fee totaling 10% of the budget. Because the package fee for the second film exceeds the commission from the first film by $8 million, the agent has an incentive either to withhold the first opportunity from the client or to convince the client to accept the second opportunity even though it pays $5 million less.*

D) <u>Uber Agency Price Is Against Individual Self-Interest</u>

The Defendants counter that the mere existence of this parallel conduct by the Uber Agencies is insufficient to establish a conspiracy, and the similarity of business practices and the fact that Uber Agencies all charge the same price may simply result from natural competitive behavior in a free market. In other words, the Defendants maintain that the resulting 3-3-10 package fee could be the result of all Uber agencies a) all having arrived at the same number independently, and b) all independently deciding not to diverge from this number and engage in price competition with each other, and c) being independently able to all raise prices above the commission rate charge by the majority of the market participants outside the Uber Agencies.

The Plaintiff points out that the Defendants' claims are inconsistent with basic economics, a fact that was missed by the District Court. The 3-3-10 packaging fee agreement is contrary to the Defendants' economic self interest, because they would not engage in this parallel conduct if they were not engaged in a conspiracy to fix prices and restrain trade. Absent a collusive agreement, each Defendants' economic self-interest would be best served by competing with each other on the package fee. For example, one Uber agency would decide to lower the package fee it charges to, say, 2.5%, 2.5%, 7.5%. Studios would then be incentivized to prefer this agency over the others because its package fee would allow studios to save millions of dollars. Likewise, talent would prefer the Agency with the lower package fee because

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[3] http://www.tvweek.com/in-depth/2003/07/packaging-prime-time/

[4] Zelenski, David. Talent Agents, Personal Managers, and Their Conflicts in the New Hollywood. University of Southern California Law Review. Vol. 76:979. Available online at: http://www-bcf.usc.edu/~usclrev/pdf/076405.pdf

studios, their ultimate clients, prefer them. Talent would also be drawn to the agency charging a lower package fee because the lower fee would mean more money available to either compensate the talent or for the show's budget.

The other Uber Agencies, of course, would be forced to respond by cutting their own package fees or risk losing business to the price-cutting agency. The price competition could continue as long as the price set by an single firm is greater than the competitive price. No firm could set a higher price without losing market share. Likewise, no group of firms, without colluding, could set a higher price, because any single firm's best interests would be served by undercutting the group's prices and taking their market share.

It is patently obvious that the current package fee of 3-3-10 does not represent the competitive price arrived upon independently by each competing firm for three main reasons. First, no competitive process existed through which the 3-3-10 fee was established. Second, the package fee is significantly higher than the commissions charged by the smaller competing firms. Third, the fee charged is independent of the actual work performed by the agency to secure the work for the client.

First, the 3-3-10 package fee did not become the "industry standard" for the Uber agencies through any competitive process by which firms undercut each other on price. No record exists or evidence presented of Uber agencies competing on package fees to establish a market price, as would be expected if firms were individually acting in their own best interests. Despite the fact that supra-competitive profits exist, no attempt has been made by any of the Uber agencies to under-cut any of the other on fees and seize market share.

Second, as shown previously, the package fee charged by Uber agencies is significantly higher than the commissions charged by the small agencies. In the example above, a smaller agency would have obtained $770,000 in commissions from Meredith Stiehm's contract for Cold Case. However, the packaging Uber agency obtained 6% of the show's budget, or $23.1M, thirty times the fee that the smaller agency would have charged, even before any back-end syndication deal. The Defendants, justify this action by claiming the artist is better off because he/she does not pay a commission. But, as explained previously, the benefit is a mirage, as Stiehm herself pointed out. The package fee the Uber agencies charge limits the budget of the show and, as a result, limits the amount available to pay the talent. Likewise, the package fee inhibits the ability of the talent to either make more episodes, or spend additional money to improve the quality of the show. As a result, the talent ultimately suffers, as does the studio, while the only beneficiary party of the packaging fees is the Uber agency.

Third, the package fee is charged regardless of any effort made to "package" talent together. In other words, the Uber agencies require the fee regardless of whether they are bringing an entire "package" of

artists together for a show or just one artist. As Polone points out, "…the only reason those [package] fees are paid is out of fear that the agency will kill a deal if its agents don't get to wet their beaks, rather than because they did any extra work or 'packaging.'"[5] As the previous Meredith Stiehm example shows and as Polone points out, the agency can make far more than its client. This scenario, for example, doesn't exist in sports contracts, where agents compete for a percentage of their client's compensation. The package fee scenarios that exist in scripted television shows would be akin to an agency requesting a percentage of an entire team's revenues as payment, rather than a percentage of their own client's salary. In that case, as with Hollywood package fees, the agent would have a conflict of interest, as the goal would be to maximize the size of the agency's own compensation, not that of the client.

Summary

The type of evidence offered to the Court in this case relies on the same inductive reasoning on which the Courts have relied for decades and continue to rely routinely when weighing statistical evidence. While, absent discovery, Plaintiff cannot provide direct evidence that Defendants met on a particular day and at a particular time and conspired to restrain trade by fixing prices, the evidence in this case is consistent with that very probable conclusion. The Defendants all set the same price at a level many times higher than that charged by smaller agencies as commissions to their clients. Plaintiff notes that basic economic theory shows that the current packaging fee behavior engaged upon by the Big 4 Uber Agencies is only consistent with maximizing their combined best interests (i.e., the best interest of the cartel), not their own individual best interest. Their own individual best interest would be to undercut the cartel price and take market share from those agencies charging a higher price. Finally, though a demonstration of consumer injury is unnecessary if the Court should decide to adjudicate Defendants' behavior under the per se rule, Plaintiff Lenhoff & Lenhoff has shown that evidence indicates significant injury to both studios and artists results from the Defendants' anti-competitive conduct through a) higher prices charged to studios, b) reduced budget available to compensate artists, c) reduced budget available to improve the quality of the show or make additional episodes. Thus, should the Court decide to apply the Rule of Reason, Plaintiff has shown that significant evidence indicates that Defendants' unjustified restraint of trade results in increased price, decreased output, and potentially decreased quality, all three of which represent anti-competitive outcomes.

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[5] Polone, Gavin. Gavin Polone on TV's Dirty Secret: Your Agent Gets Money for Nothing (Guest Column). The Hollywood Reporter, March 26, 2015.