Understanding the Economics in the Dispute Between the Writers' Guild of America and the Big Four Talent Agencies

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The long-simmering dispute between the Writers' Guild of America (WGA) and the Association of Talent Agents (ATA) rose to a crescendo in 2019. The conflict raises complex economic questions of relative bargaining power and coordination rights—namely, when can workers coordinate on wages, and when can firms coordinate on prices, in a way that does not run afoul of the antitrust laws.

The parties had been operating under the Artists' Manager Basic Agreement of 1976, which was due to expire at midnight on April 13, 2019. Negotiations between the two sides on a new agreement stalled after the top talent agencies, WME Entertainment, Creative Artists Agency (CAA), International Creative Management Partners (ICM), and United Talent Agency (UTA) (together, the "Big Four") refused to abandon the practice of charging packaging fees charged to production companies.

The WGA contends that the packaging fees represent a significant conflict of interest for the Big Four and thus violate California law, which holds that talent agents owe a fiduciary duty to conflict-free representation to the writers they represent. The new WGA Code of Conduct prohibited talent agents from deriving any "any revenue or other benefit from a Writer's involvement in or employment on a motion picture project, other than a percentage commission based on the Writer's compensation or fee." Given the financial windfall the Big Four obtained for decades from packaging fees, the prohibition on securing such fees precipitated the impasse between the WGA and the Big Four.

On April 12, 2019 sensing a deadlock, the WGA announced that "we are about to enter uncharted waters" and called on its members to fire any talent agent who refused to abide by the newly-implemented code of conduct. In a show of solidarity, mass firings ensued, as writers—including celebrities such as Stephen King, David Simon, and Patton Oswalt—fired their agents. The WGA quickly followed by filing suit against the Big Four in California state court on April 17, 2019, alleging breach of fiduciary duty and unfair competition.

In June, the talent agencies fired back. WME, CAA, and UTA, the two former of which are responsible for 79 percent of packaging, filed antitrust claims alleging that the WGA's actions constituted a group boycott that violated the labor antitrust exemption. As such, the talent agencies

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alleged that the concerted firing of talent agents represented a *per se* violation of Section 1 of the Sherman Act, which prohibits combinations that unreasonably restrain trade. WME's complaint, for example, contends that WGA solicited the assistance of third parties, such as smaller talent agencies, directors, producers, managers, and lawyers, as well as studios, in buttressing its position against the Big Four's insistence on packaging fees.

DOJ Weighs In on Behalf of the Agencies

On November 26, 2019, the U.S. Department of Justice issued a statement of interest in this matter. The Antitrust Division asserted that several main factual disputes exist and, in the DOJ's opinion, should be adjudicated at trial, including whether the Guild used nontraditional means in coordinating their dealing, and whether such coordination "serve only legitimate labor law objectives or also further any illegitimate goals such as abusing monopsony power over agents or eliminating competition in a business market."

It is impossible to miss that the tenor of the DOJ's statement is consistent with stances it has recently taken against workers in other matters, including against Uber drivers in Seattle. The DOJ's statement is also consistent with what some have dubbed the Trump administration's overarching anti-worker agenda. By focusing exclusively on the coordination of the writers, the DOJ's statement places the probative onus on WGA, and entirely ignores the potentially anticompetitive coordination among the Big Four in setting packaging fees. Whether antitrust generally, by authorizing large, powerful firms as the primary mechanisms of economic coordination, allocates coordination rights appropriately has been the subject of scholarship by law professor Sanjukta Paul.

Was the DOJ's intervention misguided? To answer that question, one has to understand the bargaining strength of the two sides in this dispute. In its complaint, the WGA alleged that "Agency compensation via packaging fees is possible because, after substantial consolidation within the industry, the Agencies now control access to all of the key talent necessary to create a new television show or feature film, including not only writers but also actors and directors." Put differently, the Big Four's dominant position in the key labor (input) markets for producing movies and television shows enables them to secure hundreds of millions of dollars in annual packaging fees from production companies. Such fees are, at best, often unrelated to talent compensation; at worst, they are inversely related.

How Packaging Fees Create a Conflict of Interest

Generally, agents acting as representatives for talent receive compensation in the form of a commission equal to a percentage of the talent's pay. Traditional commissions in the talent agent market equal ten percent of the talent's pay. However, packaging fees can be far more lucrative, as evidenced by the talent agencies unwillingness to forgo them, even at the risk of alienating their own writer clients. Notably, the Big Four all use the same "3-3-10" packaging fee structure in their dealings with production companies. Under this format, the production company pays the talent agency via three revenue streams:

- Three percent (3%) of the base network license fee per episode;

- Three percent (3%) of the base network license fee, deferred and payable out of 50 percent of the net profits on the show; and
- Ten percent (10%) of the "back-end" or Modified Adjusted Gross Receipts (MAGR) when the show is sold into syndication, which can occur multiple times for popular shows.

A key point worth noting is that the talent agencies obtain their fees "off the top"—that is, out of the gross profits. Writers also receive a percentage of the back-end syndication deal, but their fees are based on the remaining adjusted gross receipts *after* talent agency fees.

A hypothetical case makes the conflict clear. Suppose a packaged show has reached syndication, and a production company sells the show into first round of syndication for $50 million. Assume the first two "3s" out of the 3-3-10 have been paid. The final "10" represents the ten percent out of the syndication deal that the talent agency gets. Suppose the writer's contract with the production company also calls for the exact same percentage as the agency—namely, a ten percent cut out of syndication. One would be tempted to assume that both the agency and the writer would get the same amount, $5 million, because they get the same percentage. But that is not the case. The talent agency is paid "off-the top," ten percent of $50 million, or $5 million. The writer's percentage is applied to the remaining $45 million *after* the agency's $5 million has been paid. Thus, the writer gets ten percent of $45 million, or $500,000 less than the agency. Indeed, the higher the cut going to the agency, the smaller the cut going to the writer under this arrangement.

The example shows how the agency can earn more than the talent itself on a production. This agent-skewed distribution is anathema to more competitive labor markets, where not only are such arrangements non-existent, but agents' percentage is limited by the labor union. For example, Tom Condon, head of CAA's football sports agency, cannot earn more than the talent he represents on a contact, because the commission an agent can earn is capped by the NFL Players Association at three percent.

Scripted television writers, who were subject to the packaging fees until the WGA's April prohibition 2019, have faced an altogether different scenario. In her 2015 statement as a candidate for the WGA Board, Meredith Stiehm, the acclaimed writer for *Cold Case, ER, Homeland*, and other hit shows, offered her situation as an example:

> When I created *Cold Case*, my agents packaged it. It was my first show, and I was a rube – when they told me I would benefit too, since they wouldn't take their 10% from my salary, I bought it. I just didn't do the math. It wasn't until year seven of my show when I was tasked with slashing the budget that I finally noticed that my agency was making $75,000 per episode – more than I was. I was stunned. And even worse, they had a percentage of the profits.

Further, the talent agencies continue to earn packaging fees in perpetuity. This is because agents' compensation is tied not to the talent but to the show. For example, even if an agency no longer represents a certain writer, it would still continue to earn packaging fees from a show it had packaged.

Talent agencies have attempted to justify earning such fees by asserting that packaging involves putting together "comprehensive groups of key talent," as UTA claimed in its Answering Brief in *Lenhoff Enterprises v. UTA*. However, the term "packaging fee" is a misnomer in the modern era of agencies. In the 1950s, agents such as Lew Wasserman of William Morris would bring teams of talent to studios. That changed even as of 30 years ago, however, as noted in a 1989 *New York Times* article about Michael Ovitz. Agencies can command a packaging fee even if they represent a single creative element, as explained in *Programming for TV, Radio and the Internet* (Focal Press 2005).

In its statement of interest, the DOJ cited the agencies' First Consolidated Complaint in listing an array of "representative examples of work" that talent agencies may perform on packaged shows. Documentary evidence from Sony Pictures serves not only to undermine such claims, but also to show how packaging fees reduce output, a signature characteristic of anticompetitive conduct according to the consumer-welfare standard that undergirds antitrust law.

In 2015, Wikileaks released 173,132 emails and 30,287 documents leaked from a hack of Sony Pictures. These documents shine an unflattering light on the nature of packaging fees charged by the Big Four. For example, in a March 5, 2014 email, Tom Rothman, the chairman of Sony's TriStar Production and now the chairman of Sony's Motion Picture Group since February 2015, commented that,

> Also, interesting and a significant development in the director driven project world, is the stuff about caa [CAA] internal packaging control. They are demanding and getting fees now on these from the financiers (they call it a 'packaging fee' and are keeping as many emerging high end filmmaker projects *off the market* until they have full control. (emphasis added)

Likewise, in a June 13, 2014 email, then Sony TV boss Steve Mosko responded to an agency's request for a package fee:

> No need to worry about package. I've killed the deal w tribune. Your email was ill timed. Its [sic] hard for us to *create new business opportunities* when you put your hand out looking for a check…when you have done nothing and we are trying to put money in your clients [sic] pocket. Your cost made the decision for us Unreal. (emphasis added)

As indicated by these quotes, the output effect of packaging fees is decidedly negative.

Moreover, the Big Four agencies seldom, if ever, compete on price; the 3-3-10 packaging fee has been the industry's standard for many years. The logic that agencies, in the absence of any coordination, would be expected to compete on price finds support in the factual record. Prior to the mid-1990s, the standard industry package fee was 5-5-15. After starting CAA along with his former partners at William Morris, Michael Ovitz's fledgling CAA undercut the industry standard by lowering its package fee to three percent, the standard that has existed since the demise of the franchise agreement known as Rule 16(g) in 2002 and continues today.

The price competition has not continued any further, which is particularly surprising given the current litigation. Indeed, one would expect that the agency that broke ranks by offering to forgo packaging fees would capture a significant infusion of talent, at the expense of the holdout agencies.

The Big Four Have Come to Dominate Access to the Production Companies

Co-packaging occurs when more than one talent agency brings a talent element to a show, necessitating a split in the packaging fee. In the case of two talent agencies, each would get 1.5-1.5-5, or half the standard 3-3-10 fee. In such cases, the agencies that split the package effectively become horizontal shareholders. They now have common ownership in an anticipated future income stream.

Notably, both packaging and co-packaging are the province of the Big Four. The following table is excerpted from a declaration submitted in the *Lenhoff v. UTA et. al*. by Ted Tatos, one of the authors of this article, who was engaged by Plaintiff Lenhoff Enterprises, a boutique literary agency.

	BEFORE	AFTER	
	2001-2002 Season	2014-2015 Season	2015-2016 Season
Total Shows Packaged	119	350	454
Uber Agency Package Totals	81	330	434
Uber % of Total Show Packages	68%	94%	96%
Total Number of Agencies Serving Market	77	43	43
# Agencies With Market Share > 0	15	11	10
Co-Packaged Shows	27	98	144
Shows Co-Packaged Between Ubers Only	12	86	121
Shows Co-Packaged Between Ubers and Other Agencies	13	12	23
Shows Co-Packaged Between Only Non-Uber Agencies	2	0	0
Possible Ways of Choosing Two Firms out of Total with	105	55	45

Of particular note, by 2015-16 season, the Big Four or "Uber" agencies held 434 of the 454 packages (or 96 percent); their prior share was just 68 percent in the 2001-02 season. When co-packaging occurred in the shows analyzed in 2014/15 and 2015/16, it always involved at least one of the Big Four.

In light of these data, any claim that a standardized package fee is procompetitive because it enables co-packaging is absurd. First, it is readily obvious that co-packaging could occur absent a packaging-fee model. Each agency would receive the commission on their talent, just as agents for athletes on a basketball team receive a commission on the athlete(s) they represent, not on the entire team's budget. Second, to qualify as potentially procompetitive under the consumer-welfare standard, the standardized package fee would have to result in higher output and lower prices. In other words, co-packaging would have to be the driver, or cause, of any increased output. Evidence for this is quite the opposite, as observed in direct quotes above from Sony executives.

The factual record indicates that the market for representing talent is highly concentrated and dominated by four firms that all charge the same package fee and have done so for decades, notwithstanding changing economic conditions or other market forces. Indeed, as Judge Berzon observed in the Ninth Circuit's hearing on the *Lenhoff v. UTA* matter, "whether or not [Plaintiff] sufficiently pled the horizontal price fixing…it frankly seems to me their strongest argument if adequately pled…" With respect to the packaging fees, Judge Berzon explained:

> the argument here would be…something along the lines of there was a complete change and it was a complete change to a specific set of numbers…those specific numbers [packaging fees] never changed and have never been undercut by any of these four people [the Big Four]…what's odd about this is not just that everybody charges $1.99, it's that it's a specific scheme, with specific numbers at different stages and it's not varied from.

The issue in *Lenhoff v. UTA et al*., as Defendants observed, was that Plaintiff did not adequately plead price fixing. If they had, UTA's attorney acknowledged at the hearing, "I think it would be a different case…it would be an entirely different case."

Given this highly concentrated market structure among agents, it is thus surprising that the DOJ would assert that "[w]hile unions can restrict agent compensation when pursuing a legitimate union goal such as avoiding conflicts of interest, it is not a legitimate goal for a union to exert *monopsony power* over agents simply to extract additional rents." (emphasis added) To the extent there is any power imbalance here, that power resides with the Big Four, as they collectively control access to the production companies that purchase writing talent.

And it is beyond surprising to observe that the DOJ has intervened not by investigating evidence of potentially collusive price-fixing by talent agencies, but rather by inquiring whether the WGA may have breached the labor exemption to antitrust in coordinating their dealings with agents. By questioning that aspect and only that aspect, the DOJ is signaling a hostility to the labor exemption to antitrust. It is settled law that the labor exemption covers labor union activities; the WGA is merely coordinating among their own members as to the terms and condition of the writers' contracts, not on any activity in the product market, as DOJ wrongly asserts. That is classic union activity. In siding against workers in favor of powerful firms, the Antitrust Division is once more cementing rather than dispersing economic power.