VERTICAL INTEGRATION AND SELF-DEALING IN THE TELEVISION INDUSTRY: SHOULD PROFIT PARTICIPANTS BE OWED A FIDUCIARY DUTY?

INTRODUCTION

The creators of ABC's *Home Improvement* and CBS's *Walker, Texas Ranger*, *Mash* star Alan Alda, *The X-Files* popular actor David Duchovny, and producer Steven Bochco are among the players in a recently created script that has Hollywood buzzing.[1] However, do not expect a multi-million dollar production for the silver screen or even a lesser-budgeted movie of the week. The drama has only played out in closed-door settlement negotiations,[2] but may soon expand to wide release and be seen in a courtroom near you.[3]

The persons mentioned above have partaken in a series of high profile lawsuits involving profit participants who are entitled to receive a fixed percentage of the back-end gross revenue of television shows,[4] and accuse the studios of wrongfully preventing the recoupment of their fair share of the profits.[5] This type of claim is not novel in the entertainment industry.[6] These recent cases, how-

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[1] *See, e.g.*, Johnnie L. Roberts, *Suing Hollywood's Suits*, NEWSWEEK, Oct. 11, 1999, at 62-63.

[2] *See id.* at 63 (noting that the separate disputes brought by Alan Alda and the creators of *Home Improvement* have already been settled).

[3] *See infra* notes 4-9 and accompanying text. This Note, which focuses on the 1999 lawsuit between David Duchovny and Twentieth Century Fox Film Corp., was conceptualized and first written while the lawsuit was ongoing. Although the parties settled their dispute out of court on May 17, 2000, a confidentiality agreement between the parties prevents legal analysts and the general public from ascertaining the details of the settlement negotiations and the outcome. It is widely published that David Duchovny received between twenty and thirty million dollars as part of the out of court agreement, which includes both the lawsuit settlement and a $350,000-$400,000 per episode contract extension for the 2000-2001 *X-Files* television series season. It is highly probable that similar lawsuits will continue in this area, and eventually one may be litigated. This Note anticipates such continued litigation and analyzes the dilemma causing it.

[4] *See, e.g.*, Complaint at 9-10, David Duchovny and King Baby, Inc. v. Twentieth Century Fox Film Corp., No. SC058329 (Cal. Super. Ct. 1999) [hereinafter Complaint]. David Duchovny "was granted a percentage participation in the net profits of the Series [*X-Files*] and a percentage participation in the modified adjusted gross receipts of the Series as an advance against such net profits derived by the Series. King Baby was granted the percentage participation in consideration of King Baby agreeing to take less fixed episodic compensation in connection with the series and agreeing to provide Duchovny's services for an additional two years." *Id.*

[5] *See, e.g.*, Cynthia Littleton, *Synergize This: Vertical Sales Pit Players vs. Studios*, VARIETY, Aug. 23-29, 1999, at 27-28.

[6] *See id.* at 27 ("Showbiz lawyers have long charged that studios often resort to creative accounting practices and downright fraud to hide the true grosses of hit movies and TV shows."); *see, e.g.*, Paul Newman v. Universal Pictures, 813 F.2d 1519 (9th Cir. 1987) (alleging that motion picture studio conspired to fix percentage of revenue paid to artists for their services); De Guere v. Universal City Studios, 56 Cal. App. 4th 482 (Cal. Ct. App.

ever, have raised new issues apart from the more traditional profit sharing dispute where an actor sues a movie studio to recover a contractual percentage of a film's revenue, and the studio claims that, despite reported million dollar box office revenues, it has not generated enough profit to pay the actor.[7] This new crop of lawsuits raises a theory of wrongful conduct by the television studios stemming from their practice of "vertical integration."[8] The concept of vertical integration "refers to a single vast company that does everything, from creating shows at in-house studios, to airing them on company-owned networks, to then reselling the lucrative rerun rights to their own cable networks."[9] This corporate strategy became available with the emergence of media conglomerates in the 1990s that have self-contained empires consisting of film and television studios, television networks, local television stations, foreign television stations, and the distributions channels between these different entities.[10] Through vertical integration, the conglomerate has the ability to produce its own shows, then broadcast the shows on company owned television stations and cable networks.[11] The conglomerate aims to maximize profits by utilizing each of its corporate holdings to increase the value of its media and entertainment enterprise as a whole.[12]

The packaging of *The X-Files* television show is a textbook example of the vertical integration strategy.[13] Fox Entertainment Group ("FEG") is an eighty-three percent owned subsidiary of Rupert Murdoch's media giant News Corp.[14] FEG's subsidiary Twentieth Century-Fox Film Corporation, through its television division, Twentieth Century Fox Television (collectively, "Fox"), produces *The X-Files*, which premieres on FEG's own broadcast network, Fox

1997) (illustrating that television producer sued television studio to challenge studio's net profit accounting practices).

7 *See* Steve Johnson, *In Character These Days, It's Hard To Tell When TV Stars Are Acting Or Just Acting Like They Are*, CHI. TRIBUNE, Sept. 6, 1999, *available* at 1999 WL 2909373 ("[T]he usual portion-of-the-profits suit, wherein actor X wonders, using proper legal terminology, just how it is that movie Y, which took in, say, $250 million in box office receipts, is still in the red.").

8 *See, e.g.*, Roberts, *supra* note 1, at 62.

9 *Id.*

10 *See id.*

11 *See* Littleton, *supra* note 5, at 27 ("Congloms. . .have the ability to control production and exhibition by owning both studios and networks, TV stations and cablers.").

12 *See* Seth Lubove, *Media Conspiracy Theory: The Lawsuit by X-Files Star David Duchovny is a Window Into Rupert Murdoch's Masterly Vertical Integration Strategy*, FORBES, Nov. 29, 1999, *available at* 1999 WL 28466754.

13 *See* Littleton, *supra* note 5, at 27; *see also* Lubove, *supra* note 12. (stating that *The X-Files* is a "classic example" of how the theory is supposed to work because the show touches "nearly all the corners" of Rupert Murdoch's media empire).

14 *See* Lubove, *supra* note 12.

Broadcasting Company (commonly known as the "Fox Network"). The show is licensed for syndication by Fox to the FEG-owned FX Cable Network ("FX"), twenty-two Fox-owned television stations ("the station group"), and is viewed in foreign markets through News Corp.'s British Sky Broadcasting and Star TV.[15] Peter Chernin, president of both FEG and News Corp. states, "this model of vertical integration, of which we're in the forefront, is the model of the industry."[16]

While corporate managers and directors of the entertainment conglomerates laud their efforts in corporate synergy,[17] actors and producers claim that vertical integration is causing them to be cheated on their profit-sharing agreements.[18] Profit participants claim vertical integration amounts to "self-dealing"[19] that often results in the sale of a show's syndication rights at below fair market value to the company's television networks and stations, to the detriment of those with a percentage of the licensing fee profits.[20] Profit participants assert that the companies license cheaply to their subsidiaries to decrease costs for their self-owned entities.[21] Further, participants argue that this practice injures the fiduciary relationship[22] that exists between the studios and profit participants who trust the former to act on their behalf and in their best interest.[23]

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15 *See id.*; *see also* Littleton, *supra* note 5, at 27; First Amended Complaint at 2-5, David Duchovny and King Baby, Inc. v. Twentieth Century Fox Film Corp., No. SC058329 (Cal. Super. Ct. 1999) [hereinafter First Amended Complaint].

16 Lubove, *supra* note 12.

17 *See id.* (stating that even the public offering of FEG last year touted *The X-Files* as an example of the company's excellence in vertical integration).

18 *See id.*

19 *See Actor David Duchovny Alleges Contract Breach By News Corp. Unit*, WALL ST. J., Aug. 13, 1999, *available at* 1999 WL-WSJ 5464486; *see also Duchovny Sues 20th Century Fox*, THE COLUMBIAN, Aug. 13, 1999, *available at* 1999 WL 18260580 (stating that Duchovny's lawsuit contends, "Fox sits on both sides of the bargaining table in any negotiation for the distribution rights to the series, thereby enabling it to manipulate negotiations in any way that serves its corporate interest.").

20 *See, e.g.*, Joe Flint, *It's Fox vs. Fox*, ENT. WKLY., Sept. 3, 1999, at 15; Roberts, *supra* note 1, at 62.

21 *See* Adrian McCoy, *Mystery, Lawsuit Surround Future of Fox's 'X-Files'*, PITT. POST-GAZETTE, Sept. 4, 1999, *available at* 1999 WL 25690047.

> With a hit show, a studio usually passes along growing production costs to the network by increasing the licensing fee. But because Fox Corp. owns the Fox network, that would entail passing along costs to itself. And so, while viewers might be used to equating strong ratings with a show's success or demise, the corporation is staring at different figures—the overall financial benefit to the corporation.

Id.

22 *See infra* Part II.

23 *See* Complaint, *supra* note 4, at 33 (arguing that the distribution and exploitation of *The X-Files* is entirely within the control of the studio, and thus the studio is required to act with the highest duty of loyalty with respect to its profit participant).

A prime example of this controversy is illustrated in the lawsuit by David Duchovny against *The X-Files* producer Fox.[24] This Note will utilize the Duchovny-Fox lawsuit as a referential case study because the recent dispute is representative of the current legal scenario as a whole, and while the case has been settled, the terms and conditions of the settlement are confidential, allowing this Note to make an independent and unprejudiced inquiry into the dilemma that the case exemplifies. Entertainment Attorney Michael Gendler has noted the significance of the legal issues and their effect on deal-making in Hollywood's future: "[t]he studios are in the process of trying to create new paradigms for how the business works. It is an important battle that is being waged right now (by profit participants), and the results will affect both sides for many years to come."[25]

In an effort to determine whether the studios owe any fiduciary duty[26] to their contractual profit participants, this Note analyzes the unique relationship that exists between television studios as producers and distributors of their own television series, and the profit participants whose earnings depend on the fees generated by television distribution sales. Part I of this Note describes the origin of the present conflict: the repeal in the mid-1990s of the Federal Communications Commission's ("FCC") Financial Interest and Syndication Rules ("fin-syn"). Part II discusses fiduciary duty law, agency law, and limited partnership law, and also analyzes two theories by which the studios may owe profit participants a fiduciary duty of loyalty. Moreover, this section addresses the legal significance of finding whether a fiduciary relationship exists between the television studios and their profit participants. Part III explains a model for structuring future self-dealing contracts involving profit participation in the television industry, and suggests how

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24 *See id.* at 9, 25. Duchovny claims:

> Because Fox must share the profits derived from the Series with its profit participants such as Duchovny, Fox has intentionally caused the revenues payable for the distribution rights of the Series to be reduced through self-dealing with its affiliated entities and licensing the Series at below-market license fees (thereby reducing the profits of the Series that it must share with its participants such as Duchovny). The savings to Fox and its corporate bottom line arise when the affiliated entity licensing the Series from Fox pays less than the fair market value to license the Series (effecting a cost savings and increased profits to the affiliated entity) and thereby reducing the profits of the Series which must be shared with the participants. In other words, in any transaction between Fox and an affiliated entity, it is now in the financial interest of Fox to shift revenue away from the Series (where it must be shared with. . .participants) and toward the affiliated entities.

Id. at 4.

25 Littleton, *supra* note 5, at 27.

26 *See infra* Part II.

courts should address these legal disputes. Finally, this Note concludes that television studios, unless specifically contracted otherwise,[27] should owe their profit participants a fiduciary duty to ensure that vertically integrated transactions do not unfairly benefit the studios at the expense of their profit participants.

I. WHY VERTICAL INTEGRATION IS ALLOWED: THE REPEAL OF FIN-SYN

Some legal commentators have noted that corporate synergy in the media industry stymies competition and is counter to the objectives of the federal antitrust laws.[28] The Federal Communications Commission ("FCC") is the arm of the federal government that is particularly concerned with maintaining competition in the communication industries to protect the public interest.[29] On May 4, 1970, the FCC adopted the fin-syn rules, which were to take effect on September 1, 1971, to enhance competition in the television industry by prohibiting television networks[30] from engaging in the syndication business.[31] The fin-syn rules were strengthened in

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[27] *See infra* Part III.

[28] *See, e.g.*, Littleton, *supra* note 5, at 28 (quoting entertainment attorney Piece O'Donnell, who states that anti-trust regulators should take notice of media consolidation).

[29] *See* Marc L. Herskovitz, Note, *The Repeal Of The Financial Interest And Syndication Rules: The Demise Of Program Diversity And Television Network Competition?*, 15 CARDOZO ARTS & ENT. L.J. 177 n.2 (1997). The Communications Act of 1934, 47 U.S.C § 151 (1994), *amended by* Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.), granted the FCC the "authority over the use of the electromagnetic spectrum to propagate communications signals." Schurz Communications, Inc. v. FCC, 982 F.2d 1043, 1048 (7th Cir. 1992). The 1934 Act:

> provides no guidance for the exercise of this authority other than that the [FCC] is to act in accordance with the *public interest*, convenience, or necessity. Thus, with the blessing of the Supreme Court, the FCC has used this authority to closely regulate network activities by conditioning the renewal of broadcast licenses on the 'networks' accepting constraints intended to maximize the [FCC's] conception of the social benefits of broadcasting.

Herskovitz, *supra* note 29, at 177 n.2 (emphasis added).

[30] *See* 47 C.F.R. § 73.658 (j) ¶4 (1971).

> [T]he term network means any person, entity, or corporation which offers an interconnected program service or a regular basis for 15 or more hours per week to at least 25 affiliated television licensees in 10 or more states; and/or any person, entity, or corporation controlling, controlled by or under common control with such person, entity, or corporation.

Id.

[31] The fin-syn rules were codified at 47 C.F.R. § 73.658(j). *See also* 1970 Order, 23 F.C.C.2d ¶¶ 27-30, at 397-99. The FCC adopted the proposals to "eliminate the networks from distribution and profit sharing in domestic syndication and to restrict their activities in foreign markets. . . ." The Commission also prohibited networks:

> from acquiring subsidiary program rights and profit shares, as little would be accomplished in expanding competitive opportunity in television program production if we were to exclude networks from active participation in the syndication market and then permit them to act as brokers in acquiring syndication rights and interest and reselling them to those actively engaged in syndica-

1991 when legislation prohibited the networks from producing more than forty percent of their primetime programming "in house."[32]

The fin-syn rules were promulgated in response to the FCC's determination that the only three national networks, ABC, NBC, and CBS (collectively, "the three networks") had too much dominance over television programming.[33] Specifically, the FCC adopted fin-syn to prevent the development of two trends that it perceived as detrimental to the public interest. First, since the three networks were the only program providers that had national domination, the networks could impose harsh, monopolistic terms upon independent producers who wanted shows broadcast to a large national market.[34] For example, the three networks could force independent producers to relinquish future residual rights in exchange for receiving current airtime for their shows.[35] Second, the FCC feared that a competitive syndication market was disappearing because the three networks could prevent independent stations from purchasing their popular network programs in favor of network-owned subsidiary affiliate stations.[36] In response to these threats, the fin-syn rules disallowed the three network studios to "sell, license, or distribute television programs to television station licensees within the United States for non-network television exhibition or otherwise engage in the business commonly known as 'syndication' within the United States. . . ."[37] The FCC hoped that these restrictions would both encourage independent stations to bargain for syndication rights and would promote a competitive television broadcast market by preventing the three networks from usurping all syndication rights for their affiliate stations.[38]

> tion. . .the network has an advantage as a competitor in the syndication market because of its existing relations with affiliates.

Id.

[32] Evaluation of the Syndication and Financial Interest Rules, Mem. and Order, 7 F.C.C.R. 345, ¶ 5, at 349-350 (1992), *modified*, 1993 Rules, 8 F.C.C.R 3282 (1993). "In-house" programming is defined as network programming that is "(1) solely produced by the network; (2) co-produced by the network with foreign production entities; or (3) co-produced by the network with outside domestic production entities that initiate such arrangements." 8 F.C.C.R. at 3313 n.72.

[33] *See* Herskovitz, *supra* note 29, at 178 (explaining that the rules were promulgated to curtail the three networks' control over the entire broadcast universe which consisted of program creation, first-run airings and syndication decisions).

[34] *See id.* at 183.

[35] *See id.*

[36] *See id.*

[37] 47 C.F.R. § 73.658 (j) ¶ (1)(i) (1971).

[38] *See* Herskovitz, *supra* note 29, at 189 n.97 (quoting 1970 Order, 23 F.C.C.2d ¶ 30, at 398).

> Since the networks' competitive advantage stemmed in large part from its existing relationships with affiliates, the prohibition on syndication 'will permit

However, these restrictions, which otherwise would eliminate the potential for vertical integration in the television industry, are no longer in effect. In the last decade the FCC has decided that the television industry is in need of less regulation, and on September 21, 1995 the fin-syn rules were repealed.[39] The FCC believed the repeal was necessary because a more competitive television marketplace has emerged since the rules were enacted.[40] The FCC noted the development of three national networks, United Paramount Network ("UPN"), Warner Brothers ("WB"), and the major impact of Fox[41] as greatly expanding television market competition since the 1970s.[42] The FCC also pointed to the expansion of cable networks and wireless cable such as Direct Broadcast Satellite television as indicating that the three networks face substantially increased market competition.[43] Also, while the three networks provided the FCC with evidence disputing network "affiliate favoritism," proponents for retaining fin-syn did not show that network programs were syndicated primarily to network subsidiaries.[44] The FCC determined that these changes indicated that market domination by the three networks had declined to a level that warranted the repeal of the fin-syn rules.[45]

While there was no persuasive evidence indicating network "affiliate favoritism" when the fin-syn rules were repealed, it is clearly corporate practice now.[46] This is not surprising since the television

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> the networks to lend all their efforts to the sale of network programs,' rather than acting as brokers in acquiring syndication rights and reselling them to their affiliates.

Id.

39 *See* Network Financial Interest and Syndication Rules, 60 Fed. Reg. 48907 (Aug. 29, 1995) [hereinafter 1995 Rules] (final rule repealing fin-syn). This is a summary of the Report and Order adopted by the FCC on August 29, 1995 that accelerated the expiration date of the remaining rules from November 10, 1995 to August 29, 1995, the report's publication date. *See also* Federal Communications Commission Record, Report and Order, 10 F.C.C.R. 12,165 (1995) [hereinafter 1995 Order].

40 *See* 1995 Rules, at 48908 (confirming the FCC's conclusion that competitive market conditions warranted the repeal of the fin-syn rules).

41 *See* Tamber Christian, *The Financial Interest and Syndication Rules—Take Two*, 3 COMMLAW CONSPECTUS 107, 109 (1995) (noting that in 1986 Fox established its network to compete with the three networks).

42 *See* 1995 Order, at 12,170, ¶26 (describing the development of new national networks, as, "evidence of both the forward integration of existing television programming producers into the distribution of programming through broadcast television outlets and the increased number of potential purchasers of television programming").

43 *See id.* at 12,171.

44 *See* 1995 Rules, at 48909. NBC used one of its shows, *News 4 Kids* which is aired on 210 stations, only 23% of which are NBC owned, to demonstrate it does not engage in affiliate favoritism. The FCC indicated that proponents of retention did not counter with similar persuasive evidence. *See id.*; *see also* 1995 Order, at 12,171, ¶28.

45 *See* Herskovitz, *supra* note 29, at 179.

46 *See supra* notes 13-16 and accompanying text (illustrating Fox's intentional effort to be a leader in corporate synergy through its television production and distribution links).

studios are no longer prohibited from owning and syndicating their own television programs.[47] At the time of the repeal, one commentator predicted that once the network studios are "freed of the fin-syn rules, [they] will quickly engage in anti-competitive behavior, perhaps by producing more of their own programs and then airing those programs exclusively on [their] station and cable affiliates . . . ."[48] The fin-syn rules were enacted to avoid this consolidation of power, but with their repeal, the studios have gained a corporate advantage.[49] In addition to the anti-competitive disadvantage now faced by independent television producers and stations, some claim another negative result that has arisen from the removal of the restrictions is the allegation that television studios, which sell their shows' syndication rights to affiliate channels, are favoring corporate financial success at the expense of profit participants, whose financial interests are represented by the studios.[50] David Duchovny is the most recent and high profile profit participant to allege that he was financially and wrongfully injured as a result of the television studio's liberation from fin-syn rules. Duchovny's claim that Fox studio represents his financial interest, as a profit participant, in the syndication of *The X-Files* is grounded in the concept of fiduciary duty which will now be explored.

II. Fiduciary Duty or No Fiduciary Duty, That is the Question: What is the Implication?

A. *Fiduciary Duty Law and Agency Law*

A fiduciary duty[51] is defined as the highest standard of duty implied by law.[52] A fiduciary is a person having a "duty, created by his undertaking, to act primarily for another's benefit in matters

47 *See* Herskovitz, *supra* note 29, at 181 (stating that the three networks are now permitted to broadcast as much in-house programming as they wish, as well as to retain and acquire the lucrative syndication rights).

48 Christian, *supra* note 41, at 119. This is precisely the strategy that Fox uses to funnel *The X-Files* to its network affiliates and cable network.

49 *See* Telephone Interview with Stanton L. (Larry) Stein, Attorney for David Duchovny (October 27, 1999) [hereinafter Stein Interview] (on file with author) ("This situation is a welcome opportunity which the studios will embrace.").

50 *See id.* (explaining that because the fin-syn rules have been repealed, "the rules have been changed in the middle of the game."); *see also supra* notes 21-24 and accompanying text (describing in detail the profit participants' allegations).

51 *See* Robert C. Montgomery, *The Fiduciary Duties of General Partners*, 17 Colo. Law. 1959 (1988) (stating the word "fiduciary" derives from the Latin word "fides" which means faith or confidence); *see also* Daniel S. Reynolds, *Loyalty And The Limited Partnership*, 34 Kan. L. Rev. 1, 5 n.19 ("[The] moral theme is an important part of fiduciary law. Loyalty, fidelity, faith, and honor form its basic vocabulary.") (quoting Tamar Frankel, *Fiduciary Law*, 71 Cal. L. Rev. 795, 830 (1983)); *id.* at 5 (As a result, the "fiduciary principle has an intensely moral and ethical ambiance about it.").

52 Black's Law Dictionary 625 (6th ed. 1990).

connected with such undertaking."[53] Courts have held that the existence of a fiduciary duty depends on whether one party has reposed trust and confidence in another party and the latter then exercises influence and domination over the former by virtue of their relative positions.[54] The classic articulation of the fiduciary concept was expressed by Justice Benjamin N. Cardozo in *Meinhard v. Salmon*,[55] a 1928 New York Court of Appeals case between two real estate partners:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the *punctilio of an honor the most sensitive*, is then the standard of behavior.[56]

While the parties in *Meinhard* had entered into a "joint venture," which is a relationship equivalent to a partnership, the fiduciary duty extends beyond partnership agreements. In fact, Cardozo analogized the duty owed by the managing partner Salmon to his "co-adventurer" Meinhard to the duty a trustee owes to the beneficiaries of a trust.[57] Other examples of associations that signal the fiduciary duty are the relationships between a corporate director or officer to the corporation and its shareholders, agency relationships,[58] attorney-client relations, and guardianships.[59] Contracting parties do not have an inherent fiduciary duty to one another, but a fiduciary relationship can develop between contracting parties, especially when the relationship rises to the level of agency or partnership.[60]

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[53] *Id.*

[54] *See, e.g.*, Lazin v. Pavilion Partners, No. 95-601, 1995 WL 614018, at *5 (E.D. Pa. Oct. 11, 1995) (holding that a reasonable fact-finder could conclude that plaintiff "reposed a special confidence" in defendant imposing a fiduciary duty on defendant to avoid exploiting that confidence); Giangrante v. QVC Network, Inc., No. 89-8535, 1990 WL 124944, at *2 (E.D. Pa. Aug. 23, 1990) (citing City of Harrisburg v. Bradford Trust Co., 621 F. Supp 463, 473 (M.D. Pa. 1985)).

[55] 249 N.Y. 458 (N.Y. Ct. App. 1928).

[56] *Id.* at 463-64. (emphasis added). *But see* Lawlis v. Kightlinger & Gray, 562 N.E.2d 435 (Ind. App. 1990) (holding that the fiduciary duty partners owe to each other is not such a high duty that goes beyond the scope of a contract, but rather fiduciary duty is narrowly controlled by contract terms).

[57] *See* Tucker Anthony Realty Corp. v. Richard Schlesinger, 888 F.2d 969, 972 (2d Cir. 1989) (mentioning Cardozo's analogy in the trustee context); *see also* Montgomery, *supra* note 51, at 1960 (stating that fiduciary duty owed among partners has been compared to the duty owed by trustees to their beneficiaries).

[58] *See infra* notes 61-67 and accompanying text (discussing fiduciary duty under agency law).

[59] *See* Scott Fitzgibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 306-07 (1999) (listing these and other fiduciary categories).

[60] *See* Rosary-Take One Prod. Co. v. New Line Distrib., Inc., No. 89-1905, 1996 WL 79327 (S.D.N.Y. Feb. 23, 1996) (discussing the elements necessary for the relationship be-

In analyzing fiduciary duty in the participant-studio context, it is important to examine the law of agency since it contains the clearest example of the fiduciary standard, and because profit participants assert agency principles to claim the studios are liable.[61] There are two important factors used to determine the existence of an agency relationship. One is the legal authority for the agent to act in place of the principal for the purpose of creating legal relations between the principal and third parties.[62] The other crucial element is that the principal must have the ability to exercise some degree of control over the actions of the agent.[63] However, the actual degree of control required for an agency relationship cannot be precisely defined. While some degree of control is needed, "control is not an all or nothing proposition."[64] Further, an Illinois court has opined that control, while relevant, is only one factor, and the existence of an agency relationship can be established by other direct or circumstantial evidence.[65] Other relevant evidence often includes the existence of a trust relationship with reliance by the principal on the dealings of the agent.[66] Despite the difficulty in establishing an exact formula for agency relationships, "once an agency relationship is found, a fiduciary relationship arises as a matter of law."[67]

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tween contracting parties to rise to the level of a fiduciary relationship); *see also infra* notes 101-04 and accompanying text (analyzing *Rosary-Take One Prod. Co.* in detail).

61 *See* Reynolds, *supra* note 51, at 5.

62 *See In re* Coupon Clearing Serv., Inc. v. Clare's Food Market, Inc., 113 F.3d 1091, 1099 (9th Cir. 1997)(calling this "authorization element" a chief characteristic of any agency relationship).

63 *See id.* ("The right to control, rather than its exercise, is sufficient to meet this standard.").

64 RESTATEMENT (SECOND) OF AGENCY §14 (1999) ("The control of the principal does not, however, include control at every moment; its exercise may be very attenuated . . . ."); *see also* Edwards v. John Hancock Mutual Life Ins. Co., 973 F.2d 1027 (1st Cir. 1992) (illustrating that an agency relationship was found between a lender and a lender's loan trustee simply because the trustee acted under the direction of the lender-principal); Kershentsev v. Mascottte Prods., Inc., 781 F. Supp 339 (E.D.Pa. 1991) (demonstrating that instructions from an a principal to an agent can be enough to establish an agency relationship). There are elements of control that profit participants sometimes enjoy, though the author has had no access to the actual profit participant agreements in the Duchovny-Fox dispute. These elements are the right to demand fair and equitable market value for the distribution of the series, and the right to inspect the books or the right to an accounting. *See* Complaint, *supra* note 4, at 22.

65 *See In re* Telesphere Communications, Inc. v. Telesphere Communications, 205 B.R. 535, 542-43 (N.D. Ill. 1997); *see also* Maritime Ventures Int'l v. Caribbean Trading & Fid., 689 F. Supp. 1340 (S.D.N.Y. 1988) (holding that a principal's failure to exercise control was not determinative of an agency relationship when its existence was otherwise clear).

66 *See* Kirkruff v. Wisegarver, 297 Ill. App. 3d 826, 831 (Ill. App. Ct. 1998) (stating that a trust or confidence relationship with reliance by the principal is all that is required).

67 *Id.* (quoting Letsos v. Century 21-New West Realty, 285 Ill. App. 3d 1056, 1063 (Ill. App. Ct. 1996)).

Section one of the Restatement (Second) of Agency provides that:

> Agency is the fiduciary relation, which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act. The one for whom action is to be taken is the principal. The one who is to act is the agent.[68]

The Restatement instructs that an agent acts solely for the benefit of the principal in all agency matters, and unless openly agreed to by the parties, agents may not deal for their own benefit against the principal.[69] This is true even if the transaction benefits the principal.[70] In disclosed self-dealing circumstances where an agent acts for his own benefit with the principal's permission, the agent still has the fiduciary duty to "deal fairly with the principal and to disclose to him all facts which the agent knows or should know would reasonably affect the principal's judgment . . . ."[71]

B. *Studios As Agents For The Profit Participants*

Fiduciary duty has been compared to a roving linebacker that "strikes down transactions which may meet the letter but not the spirit of the law."[72] Profit participants argue that their agreements with the television studios in the post fin-syn era conflict with the "spirit of the law" and assert agency principles[73] to elicit the fiduciary linebacker. This section will illustrate that traditional producer-distributor agreements, which the studios rely on as authority to dispute a fiduciary relationship, are not comparable to the studio-participant situation. However, self-dealing in other fiduciary contexts is instructive for analyzing the present studio-participant conflict.

The existence of an agency relationship between the profit participant and the television studio is complicated by the unique circumstances between the parties. In ordinary distribution con-

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68 RESTATEMENT (SECOND) OF AGENCY § 1 (1999).

69 *Id.* §§ 387, 389.

70 *Id.* § 389 cmt. c; *see also* Reynolds, *supra* note 51, at 6 ("Section 389 thus flatly prohibits undisclosed self-dealing by enterprise fiduciaries.").

71 RESTATEMENT (SECOND) OF AGENCY § 390; *see also id.* cmt a (describing the particularity of a proper disclosure which, in a sales situation includes among other facts, the "likelihood of a higher price being obtained later . . . .").

72 Montgomery, *supra* note 51, at 1965.

73 *See, e.g.*, Complaint, *supra* note 4, at 33 (alleging that Fox, as agents for Duchovny with respect to collecting, receiving, accounting, and paying revenues derived from the distribution and exploitation of *The X-Files* owe him a fiduciary duty).

tracts, distributors and producers negotiate at arm's length.[74] Therefore, there is no agency relationship between the parties, and distributors owe no fiduciary duty to producers.[75] In the current profit participant disputes, however, the producer is also the distributor, and thus is unable to engage in arm's length negotiations with itself.[76] Accordingly, in matters connected with distribution agreements, it should not be assumed that there are no per se fiduciary duty implications. Complicating matters further, in a typical agency relationship, the principal is an owner of some property and the agent is a person or entity acting on the owner's behalf to sell or enhance the property.[77] In the profit participant disputes, the owner of the "property" is the television studio, but the studio also is alleged to be the agent on behalf of the profit participant, who is then a principal without ownership interest in the property.[78] While ownership does connote control, ownership is not necessary to show the requisite degree of control needed by a principal in an agency relationship.[79]

In the Duchovny-Fox dispute, Fox challenges the allegation that it is an agent for David Duchovny on two grounds. First, the studio points to the contract to disavow the existence of an agency relationship and any resulting fiduciary duty.[80] Echoing the dic-

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[74] *See, e.g.*, Recorded Picture Co. Prod. Ltd v. Nelson Entm't, Inc., 53 Cal. App. 4th 350 (Cal. Ct. App. 1997) (explaining that these are business contracts negotiated at arm's length where the owner of the product and the distributor is each trying to get the best deal for itself); Waverly Prod., Inc. v. RKO, Inc., 217 Cal. App. 2d 721 (Cal. Ct. App. 1963) (holding that no fiduciary relationship existed between a film producer and film distributor).

[75] *See Waverly Prod., Inc.*, 217 Cal. App. 2d at 732.

[76] *See supra* notes 13-15 and accompanying text (explaining that FEG is involved in both the production and distribution of *The X-Files*).

[77] *See, e.g.*, Letsos v. Century 21-New West Realty, 285 Ill. App. 3d 1056 (Ill. App. Ct. 1996) (illustrating breach of agency agreement where property owner-principal brought suit against real estate broker on theory that broker breached his fiduciary duties as agent to the property owner).

[78] *See* Defendant's Notice of Demurrer and Demurrer to Complaint at 5, David Duchovny and King Baby, Inc. v. Twentieth Century Fox Film Corp., No. SC058329 (Super. Ct. Cal. filed Sept. 23, 1999) [hereinafter Demurrer]. "Plaintiffs, however, have not alleged any ownership interest in the Series being distributed by Fox. Nor could they, as they expressly acknowledged in their written agreement that Fox 'owns all rights in [Duchovny's] services, name, likeness and voice in connection with the. . .Series. . . .'." *Id. But see infra* notes 138-141 and accompanying text (questioning the import of this distinction).

[79] *See supra* notes 61-67 and accompanying text (explaining the requirements necessary to prove an agency relationship).

[80] *See* Demurrer, *supra* note 78, at 8. Fox states that Duchovny agreed contractually that their relationship is: "that of creditor and debtor with respect to all matters including the production, distribution, exploitation, and any other disposition of the [Series], any elements thereof or rights therein and the computation and payment of any monies due [Plaintiffs]. . .[and] that there is no fiduciary relationship between [them]. . . ." *Id.*; *see also Waverly Prod., Inc.*, 217 Cal. App. 2d at 734 (stating that there is no fiduciary relation between a debtor and creditor because a debt is not a trust).

tates of the Indiana court in *Lawlis v. Kightlinger & Gray*,[81] Fox attorney Rita Tuzon states that, "the studio just wants to abide by the contract, while the [profit participants] want to extend the relationship to one encompassing a fiduciary duty."[82] Fox's claim, while having merit, is specific to the Duchovny-Fox dispute[83] and will not be analyzed closely, but it is worth noting two responses to Fox's stance.[84] First, though Fox emphasizes the importance of its written agreement with David Duchovny, courts have held contractual language is not dispositive regarding similar issues. Equally important, the contractual language that permits Fox to deal with its subsidiary distribution outlets, does not immunize the studio from fiduciary liability.[85] If Fox's transactions with its subsidiaries unreasonably utilize the studio's corporate position to its own advantage, but to the financial detriment of its profit participant, the participant can establish a successful claim for breach of fiduciary duty because a corporation's fiduciary obligation is separate from its contractual obligation.[86]

Fox's second argument for disputing an agency relation with David Duchovny is premised on case law involving film distribution

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[81] 562 N.E.2d 435 (Ind. Ct. App. 1990) (holding that fiduciary duty is defined narrowly by contract terms).

[82] Telephone Interview with Rita Tuzon, In-House Counsel, Twentieth Century Fox Film Corp. (Oct. 14, 1999) [hereinafter Tuzon Interview](on file with author) Fox claims that the profit participants are trying to extend the contractual relationship beyond the four corners of the contract as a litigation tactic to find a claim. *See id.*

[83] This Note focuses on the legal relationship between television studios and their profit participants via their positions in the marketplace, and this particular contractual dispute between Fox and Duchovny exceeds the scope and purpose of the paper. *But see infra* Part III (describing contractual safeguards for future self-dealing television contracts involving profit participants).

[84] *See* Rosary-Take One Prod. Co. v. New Line Distrib., Inc., No. 89-1905, 1996 WL 79327, at *1 (S.D.N.Y. Feb. 23, 1996) (citing April Enter., Inc. v. KTTV, 147 Cal. App. 3d 805 (Cal. Ct. App. 1983)). In *April Enter.*, respondents denied the existence of a joint venture and fiduciary duty because the contract explicitly denied the existence of a joint venture, but the court rejected this argument "since the conduct of the parties may create a joint venture despite an express declaration to the contrary." *April Enter.*, 147 Cal. App. 3d at 820. In *Rosary-Take One Prod.*, the court ruled on the basis of *April Enter.*, "[t]hat plaintiff's claim of breach of fiduciary duty is not barred as a matter of law by the language in the parties' Distribution Agreement deeming their relationship to be one of independent contractors." *Rosary-Take One Prod.*, 1996 WL 79327, at *1. It should follow that the language in the Fox agreement that deems the relationship that of creditor and debtor should not bar the existence of an agency relationship or a finding of a fiduciary duty if the conduct of the parties shows otherwise.

[85] *See, e.g.*, Interactive Multimedia Artists, Inc. v. Superior Court (Allstate Ins. Co.), 62 Cal. App 4th 1546 (Cal. Ct. App. 1998) (stating that both parties acknowledged that the breach of fiduciary duty claim did not arise from the contract itself); Weinberger v. UOP, Inc. 457 A.2d 701, 710 (Del. 1983) (noting that although a majority shareholder company in a freeze-out merger had the statutory and contractual powers to create the merger, these powers did not release the company from its fiduciary obligation concerning the merger). Thus, what a corporation has the power to do may still be a breach of its fiduciary duty.

[86] *See supra* note 85.

agreements where no fiduciary duty was found by the presiding court.[87] However, each of the cases relied upon by the studio is distinguishable. In *Waverly Productions v. RKO General Inc.*,[88] the California Court of Appeals rejected a film producer's argument that a distribution contract created any type of fiduciary obligation between the distributor and producer, except as to provide an accounting for proceeds received from sub-distributors.[89] The producer's main contention was that the distributor entered into sublicenses for foreign distribution of the film without the producer's authorization and against the producer's financial interest.[90] The court, which sided with the distributor, viewed the case as a purely contractual matter since the parties were "in a course of armed-length dealing."[91] The court compared the dispute to *Gonsalves v. Hodgson*,[92] where the relationship between two parties who contracted for the construction of a fishing boat was held to be one of simple contract, and not to involve trust or agency principles.[93] In both cases, California courts found no fiduciary obligation and embraced a standard for dealing consistent with marketplace competition. These two set-ups, which Fox argues bolsters its defense, are distinct from the profit participation setting because the studio is representing the financial interests of the profit participant with whom it has a contractual relationship.[94] Unlike a film producer

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[87] *See* Demurrer, *supra* note 78, at 5-6. Since there are no television distribution case precedents directly addressing agency and fiduciary principles, these cases are instructive.

[88] 217 Cal. App. 2d 721 (Cal. Ct. App. 1963); *see also* Demurrer, *supra* note 78, at 6 (discounting the fiduciary duty to account announced in Waverly as "pure dictum"). Profit participants such as Duchovny do allege that the studios, as agents, breach their fiduciary duty with respect to accounting for the revenues received from licensing. *See* Complaint, *supra* note 4, at 33. But the accounting issue is not the crux of these disputes for two reasons. First, as is the case for Duchovny, most profit participants have audit rights which allow them to "examine the . . . books of account which relate to the [Series], in order to verify the accuracy of the transactions or items of information . . . ." Demurrer, *supra* note 78, at 7. Where the profit participant has audit rights no fiduciary duty arises because the necessary elements of trust and reliance with respect to the studio's accounting are absent. *Id.* (citing Crest Enter., N.V. v. Columbia Pictures Indus., Inc., No. 80-4777, slip op. at 4 (C.D. Cal. June 19, 1981)) (explaining that having audit rights is counter to the elements of trust and reliance needed for fiduciary relations). Secondly, the basis for the profit participants' claims is not that the studios are failing to account for the profits that they receive. Participants claim that the studios' self-dealing results in below market price licensing fees that benefit the studios at the expense of the profit participants, which is a breach of the studios' fiduciary duty.

[89] *See Waverly Prod., Inc.*, 217 Cal App. 2d. at 734.

[90] *See id.* at 725.

[91] *Id.* at 733.

[92] 38 Cal.2d 91 (Cal. 1951).

[93] *See id.* In *Gonsalves*, the court held "[t]here is no rule that parties to a contract may not act for their own interest during the execution of the contract. They have no duty of loyal representation of the opposing party in the relationship. The parties here were engaged in a course of arms-length dealing." *Id.* at 99.

[94] *See* Complaint, *supra* note 4, at 9-10, 33 (describing the profit participation agree-

or a person seeking to build a ship, profit participants are not free to shop for the best contract on the market; participants depend on the studio to garner the best deal for itself, which proportionally results in the participants' success.[95] Profit participants argue that, "this is where the fiduciary relationship comes from."[96]

In *Recorded Picture Co. Prod. v. Nelson Entm't, Inc.*,[97] another case relied upon by Fox, the California Court of Appeals rejected an argument by producers of the motion picture *The Last Emperor* who brought a suit against a sub-distributor, claiming they were owed a fiduciary duty because the sub-distributor was their trustee or agent with regard to revenue proceeds from home-video distribution.[98] While acknowledging that an agent obviously does undertake fiduciary obligations, the court found that this case simply extended the notion that there is no fiduciary relation between a producer and distributor, to there being no such obligation between a producer and subdistributor.[99] The court's decision depended in large part on the authority of *Waverly Productions*[100] but the decision does not account for the disparate positions of the parties in the profit participation scenario. In the profit sharing context, the participant solely depends on the studio to generate the best licensing contract, and unlike a producer, the profit participant cannot seek a better distribution deal.[101]

This relationship puts the studio in a special position of confidence and trust since it is conducting financial transactions on behalf of the profit participant. In *Rosary-Take One Prod. Co. v. New Line Distrib., Inc.*,[102] a Southern District of New York case not mentioned in either Fox's or Duchovny's pleadings, Senior District Judge Haight opined, "fiduciary duty 'applies in every case where there has been a confidence reposed which invests the person trusted with an advantage in treating with the person so confid-

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ment and that the studio is acting on the profit participant's behalf and is in total control of the distribution of the series).

95 *See* Stein Interview, *supra* note 49 (stating that the studio has complete control of the licensing fee generated on behalf of the profit participant, in terms of market information, market value, and negotiation strategy). If the studio cannot prove that it obtained a just and equitable market rate price it is not representing the interests of the profit participant. *See infra* Part III.B (describing how the studio should establish fair prices in the self-dealing context).

96 Stein Interview, *supra* note 49.

97 53 Cal. App. 4th 350 (Cal. Ct. App. 1997).

98 *See id.*

99 *See id.* at 370-71.

100 217 Cal. App. 2d 721 (Cal. Ct. App. 1963).

101 *See supra* notes 93-94 and accompanying text (explaining that the profit participation agreement renders the participant wholly dependent on the studio to distribute the television series).

102 No. 89-1905, 1996 WL 79327 (S.D.N.Y. Feb. 23, 1996).

ing.'"[103] A film producer (Rosary) in that case claimed to have a fiduciary relationship with its distributor (New Line), due to their agreement to share profits from the film's distribution.[104] The court rejected this argument because, like in *Waverly*, the parties' relationship was purely contractual and negotiated at arm's length.[105] In the profit participant suits, the issue is not just one of simple contract because the studios gain an advantage over the participants who have approved the studio to transact for their financial interest.[106] Taken together, traditional producer-distributor agreements do not form a model for the current profit participation litigation.

The reason the preceding cases differ from the present conflict is that traditional distribution agreements are premised on non-mutual profit.[107] Like the manufacturer-distributor relationship, the producer-distributor relationship has an element of non-mutual profit, which can pit the parties against each other, although this is often not in their best interests.[108] Traditional fiduciary relationships that exist, for example, between trustees and beneficiaries, co-tenants, and between corporate directors and shareholders "preclude any element of non-mutual profit."[109] Like these accepted fiduciary relationships, profit participants and the

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[103] *Id.* at *2 (quoting Stevens v. Marco, 147 Cal. App. 2d 357, 374 (Cal. Ct. App. 1956)). *Stevens* involved the trusting of an idea, see 147 Cal. App. 2d at 362-63, but the principle is one of broad application and should apply to financial matters as well.

[104] *See id.*

[105] *See id.* The court also noted that none of the relationships in the fiduciary duty cases cited by Rosary resembled its contractual relationship with New Line. *See id.* The cases cited by Rosary involved joint ventures, partnerships or employment relationships. The court hastily dismissed Rosary's fiduciary duty argument because Rosary's relationship with New Line did not fit into one of the categories of cases cited. *See id.* This is unfortunate because this case most resembles the profit participant scenario. *See also infra* Part II.C (suggesting that the unique profit participant relationship should be analogized to other legal relationships).

[106] The studio's advantage is its ability to control the revenue stream that goes toward the participants by shifting revenue away from the series and towards affiliates. *See* Complaint, *supra* note 4, at 25-26. In *Rosary*, New Line did not have the capability to engage in this kind of dealing. *See Rosary-Take One Prod. Co.*, 1996 WL 79327, at *2. This Note is not judging whether the studios actually deal in this inequitable fashion, but the potential for such transactions is apparent.

[107] *See* Rickel v. Schwinn Bicycle Co., 144 Cal. App. 3d. 648, 654 (Cal. Ct. App. 1983). The court held that no fiduciary relationship existed between a manufacturer and the manufacturer's dealer because non-mutual profit was inherent in their relationship. *See id.* at 655. The manufacturer's pricing decisions were made for the sole purpose of increasing its total sales, which also usually benefit the dealer, but the manufacturer is legally entitled to make pricing and distribution decisions for its own financial benefit at the expense of the dealer. *See id.* at 654. Similarly, the dealer was free to try to promote the sale of companies that competed with the manufacturer. *See id.*

[108] *See id.* The business relationship between a producer and distributor is akin to the relationship between a manufacturer and dealer so the mutuality principle announced in *Schwinn* similarly applies.

[109] *Id.*

studios contract with an inherent notion of mutual benefit. Under this premise, the studio acts very much like an agent on the participant's behalf and self-dealing transactions appear problematic.

Since traditional producer-distributor agreements do not form an adequate model for the participant-studio dispute, it is necessary to explore other relationships that are relevant to the inquiry. Self-dealing concerns in other fiduciary contexts lend valuable insight into the present participant-studio dilemma. Under trust law, self-dealing by the trustee is dissuaded, not because the transaction is necessarily unfair, but because the trustee can obtain significant information about the value of the property and keep it to himself.[110] Similarly, the television studio, through self-dealing, has the ability to keep to itself information regarding the value that a series generates to itself.[111] Participants argue that this practice dilutes potential bidders, thereby devaluing the show's value on the open market.[112] Thus, while the studio's distribution agreement is "fair" according to the studio, it is not fair in terms of potential market affects.[113]

Trust law also imposes prohibitions against self-dealing "on the basis that the fraud involved in such transaction[s] is difficult to discern."[114] While the studios are not accused of fraudulent dealing, the self-dealing makes it similarly difficult for the participants to gauge the fairness of the distribution agreement since the studio is contracting with itself.[115] The similar difficulties of monitoring self-dealing in the areas of trust law and the participant-studio conflict indicates the need to incorporate the strictures associated with self-dealing in trust law to the studio-participant situation.

Still, trust law does not provide the only analogy to self-dealing in the studio-participant scenario. The conflict between the television studio and the profit participant also resembles self-dealing in

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110 *See* Stegemeier v. Magness, 728 A.2d 557, 564 (Del. Sup. Ct. 1999) (stating the rule under trust law aims to alleviate possible conflict between trustee's duty to the trust and his own self-interest).

111 *See* Complaint, *supra* note 4, at 4-5 (arguing that Fox's ability to self-deal is continuing to grow, which will allow more opportunity for manipulating negotiations for its corporate interest).

112 *See id.*

113 *See infra* Part III.B (describing how this problem can be remedied).

114 *Stegemeier*, 728 A.2d at 565.

115 *See* First Amended Complaint, *supra* note 15, at 27 (alleging that FEG's top management is involved in important aspects of FEG's subsidiaries, affiliated entities, including the negotiation and approval of major licensing agreements of the series). *But see* Tuzon Interview, *supra* note 82 (arguing that Fox and its affiliates are negotiating at arm's length because they are separate entities with separate directors making independent decisions).

minority-dominant shareholder disputes.[116] The profit participant's dependence on the studio to act for their mutual benefit is analogous to a minority shareholder's reliance on a controlling shareholder to act in the corporation's best interest. In *Trans World Airlines ("TWA"), Inc. v. Summa Corp.*,[117] Hughes Tool Company ("Toolco") owned 78% of the outstanding stock of TWA, and thus controlled the business judgments of TWA without serious opposition from minority shareholder.[118] Toolco prevented TWA from purchasing its own aircraft, but instead required TWA to lease its aircraft from Toolco.[119] The court held that Toolco, "bargained on both sides of such transactions, causing . . . [it] to derive advantages at the expense of TWA to the exclusion of and to the detriment of the latter's minority shareholders . . . the defendants [Toolco] retained the capability of arranging the terms of such acquisitions so as to benefit themselves."[120] Toolco's self-dealing created greater revenue for its wholly owned company and less revenue for TWA, whose profits had to be shared with the minority shareholders.[121]

This is analogous to the practice that participants claim is cheating them out of their just profits.[122] The profit participants are in a position similar to minority shareholders, which expect their majority shareholders to represent their best interests. *Trans World Airlines* indicates that courts will not allow majority shareholders to use their position to benefit themselves at the expense of the minority shareholders to whom the majority shareholders owe a fiduciary obligation. While there is no presumption against self-dealing in the minority-dominant shareholder context like there is in the area of trust law, the fiduciary mantle remains high enough to protect the interests of the represented party. Here, the represented party is the minority shareholder, just as the profit participant is a represented party.

In *Sinclair Oil Corp. v. Levien*,[123] another minority-dominant

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[116] This Note acknowledges that the shareholders "own" shares of a company, while profit participant are not in the same ownership position.
[117] 374 A.2d 5 (Del. Ch. 1977).
[118] *See id.* at 8.
[119] *See id.* at 10.
[120] *Id.* The court also stated, "TWA might well have been able to earn substantially more income for its minority as well as majority stockholders through increased business activity during the period of its being dominated had it not been subject to the strictures imposed by the defendants." *Id.*
[121] *See id.*
[122] *See supra* notes 21-24 and accompanying text (explaining that Duchovny accuses FEG of shifting corporate revenue to its wholly owned subsidiaries to prevent licensing revenue from being shared with him as a profit participant).
[123] 280 A.2d 717 (Del. 1971).

shareholder case that was cited by the *TWA* court, Sinclair Oil Corp. ("Sinclair") was the 97% owner of Sinclair Venezuelan Oil Co. ("Sinven") and also wholly owned its subsidiary International Oil Co. ("International"), which Sinclair used to make its natural resource purchases.[124] Profit generated by International was entirely absorbed by Sinclair, while 3% of the profit generated by Sinven went to the company's minority shareholders rather than to Sinclair.[125] This structure is similar to Fox's relationship with its affiliated broadcast entities and profit participants. The total revenue generated by Fox's broadcasting entities stays within the FEG revenue stream, while a small percentage of the profits generated by the licensing of a show seeps away from FEG to the profit participants.[126] The court in *Sinclair* found that Sinclair caused Sinven to sell its crude products to International, and that International consistently made late payments after receiving the products.[127] Sinclair caused Sinven to disregard the breach, thus allowing International (Sinclair's wholly owned company) to receive products at below market prices, to the detriment of Sinven's minority shareholders.[128] As the majority owner of Sinven, Sinclair lost profit due to the late payments, but as the sole owner of International, Sinclair also gained revenue at the expense of the Sinven minority shareholders.[129] The court held this method of self-dealing to be a breach of fiduciary duty.[130] This is analogous to the actions alleged by the profit participants against the studio. In both situations a parent company is dealing between its wholly owned entity and persons with whom the parent has to share profits, and benefits itself at the expense of the individuals who have placed confidence in the parent to maximize their profits.

To summarize, profit participants use agency principles to argue that the studio's self-dealing breaches their fiduciary duty to the profit participants. There is no precise requisite influence that the participant must exercise over the studio to establish the basis for this argument. It is likely, however, that the participant can assert sufficient evidence to establish a fiduciary relationship. The standard producer-distributor contract negotiated at arm's length,

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124 *See id.* at 719.

125 *See id.*

126 *See supra* notes 21-24 and accompanying text (explaining the participants' allegations that studios are licensing television shows at below market prices to decrease the percentage payments to profit participants and benefit the corporate revenue stream).

127 *See Sinclair Oil Corp.*, 280 A.2d at 722-23.

128 *See id.* at 723.

129 *See id.*

130 *See id.*

and potentially for non-mutual profit, does not accurately reflect the contractual relationship between the participant and the studio. The profit participant depends on the studio to license its show according to fair market value, but the studio's ability to self-deal threatens this equitable balance. Borrowing from examples of self-dealing in the areas of trust law and minority-dominant shareholder cases, it appears that courts should narrowly construe self-dealing in the participant-studio situation.[131]

C. *The Limited Partnership Analogy*

Despite the argument posited above, there is no precedent directly addressing whether a television studio owes a fiduciary duty to its profit participant. However, analogy to limited partnership law seems to provide an answer. Limited partnership law is governed by the Uniform Limited Partnership Act (ULPA).[132] It provides for a partnership with one or more general partners who run the business and have unlimited liability.[133] The general partners are in partnership with one or more partners whose liability is limited to their investment in the partnership, but who do not have control over the business' operations.[134] A profit participation agreement does not create a limited partnership,[135] but essentially the parties are partners when it comes to this profit sharing element of the contract.[136] Another reason for using the limited partnership as a basis for analyzing the participant-studio controversy is that limited partnerships are a breeding ground for self-dealing controversies.[137]

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[131] *See infra* Part III.C.

[132] UNIF. LTD. PARTNERSHIP ACT, 6 U.L.A. 346 (1986).

[133] *See id.*

[134] *See id.*; *see also* Boxer v. Husky Oil Co., 429 A.2d 995, 997 (Del. Ch. 1981) ("When the provisions of the Uniform Partnership Act and the Uniform Limited Partnership Act are read together, it is clear that the general partner in a limited partnership owes a fiduciary duty to the limited partners.").

[135] *See supra* note 78 and accompanying text (explaining that the participant does not have ownership interest in the show).

[136] *See* Swanson v. Siem, 124 Cal. Ct. App 519, 524 (Cal. Ct. App. 1932) ("The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business."); Robert W. Hamilton, *Corporate General Partners of Limited Partnership*, 1 J. SMALL & EMERGING BUS. L. 73, 75 (1997) (noting that a limited partnership is "essentially a contractual relationship").

[137] *See* Reynolds, *supra* note 51, at 25.

> Self-dealing and conflicts of interest are endemic to the limited partnership. Limited partnerships "are born in conflicts of interest, live in conflicts of interest, and sometimes poof out of existence in conflicts of interest." The general partners are typically the organizing entrepreneurs or promoters. They may be affiliated with the sellers of the entrepreneur's assets, and are frequently involved in multiple, potentially competing related enterprises.

Id. (Internal citations omitted).

Numerous courts have compared the relationship between the general partner and the limited partner to that between a corporate director and shareholder because the respective positions of the parties are parallel, and the same principle of fairness should permeate both relationships.[138] Courts explain that the principle is the same in both business forms—those in control of a business must deal fairly with those individuals who have no control, but who do have a financial interest in the enterprise.[139]

> Clearly, form alone cannot compel any meaningful conclusion about fiduciary obligation, loyalty, or their elusive object, fairness. Intuitively, one would guess that any rational norms aimed at creating fairness should take their shape more from the function and expected behavior of the players on whom such norms are imposed, than from some incantation of the structural form into which the players chose to cast their relationship.[140]

The foregoing statements illustrate that the existence of fiduciary duty obligations should not be based upon the organizational form from which a business relationship is generated. Furthermore, it is useful to compare the law's response to self-dealing in different commercial relationships when the transactions are alike. Thus, it becomes particularly instructive to analyze self-dealing in the limited partnership context to establish doctrinal norms for self-dealing in the television distribution arena.

A classic example of unfair self-dealing in the limited-partnership context is the situation where a general partner owns an entity separate from the limited partnership and sells limited partnership assets to the independent entity at a below market price.[141] In *Slingerland v. Hurley*,[142] a partnership's managing partner[143] sold partnership real estate at a price significantly below market price, to a separate corporation, for which he was the majority stockholder.[144] The court determined that the issue was simply whether or not the

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138 *See, e.g.*, Miller v. Schweikart, 405 F. Supp. 366 (S.D.N.Y. 1975); Boxer v. Husky Oil Co., 429 A.2d 995 (Del. Ch. 1981); Lichtyger v. Franchard Corp., 18 N.Y.2d 528 (N.Y. 1966).

139 *See Lichtyger*, 18 N.Y.2d at 536.

140 Reynolds, *supra* note 51, at 3.

141 *See In re* USACafes, 600 A.2d 43, 49 (Del. Ch. 1991) The court used this hypothetical in its own analysis of an action brought by limited partners who challenged the purchase of limited partnership assets by a corporate general partner. *See id.*

142 388 So.2d 587 (Fla. Dist. Ct. App. 1980).

143 The term "managing partner" is not statutory and takes on different meanings. *See* Reynolds, *supra* note 51, at 13. "One generalization that can be made, however, is that one who earns the title . . . will be held to a standard of fiduciary behavior that is articulated in even more demanding terms than the already demanding formulation of the duties of 'mere' partners." *Id.*

144 *See Slingerland*, 388 So.2d at 588-89.

managing partner's corporation paid full market value for the property it purchased from the limited partnership.[145] The case was remanded to the trial court to determine the fair market value of the property based on a court-ordered accounting.[146] In essence, the court placed the managing partner with the burden of proving the fairness of the transaction against a presumption of unfairness.[147] In holding the managing partner liable to the non-controlling partners for the potential difference between the price paid and the fair market value of the property, Chief Judge Letts opined, "[the managing partner] cannot take in-house advantage of his co-partners. . . . [T]he operating partner believes he can play the pied Piper of Hamlin and pipe all of his investors off any financial cliffs of his choosing without accountability."[148]

In a similar case, *Waldor v. Bruey*,[149] Bruey, a 50% owner in a partnership, hired the services of a company in which he was the sole owner.[150] The court reasoned that Bruey's position of power placed the onus on him to demonstrate that he was painstakingly cautious not to favor his wholly owned company at the expense of the partnership.[151] But, the independent company was charging the partnership approximately double the market price for its services, thus allowing Bruey to favor the company in which he had a 100% interest.[152] The court held that Bruey, "was in a fiduciary position and that it was his duty to hold the scales fairly and honestly balanced between self-interest and fiduciary responsibility. Instead of doing that, he feathered his own nest . . . ."[153] Like the *Slinglerland* court, this court viewed that the party holding decision-making powers over the other partner-investors was in a fiduciary position, and in that capacity had the burden to prove the fairness of its self-dealing.

The position of the parties involved in the limited partnership cases parallel the position of the profit participant and the studio. The only substantive difference between the circumstances surrounding the parties in the above cases and the positions of the parties in the participant-studio analysis is that the limited partners

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145 *See id.* at 589.
146 *See id.*
147 *See id. See also* Part III.C. *infra* (discussing the impact of this burden). The court's finding was consistent with the use of the intrinsic fairness test.
148 *Id.* at 589-90.
149 24 N.J. Misc. 354 (N.J. Ch. 1947).
150 *See id.* at 360-62.
151 *See id.* at 371. The court stated that Bruey "should have been meticulously and scrupulously careful. . . ." *Id.*
152 *See id.* at 368-69.
153 *Id.* at 371.

have an "ownership interest," whereas the profit participant is not contractually an "owner."[154] But tying the two legal settings together, if a television studio engages in self-dealing that resembles the transactions mentioned above, it would seem unjust not to hold the studio to the same fiduciary mantle, only because the profit participant is not a "co-owner" with the studio. Profit participants are in a position analogous to limited partners because they, too, have limited liability and no voice in the operation of the studio's business dealings.[155] The Supreme Court of California case of *Nelson v. Abraham*,[156] in which a fiduciary duty was owed to a profit sharing non-owner in a business association, lends credence to this conclusion.

The benefits of having a fiduciary standard in studio-profit participant agreements are evident by analyzing the limited partnership.[157] The profit participant depends on the television studio, just as the limited partner relies on the general partner. The profit participant is vulnerable to the dealings of the studio, which controls the participant's financial stake. Accordingly, the strict fiduciary standard that is applied to general partners in a limited partnership[158] should also be extended to the studio in profit participant agreements.[159]

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154 *See* Demurrer, *supra* note 78 (stating that David Duchovny disavows any ownership interest in *The X-Files* series).

155 *See* Lichtyger v. Franchard Corp., 277 N.Y.S.2d 377, 383 (N.Y. 1966). This case used the same analogy to compare a shareholder to a limited partner and the author is extending the analogy to compare the profit participant to the studio.

156 29 Cal. 2d 745 (Cal. 1947).

> Whether the agreement to share profits is merely to provide a measure of compensation for services or for the use of money, or whether it extends beyond and bestows ownership and interest in the profits themselves so as to constitute the undertaking a partnership or a joint venture, presents primarily questions of fact. . . . It is, however, unnecessary to place a precise legal designation on the relationship between the parties. The present controversy is between the parties to a contract by which the plaintiff admittedly became entitled to a one-third share of the net profits from operation without acquiring an interest in the business . . . the conduct of the parties thereunder, considering the nature of the undertaking and the surrounding circumstances, define their respective rights, liabilities and duties one to the other without the necessity for designating their relationship by a particular label.

Id. at 746-49.

157 *See* Bassan v. Investment Exch. Corp., 83 Wash. 2d 922 (Wash. 1974). "Once the limited partner has joined the partnership he has no effective voice in the decision-making process. He must, then, be able to rely on the highest standard of conduct from the general partner." *Id.* at 927-28.

158 *See* Lonnie E. Griffith, Jr., *Limited Partnership*, 59A AM. JUR. § 1335 (2d ed. 1987) (explaining that courts have applied strict fiduciary standards to the conduct of general partners vis a vis their limited partners to the extent of applying Benjamin N. Cardozo's statement "that 'not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.'").

159 *See infra* Part III. (describing a model for future agreements).

As Part II of this Note has demonstrated there are numerous types of fiduciary relationships and each involves a different level of fiduciary obligation. For example, the fiduciary standard under trust law is so strict that self-dealing by the trustee is explicitly prohibited.[160] But, the fiduciary responsibility owed in dominant shareholder and partnership disputes while still high, does permit self-dealing by the controlling parties.[161] There is no precise fiduciary category in which to fit the participant-studio dispute, but this Note has argued that the studio owes a fiduciary obligation similar to that owed by dominant shareholders to their minority shareholders and general partners to their limited partners. The significance of this conclusion will be explored further in Part III, Section C, but it is useful to discuss briefly the implication of finding the fiduciary duty in the participant-studio context.

A major impact of applying a fiduciary duty in the participant-studio context is in its effect on potential judicial adjudication.[162] If a studio bears no fiduciary responsibility to its profit participants, then under the business judgment rule, the studio and its corporate managers will enjoy powerful protection from liability, against participants who challenge the studio's dealings.[163] However, a studio's fiduciary obligation will influence courts to closely scrutinize the standard of care owed by the studio to the participant, especially when the latter alleges the studio's participation in a conflict of interest.[164]

As a result, when a profit participant challenges a studio's self-dealing, courts are likely to shift the burden of proof away from the participant, and make the studio bear the legal burden to prove the entire fairness of the transaction.[165] Thus, as Part III will illustrate, finding the studio responsible as a fiduciary to the participant has a dramatic impact on how courts could decide these cases, and provides the participant with a more desirable legal foothold. However, as discussed in the next section, imposing a fiduciary obligation upon the studio in its relationships with profit participants does not place an unreasonable burden upon the studio. But extending the fiduciary obligation to the television studio in its relations with profit participants will further the ideal of the fiduciary

160 *See supra* notes 109-114 and accompanying text.

161 *See supra* Part II.B.

162 *See infra* Part III.C.

163 *See id.*

164 *See id.*

165 *See supra* notes 135-143 and accompanying text (demonstrating that courts use burden shifting in the comparable limited partnership context). Determining which party bears the burden of proof is at stake in finding whether a fiduciary duty is owed.

principle as a "[r]oving linebacker, used to plug any gaps that turn up whenever there is some danger that an injustice might occur."[166]

III. A Future Model: Suggestions for Contracting in the Vertically Integrated Marketplace

A. *Contract Specificity: The Key to Self-Dealing*

The late Walt Disney dealt with the issue of profit sharing in a simple manner: "He didn't give cuts to actors, period . . . Bing Crosby demanded profit-sharing to star in [Disney's] 1967 flick, *The Happiest Millionaire.* Fred MacMurray got the part."[167] This is one method studios could utilize to prevent grievances from profit participants who dispute the studio's self-dealing. However, this extreme view is neither necessary nor in the interest of studios that want to reduce exorbitant salary costs to actors.

As a result of the federal deregulation in the media and broadcast industry, consolidation and vertical integration will continue to maintain an environment ripe for self-dealing. Therefore, it is necessary to view the controversy between the studio and profit participant to prevent the problem in the future.

There have been three phases of drafting profit participation agreements as they relate to the issue of self-dealing by the television studio.[168] The first category of contracts, drafted during the fin-syn era, did not address the consequences of a television production entity that licensed a show to its own broadcasting subsidiaries.[169] The second wave of profit participation contracts, such as David Duchovny's, permit studios to contract with an affiliated entity, but stipulate that the licensing fee must be a fair market value price.[170] The third and current phase of profit participant agreements provide for non-public arbitration if there is a dispute concerning the studio's dealing with its affiliates.[171] These three phases of contract have all omitted the terms that will ameliorate the conflict between the studios and profit participants.

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[166] Reynolds, *supra* note 51, at 15 (citing Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 Bus. Law. 883, 886 (1976)).

[167] Lubove, *supra* note 12.

[168] *See* Stein Interview, *supra* note 49.

[169] *See id.* (explaining that the antitrust rules prevented the studios from choosing this option).

[170] *See id.*; *see also* Complaint, *supra* note 4, at 11 ("[Fox] shall establish fair, just and equitable market rate prices in such dealings, which shall be created on a reasonable and empirically justifiable basis.").

[171] *See* Stein Interview, *supra* note 49 (noting that the non-public arbitration also prevents the possibility of recovering punitive damages).

In the future, two key factors will allow the studios to engage in self-dealing without threatening the interests of profit participants whose financial interest are represented by the studios. This section will argue that specific contractual language which discloses the studio's self-dealing and provides for an informed consent by the profit participant will reduce the threat of litigation in this area, and help to insulate the studio from potential liability.

First, for the television studio to distribute its own show to its broadcast entities, the studio must provide for self-dealing in its agreement with the profit participant. "The authorization to engage in self-dealing must be clear and explicit."[172] This mandatory criterion is borrowed from principles of partnership law that allow contract provisions to trump fiduciary ideals.[173] In *Kahn v. Icahn*,[174] the court held that a general partner did not breach his fiduciary duty by using his affiliates to compete with the limited partnership because the limited partnership agreement specifically authorized the general partner's conduct.[175] However, such conduct is contrary to fiduciary duty principles when there is no contractual authorization to engage in self-dealing transactions.[176] This requirement is a conventional and pragmatic starting point for the studios to protect themselves from potential litigation.[177]

The contract provision allowing self-dealing should also meet a minimum threshold of specificity that would justify "informed consent"[178] by the profit participant. Borrowing this provision from agency law, the studio's disclosure to the profit participant should include, "not only the price which can be obtained, but also all facts affecting the desirability of sale, such as the likelihood of a higher price being obtained later, [and] the possibilities of dealing

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[172] Tucker Anthony Realty Corp v. Schlesinger, 888 F.2d 969, 974 (3d Cir. 1989); *see also* Renz v. Beeman, 589 F.2d 735, 745 (2d Cir. 1978) ("[O]nly the most explicit language can protect a fiduciary from liability in a conflict of interest . . . .").

[173] *See* Sonet v. Timber Co., 722 A.2d 319, 322 (Del. Ch. 1998). "[P]rinciples of contract preempt fiduciary principles where the parties to a limited partnership have made their intents to do so plain." *Id.*

[174] No. 15916, 1998 Del. Ch. LEXIS 223 (Del. Ch. Nov. 12, 1998).

[175] *See id.* at *8-9 ("[A]s a matter of statutory law, the traditional fiduciary duties among and between partners are defaults that may be modified by partnership agreements.").

[176] *See* R.S. Brandt v. Bib Enter., Ltd., 986 S.W.2d 586, 591 (Tenn. Ct. App. 1998) (holding that a limited partnership agreement that expressly permitted the general partner to sell partnership assets did not likewise grant him permission to purchase partnership assets because there was no specific contractual grant of that right. The court explained that self-dealing transactions are to be construed very narrowly).

[177] *See* Montgomery, *supra* note 51, at 1965.

[178] Reynolds, *supra* note 51, at 31 (explaining that informed consent means "consent of sufficient detail and specificity. . . . Not only must the general fact of self-dealing be disclosed but also all of the facts which are material to the transaction . . . to assess its fairness.") (internal citations omitted).

with the property in another way. . . ."[179] In *Bassan v. Investment Exchange Corp.*,[180] the court supported this high standard of fiduciary behavior in the limited partnership realm, where like the profit participants, the limited partners "have very little say."[181] Disclosure of this detailed information will help ensure that the profit participant is being treated fairly if the studio distributes a show to its own affiliates, and protects the studio by illustrating the participant's informed consent if a participant later tries to protest the transaction.[182]

The profit participant who consents to a transaction in the specific manner mentioned above will not have a basis to support a claim for breach of fiduciary duty based on the studio's self-dealing. "Consent covers a multitude of, if not sins, at least deviations from what otherwise would be the demands of the punctilio of an honor the most sensitive."[183] Even within the strictures of trust law, courts have recognized that self-dealing by the trustee is not voidable if there has been specific approval by the beneficiaries.[184] Therefore, a studio's transaction, potentially voidable as self-dealing, should always be acceptable if the facts regarding the transaction are disclosed with proper detail and are approved by the profit participant.

B. *The Appraisal*

It has been suggested above that the television studio should provide the profit participant with a price quote for the distribution of its series before the studio is allowed to self-deal. Larry Stein, David Duchovny's attorney, argues that in the case of *The X-Files,* FEG should be required to seek competitive bids to establish the fair market value for the show.[185] Stein contends that this mar-

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179 RESTATEMENT (SECOND) OF AGENCY § 390, cmt. a (1999).

180 83 Wash. 2d 922 (Wash. 1974).

181 Reynolds, *supra* note 51, at 32.

> [T]he *Bassan* result seems to neatly transplant the basic Restatement formulations of the duty of loyalty into the context of the limited partnership. Its focus on forcing highly transaction-specific disclosures and consents accommodates the structural fact that the limited partnership is, so to speak, at once a corporation without directors to monitor and approve and a partnership without intimacy and effective involvement of all concerned. Absent those structural protections, a scrupulous standard of disclosure may seem the most straightforward way to an assessment of fairness.

Id. Similarly, a "scrupulous standard of disclosure" would seem the best way to assess fairness in the profit participant context.

182 *See id.* at 14. In the partnership context, "the existence of such agreement is determinative of the legitimacy of a questioned self-dealing transaction. . . ." *Id.*

183 *Id.* at 12. (internal citation omitted).

184 *See, e.g.*, Stegemeier v. Magness, 728 A.2d 557, 563 (Del. 1999).

185 *See* Stein Interview, *supra* note 49.

keting simulation should be conducted by the studios because it will ensure that the show is sold to its affiliates at the market price, instead of being sold "willy-nilly without market bids."[186] Fox attorney Rita Tuzon counters that this method of operation is unrealistic because often buyers make "pre-emptive bids" where the offer to buy is on a take-it or leave-it basis, which prevents the ability to shop a show around the market.[187]

There is an additional problem with using the simulation method to establish the fair market price of a television show. In drafting agreements between the studios and the participants, it would be extremely difficult to stipulate how the market bidding process should proceed in the face of variables, such as pre-emption and the possible lack of offers. Further, it is impractical to compel television studios into a practice of false marketing just to establish their show's fair market value, when a far more feasible alternative exists.

In the future, profit participation agreements should require that studios obtain a timely, independent appraisal of their show's value before self-dealing with affiliate entities. In general, appraisals are easily obtainable and used as a method for safeguarding self-dealing relationships.[188] In the limited partnership context, one court has noted that due to the potential for abuse in self-dealing transactions, one of the most important allowances by the controlling party is the requirement that sales be made with "an appraisal or at prices comparable to sales or purchases with unaffiliated parties."[189]

In the entertainment industry it is also practicable for studios to obtain appraisal opinions for content that the studios are selling to their subsidiaries and affiliates.[190] If studios obtain accurate appraisals of their shows' sale value, they will be protected from participants' accusations who claim that the studios breached their fiduciary duty by licensing below fair market value.[191] Unfortunately, studios have customarily used consulting firms or invest-

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186 *Id.*

187 *See* Tuzon Interview, *supra* note 82.

188 *See, e.g.*, Slingerland v. Hurley, 388 So. 2d 587, 589 (Fl. Dist. Ct. App. 1980) (holding that a managing partner's self-dealing was not excused by an emergency or lack of other offers because a current appraisal is a basic and easily obtainable requirement in such a transaction).

189 Wholey v. Cal-Maine Foods, Inc., 700 So. 2d 291, 293 (Miss. 1997).

190 *See* Interview with Derek Baine, Senior Analyst, Paul Kagan Associates, in New York, NY (Jan. 13, 2000) [hereinafter Baine Interview](on file with author).

191 *See* Jerman v. O'Leary, 145 Ariz. 397, 402 (Ariz. Ct. App. 1985) (finding that general partners were susceptible to a breach of fiduciary duty for paying below fair market value for their property because they did not have an appraisal based on current information).

ment banks to value their properties, not before distribution to their own affiliates, but only after a participant threatens to, or actually does, sue.[192] "There are a number of consulting firms and investment banks that can value these [studio] properties when they come on the market."[193] Thus, the studios should contractually be required to seek fairness opinions before they distribute the shows to their own affiliates.

By providing profit participants with full disclosure, the studios can elicit the participants' "informed consent" which will authorize the studios' self-dealing.[194] However, an integral part of full disclosure is informing the participant of the show's worth. If the studio is inclined to sell the show to its own broadcast outlets, the studio should evaluate the show's value through an independent appraisal.

C. *Burden Shifting*

This section will contend that the studio should bear the burden of proving the entire fairness of its self-dealing when a participant challenges a transaction. When business executives make a business decision in the absence of any conflict of interest, courts examine the dealing under the business judgment rule.[195] Under this standard of review, the decision-makers of the business, as long as they exercise reasonable care and good faith, are strongly protected against allegations that they are mismanaging their business.[196] Courts have recognized, however, that the business judgment rule is insufficient in circumstances where the decision-makers are able to use their authority to gain, at the expense of others who are under their control or who are owed a fiduciary duty.[197]

For plaintiffs to overcome the business judgment rule, they must show that the defendant's dealing presents a conflict of interest.[198] Self-dealing transactions, by nature, present a conflict of in-

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[192] *See* Baine Interview, *supra* note 190.

[193] *Id.*

[194] *See supra* notes 177-178 and accompanying text (explaining the contract language that is necessary to justify informed consent).

[195] *See, e.g.*, Kamin v. American Express Co., 383 N.Y.S.2d 807, 812 (N.Y. Sup. Ct. 1976).

[196] *See id.*; *but see* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (holding that the business judgment rule is not based solely on a reasonableness standard, but on informed business decisions, a higher level of care).

[197] *See, e.g.*, W.K. Warren v. Century Bankcorporation, Inc., 741 P.2d 846, 848-49 (Okla. 1987) (approving the "intrinsic fairness" test).

[198] *See, e.g.*, Bayer v. Beran, 49 N.Y.S.2d (N.Y. Sup. Ct. 1944); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719 (Del. 1971); *see also* Tucker Anthony Realty Corp. v. Schlesinger, 888 F.2d 969, 973 (2d Cir. 1989) (quoting Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984)) ("'Once a prima facie showing is made that directors have a self-interest in

terest or negative presumption, which defendants then have the burden to rebut by showing the total fairness of the transaction.[199] Courts utilize the "intrinsic fairness" test to closely examine these questioned transactions.[200]

The fairness test has been applied to self-dealing in corporate director cases, dominant shareholder cases, limited partnership cases, and should apply to participant cases due to the similarity in the relative positions of the parties in these various scenarios.[201] In general, the standard of intrinsic fairness has been applied:

> when the fiduciary duty is accompanied by self-dealing—the situation when a parent is on both sides of a transaction with its subsidiary. Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary.[202]

But at its core, the intrinsic fairness test has been applied to transactions in the absence of arms length dealing, such as when one party's fiduciary duty is accompanied by self-dealing which potentially allows it to benefit at the expense of the non-controlling party.

Comparing the participant-studio situation to other analogous scenarios, it is evident that the intrinsic fairness test should be applied when the studio licenses to the studio's affiliates and subsidiaries content in which the participant has rights. Courts have held that when directors of a corporation stand on both sides of a transaction they have to demonstrate the intrinsic fairness of the deal, and they are not protected by the business judgment rule.[203] Similarly, courts have ruled that equity requires courts to closely scrutinize dealings involving dominant shareholders, where they are in a

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a particular corporate transaction, the burden shifts to them to demonstrate that the transaction is fair and serves the best interests for the corporation and its shareholders.'") (Internal citations omitted).

[199] *See, e.g.*, *Sinclair Oil Corp.*, 280 A.2d at 719-23.

[200] *See W.K. Warren*, 741 P.2d at 849 (explaining that Delaware courts have used the intrinsic fairness test to scrutinize dealings when a parent corporation controls the making of a transaction and the shaping of contract terms with its subsidiary).

[201] *See supra* note 137-139 and accompanying text (explaining that courts similarly evaluate self-dealing transactions in different business contexts when the parties' relative positions of leverage are constant).

[202] *Sinclair Oil Corp.*, 280 A.2d at 720.

[203] *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (citing Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 110 (Del. 1952)) ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.").

position to gain through self-dealing to the detriment of their minority shareholders.[204] Also, in the limited partnership context, courts shift the burden of proof upon the self-dealing general partner to prove the fairness of a questioned transaction.[205] As this Note has already argued, the structural form, which encompasses a business relationship, should not solely govern the existence of fiduciary principles. The studio-participant relation has the same inherent vulnerabilities as the other relationships mentioned above. Also, the studio, like a general partner or dominant shareholder, is in a position of power over the profit participant. Consequently, the studio, like other controlling parties, should have the burden of proving the total fairness of its dealing when it contracts with its affiliates.

Thus, by establishing that a fiduciary relationship exists between the studio and profit participant, participants such as David Duchovny, gain a more substantial advantage than they otherwise would have in their legal battle against the studios. As this Note first explained, vertical integration is a strategy implemented by media conglomerates to maximize their profit stream. Therefore, the studio's practice of self-dealing represents, if not just a reasonable or informed business decision, a tactically profitable decision—one that, by itself, likely would be protected by the business judgment rule. But integration of the fiduciary duty into the participant-studio link, triggers the participant's ability to overcome the business judgment rule and force the studio to bear the burden of proving the entire fairness of its self-dealing. Participants, such as David Duchovny, then have a more balanced position to assert their claims of unfair dealing against the studios, and stand a far more likely chance to prevail.[206] The impact of whether a court views the studio actions under the business judgment rule or the intrinsic fairness test is at the core of the fiduciary concept.[207] While the participant's stake in a lawsuit is greatly enhanced by

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204 *See, e.g.*, *W.K. Warren*, 741 P.2d at 849; *see also Sinclair Oil Corp.*, 280 A.2d at 717 (intrinsic fairness test used when parent company allowed its wholly owned subsidiary to make late payments to its 97% owned company which benefited itself to the exclusion of the 3% minority shareholders).

205 *See, e.g.*, Tucker Anthony Realty Corp. v. Schlesinger, 888 F.2d 969 (2d Cir. 1989); *see also supra* notes 135-143 and accompanying text (demonstrating that courts shift the burden of proof in the limited partnership context).

206 *See, e.g.*, *W.K. Warren*, 741 P.2d at 849 (explaining that equity requires this scrutiny to balance the interests of parties with unequal positions of power).

207 *See supra* notes 135-143 and accompanying text. The outcomes of these cases could likely be opposite depending on whether there was a fiduciary duty owed, and thus whether the studio had the burden of proving the total fairness its dealings.

application of the intrinsic fairness test, the studio could still establish valid defenses to the participant's claim.

The studio can demonstrate the intrinsic fairness of its licensing agreements in at least two discernible ways. The studio can establish that it engaged in competitive bidding or that it gave full disclosure, including a fair appraisal, to the participant. Secondly, the studio should demonstrate that the participant gave an informed consent.[208] These efforts indicate fairness in trying to simulate arm's length negotiations.[209]

In summary, a profit participant could file a lawsuit challenging a studio's practice of self-dealing because either the recommended safeguards were not utilized or it is alleged that the safeguards lacked reliability. If a profit participant challenges the studio's transaction, the burden of proof should shift to the studio to prove the entire fairness of the transaction.

CONCLUSION

Public resentment might rise against the massive consolidation by media industry conglomerates that have followed the repeal of the fin-syn rules. But until this occurs, vertical integration in the entertainment industry will continue as a corporate revenue-creating strategy. Under this scheme, media corporations such as FEG have the power to exploit their television properties to their own affiliated broadcast entities for self-generating economic growth.

What a corporation has the power to do however, may still be a breach of its fiduciary duty to third parties.[210] A fiduciary duty arises when parties interact with each other, not at arms length but in a manner that signifies trust or confidence. In a typical agency relationship one party is acting for another's benefit. The standard of behavior that is expected in these relations has been classically articulated as, "[n]ot honesty alone, but the punctilio of an honor the most sensitive . . . ."[211]

Many commercial relationships engender fiduciary principles and fiduciary duties can arise between contracting parties. The relationship between the profit participant and the television studio is unique and does not fit neatly into traditional fiduciary categories such as partnership or agency. But comparing this relationship to other business relations, it is apparent that the studio

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208 *See Tucker Anthony Realty Corp.*, 888 F.2d at 973-74.
209 *See id.*
210 *See* Interview with Charles Yablon, Professor, Benjamin N. Cardozo School of Law, in New York, NY (Oct. 29, 1999) (on file with author).
211 Meinhard v. Salmon, 249 N.Y. 458, 464 (N.Y. 1928).

should owe the profit participant a fiduciary duty. This is consistent with fiduciary duty principles that aim to uphold the "spirit of the law," when self-dealing can injure one party that is reliant upon another controlling party.

Imposing a fiduciary obligation upon the studio is not a hardship and if the studio complies with certain safeguards, it will be protected against frivolous litigation from profit participants who claim unfair dealing. A television studio that distributes its series to affiliated entities should contract specifically for that right. Also, the studio should include a timely appraisal of the show's worth or at least shop the show on the open market to achieve an accurate pricing. If a studio undertakes these measures, it will be able to prove the entire fairness of its self-dealing transactions.

Television studios may completely avoid the present conflict with their profit participants in two ways: distribute their television shows to non-affiliated entities or refuse to enter into profit-participant agreements. These alternatives are not likely to occur, and as this Note has pointed out, are not necessary. Vertical integration and profit participation can co-exist in the new millennium as long as the fiduciary linebacker stands guard.

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