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BANKRUPTCY COURT DENIES NETFLIX EARLY STREAMING OF FILMS

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[The Legal Intelligencer](#)

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AUTHORS



Francis J. Lawall
Partner | 215.981.4481



Lesley S. Welwarth
Associate | 248.359.7312

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Unlike standard civil litigation, a single bankruptcy proceeding can often include multiple seemingly unrelated adjudications that, in hindsight, have a much greater subsequent impact than an unsuspecting litigant might expect. A recent example of that was evidenced through a May 27 order entered by U.S. Bankruptcy Judge Michael E. Wiles of the Southern District of New York that barred Netflix Inc. from distributing, and even "contending that they have the rights to distribute" two Relativity Media-produced films prior to movie theater release per the terms of the parties' license agreement in *In re Relativity Fashion*, Case No. 15-11989, Doc. No. 1932 (Bankr. S.D.N.Y. May 27, 2016); see also Doc. No. 1948 (corrected transcript of decision filed June 1, 2016). Finding that it was essential to the feasibility of Relativity's confirmed plan and relying on clear confirmation hearing testimony, the court denied Netflix's subsequent claim that it had the right to stream certain films prior to their theatrical release.

Before July 2015, when Relativity Media and its 150 affiliates filed for Chapter 11 protection, Relativity and Netflix entered into a movie-licensing agreement that contemplated execution of film-specific notices of assignment as part of Netflix's obligations to Relativity. The notices of assignment required Netflix to pay a licensing fee to Relativity's secured lender upon certain conditions with payment due 12 months after an initial "theatrical release" in movie theaters nationwide.

The notices of assignment at issue originally provided "outside dates" of June 17 and June 30 for the films "Masterminds" and "Disappointment Room." Payment of the license fee was to coincide with the date on which Netflix began distributing and streaming the film to subscribers. Consistent with industry custom, Section 5.6 of the agreement required Netflix to "promptly upon the request of Relativity, enter into all agreements reasonably requested by Relativity ... which extends or is willing to extend credit to Relativity against License Fees payable to Relativity hereunder." The notices of assignment also included an arbitration clause.

In its objection to confirmation of Relativity's plan and assumption of the licensing agreement, Netflix argued that Relativity could not demonstrate adequate assurance of future performance because it challenged Relativity's ability to release the films on schedule (Relativity had canceled and rescheduled the release dates multiple times in 2015) and whether it could release the films to the minimum number of theater screens simultaneously. Netflix's own witness confirmed that its license fee is calculated based upon domestic box office revenue for each film and that a material requirement of the agreement is that "the films provided must be first run, theatrically released films." Noteworthy is the fact that Netflix's objection failed to argue that it was contractually entitled to stream the films prior to their theatrical release.

The court overruled Netflix's assumption objection, the plan was confirmed in February and became effective in April. Netflix appealed the confirmation order but two months later, voluntarily dismissed its appeal.

During the confirmation process, Relativity and its secured lender informed the court and parties in interest (including Netflix) that they had agreed to the postponement of the films' release dates to later this year. Notwithstanding the prior knowledge of the

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release date extensions, Netflix later refused to sign amendments which would extend the fee payment and release dates. As a result, Relativity sought an order from the court compelling Netflix to sign the extension date amendments. In response, Netflix contended that it had the right to distribute and stream the films even though the films had yet to be released in theaters. Also before the court was whether this dispute was one that had to be arbitrated, and whether under *Stern v. Marshall*, 131 S.Ct. 2594 (2011), the court had constitutional authority to issue a final ruling on the debtors' motion.

According to the court, it could not have been any clearer at the confirmation hearing that the planned distribution sequence (theater releases of the films followed later by Netflix distribution) was key to the plan as it would impact both the debtor's financing arrangements and recoveries projected for unsecured creditors. Moreover, the court - recalled that Netflix's position throughout the confirmation hearing was that: theatrical release of the movies was a material requirement under the agreement and necessary to qualify the movies for distribution and the debtors' forecasted benefits under the agreement were key to the debtors' survival and plan feasibility.

The court therefore found Netflix's refusal to sign the date extension amendments (based on its new position that Netflix had the right to distribute the movies prior to theatrical release) to be irreconcilable with its assertions made during confirmation. The court further noted that as a practical matter, if Netflix is not barred from distributing the movies before they go to the box office, theatrical release after Netflix streaming would never happen and Relativity would receive no license fee, all of which Netflix knows perfectly well.

The court denied Netflix's request to have the matter sent to arbitration. It reasoned that the issue of whether res judicata and judicial estoppel bar Netflix from arguing its current position necessarily boils down to what was previously concluded at confirmation and why—issues which should be determined by the presiding court, not an arbitrator. Further, enforcement of the plan terms against Netflix affect the entire confirmation process and impact all creditors, none of which are party to any arbitration agreement. Furthermore, the court found no arbitration clause in the license agreement (just in the assignment notice) and thus, the issue of whether Netflix is required under Section 5.6 of the agreement to sign the date extension amendments was not a dispute subject to arbitration.

Noting Netflix's testimony at the confirmation hearing, the court then ruled that under the doctrines of res judicata and judicial estoppel, Netflix was barred from asserting that it has distribution rights based on the original assignment notices and likewise enjoined Netflix from streaming the movies at any time earlier than the time specified in the license agreement (i.e., prior to theatrical release). The court's injunction against Netflix was buttressed by the court's belief that Netflix's new contract - interpretation lacked good faith and was asserted as leverage to terminate the contract.

The court next assessed Relativity's request, made pursuant to Bankruptcy Code Section 1142(b), for the court to compel Netflix to sign the extension date

amendments as required under Section 5.6 of the agreement. Section 1142(b) of the Bankruptcy Code provides, in relevant part, that "the court may direct any necessary party to ... perform any act ... that is necessary for the consummation of the plan." The court found that, as a matter of custom and under the contract, Relativity and its lender are entitled to new assignment notices that would incorporate reasonable new outside dates. However, the court reasoned that Section 1142(b) does not go so far as to authorize the court to impose upon Netflix the new outside dates proposed by Relativity. Instead, the court strongly signaled to Relativity that it may seek—in another judicial forum—to compel Netflix's execution of amended assignment notices with new outside dates. It is easy to assume that Relativity will take the court's advice in this regard.

The court likewise denied Netflix's *Stern* claim because there was no stare decisis preventing the bankruptcy court from enforcing its own prior plan confirmation order or making a final ruling as to res judicata and judicial estoppel matters in the context of the confirmation process.

The *Relativity* decision highlights the need in a bankruptcy proceeding to be mindful of the potential impact an asserted position at one hearing may have later in the case, even if it involves different circumstances. Among other examples of this conundrum include whether a secured creditor takes the position at the outset of the case as to whether or not it is fully secured. In this case, Netflix has already filed its notice of appeal with the U.S. District Court for the Southern District of New York. It will be interesting to see how things play out on appeal.

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