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# The 'Bones' arbitration: An American cautionary-tale for Australian practitioners

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Not all that glitters is gold in Hollywood, particularly when the arbitrators get involved.

This time last year, we explored how and why proceedings brought by the producer and director of *Mad Max: Fury Road* against Warner Bros Feature Productions Pty Ltd were stayed by the New South Wales Court of Appeal and referred to arbitration in Los Angeles.

This year, we look at why Fox found itself the subject of inflamed criticism from a JAMS Arbitrator (the Hon. Peter D Lichtman), who ruled that Fox must pay $178.7 million to former producers and stars of the popular crime television series 'Bones'. The Arbitrator's ruling became public after the award creditors filed a petition to confirm the award in the Superior Court of California of the County of Los Angeles (**LA Superior Court**). The skeletons in Fox's closet were thus thrust into the spotlight, taking arbitration fans behind-the-scenes into the world of arbitration in the entertainment industry.

## Fox's grave mistakes

Screening from 2005 – 2017, 'Bones' was based on a series of best-selling fiction novels by Kathleen Reichs. The show was directed and produced by Barry Josephson, starring Emily Deschanel and David Boreanaz in the lead roles.

Ms Reichs, Mr Josephson, Ms Deschanel and Mr Boreanaz (together, **the Respondents**) had individual agreements with a Fox subsidiary, Twentieth Century Fox Film Corporation (**Studio**). Each agreement contained a term guaranteeing that:

> 'Fox's transactions with Affiliated Companies will be on monetary terms comparable to the terms of which the Affiliated Company enters into similar transactions with unrelated third-party distributors for comparable programs.'[1]

1 Amended Final Award, JAMS Arbitration Case Reference No. 1220052735, 4 February 2019 (**Award**).

As contemplated by the clause, the Studio licensed seasons 5 and 6 of Bones to its affiliate broadcasting company, Fox Broadcasting Company (**Network**), for $2 million per episode. This licence fee was far less than might be expected for a show of Bones' popularity, because the Network refused to pay its subsidiary a full cost-of-production licence fee. In the Arbitrator's view, due to commands from upper management, the Studio willingly accepted the lesser licence fee from the Network, to the detriment of the show's talent (being, the Respondents).

Eventually, the aggrieved talent caught wind of the suspicious dealings behind Bones' licencing arrangements. They initiated court proceedings claiming that the Studio not only breached the affiliate transaction protection clause, but never attempted to comply with it at all. They further alleged that this dealing, compounded by many additional instances of misconduct by the Network, gave rise to claims against the Network for breach of contract, fraud, tort (including intentional interference with contract, self-dealing and inducement of breach of contract).

Seeking dispute resolution in respect of these claims in arbitration rather than litigation, the Network filed a Demand for Arbitration with the JAMS arbitration body in Los Angeles (which is how the Network and others became the Claimants in the arbitration and the aggrieved talent became the Respondents). The proceedings occurred over two and a half years culminating in a 66-page ruling awarding the Respondents almost US $179 million in damages (being approximately $33 million in contractual damages and $129 million in punitive damages, $10 million in interest and $7 million in legal fees). Although the Arbitrator's ruling sets out each claim in detail, this article will focus primarily on the Arbitrator's consideration of the issues of arbitrability and assessment of damages.

## Arbitrability found to be a dead-end argument

The Arbitrator did little to conceal his dismay at the Network's contention that *'certain critical issues presented and argued by the Respondents were not arbitrable and as such, outside the purview and authority of the arbitrator and the matters before him'.* The Arbitrator's frustration stemmed from the fact that the Network put forward its arbitrability arguments for the first time in the 'final hour of closing arguments', after more than four weeks of hearings.[2]

In any case, the Arbitrator considered the Network's submissions, contending that the following two claims raised by the Respondents were not arbitrable:

(a) the 'Hulu ownership claim', which was part of the Respondents' claim that the Network licenced in-season streaming rights for Bones to its affiliate Hulu on artificial monetary terms in violation of self-dealing provisions contained in the Respondents' agreements; and

(b) the 'reasonable and non-discriminatory claim', which concerned whether the Studio breached its obligation to distribute Bones 'on a reasonable and non-discriminatory basis'.

Both claims were characterised as 'Self-Dealing Claims', being 'claims related to the allegations that the Studio entered into transactions with affiliates on terms that were not comparable to the terms on which the affiliated entity entered into similar transactions with unrelated third parties.'[3]

The Arbitrator required the Network's jurisdictional arguments to overcome three barriers, being judicial estoppel, acceptance and waiver. As to the first barrier of judicial estoppel, his Honour noted that under California law, 'parties may expressly agree to arbitrate: (1) in a contract signed before a dispute arises…; or (2) in a binding stipulation to arbitrate entered into after a dispute has arisen.'[4] The present case was not contentious in this respect, as the parties had signed both a contract and a binding stipulation expressly agreeing to arbitrate.

2 Ibid at 3.
3 Ibid at 6.
4 Douglass v Serenivision, Inc., 20 Cal. App. 5th 376, 378 (2018).

In further confirmation of these two arbitration agreements, the Network submitted a Statement of Claim to JAMS, stating:

> 'All of the claims raised in [the Respondents] Complaints, however, are subject to the parties' agreements to arbitrate. Indeed, binding and applicable arbitration provisions are found in the very Agreements that the Respondents claim they want enforced'.[5]

The Network then moved to compel arbitration of the Respondents' claims in the LA Superior Court and in April 2016, Judge Rico issued an Order granting the Network's motion to compel and staying the non-arbitrable claims. His Honour also held that the Self-Dealing Claims were subject to arbitration. Given that the Network had obtained the relief it sought in the LA Superior Court, the Arbitrator determined that the doctrine of judicial estoppel prevented the Network from back flipping and asserting an inconsistent position in the present arbitral proceedings.[6]

As to the second issue, the Arbitrator conducted an 'Arbitrator Management Conference' 18 days after Judge Rico issued the Order, during which the Arbitrator ordered the parties to reach a formal stipulation as to each claim that would be subject to arbitration.[7] Accordingly, the parties agreed on a 'Stipulation Regarding Claims in Arbitration',[8] stating that: 'The Self-Dealing and 2009 Release Claims are arbitrable; the Contingent Compensation and Failure to Permit Audit Claims are not'.[9]

Pointing out that Judge Rico's Order set the scope of the arbitration and could not be challenged, the Network argued that the Order circumscribed the arbitral proceedings and nullified the Stipulation agreed to by the parties subsequent to the Order. However, the Arbitrator disagreed, confirming that the Stipulation was not voided by virtue of the Order, rather it served to confirm the parties' understanding of the Order's terms. He went on to say that the two claims were clearly within the scope of the arbitration, as they related to the Self-Dealing Claims which the parties explicitly agreed to arbitrate, in both a signed agreement before a dispute arose and in a binding stipulation to arbitrate entered into after the dispute arose.[10]

As to the third barrier, JAMS Rule 11 provides that 'jurisdictional and arbitrability disputes…shall be submitted to and ruled on by the Arbitrator.' Further, JAMS Rule 9(f) stipulates that:

> '[j]urisdictional challenges under Rule 11 shall be deemed waived, unless asserted in a response to a Demand or counterclaim or promptly thereafter, when circumstances first suggest an issue of arbitrability.'

As a comparison, this rule serves a similar purpose to Rule 28.3 of the ACICA Rules, providing that:

> 'A plea that the Arbitral Tribunal does not have jurisdiction shall be raised no later than in the Statement of Defence referred to in Article 26, or, with respect to a counterclaim, in the reply to the counterclaim.'

The words '*or promptly thereafter*' of JAMS Rule 11 provides arbitrators with more discretion than ACICA arbitrators to receive jurisdictional challenges after the defence or reply to counterclaim is submitted. Considering this difference, it is interesting to note that the Arbitrator still took a strict approach and rejected the Network's claim definitively on the basis that it was well outside the time frame within with a jurisdictional challenge could be brought under the JAMS Rules. To this end, his Honour pointed out that the Network willingly participated in the arbitration over the past two and a half years without challenging the arbitrator's jurisdiction. The Network initiated the arbitration in the first place, in

5 Award at 5.
6 Ibid at 5.
7 Ibid at 6.
8 Ibid at 6.
9 Ibid 6.
10 Ibid at 7.

addition to participating in discovery and engaging in a month-long arbitration hearing. The Network was therefore deemed to have waived its right to challenge the Arbitrator's jurisdiction.[11]

Thwarted but not discouraged, the Network then sought to rely on a principle raised in the case of *Ficek v S. Pac. Co.*[12] (**Ficek**), submitting that waiver can only apply if a party waits until *after the arbitrator's decision* to raise an objection. Unsurprisingly, the arbitrator rejected this 'last-minute' argument on the basis that the United States Court of Appeals for the Ninth Circuit had actually interpreted the principles in Ficek to be equally applicable to objections raised before the arbitrator's decision, reasoning that 'it would be unreasonable and unjust to allow [the defendant] to challenge the legitimacy of the arbitration process, in which he had voluntarily participated over a period of several months.'[13]

Ultimately, the arbitrator rejected all of the Network's submissions challenging the arbitrator's jurisdiction, bluntly describing them as 'frivolous' and 'a transparent attempt to derail this Arbitration before the final award is issued.'[14]

## Punitive damages - the Respondents' weapon of choice

Ultimately, the Arbitrator found that the Network did indeed breach its various agreements with the Respondents, as well as fraud and tortious interference with contract.

An interesting issue to which the Arbitrator gave lengthy consideration was whether, and to what extent, punitive damages should be awarded. As a preliminary point, the Arbitrator confirmed the general jurisdiction of arbitrators to award punitive damages.[15] This reflects the position in Australia that punitive damages (often called exemplary damages) are available to arbitrators in exceptional circumstances where they feel that such damages are necessary to punish and deter the defendant, above and beyond merely compensating the aggrieved party.[16]

His Honour also confirmed the causes of action to which punitive damages attached, explaining that punitive damages are available for tortious interference with contract and inducement of breach of contract.[17] In this respect, the Arbitrator was satisfied that the same evidence establishing the Network's tortious interference with, and inducement of breach of, the Respondents' agreements with the Studio also supported an award of punitive damages.[18]

In addition, the Arbitrator agreed with the Respondents that punitive damages ought to be awarded against the Network for other tortious conduct committed in the context of the Bones licensing agreements, including the Studio's and the Network's 'fraudulent, oppressive and malicious acts' in inducing Josephson's and Reichs's signatures on a release purporting to extinguish their rights to challenge the licence fees.[19]

Having made these preliminary points, the Arbitrator outlined three criteria for an award of punitive damages:

(a) the reprehensibility of the defendant's conduct;

(b) the reasonableness of the relationship between the award and the plaintiff's harms; and

(c) in view of the defendant's financial condition, the amount necessary to punish him or her and discourage future wrongful conduct.[20]

The Arbitrator also emphasised that there is 'no legally

11 Ibid at 8 and 9.
12 338 F .2d 665, 657 (9th Cir. 1964).
13 *Fortune, Alsweet & Eldridge, Inc. v Daniel*, 724 F .2d 1355, 1357 (9th Cir. 1983).
14 Award at 9.
15 Ibid at 53; *Mastrobuono v Shearson Lehman Hutton, Inc.,* 514 U.S. 52, 58 (1995).
16 See for example, discussion in Duncan Miller, 'Public Policy in International Commercial Arbitrations in Australia' (1993) 28 *Australian Construction Law Newsletter* 5.
17 *Duff v Engelberg,* 237 Cal. App. 2d 505, 508 (1965).
18 Award at 54; *Webber v Inland Empire Invs.,* 74 Cal. App. 4th 884, 911-12 (1999).
19 Ibid at 54.
20 Kelly v Haag, 145 Cal. App. 4th 910, 914 (2006).

prescribed formula',[21] but instead a 'wide range of reasonableness for punitive damages reflective of the fact finder's human response to the evidence presented.'[22]

In accordance with the principles set out above, the Arbitrator considered a number of factors in determining the reprehensibility of the Network's conduct.[23] At first glance, the Arbitrator's views in relation to the reprehensibility of the Network's conduct were obvious, due to the remarkably emphatic language used in the award, for example: 'the Arbitrator finds Fox's position… to be patently absurd' and 'merely describing the testimony as false is far too generous. The Arbitrator is convinced that perjury was committed by the Network witnesses. Accordingly, if perjury is not reprehensible then reprehensibility has taken on a new meaning.'[24]

Beyond this colourful language, the Arbitrator considered the facts in more detail, finding first that the Respondents were financially vulnerable in the sense that they depended upon the Network and Studio for their careers and livelihoods. This vulnerability was said to be exploited by the Network in its position of relative financial power.[25] Second, the Network repeated its tortious conduct from 2005 to approximately 2009, which involved the disingenuous motive of maximising profits and minimizing participant leakage. Given the gravity and repetitiveness of these torts, the Arbitrator was dismayed by the 'cavalier attitude' of the Network and its witnesses, who took no responsibility or expressed any remorse.[26] Third, the Arbitrator took into account that the Respondents' harm was the result of the Network's intentional acts of fraud and malice in connection with its fraudulent inducement of the release and tortious interference with contract. By these three factors, the Network had clearly engaged in reprehensible conduct deserving of a punitive damages award at the 'higher end of the scale'.[27]

In relation to the second criterion, the Network asserted that according to judicial principles, where compensatory damages are substantial, punitive damages should be lower than the compensatory damages award. To that allegation, the Arbitrator pointed out that a contractual arbitration is:

> 'a private proceeding, arranged by contract, without legal compulsion… Consequently, the arbitration and award themselves [are] not governed or constrained by due process, including its elements applicable to judicial proceedings to impose punitive damages.'[28]

As such, the Arbitrator determined that judicial principles did not limit the tribunal's discretion to decide the amount of punitive damages in arbitration.[29] Along the same lines, judicial authorities did not dictate the amount of damages awarded by the Arbitrator, although he chose to be guided by them.

The Arbitrator analogised the decision of *Bardis v Oates,*[30] in which punitive damages of nine-times the compensatory damages was awarded due to the defendants' repeated and intentional self-dealing constituting 'egregious misconduct'.[31] The Arbitrator likened the case to the Network's behaviour, reinforcing that the Network engaged in a company-wide pattern and practice of fraudulent self-dealing by which it enriched itself in violation of the Studio's agreements with the Respondents.

Ultimately, the Arbitrator awarded punitive damages five times the amount of Respondents' actual damages, resulting in a total of almost $129 million. The Arbitrator

21 *State Farm Mutual Auto Ins. Co. v. Campbell,* 538 U.S. 408, 424-25 (2003).
22 *McGee v Tucoemas Fed. Credit Union*, 153 Cal. App. 4th 1351, 1362 (2007).
23 Award at 56-62.
24 Award at 57.
25 Award at 56.
26 Award at 57.
27 Award at 58.
28 *Rifkind & Sterling, Inc. v Rifkind*, 28 Cal. App. 4th 1282, 1291 (1994).
29 Award at 59.
30 119 Cal. App. 4th 1 (2004).
31 Ibid at 22-23; Award at 60.

considered that this 5:1 ratio represented only 0.6% of 21st Century Fox's (a Network subsidiary that would likely pay the award) stipulated net wealth. This was well below the 10% cap recognised under California law,[32] but reasonable and necessary to punish the Network for its reprehensible conduct and deter it from future wrongful conduct.[33]

The Respondents were also awarded the costs of the arbitration.

## Final thoughts

Although the arbitration took place in Los Angeles and applied the JAMS Rules, we can draw several useful observations relevant to Australian practitioners.

Parties who wish to challenge an arbitrator's jurisdiction should do so as soon as possible in pleadings and the hearing. As demonstrated in the Bones arbitration, arbitrators may not take kindly to parties who contend the tribunal's jurisdiction at the last minute and appear to be merely trying to subvert the award. In any case, parties must take heed of timelines stipulated in the relevant arbitration rules, such as Rule 28.3 of the ACICA Rules.

This award endorses the availability of punitive damages in arbitration, although in Australia as in the US, arbitrators will consider a number of different factors and limitations to determine whether, and to what extent, punitive damages are appropriate.

Although arbitration is typically conducted in a private forum, arbitral awards do not always remain private. Arbitrators should keep this in mind when drafting and considering the tone of their award; likewise, parties should conduct themselves carefully during and after the arbitration, as the skeletons could very well be dug up for scrutiny by the general public.

32 See e.g. *Sierra Club Found. v Graham*, 72 Cal. App. 4th 1135, 1163 (1999).
33 Award at 62.