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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

In re:	Case No. 17-29073
VIDANGEL, INC.,	Chapter 11
Debtor.	Judge Kevin R. Anderson

THE DEBTOR'S REPLY TO THE STUDIOS' SUPPLEMENTAL BRIEFING ON THE STUDIOS' MOTION FOR STAY RELIEF

VidAngel, Inc. (the "Debtor" or "VidAngel"), by and through its undersigned counsel, respectfully submits this reply to the Studio's supplemental briefing [dkt. no. 212] (the "Supplemental Brief") on the Motion for Relief from the Automatic Stay [dkt. no. 69] (the "Motion") filed by Disney Enterprises, Inc., Lucasfilm Ltd. LLC, Twentieth Century Fox Film Corporation, Warner Bros. Entertainment Inc., MVL Film Finance LLC, New Line Productions, Inc., and Turner Entertainment Co. (together, the "Studios").

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PRELIMINARY STATEMENT

The Studios are incorrect about what the evidence will show. The evidence will show that VidAngel's business has turned a corner and is now profitable. But the Debtor cannot yet afford a jury trial in California. It continues to need the breathing space of the automatic stay. Also, the evidence will show that VidAngel's relationship with Harmon Brothers Marketing LLC was entirely arms-length and in the best interest of the Debtor and its estate.

The Studios are also incorrect about how the law should be applied. *Res judicata* does not apply here because there was no "adjudication on the merits" in California. Further, abstention and the "first to file rule" are both irrelevant to whether the Debtor remains entitled to further breathing space. Further, the Studios have misapplied the *Curtis* Factors. Finally, while their claims must eventually be reduced to a sum certain, the Studios cannot show why they are entitled to that relief immediately, with the jury trial they insist on, when doing so would jeopardize the Debtor's ability to reorganize under chapter 11.

Originally, the Studios sought dismissal or stay relief. More recently, they have backed off dismissal. They argue in their Supplemental Brief that (i) VidAngel is being run into the ground, (ii) the Studios need to liquidate their claims *ASAP* to preserve the deteriorating value of their alleged "interest in the Debtor," and (iii) the Debtor is self-dealing. Today, they sound like they want a conversion to chapter 7.

Ultimately, the problem here is that a jury trial in California – which the California court has set for at least *eight months of discovery, substantial motion practice, and a seven-day jury trial* – is the *least* efficient way to liquidate the Studios' claims. For the Debtor, with all its duties to all its stakeholders, it is the most punishing way to proceed. If the stay were lifted immediately and without conditions, that could be fatal for the Debtor – chapter 7. Of course, if the Studios would agree to a more efficient procedure, their claims could be liquidated faster and less

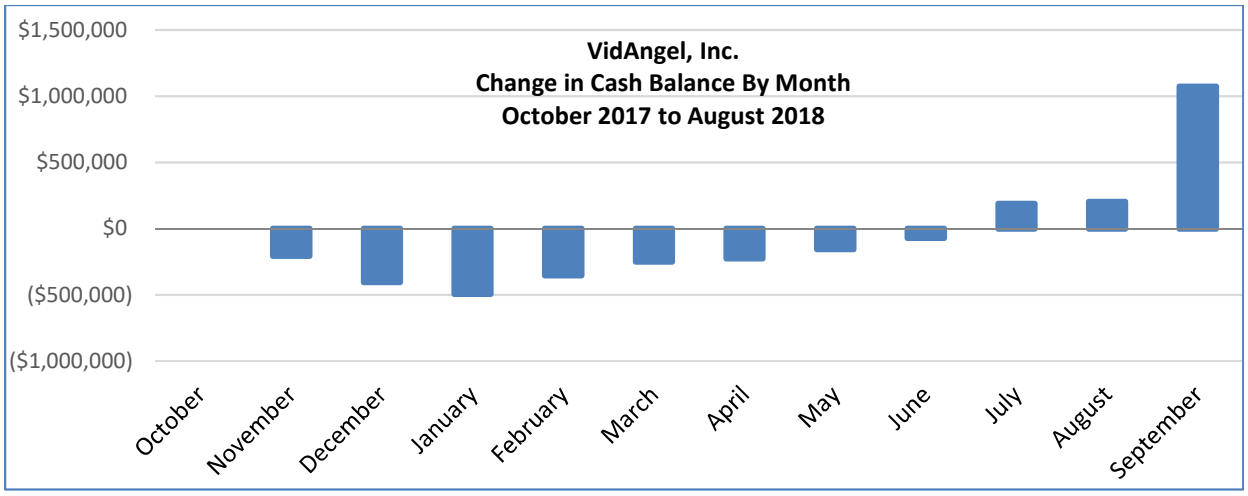
expensively. But so long as the Studios insist on pursuing the *least* efficient way, they should have to wait at least until the Debtor has built its cashflow to the point where it can afford a legal war in California *and* emerge successfully from chapter 11.

REPLY

1. VidAngel is on a trajectory toward profitability.

In their Supplemental Brief, the Studios paint a misleading picture of VidAngel's business fortunes. Using only one criteria, "assets" (which is an incomplete indicator of any company's financial health), and only two data points, October 17, 2017 (the Debtor's petition date) and July 31, 2018 (from the Debtor's most recent Monthly Operating Report), the Studios simplistically depict VidAngel's fortunes as falling like a stone.

To the contrary, the evidence will show that VidAngel's fortunes have risen substantially in 2018 and will continue to improve going forward:



2. VidAngel cannot now afford a jury trial in California.

In their Supplemental Brief, the Studios chide VidAngel for seeking extensions of exclusivity instead of proposing a plan. But VidAngel was cashflow negative from its petition date until last summer. When the Studios got a preliminary injunction in California, VidAngel was suddenly fighting for its life, its income was completely cut off. VidAngel had to focus its resources on trying to verify the legality of its new streaming model and promoting its original content, which has recently gained traction and taken off. It would have been wasteful for VidAngel to propose a plan prior to the reversal of its fortunes. It needed to return to profitability first. Now that it has done so, it has begun to work on its plan.

The Studios also chide VidAngel by calling "a sham" its efforts to verify the legality of its streaming model in the declaratory judgment action in the Utah federal district court. The Studios fault VidAngel for not accepting the district court's invitation to transfer the case to California. But, again, it cannot afford that now. As soon as it can, VidAngel will want to pursue a declaratory judgment action. But for the time, VidAngel can only afford to focus its energy on getting Congress to pass the Family Movie Act Clarification Act of 2018 (H.R. 6816).

Finally, the Studios chide VidAngel for having accomplished *nothing* in its bankruptcy case, other than delaying the California action. Of course, the California action relates to VidAngel's disc-based model, which it has not used in years. Not having to litigate that old history in California was *exactly* the breathing space that VidAngel needed for a much more important accomplishment – stabilizing, turning the corner, and becoming profitable again. Indeed, under the protections of the bankruptcy code, VidAngel has accomplished in this case *exactly* what Congress was hoping for – becoming profitable again.

3. Harmon Brothers.

In their Supplemental Briefing, the Studios emphasize that, post-petition, VidAngel paid some $800,000 to Harmon Brothers Marketing LLC ("HB"), which is partially owned by VidAngel's CEO, Neal Harmon. The evidence will show: (i) 85% of the funds that VidAngel paid to HB, HB then paid through to its advertising outlets, (ii) VidAngel's contract with HB was a "sweetheart" deal for VidAngel, (iii) Neal Harmon and his brothers abided strict ethics walls, and (iv) HB has terminated its relationship with VidAngel because, among other things, it was unprofitable. The Studios' focus on HB is tactical, misleading, and irrelevant to whether the stay should be lifted.

4. *Res Judicata* is inapplicable.

The Studios state in their Supplemental Brief that "VidAngel's declaratory relief claims [in adversary proceeding no. 18-2016 ("AP-16")] are barred by *res judicata* and, while not at issue in this motion, should ultimately be dismissed." Supplemental Br. at 18. The Studios' statement is partially correct – *res judicata* is not at issue in this motion.

In fact, *res judicata* is inapplicable in this case. *Res judicata* translates to "a thing adjudicated" and is the legal principal that an issue that has been definitively settled by judicial decision may not be relitigated.[1] *Res judicata* does not apply in AP-16 because there has not been an adjudication of VidAngel's liability in California. Indeed, the Studios admit that when they say, if the stay is lifted, the "California Court will determine liability…." Supplemental Br. at 11. They are correct. The California Court has entered an injunction, but it has *not* adjudicated VidAngel's liability. It has yet to do so.

[1] *Res Judicata*, Black's Law Dictionary, (10th ed. 2014).

Ignoring the facts in this case, the Studios cite cases where courts applied *res judicata* due to a prior adjudication on jurisdictional grounds, which is not what happened here. In *Eaton v. Weaver Manufacturing Company*, plaintiffs first sued Volkswagen in Oklahoma state court for injuries sustained when an automobile lift machine caused a vehicle to fall on plaintiffs. *Eaton v. Weaver Manufacturing Company,* 582 F.2d 1250, 1251 (10th Cir. 1978). A state court in Oklahoma found it had no personal jurisdiction over Volkswagen. *Id.* at 1255. Then the plaintiffs brought a second suit against Volkswagen in federal district court in Oklahoma asserting the same claims. *Id.* The district court held, and the 10th Circuit affirmed, that the state court judgment was an adjudication on the merits, and *res judicata* precluded these claims in *any* trial court in Oklahoma. *Id.* Here, VidAngel's counterclaims were dismissed as duplicative, not for want of jurisdiction. In *Eaton*, there was a disposition on the merits. Here there has been no such disposition. *Eaton* is inapposite.

Similarly, in *Federated Department Stores, Inc. v. Moitie.* 452 U.S. 394, 39 (1981), seven consumers brought antitrust suits in federal court in California alleging price fixing. Their consolidated suits were dismissed for lack of standing, and then two of the seven plaintiffs filed state court actions instead of appealing the original decision. *Id.* The Supreme Court held, under *res judicata*, the refiled plaintiffs' actions must be dismissed. *Id.* That is not what happened here. *Moitie* is also inapposite.

Finally, the Studios cite to a case where *res judicata* prevented plaintiffs from relitigating in a state court action the same issues already adjudicated in a federal court action against the same parties. *See Hung v. Tribal Techs*., No. C 11-04990 WHA, 2018 WL 827934, at *2 (N.D. Cal. Feb. 12, 2018). Again, that is not what happened here. *Hung* is also inapposite.

The cases cited by the Studios do not support *res judicata* barring VidAngel's claims. *Eaton* holds that a lack of personal jurisdiction is a final determination for the entire state and cannot be relitigated in another trial court. But in the California Action, VidAngel's declaratory relief counterclaims were not dismissed because the issues could not be reached by the California Court. Rather, the court found that these issues were already there in the existing claims and affirmative defenses. Whereas the plaintiffs' claims in *Federated Department Stores* were dismissed for lack of standing, the issues regarding the legality of VidAngel's disc-based model have yet to be decided. As the Studios admit, the California Court has not yet adjudicated VidAngel's liability on the merits. *Res judicata* is simply inapplicable in this case.

5. Abstention and the "first to file rule" are inapplicable.

Abstention and the "first to file rule" are also inapplicable because this Court's impending decision is not about deferring to the court in California. Rather, it is about timing and whether continuing the automatic stay will benefit the Debtor, its estate, and creditors. It's about what will improve the Debtor's chances to succeed in chapter 11.

6. The Studios misapply the *Curtis* factors.

In their Supplemental Brief, the Studios quote some of the Congressional history of 11 U.S.C. § 362(d)(1):

> It will often be more appropriate to permit proceedings to continue in their place of origin, *when no great prejudice to the bankruptcy estate would result*….

S. Rep. No. 989, 95th Cong., 2d Sess. 50, reprinted in 1978 U.S.C.C.A.N. 5787, 5836 (emphasis added). Here, the prejudice to the Debtor is great, as it cannot afford a jury trial in California now while it is (i) prudently building its original content business (which has proven successful), (ii) trying to verify the legality of its streaming model (for the time being, by supporting clarifying legislation), and (iii) preparing and confirming a feasible plan. Ultimately, *Curtis* simply wants to

know what's in the estate's best interest. Viewed in this context, all the relevant *Curtis* factors weigh in favor of denying the Studios' motion and leaving the stay intact for now:

a. Partial or complete resolution of issues.

In their Supplemental Brief, the Studios argue that determination of their claims is necessary. VidAngel agrees. Eventually, it will be necessary. But that begs two critical questions: First, *when* is that determination necessary? Certainly, it is unnecessary before plan confirmation; indeed, it should be made after confirmation. As the Debtor stated in its Supplemental Brief, it is confident that it can confirm a plan without knowing the exact amount of the Studios' claims.[2] Second, *how* is that determination made? It could be agreed to, mediated, arbitrated, litigated in Utah district court, or estimated by this Court. Any of those mechanisms would be much less punishing on the Debtor.

[2] One mechanism available to the Debtor is to implant a disputed claims reserve in its plan. Disputed claims reserves are ubiquitous. *See In re Abeinsa Holding, Inc.*, 562 BR 265 (Bankr. D. Del. 2016) ("PGE argues that the Disputed Claim Reserve should hold the full face amount of the claim until an estimation proceeding can be held. In my experience, that would be highly unusual. Moreover, there is no basis in the record that would make such a requirement necessary. I conclude that the provisions for a Disputed Claim Reserve set forth in the EPC Reorganizing Plan are reasonable and provide protection to the Holders of Disputed Claims. The record before me supports the feasibility of the Plan"; *Matter of Gardinier, Inc., 55 BR 601 (Bankr. M.D. Fla. 1985)* ("In light of the fact that Gardinier is willing to preserve funds to pay the appropriate dividend to Florida Cities in the event their claim is ultimately allowed with finality and in light of the fragile status of this reorganization proceeding, this Court is of the considered opinion that to exercise the discretion granted by Bankruptcy Rule 3018 would not only be improper but, in fact, would be an abuse of that discretion."); *In re Mangia Pizza Investments, LP*, 480 BR 669 (Bankr. W.D. Tex. 2012) (citing *Gardinier*); *In re Asbestos Claims Management Corp.*, 294 BR 663 (N.D. Tex. 2003) ("Based on the above estimates, the amount required from the NGC Settlement Trust, on behalf of Reorganized ACMC, to fund the Administrative and Priority Claims Reserve shall be $1,500,000."); *In re New Investments, Inc.*, 840 F. 3d 1137 (9th Cir. 2016); (confirmation order required that the debtor set aside $670,000 as a disputed claim reserve); *In re Best Payphones, Inc.*, 523 BR 54 (Bankr. S.D.N.Y. 2015) ("The Plan provided that all allowed administrative and unsecured claims would be paid in full on the effective date, (Plan at Arts. III, IV), and established an escrow reserve that would be used to satisfy a disputed claim once it became an allowed claim.")

Furthermore, while the Studios want this factor to be applied from their perspective, the Debtor maintains it should also be applied from its perspective. The pertinent "issues" in the Debtor's bankruptcy case revolve around how it can confirm a feasible plan. The pre-confirmation determination of the Studios' prepetition claims is not necessary for that, much less paramount. Nor does it justify a year of hard-fought litigation in California starting now. The Studios rely on *In re Horizon Womens Care*, 506 BR 553 (Bankr. Colo. 2014). But in that case the court lifted the stay of an appeal of a state court decision, over which the bankruptcy court had no jurisdiction. *Horizon* is inapposite.

b. Lack of any connection with or interference with the bankruptcy case.

In *Curtis*, the court wrote,

> *The most important factor* in determining whether to grant relief from the automatic stay to permit litigation against the debtor in another forum is the effect of such litigation on the administration of the estate. Even slight interference with the administration may be enough to preclude relief in the absence of a commensurate benefit.

In Re Curtis, 40 B.R. 795, 806 (Bankr. D. Ut. 1984) (emphasis added). The evidence will show that the Studios' proposed jury trial in California *will* interfere substantially with VidAngel's administration of its estate, if it begins immediately. It could easily tip the Debtor from chapter 11 into chapter 7. The Studios rely on *In re Touchstone Home Health*, 572 B.R. 255 (Bankr. Colo. 2017). In that case, the court had to decide whether a debt-collection action should be decided by the bankruptcy court or in an arbitration that was very close to holding a final hearing. In choosing arbitration, the court noted, "[t]he Claim could be decided by arbitration as quickly and efficiency as in this Court…. At worst, the Arbitration would cost about the same as adjudication in [this] Court …. " *Id*. at 282-83. *Touchstone* sheds no light on the circumstances of this case, where the Studios insist on pursuing the least efficient, most expensive, and most interfering way to liquidate their claim.

c. Specialized tribunal.

In their Supplemental Brief, the Studios state that "the California Court has experience adjudicating [the Studios'] claims and the DMCA and Copyright Act." Supplemental Br. at 2. However, as the Debtor explained in its Supplemental Brief, "experience" with a case does not create a "specialized tribunal [that] has been established" to hear the claim. *Curtis*, 40 B.R. at 800. No specialized tribunal has been established to determine damages in copyright cases. Any federal court in the land can determine damages in copyright cases. In any event, the California court's familiarity with the parties and the injunction will not mean much when a jury eventually sees the evidence and hears the arguments on damages; at least, not enough to justify the expense and distraction to the Debtor of a hard-fought legal war in California that could start soon.

d. No prejudice to other parties.

In their Supplemental Brief, the Studios note that the OUST did not form a creditors committee in this case, and that *they alone* are "pressing an interest in VidAngel's estate." Supplemental Br. at 3. Neither observation is relevant to the fact that there are thousands of stakeholders in VidAngel that will be prejudiced if the cost and disruption of a jury trial in California prevents the Debtor from growing its business and confirming a feasible plan. They will be *deeply* prejudiced if the Debtor's trajectory therefore swings from chapter 11 to chapter 7.

e. Judicial economy and readiness for trial.

The Studios claim that "judicial economy" is "best served" by liquidating claims before the court that "knows the parties and the factual and legal issues" and can schedule final hearings "in short order." Supplemental Brief at 13. The Debtor disputes that the proceedings in California will conclude "in short order." Before there can be a *seven-day* jury trial, there will be *eight months* of substantial motion practice and discovery, including percipient and expert witnesses, and terabytes of documents and records. And it is *very* relevant that this case pits the deep-pocketed

Studios against VidAngel – a small Utah company with penchant for success in the "family-friendly" entertainment industry – whose efforts to filter Hollywood films (as allowed by law) have the Studios *up in arms*. In no event will the Studios' claims be liquidated efficiently or "in short order."[3]

f. Balance of harm.

This court will balance all the evidence before ruling on the Studios' lift-stay motion. On one side of the scale are the Studios' list of harms: (i) the supposedly eroding value of the Debtor's business prospects (which is inaccurate), and (ii) the delay of what the Studios refer to as their "right" to have their claims liquidated. On the other side of the scale is the harm to the Debtor: the cost of a legal war in California that would interfere greatly with its current efforts to prudently grow its businesses and confirm a feasible plan. Simply, that harm to the Debtor greatly outweighs the delay to the Studios in having their claims liquidated.

In their Supplemental Brief, the Studios state that "VidAngel faces *no* cognizable prejudice from the resolution of [the Studios'] claims in the California Court." Supplemental Br. at 2 (emphasis added). Not so. Here, there *is* cognizable prejudice the Debtor in the estimated $800,000 cost to the Debtor to prepare for and have a jury trial in California. The Studios rely on *In re Santa Clara County Fair Ass'n, Inc. (Santa Clara County Fair Ass'n, Inc. v. Sanders)*, 180 B.R. 564 (9th Cir. BAP 1995). But *Santa Clara* stands for the unremarkable proposition that the fact a debtor would incur litigation expenses if the stay were lifted "do[es] not *compel* a court to

[3] If the stay were lifted, and VidAngel found liable, then the studios would have an election between actual and statutory damages. The discovery on actual damages would be considerably more expensive, but the Studios keep their right to elect until the end of trial. VidAngel is hard-pressed to imagine how the Studios were actually damaged, so VidAngel expects the Studios ultimately to elect statutory damages. If the Studios made that election sooner rather than later, the California action would be substantially less expensive for the Debtor.

deny stay relief." *Id*. at 566 (emphasis added) (not abuse for bankruptcy court to lift stay where debtor would then litigate in only one court instead of two).

The Studios' reliance on *Santa Clara* is misplaced. In fact, the "[f]inancial hardship to the movants must, *of course*, be balanced against financial hardship *to the debtors*." *Curtis*, 40 B.R. at 806 (emphasis added). The Studios have yet to describe any financial hardship they will endure if the stay is not lifted. On the other hand, the evidence will show that the Debtor's financial hardship is the most important consideration that tilts toward denying the Studios relief from the stay at this time. *In re Rogers*, 539 B.R. 837 (C.D. Calif. 2015), which the Studios also rely on, cites to *Santa Clara* approvingly, but it did so in a case where "the record does not contain *any* documentary evidence concerning projections regarding the comparative attorneys' fees and expenses that would be amassed by litigating in the different fora was before the Bankruptcy Court." *Id*. at 848 (emphasis added). There will be no such inadequacy in the record in this case.

Ultimately, the Debtor can grow its businesses and confirm a feasible chapter 11 plan, or the Studios can liquidate their claims now in California. Not both.

CONCLUSION

The Debtor, its estate, and its creditors will be prejudiced if the stay is lifted because the cost of a legal war in California will prevent the Debtor from growing its businesses, which it must do to confirm a feasible plan. It still needs breathing space. So long as the Studios insist on pursuing the least efficient and most expensive way to liquidate their claims, they should have to wait until that way is affordable to the Debtor.

Dated this 28th day of September, 2018.

/s/ *J. Thomas Beckett*

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PROOF OF SERVICE

I hereby certify that on September 28, 2018, I caused a true and correct copy of the foregoing **THE DEBTOR'S REPLY TO THE STUDIOS' SUPPLEMENTAL BRIEFING ON THE STUDIOS' MOTION FOR STAY RELIEF** to be served as follows:

On September 28, 2018, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system, which sent notification of such filing to the following:

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Dated September 28, 2018.

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