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ILLUSORY PROFITS: NET PROFIT AGREEMENTS IN LIGHT OF *BUCHWALD V. PARAMOUNT*

ADAM SETH BIALOW*

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Zero Mostel: You were saying that under the right circumstances, a producer could make more money with a flop than he could with a hit?

Gene Wilder: Yes. It's quite possible.

Zero Mostel: You keep saying that, but you don't tell me how! How can a producer make more money with a flop than he could with a hit?

Gene Wilder: Well, it's simply a matter of creative accounting.¹

I. INTRODUCTION

In the motion picture *The Producers*, Gene Wilder and Zero Mostel have the witty banter written above. Their exchange is unfortunately indicative of a very real problem in the motion picture industry. The method by which motion picture studios calculate profits has been increasingly disputed in recent months by those who anticipated fame and fortune from sharing in the "net profits" of a motion picture. The problem with this "creative accounting" is that the resulting "net profits" rarely materialize. A person unfamiliar with studio accounting practices might assume that a motion picture makes a profit after the amount of money laid out as an initial investment is recouped. However, profits are not so easily calculated in the entertainment industry.

* J.D., Touro College, Jacob D. Fuchsberg Law Center, 1992; B.A., Hofstra University, 1988.

1. *Primetime Live: Fatal Subtraction* (ABC News television broadcast, Mar. 22, 1990) (quoting *THE PRODUCERS* (Embassy Pictures 1968)).

In reality, a film begins to show a profit only at the "break-even" point. According to Robert Enders, an entertainment attorney specializing in the motion picture and television areas, the "break-even" point is defined as a rare occurrence because "in most cases the costs of a film escalate far ahead of the pace at which receipts are generated."² Furthermore, Mr. Enders states that, "fewer than five percent of motion pictures released earn a profit."³

In order to arrive at the "break-even" point, a studio deducts certain amounts from its share of the money generated from ticket revenues. When the press reports that a film "grossed" a particular dollar amount, the general misconception is that this whole amount is received by the studio.⁴ However, approximately forty to sixty percent of the ticket revenue first goes to the theaters that exhibited the motion picture. Costs of production (also referred to as the negative cost), distribution fees, advertising fees, and numerous surcharges are then deducted from this amount. The remaining amount, if any, is the "net profit." If the profit participant had enough clout, he or she could have negotiated a percentage of the gross received by the studio. In this instance, the percentage could have been taken "off the top" (before anything is deducted), at the "break-even point" or any other point in time that the agreement would define.

This Article will review how net profits are determined in the motion picture industry, analyze the effects *Buchwald v. Paramount Pictures Corp.*⁵ may have on the way contracts for net profits participation are made in the future, and offer a variety of expert opinions on the way business practices in the industry may change as a result of the *Buchwald* decision. This Article also includes interviews with the named plaintiff in the case, Art Buchwald, and one of his attorneys, Zazi Pope. Neither Paramount Pictures, nor its counsel responded to numerous requests for comment, other than what was already stated in the press.

2. *Entertainment Finance Special Report*, THE HOLLYWOOD REP., August 1990, at F37.

3. *Id.*

4. See *Letters to the Editor*, WALL ST. J., April 27, 1990, at A13 (where a letter to the editor criticized the press for giving the public the impression that studios receive more money than they actually do; he wished to make it clear that the total gross revenue from ticket sales is not kept by the studio, but is first shared with exhibitors and then has expenses deducted.).

5. *Buchwald v. Paramount Pictures Corp.*, 17 Media L. Rep (BNA) 1257 (Cal. Sup. Ct. 1990).

II. *Buchwald v. Paramount Pictures Corp.*

In early 1982, Art Buchwald⁶ (Buchwald) prepared a screen treatment, eight pages in length entitled "It's a Crude, Crude World."⁷ In March 1982, Buchwald sent his treatment to Alain Bernheim (Bernheim).⁸ Bernheim had registered the work with the Writers Guild of America, as a way of documenting Buchwald's claim that it was his own work as of that date.⁹ Buchwald then condensed his eight page treatment into three pages, which still contained the essence of the original.¹⁰ It was then pitched to Paramount Pictures by Bernheim as a vehicle for actor Eddie Murphy.¹¹

Paramount expressed tremendous interest in the possibility of developing the concept into a feature film. Bernheim was signed as a producer, and Buchwald sold his rights to his story which was then entitled *King for a Day*.¹² In addition to the rights to the story, Paramount had various options to extend the time in which they were given to develop the story into a motion picture. "According to Paramount creative executive David Kirkpatrick, in his ten years at Paramount, Buchwald's treatment was the only one optioned by Paramount."¹³ Prior to reviewing Buchwald's treatment, Paramount had only optioned screenplays.¹⁴

By July 1984, two options had been exercised on Buchwald's work. A third option, a one year extension, was purchased by Kirkpatrick "for cheap money" upon the instruction of then studio chief Jeffrey Katzenberg.¹⁵ On March 29, 1985, Bernheim received notice that the project was in "turnaround."¹⁶ In May 1986, Buchwald had found another studio to option his story.¹⁷ By November 1987, Bernheim had received information that Paramount was pro-

6. Art Buchwald is a syndicated columnist and Pulitzer Prize-winning author based at THE WASH. POST.

7. *Buchwald*, 17 Media L. Rep. (BNA) at 1257.

8. *Id.* (Bernheim was also a plaintiff in the case).

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Buchwald*, 17 Media L. Rep. (BNA) at 1258.

14. *Id.*

15. *Id.* at 1260.

16. *Id.* (The phrase "turnaround" allows the producer one year to take the project to another studio and offer it as his own without help or interference from the original studio. The new studio, however, must reimburse the original studio for any pre-production or development costs.)

17. *Id.* at 1261.

ceeding with a project that bore a striking resemblance to Buchwald's story and that it starred Eddie Murphy, the same actor Bernheim had suggested for the role.¹⁸ After a meeting between Bernheim and a Paramount executive, the studio "insisted" that their new project had no relation to Buchwald's story.¹⁹ In January 1988, Warner Bros. Inc., the studio that Buchwald made the second deal with, cancelled the project clearly citing Paramount's film starring Eddie Murphy as one of the reasons.²⁰ Buchwald and Bernheim then commenced an action against Paramount Pictures Corporation.

Buchwald said that most people "were extremely supportive of his decision to bring the action, but [they did so] off the record, from fear of retaliation."²¹ "Unfortunately, the Writers Guild was the least supportive," he continued. Buchwald acknowledged that the lack of support was probably because the Guild didn't want to alienate themselves from the studios with whom they worked so closely.²²

During the first phase of the trial, the court concluded that "*Coming to America* was a [motion picture] based upon Buchwald's treatment *King for a Day*," and that the works were "substantially similar."²³ Judge Harvey A. Schneider ruled that the case was not about whether "Eddie Murphy 'stole' Buchwald's concept *King for a Day*."²⁴ He continued, "[r]ather, this case is primarily a breach of contract case between Buchwald and Paramount (not Murphy) which must be decided by reference to the agreement between the parties and the rules of contract construction, as well as the principles of law enunciated in the applicable legal authorities."²⁵ The Judge decided that the second phase of the trial would focus on the contract that was made and determine the enforceability of such an agreement.

In the second phase of the trial, the court reached "the inescapable conclusion that the Bernheim-Paramount contract [was] a contract of adhesion."²⁶ The court defined a contract of adhesion

18. *Id.*

19. *Id.*

20. *Id.*

21. Telephone interview with Art Buchwald, syndicated columnist and Pulitzer Prize winning author based at THE WASH. POST (May 21, 1992).

22. *Id.*

23. *Buchwald*, 17 Media. L. Rep. (BNA) at 1267.

24. *Id.* at 1261.

25. *Id.*

26. *Buchwald v. Paramount Pictures Corp.*, No. C 706083 (Cal. Superior, Dec. 21, 1990) Phase II at 5 (not officially published)[hereinafter *Buchwald Phase II*].

as "a standardized contract which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it."²⁷ Although Paramount claimed that "it freely negotiates its net profit formula with the talent," the court concluded that the "plaintiffs have proved by a preponderance of the evidence that Paramount [Pictures] negotiate[d] its net profit formula with only a relatively small number of persons who possess the necessary 'clout,' and even these negotiations result in changes that are cosmetic, rather than substantive."²⁸ The court also noted that "[T]here is evidence in the record to support the conclusion that essentially the same negotiations are conducted at all studios and that when one studio revises a provision of its net profit formula, that revision is adopted by the other studios."²⁹

The court also held that "certain provisions of Paramount's net profit formula were unconscionable."³⁰ According to the court, California Civil Code section 1670.5 states "[i]f the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result."³¹

Among the seven provisions struck down (similar to those discussed subsequently regarding a competing studio), was a ten percent advertising surcharge found not to be in proportion to actual costs, a fifteen percent overhead surcharge for overhead which was determined not to be in proportion to actual costs, and the interest on the production costs and overhead.³² Paramount offered no justification for any of these charges, except the fifteen percent overhead charge, which was "abandoned during a hearing held in the case."³³ Zazi Pope,³⁴ one of the attorneys for the plaintiffs, said that "[Paramount] originally had a 'risky business' defense that motion pictures are risky ventures and that winning films pay for

27. *Id.* at 3 (citing *Graham v. Scissor-Tail, Inc.* 28 Cal.3d 807, 817 (1981)).

28. *Id.* at 4.

29. *Id.* at 4,5.

30. *Id.* at 24.

31. *Id.* at 6, n.2 (citing CAL. CIVIL CODE §1670.5).

32. *Id.* at 24, 25.

33. *Id.* at 25.

34. Telephone interview with Zazi Pope, an attorney with the Los Angeles office of Kaye, Scholer, Fierman, Hays & Handler (May 18, 1992).

losers." She added that, "[t]hey abandoned this defense when they became aware of having to subject their files to disclosure of prior dealings."³⁵

In the third phase of the trial, the court had to determine what damages, if any, the plaintiffs were entitled under the remaining terms of the contract. The court "declined to accept" either the plaintiffs' or defendants' evidence regarding the value of both Buchwald's and Bernheim's services and decided to rely upon a previous ruling as a guideline.³⁶ Under the original terms of his contract, Buchwald was to receive "65,000 dollars, 1.5 percent of the net profits, and a screen credit if Paramount made a movie based upon his story."³⁷ Bernheim, as producer, was to earn "200,000 dollars plus 40 percent of the net profits, reducible to 17.5 percent under a studio formula. . . ."³⁸

The court relied upon a case which stated that if a conflicting range of testimony was offered by both the plaintiff and defendant, the court was vested with the authority to "decide upon a value which falls in between the range of the opinion testimony."³⁹ The court also decided to apply a rule of law that was generally reserved for eminent domain cases which state, "[t]he fair market value of property taken for which there is no relevant market is its value on the date of valuation as determined by any method of valuation that is just and equitable."⁴⁰

In estimating the value of Bernheim's services, the court held that 750,000 dollars was "fair and just compensation" for his contribution to Paramount's motion picture.⁴¹ "The court observe[d] that, given the fact it was stipulated that Paramount ha[d] earned tens of millions of dollars of gross profits from 'Coming to America,' the compensation awarded to Bernheim represent[ed] less than 1 percent of Paramount's gross profits (if 'Coming to America' generated gross profits as high as \$100 million) and less than 5 percent of the Paramount's gross profits (if 'Coming to America' generated gross profits as low as \$20 million)."⁴² The

35. *Id.*

36. *Buchwald v. Paramount Pictures Corp.*, No. C 706083 (Cal. Superior, Mar. 16, 1992) Phase III at 4 (not officially published) [hereinafter *Buchwald Phase III*].

37. *PIERCE O'DONNELL & DENNIS McDUGAL, FATAL SUBTRACTION: THE INSIDE STORY OF Buchwald v. Paramount* xxv (1992).

38. *Id.*

39. *Buchwald Phase III* at 4, 5 (citing *People ex. rel. Dept. of Public Works v. Peninsula Enterprises, Inc.*, 91 Cal. App. 3d 332, 346-347 (1979)).

40. *Id.* at 6 (citing CAL. CIV. PROC. CODE § 1263.320 (b)).

41. *Id.* at 10.

42. *Id.*

court based its decision on testimony that, "Paramount and other studios consider[ed] one percent of gross profits to be the equivalent of two percent of net profits."⁴³

An expert for the plaintiffs had testified that Bernheim should have received contingent compensation of between twelve and one-half percent and thirty-five percent of net profits, which never materialized.⁴⁴ An expert for the Defendant testified that the amounts were between five and ten percent.⁴⁵ The court took the low number from each and utilized the two to one conversion, arriving at a figure of six and one-quarter percent using an estimate of 20,000,000 dollars as the gross profits that Paramount received.⁴⁶ This resulted in a range of possible damages of 500,000 dollars to 1,200,000 dollars, from which the court decided on the 750,000 dollar amount.⁴⁷

In estimating the value of Buchwald's services, the court relied upon several factors. First, Buchwald had a unique concept. Second, Buchwald would have received a large amount of media attention for creating the concept of a major motion picture. Third, Paramount's earnings of "tens of millions of dollars of *gross profits*" (emphasis added) from their production of *Coming to America* was significant because the story was based upon Buchwald's idea.⁴⁸

The court arrived at a figure of 150,000 dollars, which was not even close to the 6,200,000 dollars that Buchwald's expert had opined he was entitled to.⁴⁹ The court's award of damages to Buchwald ended up being almost twice the amount that Paramount's expert had indicated as being appropriate.⁵⁰ In the decision, there was no mention of the method upon which Buchwald's one and one-half percent interest in the net profits was converted into gross profit share.

Prior to this phase of the trial, the plaintiffs had estimated their combined damages to be 28,000,000 dollars, to which the defendant had replied, "Buchwald and Bernheim must be floating in never-never land."⁵¹ When questioned whether the plaintiffs had overestimated the value of the case, their attorney Zazi Pope re-

43. *Id.* at 12.

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.* at 13.

49. *Id.*

50. *Id.*

51. *Suit Asks Slice of 'America' Pie*, WASH. POST, Jan 17, 1992, at C6.

plied, "[t]he judge in this case was traditionally conservative regarding damages."⁵² The distribution of any net profits to profit participants was not discussed in the case specifically, because Paramount had claimed that *Coming to America* was still showing no profits and had a deficit of 18,000,000 dollars.⁵³ Since the net profits the plaintiffs were entitled to never materialized, the court decided to use an alternative method of computing compensation for the plaintiffs. For a complete breakdown of an estimate of Paramount's net profit participation statement for *Coming to America*, please see Appendix A.⁵⁴

III. ENTERTAINMENT INDUSTRY DEFINITION OF NET PROFITS

The number of ways the term "net profits" has been defined is equalled only by the number of reactions the use of the term will evoke. A studio attorney may state that net profits are paid to an individual after the studio has recouped its initial costs of financing, producing, and distributing a motion picture. This attorney would be likely to further argue that the surcharges and other costs of overhead that are deducted from the studio's share of the gross help offset the costs of running a studio and absorb the losses from failed ventures. However, an attorney on the other side of a bargaining table would be likely to offer a different opinion. Pierce O'Donnell, an attorney with the Los Angeles office of Kaye, Scholer, Fierman, Hays & Handler, who represented writer Art Buchwald and producer Alain Bernheim in their case against Paramount, said "[i]n the Alice in Wonderland world of Paramount and every other studio, net profits are not profits, profits are expenses, and break even is not an even break."⁵⁵ Eddie Murphy, an actor who has had a long-term affiliation with Paramount Pictures commented, "[n]et profits are monkey points— you look at them [in the agreement] and laugh like a monkey."⁵⁶

In response to criticism that few profit participants receive any money for their share of net profits, Paramount Pictures released a list of twenty-nine motion pictures that have paid net profits to eighty-nine actors, directors, writers, and producers since

52. Telephone interview with Zazi Pope, *supra* note 34.

53. Henry J. Tashman, *Hit Picture Still Shows No Profit*, THE NAT'L L.J., April 30, 1990, at 17.

54. See *id.* (The figures stated in the article are "reconstructed based upon Paramount's interrogatory answers in the case and the plaintiffs' contract with Paramount.")

55. Dick Goldberg, *Studio Claims 29 of Its Films Paid Net Profits*, L.A. DAILY J., July 16, 1990, at 1.

56. *Id.*

1975.⁵⁷ No breakdown was given regarding whether actors, directors, writers, or producers had received a greater share of this money, nor were any of specific identities revealed. This information would appear pertinent to the Buchwald and Bernheim case and is likely to be the reason why the information was not disclosed. Among the films listed that accounted for 155,000,000 dollars in net profit payments, were: *Grease*, *The Bad News Bears*, *Ordinary People*, *Star Trek II, III, IV*, and *Flashdance*.⁵⁸ Also included on the list were the following motion pictures that Eddie Murphy appeared in: *Trading Places*, *48 Hours*, *Beverly Hills Cop*, *Beverly Hills Cop II*, and *Raw* (concert film).⁵⁹

Some profit participants who received net profits were more than happy to discuss how it affected them. Douglas Day Steward, who wrote the screenplay for *An Officer & A Gentleman* claimed he received over 5,000,000 dollars from his five percent share of the net profits.⁶⁰ He said for that film "there were no gross profit participants."⁶¹ This meant that nobody received money before the expenses were deducted by the studio. He conceded, however, that today he knows that gross percentage points deducted from the start "affect the [possibility] of net [profits] down the line" and he would "not expect that type of payout anymore."⁶²

There are many well known people in the entertainment industry who have quietly challenged studio accounting practices. The reason they do not receive much publicity is because their cases are usually settled and have the terms of the agreement sealed by the court. Occasionally such settlements leak out and become public. For example, actor James Garner of *The Rockford Files*, was contractually entitled to thirty-seven percent of the net profits from his television series, yet received an amount less than 300,000 dollars.⁶³ He sued and reached a settlement of approximately 12,000,000 dollars.⁶⁴

In another television related dispute, the series *Hart to Hart* became the subject of litigation regarding its net profits.⁶⁵ This series had been syndicated in seventy-five countries and had grossed

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. Goldberg, *supra* note 55.

62. *Id.*

63. Dana Wechsler, *Profits? What Profits?*, FORBES, February 19, 1990, at 38.

64. *Id.* Pierce O'Donnell represented NBC as co-plaintiff with James Garner against Universal/MCA. See O'DONNELL & McDUGAL, *supra* note 37.

65. *Id.*

137,000,000 dollars, yet it still showed a loss of 16,000,000 dollars in November of 1985.⁶⁶ Sidney Sheldon, creator of the show and stars Robert Wagner and Stephanie Powers, who were supposed to share in the net profits, sued Columbia Pictures Industries and Spelling-Goldberg Productions "for systematically rendering false and fraudulent accounting statements."⁶⁷ A settlement was reached in 1989 for approximately 5,000,000 dollars.⁶⁸

IV. EVOLUTION OF NET PROFITS

In *Buchwald v. Paramount*, Mel Sattler, former head of business affairs at Universal Pictures, testified for the defendant Paramount in a deposition that the concept of net profits "started with actor Jimmy Stewart's back-end deal⁶⁹ for *Winchester '73*, in 1950."⁷⁰ At that time, Stewart commanded an acting fee of 250,000 dollars per motion picture, which the financially strapped Universal Studios could not afford.⁷¹ "In lieu of an up front salary, Stewart agreed to star for fifty percent of the landmark western's 'net profits,' defined as any receipts after the film earned back twice its negative [production] cost."⁷² Sattler added that "[i]f 'Winchester' never reached break-even, the actor would have received nothing for his services."⁷³ He continued, "[n]et profit deals today come in addition to up front compensation and don't require the performer to share the risks."⁷⁴ It is because of this change that Sattler claims that net profit participants today do not have as strong a claim for sharing in the profits.⁷⁵ This opinion is probably based on the fact that the professionals in today's entertainment industry often belong to guilds which have the bargaining power to watch over that person's interests. In turn, these guild members may have acquired guaranteed minimum compensation through various collective bargaining agreements. For instance, before entering into an agreement, a writer can consult with a representative of the Writers Guild and obtain general guidelines and the guild mini-

66. Wechsler, *supra* note 63.

67. *Id.* at 39.

68. *Id.*

69. A back end deal is one where a share of profits, if any, is received after all deductions have been made.

70. *Life After Buchwald*, THE HOLLYWOOD REP., August 1990, at F-26,27.

71. *Id.*

72. *Id.*

73. *See id.* at 27.

74. *See id.*

75. *See id.*

mums for sale of a literary work for use in a motion picture.

However, quite a few cases contradict this assessment of the history of net profits. For example, in 1946, *Bercovici v. Chaplin*⁷⁶ involved a dispute over sharing the net profits from producing motion pictures. In *Holmes v. Columbia Pictures Corporation*⁷⁷ the dispute was over a third party receiving net profits. Although these cases did not receive a full trial on their merits or the legality of net profits, the cases clearly indicate that net profit participation existed before 1950. Zazi Pope, one of the attorneys for plaintiffs Art Buchwald and Alain Bernheim in the Paramount case, speculated that “[m]aybe [actor Jimmy] Stewart was the first to openly talk about such an agreement, but we did know [at trial] of the existence of other net profit agreements prior to the date that the defendant’s witness had claimed.”⁷⁸

V. WHERE DOES THE MONEY GO?

The following is an analysis of pertinent sections of a sample net profits agreement used by Warner Bros. Inc. and is representative of most net profit agreements prior to the *Buchwald* decision. A reproduction of these sections can be found in Appendix B, however the entire text of the agreement is readily available in many legal libraries. It can be found in either the loose-leaf treatise, “Lindey on Entertainment, Publishing and the Arts,”⁷⁹ or in the Practising Law Institute’s “Counseling Clients in the Entertainment Industry.”⁸⁰

The analysis starts first with paragraphs two and three. Paragraph two defines net profits as “[a]n amount equal to the excess, if any, of the gross receipts of the Picture” less distribution fees, expenses, costs of production, interest, and any other costs. According to paragraph three, receipts from ticket sales are not included in the gross receipts accounting figures until “actually received.” This qualification affects the calculation of net profits. In generally accepted accounting methods any outstanding money owed to the studio would be labeled “accounts receivable” and would be considered an asset. In this contract, no provision exists

76. See *Bercovici v. Chaplin*, 7 F.R.D. 61 (S.D. N.Y. 1946).

77. See *Holmes v. Columbia Pictures Corp.*, 109 F.Supp. 327 (S.D.Cal. 1953).

78. Telephone interview with Zazi Pope, *supra* note 34.

79. 2 ALEXANDER M. LINDEY, LINDEY ON ENTERTAINMENT, PUBLISHING AND THE ARTS: AGREEMENTS AND THE LAW, at 5-167 (1992).

80. 2 PRACTISING LAW INSTITUTE, COUNSELING CLIENTS IN THE ENTERTAINMENT INDUSTRY, at 581 (1992).

for anticipated revenue counting as an asset. Therefore, it gives the appearance that the motion picture has less revenues than it actually does. According to the clause and the rider, any money owed from Warner's direct distribution or from exhibitors under Warner's control was not included in the gross receipt calculations until that money was "actually received" by the studio.

It is of interest to note that a similar method of accounting was used by Paramount Pictures regarding the disputed contract in the *Buchwald* case. According to Pierce O'Donnell, attorney for the plaintiffs, "Paramount maintained two accounting systems: one for itself and another for its net profit participants."⁸¹ He continued, "the first set of books, based on what accountants call generally accepted accounting principles (GAAP), was how Paramount was legally obligated to account to its stockholders, the IRS, and the Securities and Exchange Commission."⁸²

Query whether the logic of excluding money owed but not yet paid to Warner from the gross receipt calculation, given standard accounting principles, makes sense. The deviation from standard practice in determining gross receipts not only appears inequitable, but also hints at a deliberate attempt by the studio to withhold earnings due the profit participant through their "creative accounting". Thus, the inequity of the "actually received" requirement cannot be overstated. In addition, if the money is owed from a division under Warner's control, what is the reason for the absence of provisions setting guidelines for time limitations on the transfer of funds to the parent company? Even absent such control, the net profit participant would understand the entire financial picture more thoroughly by receiving an accounting of any anticipated revenue which is outstanding.

Next, according to paragraph four, distribution fees range from thirty to forty percent of the gross receipts. In addition to this percentage being deducted from the studio's share of the gross receipts, so are expenses associated with distribution. According to David Robb, a noted entertainment journalist affiliated with *The Hollywood Reporter*, "[t]he distribution fee is essentially a sales commission for booking the film into theatres all over the world, for collecting these revenues, and for negotiating deals for the distribution of the film on TV, pay TV, and in-flight showings."⁸³

81. O'DONNELL & McDUGAL, *supra* note 37.

82. *Id.*

83. David Robb, *How studios determine their distribution fees*, THE HOLLYWOOD REP., August 17, 1992, at 18.

Paragraph five defines these expenses as "whatever kind or nature. . .[that is] customary. . .in the motion picture industry." This overly inclusive definition of expenses allows creative accountants to reduce gross receipts substantially, thereby causing a decline in the profit participant's expected earnings pursuant to their contract.

Paragraph five also gives the studio the option of withholding "appropriate reserves" of money to be used to pay any outstanding debts. At first glance, this may appear reasonable, but the rider to this paragraph states that this money can be held up to eighteen months, with an even longer period for money set aside for tax purposes. During this time period, these amounts are not included in gross receipt calculations. Along with the myriad of creative accounting procedures and write off provisions contained in the contract, no limit exists on the amount of money a studio may withhold other than the word "appropriate". This is yet another example of how overly broad contract provisions can be used to reduce the profit participant's expectations of income. A more equitable provision would require that a certain percentage of the distribution budget be held for a specified period rather than engaging in the uncertainty of what may be deemed "appropriate".

In a further discussion of expenses in paragraph five, subsection (b), the studio is authorized to spend with "uncontrolled discretion" any amount that it deems necessary to "exploit" the motion picture. The only possible problem here is that this money may be spent at "in house" departments, which may or may not offer competitive rates for these services. The most striking part of this clause relates to a ten percent surcharge added on to all costs from this clause in order to "cover the indirect cost of the studio's advertising and publicity departments, both domestic and foreign." This practice was held unconscionable in the *Buchwald* decision.⁸⁴ If these services were purchased from the studio itself, the producers had already been charged for these services at a price which no doubt included a reasonable profit margin. The surcharge simply adds additional profit for the studio, thereby decreasing the amount of possible funds available to profit participants. In addition to the surcharge, the clause also provides for the studio to deduct an additional amount of money in order to "receive salaries and expenses" of all those who had a role in the "preparing and delivering the motion picture. . . ." Under these terms, mainte-

84. *Buchwald Phase II*.

nance people or studio guards could feasibly have their salaries paid by any production which uses the studio's lot.

On top of any costs of the production being deducted from the gross, an overhead charge of fifteen percent is charged on all expenditures as well as interest on these costs and the surcharge itself. In *Buchwald*⁸⁵, the court found that Paramount had charged an additional fifteen percent surcharge on studio overhead, which the court determined had no relevance to the cost of motion picture production. Having found no relationship between the surcharge and the cost of production to exist, the court held that the surcharge and interest provisions to be unconscionable.⁸⁶

Paragraph nine sets forth terms for the computation of interest. The interest rate is "equal to" 125 percent of the prime rate calculated as of the date that the expenses were charged to the production. As of May 19, 1992, this would be an interest rate of 8.125 percent.⁸⁷ If the calculation was for the same period a year before, the interest rate would have been 10.625 percent.⁸⁸ The possibility of fluctuations in the interest rate, no matter how dramatic these changes may be, will work to frustrate the profit participant's expectations of return at the signing of the contract. According to this agreement, a drop in interest rates would cause the studio to lose money because of a lower rate of return on what they consider to be their investment. As a result, the possibility of net profits being realized is substantially decreased with a drop in the interest rate. Of course, if interest rates rose, the possibility of net profits may increase, however, at the expense of the net profit participant. An equitable solution would be to set the interest rate at a specific amount rather than on the prime rate. Another possible option is to set the interest rate at 125% of the prime rate, but not more or less than a particular percentage.

In paragraph ten, the relevant provisions discussing the profit participant's earnings statements are discussed. The paragraph states that Warner will give the profit participant a "periodic statement" in "summary form" of any calculations covered by this agreement. However, the statement provides no pertinent information to the profit participant upon which he/she may evaluate where they stand. A possible solution is to require a periodic state-

85. *Id.*

86. *Id.*

87. N.Y. TIMES, May 19, 1992, at D-12, (The prime rate for this date was listed as 6.5%).

88. *Id.*

ment containing a reasonably detailed breakdown of all calculations in order to give the profit participant a realistic picture of where he/she stands. In addition, this paragraph places a two year limitation on the amount of time in which the profit participant may challenge the accuracy of these accounting statements. Furthermore, in a rider to paragraph eleven, there is a similar clause where the parties to the contract waive their rights to "file any suit, action or proceeding against the studio," if the action was not commenced within a specified time period. Because the profit participant does not receive a full and accurate disclosure of the calculations, it could be long after the contractual limitation period expires before any discrepancy in the statements would be discovered.

In paragraph eleven, accounting methods and auditing rights are discussed. This section states that the profit participant may have access to the books for an audit, so long as it is done during "normal business hours" and does not interfere with "normal business activities." One problem with this language is that "normal business activities" are not defined. What if, for example, one ledger holds the accounting figures for more than one project? Would the prevention of someone using this book during the audit constitute a breach? This may appear insignificant at first glance. However, a dispute over millions of dollars may cause the parties to act out of the ordinary. Therefore, the clearer this is made to be, the better off the parties will be later, should a dispute arise.

Another potential problem for the profit participant who wants to examine the books is contained in a rider to paragraph eleven. This provision states that the studio is pre-approved to use certain accounting firms, while any other party to this contract who wishes to audit the books may only do so if the accountant is deemed "reputable" by the studio. Rather than requiring a party to wait for studio approval of an accounting firm, it would be more equitable to state that any party may use a firm considered one of "the big six" accounting firms, so long as there is no conflict of interest. Since the contract already vests Warner with that right, giving a reciprocal right to the profit participant would be equitable.

VI. WHAT THE FUTURE MAY HOLD

Although the odds against a deal being made for an unproduced writer are very high, more than 30,000 film and television scripts were registered with the Writers Guild of America in West

Hollywood, California last year.⁸⁹ The relatively small percentage who were able to make a deal were likely to include some writers who thought they had made a great deal by receiving a share of the project's net profits, only to later discover that these percentage points were virtually worthless. As previously mentioned, only those parties who had some clout would have been able to negotiate a share of the gross that would put them on par with the studio. Commenting on the *Buchwald* decision, Peter Dekom, a Los Angeles entertainment attorney, claimed that "[it] is a disaster that will change the entertainment business permanently and irreversibly."⁹⁰ He speculated that "hundreds of writers and producers will sue studios for new accountings of profits."⁹¹

As a result of the *Buchwald* case, the studios will more than likely have to re-write their profit participation agreements to be in compliance with the court's holding. This will leave studios with the option of formulating a new method of accounting for profits or lead to more "up-front" money being paid with little or no share of profits. Peter Dekom further speculated that studios will be reluctant to deal with individuals with "low bargaining power . . . [because] . . . the studio[s] won't want to take the risk [of being sued]."⁹²

According to New York entertainment attorney Elliot H. Brown, a partner at Franklin, Weinrib, Rudell & Vassallo, P.C., "[s]o far there does not seem to have been any significant changes in net profit definitions since the *Buchwald* case."⁹³ "Warner Bros., however, has changed its contract to provide that participants who would previously have shared in 'net profits,' now share in 'defined proceeds.'"⁹⁴ A prominent entertainment attorney with over 45 years experience in the field, who wished to remain anonymous, stated, "Any knowledgeable lawyer, agent, or accountant involved in the entertainment industry knows that 'net profits' are illusory" and that these net profit deals evolved primarily "to give the [recipient] the illusion of being a big shot." He added that "[o]ccasionally they get lucky. . . ."

One studio executive offered his opinion that he did not expect the decision to hold up on appeal. He analogized the situation

89. HOUSTON CHRON., Apr. 12, 1992, at 6.

90. Amy Stevens, *Paramount Ordered to Refigure Buchwald's Fee in Movie Dispute*, WALL ST. J., Dec. 24, 1990, at 12.

91. *Id.*

92. *Id.*

93. Elliot H. Brown, *Fatal Subtraction*, N.Y. L.J., September 14, 1992, at 2.

94. *Id.*

to a customer who buys products at a supermarket and then refuses to pay the entire bill because one of the groceries in question was too high in price.⁹⁵ What this attorney did not address was how he would feel if his understanding of the price of a specific item was five dollars, but he was billed 1000 dollars. If this were to happen to him, wouldn't he want to question the price of the other items on the bill before paying?

Furthermore, a handful of studios control the game. It is their "bat and ball", so to speak, and they can play with whomever they choose. The large number of scripts submitted each year exceeds the small amount which are actually purchased. Not only is this evidence of the studios stronger bargaining power relative to writers, but also evinces the competitive nature of the industry. Writers understand these conditions and feel pressure to close a deal before an offer is withdrawn. The probable consequence is that writers are not fully informed regarding the actual value of their net profit participation.

It has been argued that Buchwald and Bernheim got what they bargained for in their contracts. If that is the case, are the agents who make these type of deals for their clients at fault? A commentary by L. Gordon Crovitz in the *Wall Street Journal* takes that position.⁹⁶ In his article, Crovitz launched what could be interpreted to be a personal attack on Buchwald, and espoused the view that a contract is sacred and not to be broken. He stated that "Buchwald brought new meaning to the term 'court jester'. . . and . . . was not a person with no bargaining power, but a Pulitzer Prize winning writer who was represented by one of the top executives at the William Morris Agency."⁹⁷

In an interview, Buchwald commented that he didn't personally know Crovitz and couldn't understand his motivation in writing such an article.⁹⁸ Buchwald responded in his own commentary that the case would have been dismissed if it was frivolous.⁹⁹ He wrote the only thing funny about the case was that "Paramount did a lot of funny things with its books that prevented *anyone* from getting net profits."¹⁰⁰ Buchwald's attorney commented that

95. Dick Goldberg, *Entertainment Bar in Uproar Over 'Buchwald'*, L.A. DAILY J., Jan. 3, 1991, at 1.

96. See L. Gordon Crovitz, *Rule of Law*, WALL ST. J., Jan. 9, 1991, at A10.

97. *Id.*

98. *Supra* note 21 (Buchwald telephone interview).

99. See Art Buchwald, *Paramount's Funny Books Are No Laughing Matter*, WALL ST. J., Jan. 23, 1991, at A12.

100. *Id.*

the "agents were not at fault because they couldn't get a better deal."¹⁰¹ She added, "[i]t was an adhesion contract with no opportunity to negotiate - if you wanted a deal, you agreed to their terms."¹⁰²

Clients would probably be best advised to get as much as they can in "up-front" compensation, thereby eliminating the need to rely on the uncertainty of net profits. If this is not possible, then clients should be informed of the consequences such profit participations are likely to foster. Pope is of the opinion that studios are unlikely to use the same formula for net profits in the future and may rename this type of contract "contingent compensation," which would still not guarantee a return.¹⁰³

The fact that the contract is renamed "contingent compensation," or has certain clauses reworded, does not guarantee a greater chance of receiving any share of profits. Some studios have attempted to minimize the negative connotation that the term "net profits agreement" now has by telling profit participants that they are receiving a share of the "adjusted gross profits." In actuality, the manner by which the adjusted gross profits are calculated is essentially the same as the former net profit calculations. The recipient is still left with a share of the profits essentially worth nothing unless the film has a low budget or no gross profit participants that would affect the potential of future net profits.

Although the *Buchwald* decision resulted in a 900,000 dollar verdict for the plaintiffs, one estimate is that the case cost their attorneys at least 2,500,000 dollars to litigate - a cost clearly not covered by the attorneys' share of the damages.¹⁰⁴ Commenting on the financial loss to his firm, attorney Pierce O'Donnell stated, "The case had an ironic twist. Everyone made out but the lawyers."¹⁰⁵ O'Donnell emphasized that "the outcome was a victory for the creative community," and he looked forward to defending the decision should the defendants chose to appeal.¹⁰⁶ In addition to damages, estimated costs to Paramount included 3,000,000 dollars in legal fees and 300,000 dollars in court costs.¹⁰⁷

Presently, Paramount has not filed an appeal. Under Califor-

101. Telephone interview with Zazi Pope, *supra* note 34.

102. *Id.*

103. *See id.*

104. David Robb, *Only \$150,000 for Buchwald*, THE HOLLYWOOD REP., March 17, 1992, at 1.

105. *Id.*

106. *Id.*

107. *Id.*

nia law, a notice of appeal must normally be filed "before the earliest of" either sixty days after the mailing or service of a "notice of entry"¹⁰⁸ or 180 days after the date of entry of the judgment.¹⁰⁹ If the notice of appeal is not timely, then the "judgment is affirmed, notwithstanding any other provision of law. . . and [shall] thereafter be forever binding and conclusive, as to all matters adjudicated. . ."¹¹⁰

In an action which may test the *Buchwald* decision, the executive producers of the motion picture *Batman*, Benjamin Melniker¹¹¹ and Michael Uslan, have filed suit against Warner Bros. Inc. for what they claim is a denial of their share of the profits.¹¹² The unconscionability theory in the *Buchwald* case is the basis of one of a number of causes of action alleged against Warner Bros. and may be revisited. The dispute stems from an agreement that Melniker and Uslan claim to have been "forced to sign," which "stripped them of their share of the film's gross profits in exchange for executive producer credits and a share of the film's net profits."¹¹³

According to the article, the motion picture realized over 200,000,000 dollars, but the studio claimed it was still 35,000,000 dollars short of returning any net profits.¹¹⁴ As of December 31, 1991, that amount was amended to be gross receipts of greater than 285,000,000 dollars and a net deficit of still more than 20,000,000 dollars.¹¹⁵ Warner Bros. stated, in its answer to the complaint, that the cause of action was "frivolous" because the film had not realized any net profits according to the terms of its agreement with the plaintiffs.¹¹⁶

According to Art Buchwald, "The studios are still making the same deals as before, but if the appeal is won, net profits will have

108. According to this statute, a "file-stamped copy of the judgment or appealable order may be used in place of the document entitled 'notice of entry.'"

109. CAL. CT. R., Rule 2(a).

110. CAL. CIV. PROC. CODE § 870.

111. Benjamin Melniker held positions as Vice President-General Counsel and Executive Vice President of Metro-Goldwyn-Mayer, Inc. from 1954-1970. (employment verified during phone conversation with Mr. Melnick on March 1, 1993). It is of interest to note that Pierce O'Donnell is one of the attorneys representing the plaintiffs. See O'DONNELL & McDUGAL, *supra* note 37.

112. *Batman Statements Put Accounting in the Spotlight*, WALL ST. J., Mar. 22, 1991, at B4.

113. *Id.*

114. *Id.*

115. David Robb, *Warners: Bat Suit Frivolous*, HOLLYWOOD REP., May 5, 1992, at 4.

116. *Id.*

to be redefined permanently."¹¹⁷ "Every person has had a story about what happened to them similar to mine. There are a lot more victims than most people think. Most of them can't open their traps because they're afraid of being boycotted."¹¹⁸ Buchwald stated that he does not know whether he or his partner, Bernheim, have been "blacklisted", but does know that Bernheim "[is] currently involved in some projects."¹¹⁹ Buchwald stated that he was currently spending time working on his autobiography.

Buchwald opined, when asked to speculate as to why Paramount did not settle the case, that "[Paramount] thought I would go away, but I didn't."¹²⁰ He further explained that as time passed, the studio tried to settle but wanted to "muzzle him," which Buchwald said he would never stand for.¹²¹ "If I needed money, maybe I would have compromised, but I wasn't doing it for the money— it was more important for me to stand by what I believed in," Buchwald continued.¹²² He drew the conclusion that "Paramount made one mistake after another," and referred to it to being "their Vietnam."¹²³ Buchwald concluded by stating that the majority of the general public does not realize the "far-reaching implications that the case can have in other industries, if the decision is upheld."¹²⁴ Unless the holding of the court is overturned on appeal, "the net profit formula as written [in the Paramount agreement] no longer exists," according to Judge Harvey A. Schneider.¹²⁵

VII. UPDATE

On July 31, 1992, Judge Schneider denied a motion by Paramount to vacate and set aside the court's judgment in order to receive a new trial.¹²⁶ On August 21, 1992, Paramount filed a notice of appeal with the California Second District Court of Appeal.¹²⁷ As of March 1993, attorney Charles P. Diamond was "waiting for the record to be assembled" and he anticipated the filing of the

117. Telephone interview with Art Buchwald, *supra* note 21.

118. *Entertainment Finance Special Report*, HOLLYWOOD REP., August 1990, at F27.

119. Telephone interview with Art Buchwald, *supra* note 21.

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

125. *Buchwald Phase II*, at 30.

126. *Paramount Files Notice of Appeal with CA court in Buchwald*, ENT. LITIG. REP., October 19, 1992.

127. *Id.*

actual appeal "within 60 days."¹²⁸

Appendix A¹²⁹

Net Profit Participation Statement for 'Coming to America'

<i>Item</i>	<i>Amount in Millions:</i>
Worldwide Retail Receipts About	\$ 275
Paramount's Gross Receipts	\$ 125
Paramount's Distribution Fees	\$ (42)
Distribution Expenses ¹³⁰	\$ (36)
Direct & Indirect Cost of Production ¹³¹	\$ (59)
TOTAL NET PROFIT (LOSS) WITHOUT INTEREST	\$ (12)
INTEREST ON UNRECOUPED PRODUCTION COSTS	\$ (6)
TOTAL DEFICIT	\$ (18)

Appendix B¹³²

Net Profits Agreement: Selected Provisions

1. *Definition of Parties:* "Warner" means Warner Bros. Inc., a Delaware corporation, and its subsidiaries engaged in the business of distributing motion pictures for exhibition in theatres and for broadcasting over television stations, but shall not include any other persons, firms or corporations licensed by Warner to distribute motion pictures in any part of the world. Nor shall such term include: any person, firm or corporation distributing the Picture for purposes other than exhibition in theatres or by television stations; exhibitors or others who may actually exhibit the Picture to the public; radio or television broadcasters, cable operators; manufacturers, wholesalers or retailers of video discs, cassettes or similar devices; book or music publishers; phonograph record producers or distributors; merchandisers, etc., whether or not any of the foregoing are subsidiaries of Warner. As used herein, a "subsidiary" of Warner refers to an entity in which Warner has at least 50% interest.

128. Telephone interview with attorney Charles P. Diamond of the Los Angeles office of O'Melveny & Meyers (March 18, 1993).

129. Henry J. Tashman, *Hit Picture Still Shows No Profit*, THE NAT'L L.J., April 30, 1990, at 17.

130. Includes advertising, movie prints and dues.

131. Also known as 'negative costs'

132. LINDEY, *supra* note 79 (form contributed by John A. Schulman, Esq. and Warner Bros., Inc., Release #24, September 1991).

“Participant” means the party under the foregoing agreement who or which is entitled to participate in the gross receipts or net profits of the Picture, and the successors and permitted assigns of such party.

2. *Net Profits*: As between Warner and Participant, the “net profits” of the Picture means an amount equal to the excess, if any, of the gross receipts (as defined in 3 hereof) of the Picture over the aggregate of the following, which shall be deducted in the order listed:

(a) Warner’s distribution fees set forth in 4 hereof.

(b) Warner’s expenses in connection with the distribution of the Picture, as set forth in 5 hereof.

(c) The cost of production of the Picture, plus an amount equal to interest thereon, all as provided for in 9 hereof, and plus such other costs, if any, as may have been incurred in connection with the financing of the cost of production of the Picture. Said interest and other costs shall be recouped before said cost of production.

(d) All contingent amounts consented to by Warner and not included in the cost of production of the Picture payable to Participant or any third party based upon, or computed in respect of, the gross receipts of the Picture (as defined in the relevant agreements), or any portion thereof.

Net profits shall be determined as of the close of each accounting period provided for in 10 hereof.

3. *Gross Receipts*: As used herein, the term “gross receipts” means the aggregate of:

(a) All film retails actually received by Warner from parties exhibiting the Picture in theatres and on television where Warner distributes directly to such parties (hereinafter referred to as “exhibitors”).

(b) Where Warner grants theatrical distribution rights to a subdistributor on a basis requiring it to account to Warner with respect to film rentals, either: (i) the film rentals received by such subdistributor from exhibitors which Warner accepts for the purpose of its accountings with such subdistributor; or (ii) Warner’s share (actually received) of film rentals received by such subdistributor; whichever Warner elects from time to time as to each subdistributor.

(c) In respect of licenses of exhibition or distribution rights by means of video discs, cassettes or similar devices, an amount equal to 20% of (i) the gross wholesale rental income therefrom and (ii) the gross wholesale sales income therefrom less a reasonable allow-

ance for returns.

(d) All amounts actually received by Warner from the following: (i) trailers (other than trailers advertising television exhibitions of the Picture); (ii) licenses of theatrical distribution rights for a flat sum; (iii) licenses of exhibition or distribution rights other than those referred to in (a), (b), (c) and (d) (ii) of this 3, specifically including licenses to cable operators; (iv) the lease of positive prints (as distinguished from the licensing thereof for a film rental); and from the sale or licensing of advertising accessories, souvenir programs and booklets; and (v) recoveries by Warner for infringement of copyrights of the Picture.

(e) All monies actually received by Warner on account of direct subsidies, aide or prizes relating specifically to the Picture, net of an amount equal to income taxes based thereon imposed by the country involved, if any. If local laws require use of such monies as a condition to the grant of such subsidy or aide, such monies shall not be included in gross receipts until actually used.

(f) See Exhibits "1," "2" and "3" attached hereto.

In no event shall rentals from the exhibition of the Picture which are contributed to charitable organizations be included in gross receipts.

4. *Distribution Fees*: Warner's distribution fees shall be as follows:

(a) 30% of the gross receipts of the Picture derived by Warner from all sources in the United States and Canada.

(b) 35% of the gross receipts of the Picture derived by Warner from all sources in the United Kingdom.

(c) 40% of the gross receipts of the Picture derived by Warner from all sources other than those referred to in (a) and (b) above.

(d) Notwithstanding the foregoing; (i) with respect to sums included in the gross receipts pursuant to 3(b)(ii) and 3(d)(ii) hereof, Warner's distribution fee shall be 15% of such sums; (ii) if Warner shall license the exhibition of the Picture on free television, the aforesaid percentages as to amounts received and collected by Warner from sources in the United States, shall be 30% if collected from a network for national network telecasts in prime time; and 35% in all other instances, and, as to amounts received and collected by Warner from sources outside the United States 40%; (iii) no distribution fee shall be charged on gross receipts referred to in 3(e) or 3(f) hereof.

All distribution fees shall be calculated on the full gross receipts without any deductions or payments of any kind whatsoever.

5. *Distribution Expenses*: Warner's deductible distribution expenses in connection with the Picture shall include all costs and expenses incurred in connection with the distribution, advertising, exploitation and turning to account of the Picture of whatever kind or nature, or which are customarily treated as distribution expenses under customary accounting procedures in the motion picture industry. If Warner reasonably anticipates that additional distribution expenses will be incurred in the future, Warner may, for a reasonable time, set up appropriate reserves therefor. Without limiting the generality of the foregoing, the following particular items shall be included in distribution expenses hereunder:

(a) The cost and expense of all duped and dubbed negatives, sound tracks, prints, release prints, tapes, cassettes, duplicating material and facilities and all other material manufactured for use in connection with the Picture, including the cost of inspecting, repairing, checking and renovating film, reels, containers, cassettes, packing, storing and shipping and all other expenses connected therewith and inspecting and checking exhibitors' projection and sound equipment and facilities. Warner may manufacture or cause to be manufactured as many or as few duped negatives, positive prints and other material for use in connection with the Picture as it, in its sole discretion, may consider advisable or desirable.

(b) All direct costs and charges for advertisements, press books, artwork, advertising accessories and trailers (other than (i) prints of trailers advertising free television exhibition of the Picture, and (ii) the trailer production costs which are included in the cost of production of the Picture), advertising, publicizing and exploiting the Picture by such means and to such extent as Warner may, in its uncontrolled discretion, deem desirable, including, without limitation, pre-release advertising and publicity, so-called cooperative and/or theatre advertising, and/or other advertising engaged in with or for exhibitors, to the extent Warner pays, shares in, or is charged with all or a portion of such costs and all other exploitation costs relating to such theatre exhibition. Any reuse fees and costs of recording and manufacturing masters for phonograph records, which Warner shall advance in order to assist in the advertising and exploitation of the Picture, shall be treated as costs hereunder to the extent unrecovered by the record company. Where any Warner advertising or publicity employee (other than an executive supervisory employee) or facility is used for the Picture, the salary of such employee and the cost of such facility (while so used for the Picture) shall be direct costs hereunder. Any costs and charges referred to in this (b) (and not included in the

cost of production of the Picture), expended or incurred prior to delivery of the Picture, shall be included in direct costs under this (b). There shall also be included as an item of cost a sum equal to 10% of all direct costs referred to in this (b) to cover the indirect cost of Warner's advertising and publicity departments, both domestic and foreign.

(c) All costs of preparing and delivering the Picture for distribution (regardless of whether such costs are the salaries and expenses of Warner's own employees or employees or parties not regularly employed by Warner), including, without limitation, all costs incurred in connection with the production of foreign language versions of the Picture, whether dubbed, super-imposed or otherwise, as well as any and all costs and expenses in connection with changing the title of the Picture, recutting, re-editing or shortening or lengthening the Picture for release in any territory or for exhibition on television or other media, or in order to conform to the requirements of censorship authorities, or in order to conform to the peculiar national or political prejudices likely to be encountered in any territory, or for any other purpose or reason. The costs referred to in this (c) shall include all studio charges for facilities, labor and material, whether or not incurred at a studio owned or controlled by Warner.

9. Cost of Production; Interest:

(a) The "cost or production" of the Picture means the total direct cost of production of the Picture, including the cost of all items listed on Warner's standard Delivery Schedule, computed and determined in all respects in the same manner as Warner then customarily determines the direct cost of other motion pictures distributed and/or financed by it, plus Warner's overhead charge. The determination of what items constitute direct charges and what items are within said overhead charge shall be made in all respects in the same manner as Warner customarily determines such matters. The full amount of all direct costs of production of the Picture (whether payable in cash, deferred or accrued) shall be included in the direct cost of the Picture at the time liability therefor is incurred or contracted, regardless of whether the same has actually been paid to the party or parties entitled thereto at the time involved. Deferments and participations in gross receipts of the Picture consented to by Warner (however defined) shall be treated as direct costs of production, whether the same shall be in a definite amount or based on a percentage of the gross receipts, and whether the same are fixed obligations or are contingent upon receipts of the Picture; provided, however, contingent participa-

tions based on a percentage of gross receipts as defined in the applicable agreement shall not be included in the direct cost of production beyond recoupment under 2(c) hereof.

(b) Warner's overhead charge shall be in an amount equal to 15% of the direct cost of production of the Picture, with the understanding that any production facilities, equipment or personnel supplied by Warner or by a studio owned or controlled by Warner, or in which Warner has a substantial financial interest (and which are not furnished within the overhead charge) shall be supplied at Warner's usual rental rates charged for such items, and such charges shall be treated as direct costs of production of the Picture and shall bear said 15% overhead charge. Warner's overhead charge shall accrue and be included in the cost of production of the Picture concurrently with the incurring of the respective items of direct cost to which it applies.

(c) The amount equal to interest provided for in 2(c) hereof shall be calculated at a rate per annum equal to 125% of the prime commercial rate of First National Bank of Boston from time to time in effect. Said amount shall be calculated from the respective dates that each item is charged to the Picture until the close of the accounting period during which the cost of production is recouped under 2(c) hereof, except that interest on deferred amounts shall be calculated from the date of payment.

(d) Concurrently with delivery to Participant of the first earnings statement hereunder, Warner will (subject to revisions and correction) deliver to Participant an itemized summary of the cost of production of the Picture. Participant shall have the right to audit such statement in accordance with 11 hereof.

(e) If the final cost of production shall exceed the budgeted cost by 5% or more, then for the purposes of 2(c) hereof there shall be added to the actual cost of production of the Picture an amount equal to the amount by which the final direct cost exceeds 105% of the budgeted direct cost. For the purposes of this subdivision (e), the final direct cost shall not include costs incurred solely by reason of force majeure events, union increases not reflected in the budget, and over-budget costs incurred at the request of an officer of Warner having the rank of Vice President or higher over the written objection of Participant.

10. *Earnings Statements*: Warner shall render to Participant periodic statements showing, in summary form, the appropriate calculations under this Agreement. Statements shall be issued for each calendar quarter until the Picture has been in release for 4 years from and including the quarter in which the Picture was first

released, and thereafter annually. Each such quarterly or annual period, as the case may be, is herein referred to as an "accounting period." No statements need be rendered for any accounting period during which no receipts are received. Statements rendered by Warner may be changed from time to time to give effect to year-end adjustments made by Warner's Accounting Department or Public Accountants, or to items overlooked, to correct errors and for similar purposes. If Warner shall extend credit to any licensee with respect to the Picture, and if such credit has been included in the gross receipts, and if, in the opinion of Warner, any such indebtedness shall be uncollectible, the uncollected amount may be deducted in any subsequent earning statement. Should Warner make any overpayment to Participant hereunder for any reason, Warner shall have the right to deduct and retain for its own account an amount equal to any such overpayment from any sums that may thereafter become due or payable by Warner to Participant or for Participant's account, or may demand repayment from Participant, in which event Participant shall repay the same when such demand is made. Any U.S. dollars due and payable to Participant by Warner pursuant to any such statement shall be paid to Participant simultaneously with the rendering of such statement; provided, however, that all amounts payable to Participant hereunder shall be subject to all laws and regulations now or hereafter in existence requiring deduction or withholdings for income or other taxes payable by or assessable against Participant. Warner shall have the right to make such deductions and withholdings and the payment thereof to the governmental agency concerned in accordance with its interpretation in good faith of such laws and regulations, and shall not be liable to Participant for the making of such deductions or withholdings or the payment thereof to the governmental agency concerned. In any such event Participant shall make and prosecute any and all claims which it may have with respect to the same directly with the governmental agency having jurisdiction in the premises. The right of Participant to receive, and the obligation of Warner to account for, any share of the net profits of the Picture shall terminate if the Picture has been made available for exhibition on syndicated television in the U.S.A., and if the first earnings statement issued thereafter shows a deficit under 2 hereof which would require in excess of \$500,000 of gross receipts before Participant would be entitled to receive any net profits hereunder. In the event a new medium of exhibition shall thereafter be developed and there shall be substantial exhibition and distribution of the Picture by such new medium

which is likely to generate gross receipts of \$500,000 or the amount of the deficit, whichever is larger, Participant may audit Warner's records for the purpose of determining whether the Picture has earned, or is likely to earn, any net profits, and if, as a result of such audit, it is determined by mutual agreement, or in the event of dispute appropriate legal proceedings, that the Picture has earned, or is likely to earn, net profits as herein defined, accountings hereunder and payments, if required, shall be reinstated.

11. *Accounting Records re Distribution: Audit Rights:* Warner shall keep books of account relating to the distribution of the Picture, together with vouchers, exhibition contracts and similar records supporting the same (all of which are hereinafter referred to as "records"), which shall be kept on the same basis and in the same manner and for the same periods as such records are customarily kept by Warner. Participant may, at its own expense, audit the applicable records at the place where Warner maintains the same in order to verify earnings statements rendered hereunder. Any such audit shall be conducted only by a reputable public accountant during reasonable business hours in such manner as not to interfere with Warner's normal business activities. In no event shall an audit with respect to any earnings statement commence later than twenty-four (24) months from the rendition of the earnings statement involved; nor shall any audit continue for longer than thirty (30) consecutive business days; nor shall audits be made hereunder more frequently than once annually; nor shall the records supporting any earnings statement be audited more than once. All earnings statements rendered hereunder shall be binding upon Participant and not subject to objection for any reason unless such objection is made in writing, stating the basis thereof, and delivered to Warner within twenty-four (24) months from rendition of the earnings statement, or if an audit is commenced prior thereto, within thirty (30) days from the completion of the relative audit. If Warner, as a courtesy to Participant, shall include cumulative figures in any earnings or other statement, the time within which Participant may commence any audit or make any objection in respect of any statement shall not be enlarged or extended thereby. Participant's right to examine Warner's records is limited to the Picture, and Participant shall have no right to examine records relating to Warner's business generally or with respect to any other motion picture for purposes of comparison or otherwise; provided, however, that where any original income or expense document with third parties relates to the Picture and to other motion pictures, Participant shall have the right to examine the entire

document without deletions therefrom.

12. *Ownership*: Participant expressly acknowledges that Participant has and will have no right, title or interest of any kind or character whatsoever in or to the Picture, and no lien thereon or other rights in or to the gross receipts or net profits of the Picture; and that the same shall be and remain Warner's sole and exclusive property, and Warner shall not be obligated to segregate the same from its other funds, it being the intent and purpose hereof that the net profits or gross receipts, as the case may be, of the Picture are referred to herein merely as a measure in determining the time and manner of payment to Participant; and that Warner shall not be deemed a trustee, pledgeholder or fiduciary. Participant shall have no right, title or interest of any kind or character whatsoever in or to the literary, dramatic or musical material upon which the Picture is based, or from which it may be adapted; and Warner shall have the sole and exclusive right to utilize, sell, license or otherwise dispose of all or any part of its right in such material upon such terms and conditions as it may deem advisable, all without consulting or advising Participant and without accounting to Participant in any manner with respect thereto.

*Appendix C*¹³³

Net Profits Agreement: Selected Rider Provisions

All paragraph references herein refer to paragraph numbers in the Exhibit to which this rider is attached. The provisions herein shall control to the extent they conflict with the provisions in the Exhibit to which this rider is attached.

Paragraph 2: The first sentence in paragraph 2(c) shall end after the words "in 9 hereof."

Paragraph 3: Warner shall elect paragraph 3(b)(i) during the initial theatrical release of the Picture in the following territories: United Kingdom, Canada, France, West Germany, Italy, Australia, New Zealand, Benelux, Scandinavia, Switzerland and Japan.

Gross receipts shall include all sums actually received by Warner from recoveries of infringement, unfair competition, trademark and piracy actions with respect to the Picture. Recoveries by Warner from infringement, unfair competition, trademark and piracy actions with respect to the Picture representing penalties rather than actual or statutory damages shall be included in gross receipts of the Picture without any distribution fee. Gross receipts

133. *Id.* at 5-183.

shall also include all sums derived by Warner from distribution of the Picture on a four-wall basis as such term is commonly understood in the motion picture industry.

In subparagraph (d), the parenthetical in the second and third lines is deleted. Licenses to cable operators referred to in paragraph 3(d)(iii) specifically include all forms of pay, subscription, and other types of non-free television.

Paragraph 4: The distribution fee on gross receipts of the Picture derived by Warner from prime time United States telecast of the Picture on free television on ABC, NBC or CBS or another national network (if any) shall be 25%. For a network other than ABC, NBC or CBS to be considered a national network, it must (i) own or be affiliated with over 200 television stations or a sufficient number to give national coverage comparable to ABC, NBC or CBS; (ii) offer Warner centralized purchasing of motion pictures for distribution to the owned or affiliated stations; (iii) offer a centralized clearing for distribution of the Picture over said television stations (i.e., the network clears telecast of the Picture over its stations — not the distributor); (iv) handle itself or through affiliated stations the sale of advertising; and (v) pay a single pre-agreed sum for telecast of the Picture over all of its owned and affiliated stations.

Paragraph 5: If Warner sets up reserves, such reserves must be reasonable and appropriate, and shall be liquidated in no more than 18 months, except for reserves for taxes, which Warner may withhold longer. If Warner sets up a reserve for taxes which Warner later discovers are not payable, Warner shall credit such reserve back into gross receipts. In addition, Warner shall reduce the interest on unrecovered production cost by an amount equal to the interest which accrued on an amount of production cost equal to the reserves so withheld. In paragraph 5(a); the cost of tapes and cassettes referred to therein shall not include any manufacturing costs of home video exhibition or distribution.

In 5(b), subdivision (i) is deleted.

In 5(b) and 5(c), the salaries and expenses of Warner's own employees will be charged to a Picture only if such employees substantially work on that Picture directly. Where any Warner advertising or publicity employee (other than an executive supervisory employee) or facility is used for the Picture, then the salary of such employee and the cost of such facility (while so used for the Picture) shall be direct costs under Paragraph 5.

In 5(a) and 5(b), if Warner receives any discounts, rebates or credits (not including any cash discounts for accelerated payment),

such discounts, rebates or credits shall be credited to the costs referred to in subdivision (a) and (b).

In 5(b), reuse fees and costs of recording and manufacturing masters for soundtrack phonograph records will only be charged as distribution expenses to the extent the record company does not pay same.

In 5(d), line 2, the word "gross" shall be inserted before the word "income." Change the words "Subject to" on line 19 to "Notwithstanding." A subparagraph (iii) shall be added at the end of subparagraph (d) with the following: "If Warner receives a refund from the taxing authority which previously assessed any taxes previously deducted hereunder, the amount of such refund together with any interest received thereon shall be credited against sums deductible under this paragraph 5."

In 5(f), deductible costs and expenses will not include the salaries of Warner's regularly employed in-house legal or accounting staff.

In 5(g), the dues and assessments referred to therein shall be limited to 1% of the gross receipts of the Picture.

In 5(h), the word "reasonably" shall be inserted in between the words "may deem" and "necessary" on line 5. The last sentence of subparagraph (h) shall be revised to read the following: "Nothing herein contained shall be construed as a waiver of any of Participant's warranties contained in this Agreement, or waiver of any right or remedy at law or otherwise which may exist in favor of Warner against Participant, which rights may include the following: the right to require Participant to reimburse Warner on demand for any liability, cost, damage, or expense arising out of, or resulting from, any breach by Participant of any warranty, undertaking or obligation by Participant, or any right on the part of Warner to recoup or recover any such cost or expense out of Participant's share of any monies payable hereunder, rather than treating such costs or expenses as distribution expenses."

In 5(i) after "gross receipts and net profits of the picture" on lines 11-12 add the following: "but excluding from this subdivision (i) any participations in gross receipts and net profits." Delete the phrase in lines 16-18; "or to compensation for services rendered beyond any guaranteed period referred to in the foregoing agreement."

In 5(j), there shall be added at the end thereof the following: "Insurance recoveries relating to cost of production of the picture shall be credited first to recoupment of cost of production of the picture and then to recoupment of distribution expenses. All other

insurance recoveries relating to distribution expenses as described in this paragraph 5 shall be credited against distribution expenses. Distribution expenses which are reimbursed by a third party and distribution expenses incurred but not ultimately paid by Warner shall be credited to distribution expenses under paragraph 5 (unless such reimbursements and/or payments of expenses are made by parties to financing arrangements with Warner)."

Paragraph 11: The applicable records subject to audit shall include the records pertaining to the cost of production of the Picture. Change 24 to 36 in lines 13 and 20-21. Audits shall not continue for longer than sixty (60) consecutive business days. The words "or if an audit is commenced prior thereto, within thirty (30) days from the completion of the relative audit" in lines 21-23 are deleted and the following substituted: "provided however, that if an audit is completed at least one hundred twenty (120) days prior to the expiration of said thirty-six (36) month period, Warner may give written notice to Participant at any time after ninety (90) days from the completion of such audit requiring Participant to advise Warner in writing of any objections to the earnings statement involved, specifying the particulars of such objection, and if Participant does not make such written objections specifying the particulars thereof within sixty (60) days from receipt of such notice from Warner or, whether or not Warner gives such written notice to Participant, upon the expiration of said thirty-six (36) month period, whichever is earlier, Participant shall thereafter be barred from making any such objection or filing any suit, action or proceedings against Warner with respect to the earnings statement involved." Warner preapproves Laventhal & Horworth; Gelfand, Breslauer, Rennert & Feldman; Selwyn Gerber and Breslauer; Jacobson, Rutman and Sherman; Phil Hacker & Company and any of the so called "big six" national accounting firms to conduct audits. In line 17 after the words "more than once", add "except Participant shall not be precluded from again examining such records if the earnings statement is later altered or amended by Warner."