

HOLLYWOOD ACCOUNTING: PROFIT PARTICIPATION AND THE USE OF MEDIATION AS A MODE OF RESOLVING THESE DISPUTES

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I. INTRODUCTION

Every actor hopes to star in a great movie that makes substantial profits. But if you're hoping to earn profits based on the success of your film and you want to be paid on a timely basis, then one company you certainly do not want to do business with is Defendant Morgan Creek Productions.¹

In 2012, actor Kevin Costner accused the film company, Morgan Creek Productions, of diverting money by assigning the foreign distribution rights on *Robin Hood* from Morgan Creek to a company owned by Morgan Creek CEO James Robinson.² Costner claimed that he did not accrue his profit participation statements in 2010 and 2011 and late financial statements from 2004 to 2009, to which he was owed from his initial agreements to act in the movie.³ This is just one of many examples of profit participation claims that end up in litigation.

Profit participation agreements, otherwise known as contingent compensation agreements, have engendered much debate

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¹ Eriq Gardner, *Kevin Costner Settles Lawsuit Over 'Robin Hood' Profits*, HOLLYWOOD REP. (Aug. 11, 2014, 11:28 AM), <http://www.hollywoodreporter.com/thr-esq/kevin-costner-settles-lawsuit-robin-724616> (quoting a statement from Costner's complaint).

The actor sued in July 2012, taking a bold shot against the independent studio The participation rights were sold as a package, and Costner objected to the allocation of fees for every movie in this package, regardless of performance. The lawsuit included other accounting claims on behalf of Costner, who was entitled to 15 percent of the adjusted gross receipts of the picture in excess of \$100 million, plus further participation on home distribution The parties told the judge on Friday that the case has been settled. An attorney for Morgan Creek confirms the settlement, adding that he couldn't discuss the terms.

² *Id.*

³ *Id.*

since they were first introduced.⁴ These agreements were created as ways to decrease risk of production for studios, whereby talent would agree to receive less “up front” fees in consideration of more lucrative proceeds from the gross receipts of the production.⁵ Lawsuits over profit participation agreements occur when the participants⁶ do not accrue their fair share of the profits according to their contracts agreed to prior to their film or television work. Recent lawsuits that demonstrate this include: the producers of *The Black Dahlia* (2006) sued the production company Nu Image for failing to pay them according to their profit participation agreement;⁷ actor Richard Dreyfuss sued Disney for profits owed from starring in *What About Bob* (1991);⁸ and producer Irwin Winkler sued Warner Bros. for fifty percent of net profits he claimed to have been cheated out of from producing *Goodfellas* (1990).⁹ Most profit participation claims blame the questionable nature of “Hollywood Accounting”¹⁰ practices.¹¹ Although, there are a vari-

⁴ Adam J. Marcus, *Buchwald v. Paramount Pictures Corp. and the Future of Net Profit*, 9 CARDOZO ARTS & ENT. L.J. 545, 545–46 (1991) (discussing the ambiguity of the term “net profits” and its definition within contracts in the entertainment industry).

⁵ Doron Eghbali, *What Are Gross Participation and Net Profits in Motion Pictures?*, AVVO (Dec. 15, 2010), <http://www.avvo.com/legal-guides/ugc/what-are-gross-participation-and-net-profits-in-motion-pictures>.

⁶ Hereinafter, “participant” will be used interchangeably with “actors” and “talent.”

⁷ Austin Siegemund-Broka, *‘The Black Dahlia’ Producers Sue Nu Image Claiming Unpaid Profits*, HOLLYWOOD REP. (July 22, 2015, 12:48 AM), <http://www.hollywoodreporter.com/thr-esq/black-dahlia-producers-sue-nu-810502>.

⁸ Dominic Patten, *Disney Slammed by Richard Dreyfuss over ‘What About Bob?’ Profits*, DEADLINE HOLLYWOOD (Apr. 9, 2015, 6:37 PM), <http://deadline.com/2015/04/richard-dreyfuss-sues-disney-what-about-bob-profits-lawsuit-1201407598/>.

⁹ Eriq Gardner, *‘Goodfellas’ Producer Sues Warner Bros. over Lack of Any Profits*, HOLLYWOOD REP. (Sept. 22, 2015, 3:30 PM), <http://www.hollywoodreporter.com/thr-esq/goodfellas-producer-sues-warner-bros-826413>.

¹⁰ Renee Howdeshell, *Hollywood Accounting: Another Good Reason to Read (and Audit) Your Contracts*, BETWEEN NUMBERS (Mar. 24, 2011), <http://betweenthe numbers.net/2011/03/hollywood-accounting-another-good-reason-to-read-and-audit-your-contracts/>.

Hollywood accounting (or Hollywood bookkeeping) is the term used to describe how studios report profits on movies and television series. It often carries a derogatory connotation because of various common practices, which don’t follow Generally Accepted Accounting Principles (GAAP) or necessarily reflect market realities. These contractually-based practices often serve to reduce revenues, inflate costs, and eliminate the profits upon which royalties or participations are paid to actors, writers, etc.

¹¹ E.g., Dustin Rowles, *10 Movies that Made Hundreds of Millions in Box-Office Dollars and yet Somehow Showed No Profit*, PAJIBA (Aug. 19, 2013), http://www.pajiba.com/box_office_round-ups/10-movies-that-made-hundreds-of-millions-in-boxoffice-dollars-and-yet-somehow-showed-no-profit.php.

“Hollywood accounting” is a neat trick the studios use to avoid paying back-end profits to those contractually obligated to them . . . Here are 10 films that you would *think* showed a huge profit, but according to the Hollywood accountants, they all

ety of reasons why this might occur, what is important to note is not only why they occur, but also how they are resolved.

When dealing with producers, talent, or production companies, studios tend to include mandatory arbitration clauses in their contracts.¹² Ronald Nessim,¹³ an entertainment attorney, conducted a survey in 2013 in which he asked several talent-side entertainment industry lawyers to send him their contracts negotiated between the talent they represent and major studios.¹⁴ He received twenty-six contracts, containing dispute resolution provisions, entered into between 2011 and 2013.¹⁵ Of the twenty-six contracts he received, twenty-two of them contained mandatory arbitration provisions and twenty-one of the twenty-two contracts designated JAMS as the forum to handle those disputes.¹⁶

Studios seek to incorporate mandatory arbitration clauses into their contracts because they have been burned in the past, losing in jury trials over profit participation agreements.¹⁷ For example, Ceadador, a British production company, was awarded \$270 million in a jury verdict against Disney, over the profits of the television pro-

either lost millions of dollars, or never made a profit (meaning those owed back-end profits didn't receive a dime) . . .

1. *My Big Fat Greek Wedding* cost \$6 million to make and made over \$350 million at the box office, and yet lost \$20 million.

2. The *Lord of the Rings* trilogy made over \$2.9 billion in box office, and yet showed "horrendous losses."

3. *Return of the Jedi* made \$475 million on a \$32 million budget, yet has never shown a profit.

4. *Harry Potter and the Order of the Phoenix* made \$939 million worldwide, and yet ended up with a \$167 million loss.

5. *Forrest Gump* earned \$667 million, yet shows a loss of \$31 million.

6. *JFK* earned \$150 million worldwide but showed \$0 in profit.

7. *Coming to America* made \$288 million in revenue, yet showed no profit.

8. Michael Moore's *Fahrenheit 9/11* made \$220 million worldwide, and yet apparently showed no profit.

9. *The Exorcism of Emily Rose* made \$150 million on a \$19 million budget and turned no profit.

10. *Batman*, which made \$411 million worldwide, showed a \$36 million deficit.

See Sisto, *infra* note 23, at 21.

¹² See Ronald J. Nessim, Profit Participation Claims, in ENTERTAINMENT LITIGATION 408 (Charles J. Harder ed., 2011).

¹³ Ronald J. Nessim, BIRD MARELLA P.C., <http://www.birdmarella.com/attorneys/ronald-j-nessim/> ("Ron Nessim has been on the winning side of more than 40 criminal and civil trials and arbitrations. He has argued numerous appeals in both federal and state courts, including in the United States Supreme Court, and has been at the center of numerous precedent-setting, high-profile civil and white-collar criminal law cases.").

¹⁴ Nessim & Goldman, *infra* note 118, at 236.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Nessim, *supra* note 12.

gram, *Who Wants to Be a Millionaire?* “The jury agreed with the argument of British production company, Celador, that Disney subsidiaries, including the ABC network and the Buena Vista Television Studio, structured agreements so that ABC would reap huge profits, but Celador would receive little or nothing from its 50 percent participation.”¹⁸ As past civil litigation would suggest,¹⁹ juries tend to side with the smaller participants over large corporate studios.

Although anecdotal evidence suggests that studios have been much more successful in private arbitration, it is generally perceived that arbitrators are more friendly to studios than are juries.²⁰ “Participants usually attribute this to ‘repeat player bias’ by the big arbitrator providers, such as JAMS—The Resolution Experts, which the studios generally designate in the arbitration clauses of their contracts with participants.”²¹

There appears to be a perceived bias on both ends of jury trials and arbitration. However, one might consider whether there are any alternatives to these approaches, where profit participation agreement disputes can be resolved in a way without perceived biases. This Note will explore the background and issues that arise with participation agreements along with alternative means of solving these disputes.

This Note proposes that the entertainment industry employ mediation to resolve profit participation disputes. Section II of this Note focuses on profit participation agreements through their history and their legal context. Section III provides a discussion of

¹⁸ *Id.*

¹⁹ *Id.* (noting an example in 2007 where the jury sided with the participant where the creators of the television series, *Will & Grace*, brought profit participation claims to trial. “Although, the case settled after the jury finished deliberations and no verdict was entered, the press reported that the jury voted to return \$49.5 million verdict in favor of the participants on their contract claims.”); Jean-Luc Renault, ‘Hollywood Accounting’ Exposed: Verdicts Forcing Studios to Re-examine Profit-Participation Contracts, DAILY J. ENT. & SPORTS (Oct. 15, 2010), <http://www.kwikalaw.com/links/Fitzgerald/Hollywood%20Accounting%20Exposed%20-%20Chad%20quote.pdf> (providing an example of a successful participant agreement in which “a \$3.2 million verdict in favor of Ladd, in 2010, in his dispute against Warner Bros., which the producer accused of selling television licenses for his movies in bundles with others for a blanket fee, regardless of the films’ individual values—cutting him out of potential profits under his revenue-sharing agreement.”); *Ladd v. Warner Bros. Entm’t, Inc.*, 110 Cal. Rptr. 3d 74 (Cal. App. 2d Dist. 2010). On the same day as the Celador decision, a jury awarded Don Johnson \$23 million for Johnson’s role on the television show, *Nash Bridges*. “Johnson, whose contract stipulated that he owned half the copyrights to the show, sued Rysler Entertainment, which claimed that it never made a profit from the show and had nothing to share with Johnson.” Jean-Lu Renalt *supra*.

²⁰ Nessim, *supra* note 12, at 408.

²¹ *Id.*

the arbitration and litigation of participation claims, as well as their weaknesses. In Section IV, this Note proposes the use of mediation in handling claims in the entertainment industry and a new model of mediation that would best serve profit participation disputes. With the engagement of mediation, profit participation lawsuits can be handled in the most effective and fair way for both the studio and participant.

II. BACKGROUND

A. *The Profit Participation Agreement*

Profit participation agreements are a common contractual practice often seen within film and television transactions between studios, talent, and producers. Within the motion picture and television industry, profit participation agreements are used to negotiate a percentage of the film's profits to lessen the amount a studio or production company will pay upfront before production begins.²² Once a producer finalizes a distribution deal with a major studio or production company, the producer is generally paid a fixed producer's fee as well as a percentage of the film or television show's profits.²³ Talent attached to any particular production can anticipate being compensated a salary in accordance with the provisions of the various collective bargaining agreements that govern the relationships between signatory production companies and actors, writers, and directors.²⁴ Moreover, talent will contract for a pre-determined salary in film or television, but, occasionally, talent who have sufficient clout to negotiate might be able to get a package deal that includes various forms of compensation contingent upon the financial success of the films to which they are attached.²⁵ Put more simply, profit participation is a right to participate in the profits of a film or television show.²⁶ These agreements are tremendously appealing to talent, because depending on the success

²² Hillary Bibicoff, *Net Profit Participations in the Motion Picture Industry*, 11 *LOY. L.A. ENT. L. REV.* 23, 23 (1991) ("In addition to a salary, actors often contract to receive a percentage of 'net profits' from a movie in which they are involved. Investors also agree to receive a percentage of net profits from the movie as a way of receiving a return on their investments.").

²³ Joe Sisto, *Profit Participation in the Motion Picture Industry*, 21 *ENT. & SPORTS LAW* 1, 21 (2003).

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

of the film or television show, there is a chance to earn much more than just the fixed salary stated in their contracts.

B. *A History of Profit Participation*

With the advent of “talking pictures” in the 1920s, a host of new personalities infiltrated the movie business and fed audiences a newfound hunger for the “movie star.”²⁷ During that time period, the most creative talent²⁸ (including producers) were under contract to the major motion picture studios.²⁹ In this era, referred to as the studio “star system,” the studios would retain the talent’s services for a specified term, which could have been many years, for a fixed weekly salary.³⁰ Any profits accrued by these films were retained solely by the studios.³¹ However, in 1936, this system took a turn, when Groucho Marx agreed to star in the motion pictures *Night at the Opera* and *Day at the Races*.³² To star in these films, he agreed to a compensation of fifteen percent of the gross receipts derived by his employer, who at the time was MGM. Thus, profit participation was born.³³ Inspired by Marx’s highly profitable deal, other major talent started to rebel against the studio star system by refusing to sign long-term contracts with studios and by demanding greater creative and financial control.³⁴

This trend continued into the 1950s, whereby major talent no longer signed long-term contracts and instead negotiated for the net profits of the films they were attached to on a picture-by-picture basis.³⁵ During the same period, and with the emergence of television, motion picture studios found themselves competing for

²⁷ *Id.* at 21.

²⁸ Hereinafter, “talent” will be used synonymously with “producers,” “actors,” “writers,” or any other employees on the creative side of a film or television show.

²⁹ Sisto, *supra* note 23, at 21.

³⁰ *Id.*

³¹ *Id.*

³² See *History*, HACKER DOUGLAS & Co. LLP, <http://www.filmaudit.com/history.html> (last visited Jan. 14, 2016).

³³ *Id.*

³⁴ Sisto, *supra* note 23, at 22 (noting that such stars who rebelled against the studio system included Bette Davis, Cecil B. DeMille, Olivia De Havilland, Jimmy Stewart, William Holden, Don Ameche, etc.).

³⁵ *History*, *supra* note 32 (noting that the net profit definitions provided for the deduction from gross receipts of specified expenses and fees to the studios before any net profits were reported. “Despite these restrictions, many of the early films such as *The Ten Commandments*, *Samson and Delilah*, *Winchester 73* and *The Bridge Over the River Kwai* reported significant net profits resulting in large payments to the profit participants.”).

audiences, and as a result, produced fewer films.³⁶ These factors ultimately led to talent not needing to attach themselves to the studio system, and the “star system” collapsed.³⁷ “In the 1980s and 1990s, as major directors and stars such as Paul Newman, Robert Redford, Barbra Streisand, Jack Nicholson, Dustin Hoffman, Harrison Ford, and Steven Spielberg rose to international fame, they insisted that their profit participation be based on a percentage of gross receipts only.”³⁸ Because talent, such as the aforementioned, had significant leverage in the entertainment industry at that time (and for the most part still do), the studios were forced to reluctantly grant them gross participation, thereby netting participants huge sums of profit.³⁹ Nevertheless, the windfall for talent was short-lived and the vast majority of profit participants were subject to studio net profit definitions.⁴⁰ In most cases, the net profit reported was less than zero.⁴¹

Studios began to develop accounting methods and contractual definitions designed in such a way that, once all deductions were made from the gross profits earned by a film, there was not much left to distribute to the profit participants.⁴² “The bigger names in Hollywood occasionally muscled gross profit participations into their contracts, yet at times, still ran into issues of receiving their profit participation.”⁴³ For example in 1996, Jeffery Katzenberg initiated a lawsuit against Disney, claiming that Disney deprived him of his fair share of net profits as stated in his employment contract while he was an executive there.⁴⁴ After this long feud over the valuation of a two percent bonus based on past and future profits of all films and television shows produced while he was at Disney, Katzenberg was awarded a settlement of about \$275,000,000. Nonetheless, the vast majority of profit participants remain subject

³⁶ Sisto, *supra* note 23, at 22.

³⁷ *Id.*

³⁸ *History*, *supra* note 32.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² Sisto, *supra* note 23, at 22.

⁴³ *Id.*

⁴⁴ *History*, *supra* note 32. See, e.g., Kim Masters, *The Epic Disney Blow-Up of 1994: Eisner, Katzenberg and Ovitz 20 Years Later*, HOLLYWOOD REP. (Apr. 9, 2014, 10:00 AM), <http://www.hollywoodreporter.com/features/epic-disney-blow-up-1994-694476>. See also James Bates & Claudia Eller, *Katzenberg Settles Lawsuit Against Disney*, L.A. TIMES (Nov. 11, 1997), <http://articles.latimes.com/1997/nov/11/news/mn-52593>.

to studio definitions of net profits, which ultimately allow for a plethora of deductions from the gross proceeds.⁴⁵

C. *A Vertical Integration of the Entertainment Industry*

A reason why profit participation claims continue to persist is due to vertical integration within the entertainment industry.⁴⁶ In 1970, the Federal Communications Commission (“FCC”) adopted the financial syndication rules (“fin-syn rules”), which were enacted to regulate competition in the television industry by restricting television networks from engaging in the business of program syndication.⁴⁷ The fin-syn rules gained even more traction when legislation prohibited the networks from producing more than forty percent of their primetime programming within their own network.⁴⁸ In 1995, the fin-syn rules were repealed because of the emergence of a booming and more competitive marketplace for television networks.⁴⁹ After the rule was quashed, broadcast networks were allowed to own their own primetime programming, which ultimately led to the widespread “vertical integration” of networks and studios, as well as the demise of almost all independent television studios.⁵⁰

A vertically integrated entertainment company transaction might own, among other things (1) studios that make and own television programs and feature movies; (2) distribution companies that license and sell those programs to affiliated and unaffil-

⁴⁵ *History, supra* note 32.

⁴⁶ Nessim, *supra* note 12, at 406.

⁴⁷ See Simon, *infra* note 104, at 438 (“The fin-syn rules were promulgated in response to the FCC’s determination that the only three national networks, ABC, NBC, and CBS (collectively, “the three networks”) had too much dominance over television programming.”).

⁴⁸ *Id.*

The fin-syn rules were codified at 47 C.F.R. § 73.658(j). FCC adopted the proposals to ‘eliminate the networks from distribution and profit sharing in domestic syndication and to restrict their activities in foreign markets’ The Commission also prohibited networks from acquiring subsidiary program rights and profit shares, as little would be accomplished in expanding competitive opportunity in television program production if we were to exclude networks from active participation in the syndication market and then permit them to act as brokers in acquiring syndication rights and interest and reselling them to those actively engaged in syndication . . . the network has an advantage as a competitor in the syndication market because of its existing relations with affiliates.

⁴⁹ *Id.* at 439.

⁵⁰ Nessim, *supra* note 12, at 406; see also Stanton L. Stein & Marcia J. Harris, *Vertically Challenged*, 26 L.A. LAW. 30, 31 (2003).

iated broadcast, cable, and foreign TV networks as the studio's agent; and (3) broadcast, cable, and foreign TV networks that license programs to air on their network.⁵¹

Before the regime of the vertical integration of the entertainment industry, the financial interests of the studio and participant were aligned in matters of licensing television programs or films to networks.⁵² Both the studio and the participant had the same goal of increasing revenue by obtaining the highest possible license fee from third-party networks, after which both, the studio and the participant, would share the profits based on the amount of participation expressed in their agreements.⁵³ However, vertical integration created the opposite incentive, because the nature of a vertically integrated entertainment company is both to produce its own program and air it on its own affiliated networks.⁵⁴ Although the entertainment company makes less money from lower licensing fees, affiliated networks keep one hundred percent of the profit.⁵⁵ Furthermore, because the entertainment company is bargaining for lower licensing fees, they are also producing less revenue to share with the participants.⁵⁶ Simply stated, if the studio has less profit, it pays less to its participants, and the vertically integrated company comes out on top.⁵⁷

This has infuriated many profit participants over the years. For example, in 1999, David Duchovny filed a lawsuit against Fox claiming that he was financially and wrongfully injured as a result of the television studio's liberation from fin-syn rules and the studio's constant practice of self-dealing.⁵⁸ At the time of the lawsuit, David Duchovny starred in *The X-Files*, an immensely successful show.⁵⁹ The vertical integration of Fox was transparent when Fox sold the series to its own broadcast network including, Fox Broadcasting Co.; its own cable network, FX Cable Network; and the syndication rights to its own group of stations, Fox Television Stations.⁶⁰ In his complaint, Duchovny claimed to have been "cheated

⁵¹ Nessim, *supra* note 12, at 406.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ Nessim, *supra* note 12, at 407.

⁵⁸ Simon, *infra* note 104.

⁵⁹ Janet Shprintz, *Duchovny Sues Fox over TV Rights Sales*, VARIETY (Aug. 13, 1999, 12:00 AM), <http://variety.com/1999/biz/news/duchovny-sues-fox-over-tv-rights-sales-1117750376/>.

⁶⁰ *Id.*

out of millions of dollars from the television series” and “because of corporate greed, Fox intentionally reduced revenues to profit participants by selling the show to its affiliates instead of seeking the most competitive and beneficial deal.”⁶¹ The complaint also alleges that Fox paid the executive producer of the show four million dollars in “hush money” and a new deal for a thirteen episode show, for his silence as to Fox’s self-dealing.⁶² The lawsuit was later settled out of court and Duchovny returned to acting in the show.⁶³ However, vertical integration plays a role as to why participants do not accrue profits according to the network’s true revenue streams. Although a clever way by the vertically integrated companies to both maximize and retain profits, some participants can generally sense when profits are being withheld from them, and this starts with the ambiguity of the definition of “profits” incorporated into the terms of their contracts.

D. *Defining Profit*

In Hollywood, “profit” is an ambiguous term.⁶⁴ For example, if a film costs \$50 million to make and another \$50 million to market, and it then earns more than \$300 million at the box office, the obvious assumption is that the participants will reap great profits.⁶⁵ However, the reality is the studios will often claim that the profits earned, by an otherwise box-office blockbuster, is less than zero.⁶⁶ Mark Weinstein, associate professor of Business and Law in the USC Gould School of Law, concisely lays out how the numbers are crunched by studios when determining profits:

First, there are the distribution fees and expenses. These include (1) the distribution fee (30 percent United States and Canada, 35 percent the United Kingdom, and 40 percent elsewhere), (2) direct advertising and publicity expenses, (3) the cost of prints, and (4) overhead charges of 10 percent of direct ad and publicity costs. Next are the costs of getting the master print created. These include (1) the direct costs of production (the “negative cost”), which includes all development and pro-

⁶¹ *Id.*

⁶² *Id.*

⁶³ Maria Aspan, ‘*X-Files*’ Are Closed; A Lawsuit Opens, N.Y. TIMES (Jan. 23, 2006), http://www.nytimes.com/2006/01/23/business/23carter.html?_r=0.

⁶⁴ Sisto, *supra* note 23, at 21.

⁶⁵ *Id.*

⁶⁶ *Id.*

duction costs, including all *gross* participations, (2) the overhead charge, which is specified as 15 percent of the cost of production (including gross participations), and (3) interest expense. Paramount subtracts from the revenues interest on the direct production and overhead at the rate of 125 percent of prime. While the interest is stated last, in fact it is recovered *before* any production costs are credited. That is, if any funds from gross revenues remain in an accounting period after paying of gross participations and the distribution-related expenses, those funds are first used to pay off the outstanding interest bill, and only after the interest is covered do they go to pay down the negative costs. Thus, the “net profit” is zero until the movie has recovered all the costs of distribution, the overhead and the direct negative cost, and interest charges on the negative costs and overhead.⁶⁷

The majority of profit participation lawsuits arise due to the lackluster definition of what constitutes “net profits.”⁶⁸ In effect, when profit participants remain subject to the studios’ conception of what “net profits” means, studios can make frivolous deductions from the gross proceeds.⁶⁹ “Such opaque profits definitions are used to manipulate and artificially depress participants’ reported “profits” while keeping the majority—if not all—of the profits for the studios.”⁷⁰ For instance, the contract of a producer of the television series *Bones*, who sued Fox Studios under a profit participation claim, included the definition of “Modified Adjusted Gross Receipts,” which was forty-five pages long, the last eleven pages of which were glossary defined terms.⁷¹ The general view is that when studios, networks, or production companies make such long and

⁶⁷ Mark Weinstein, *Profit Sharing Contracts in Hollywood: Evolution and Analysis*, 27 J. LEGAL STUD. 67, 75 (1998).

⁶⁸ Marcus, *supra* note 4 (“Actors, producers, directors, and writers have criticized and derided the manner in which net profit is determined, claiming that the motion picture industry’s accounting system provides a profit participant little hope of ever recovering a share of a film’s net profit.”).

⁶⁹ Sisto, *supra* note 23, at 22.

⁷⁰ Complaint at ¶ 4, *Wark Entm’t, Inc. v. Twentieth Century Fox Film Corp.*, No. BC602287, 2015 WL 7736879 (Cal. Super. Ct. Nov. 25, 2015).

⁷¹ *Id.*; Matthew Belloni, ‘*Bones*’ Producer Sues Fox for “Accounting Chicanery,” *Claims Top Execs “Threatened” Him*, HOLLYWOOD REP. (Nov. 25, 2015, 9:52 AM), <http://www.hollywoodreporter.com/thr-esq/bones-producer-sues-fox-accounting-843854>.

Bones executive producer Barry Josephson filed a bombshell lawsuit against the Fox network and the parent of studio 20th Century Fox Television, claiming he’s been shortchanged due to Fox’s “unrelenting efforts” to cheat him out of his share of profits from the longest-running hour long drama in Fox’s history. He also says he was “fraudulently threatened” by Rice and other executives into accepting a lower license fees from Fox or else face immediate cancellation of the show.

ambiguous definitions in their contracts, it is done in hopes that participants will overlook certain contractual provisions to keep them from receiving future profits.

The right to participate in a film's financial success may be broken down into two basic elements: (1) participation in either the net or gross receipts of the film; and/or, (2) the right to a lump sum payable when the film's receipts have attained a predetermined level (also called a "deferment"). The recent trend has been to refer to the revenues earned by a film as "proceeds" rather than profits. Some agreements will refer to the earnings as "receipts." Often, all three terms are used interchangeably, as though the purpose was to maximize confusion in order to retain maximum profit.⁷²

A director or writer who negotiates to receive a percentage of the producer's gross proceeds is likely to have his or her own definition. This *gross* might well be offset by agency commissions, legal fees, or a large variety of incidentals—from the costs of shipping distribution materials to foreign countries for potential licensing, to a full recoupment of basic production costs.⁷³ Thus gross becomes *adjusted gross*.⁷⁴

Confusion further proliferates due to film companies being permitted to calculate net profits differently for different purposes.⁷⁵ There are generally four different purposes for which net profits are calculated: "1) Calculating earnings based upon *generally accepted accounting principles*,⁷⁶ which is used for reporting earnings to the SEC. 2) Calculating income and loss for tax purposes. 3) Calculating payments to profit participants, such as writers and actors. 4. Calculating cash available to make distributions to equity holders."⁷⁷ When paying profit participants, the goal of the film company is generally to calculate and report net profits as low as possible.⁷⁸ The lower the net profit, the less companies have to pay out to the participants.

⁷² Sisto, *supra* note 23, at 22.

⁷³ HOWARD J. BLUMENTHAL & OLIVER R. GOODENOUGH, *THE BUSINESS OF TELEVISION: THE STANDARD GUIDE TO THE TELEVISION INDUSTRY* 318 (4th ed. Billboard Books, 3 Rev Upd ed. 2006).

⁷⁴ *Id.*; *see also* Eghbali, *supra* note 5 (noting that the adjusted gross is calculated based on gross revenues minus the negotiated distribution fees; for example, a percentage of gross based on media and territory distribution expenses or the costs of releasing the picture without limitation film prints and advertising).

⁷⁵ SCHUYLER M. MOORE, *THE BIZ* 135 (4th ed. 2011).

⁷⁶ Hereinafter, "GAAP."

⁷⁷ MOORE, *supra* note 75.

⁷⁸ *Id.*

Additionally, filmmakers generally agree to either two types of participation agreements: gross proceeds participation or net proceeds participation, with each having their own accounting formulas.⁷⁹ Even when it would seem as though a studio has profited from a movie, the studio accountants may not attribute it a profit. For instance, if a film company or studio spent \$25 million for production costs and another \$25 million for distribution costs and the movie made \$52 million, one would logically think that the profit of the film was \$2 million. However, studio accountants might disagree because under accepted accounting standards, the studio's large overhead expenses, such as salaries, office supplies, electricity, and other necessary expenses can be properly allocated to the film.⁸⁰ When these expenses are taken into account, they tend to reduce whatever profits the film made. Moreover, under prevailing law, an accountant has a lot of discretion as to whether a film has, for accounting purposes, become profitable. "Industry insiders joke that true creativity lies not with the talent, but with the accountants."⁸¹ Therefore, because large studios and talent have different definitions of what constitutes "net" or "gross" profits and different accounting practices, lawsuits persist.

E. *The Accounting Process*

A participant who has agreed to a contingent compensation agreement has the right to request an accounting from the studio based upon the express terms of the contract and on the notion of the implied covenant of good faith and fair dealing.⁸² Without this, it would be nearly impossible for such a party entitled to profits to determine whether there were any profits at all.⁸³ Profit participants, who enter into contingent compensation agreements with studios or film companies, catch these companies in the act of "Hollywood Accounting" practices through an audit.⁸⁴ Studios employ an army of accountants and contract administrators to "analyze contracts, profit definitions, and revenue streams."⁸⁵ From

⁷⁹ GREGORY BERNSTEIN, UNDERSTANDING THE BUSINESS OF ENTERTAINMENT: THE LEGAL AND BUSINESS ESSENTIALS ALL FILMMAKERS SHOULD KNOW 214 (2015).

⁸⁰ *Id.*

⁸¹ Sisto, *supra* note 23, at 21.

⁸² Nessim, *supra* note 12, at 434.

⁸³ *Id.*

⁸⁴ Complaint, *supra* note 70, at ¶ 5.

⁸⁵ *Id.*

there, they generate accounting statements to the participants.⁸⁶ Conversely, profit participants typically will employ only a single accountant or business manager.⁸⁷ Further, the accounting statements issued by the studio will contain generic line entries for expenses and revenues, and they generally reveal little to nothing about how the studio is calculating the expenses and revenues of the film or television series.⁸⁸

Profit participants may also negotiate to have an outside accounting firm go to the studio or film company, with written notice and approval, to review necessary documents such as the studio's books and records.⁸⁹ Studios will often make the auditing process as onerous as possible by imposing arduous terms that add to a participant's financial burden.⁹⁰ For instance, often studios will impose a specified timeframe for participants to file audit report, and the participation statements are deemed incontestable and not an auditable unless they meet that timeframe.⁹¹ However, between the time it takes for a participant to notice the audit and actually commence the audit usually spans a year or more. Moreover, the audit itself will usually take a year or more from the time it is commenced to its conclusion, and that only depends on how accommodating the studio or film company is.⁹² At the end of the accounting firm's audit review, the firm provides the participant with an audit report detailing the findings.⁹³ The auditing of the studio's books and records will typically range from \$50,000 to well over \$100,000, which demonstrates how much of a financial burden these claims can actually be.⁹⁴

After an audit report is finished, the participant must submit the report to the studio or film company as an official "objection" to the studio's accounting methods and typically request to meet them to discuss the audit's findings.⁹⁵ Without surprise, such meetings often take such a long time to transpire, so that, once they do take place, the studios or film companies will likely dispute the

⁸⁶ *Id.* at ¶ 5.

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.* at ¶ 6.

⁹⁰ Complaint, *supra* note 70, at ¶ 6.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.* at ¶ 7.

findings within the audit report.⁹⁶ Sometimes a studio or film company will be willing to settle with the participant for a nominal sum based on the findings in the audit report.⁹⁷ However, depending on the participant, the nominal sum may prove to be unsatisfactory, and they will generally take the participation claim to trial.⁹⁸

A participant may also use an “equitable accounting action” to challenge the improper accounting methods used by the studio or film company, including the reported costs and classifying of items as costs of productions.⁹⁹ Participants may commence an action for an accounting, as it is equitable in nature, and may ask a defendant to account for profits where “the accounts are so complicated that an ordinary legal action demanding a fixed sum is impracticable.”¹⁰⁰ However, a participant who ultimately wants to bring their claim to trial and would rather have a jury decide if there has been a breach of contract, may want to abstain from asserting an equitable accounting cause of action.¹⁰¹

F. *Fiduciary Duty*

Historically, there was a great deal of litigation focused on whether studios even owed a fiduciary duty to participants.¹⁰² A “fiduciary duty” is defined as the highest standard of duty implied by law.¹⁰³ In this context, the studios would be considered fiduciaries, that would then have a “duty, created by his undertaking, to act primarily for another’s benefit in matters connected with such undertaking.”¹⁰⁴ Participants would claim that the pure nature of their participation, coupled with the studio’s exclusive control over

⁹⁶ Complaint, *supra* note 70, at ¶ 7.

⁹⁷ *Id.*

⁹⁸ *Id.*

This is what happened here in plaintiff Josephson’s audit of Fox’s books and records for *Bones*: Josephson went through the laborious and expensive process of conducting an audit that uncovered tens of millions of dollars in claims against Fox, every one of which Fox summarily rejected. Nearly a year after rejecting all of his claims, Fox offered Josephson a negligible sum on only one claim in the audit report, effectively forcing his hand in the instant complaint.

⁹⁹ Nessim, *supra* note 12, at 434.

¹⁰⁰ *Id.*; *De Guere v. Universal City Studios Inc.*, 56 Cal. App. 4th 482, 507–08 (1997).

¹⁰¹ *De Guere*, 56 Cal. App. 4th at 434.

¹⁰² Nessim, *supra* note 12, at 431.

¹⁰³ *Fiduciary Duty*, BLACK’S LAW DICTIONARY 625 (6th ed. 1990).

¹⁰⁴ Marc Simon, Note, *Vertical Integration and Self-Dealing in the Television Industry: Should Profit Participants Be Owed a Fiduciary Duty?*, 19 CARDOZO ARTS & ENT. L.J. 433, 440–41 (2001).

matters such as the deal-making, production, and distribution of the film or television program, and information about covering the calculation of the participation (the revenue and deductions of a film or television show) created a fiduciary relationship between studio and participant.¹⁰⁵ Specifically, the fiduciary duties that participants hold studios accountable for are for proper accounting practices for revenues received and owing, and/or to maximize the total revenues for the participants.¹⁰⁶ Courts have determined that the existence of a fiduciary duty depends on whether one party has posited confidence and trust in another party and the latter party then exercises influence over the former by virtue of their relative positions.¹⁰⁷ This means that a fiduciary duty exists based on the extent of the relationships between both parties. The more reliance one party has on the other, the stronger the indication that a fiduciary duty exists.

In the past, studio executives were under the impression that they owed this type of fiduciary duty to profit participants.¹⁰⁸ This was only until two developments occurred, which made these types of fiduciary duty claims more difficult for participants.¹⁰⁹ The first development came from the decision of *Wolf*, which held that “fiduciary obligations are not necessarily created when one party entrusts valuable intellectual property to another for commercial development in exchange for the payment of compensation contingent on commercial success.”¹¹⁰ The second development prima-

¹⁰⁵ Nessim, *supra* note 12, at 431.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*; see, e.g., *Lazin v. Pavilion Partners*, No. 95-601, 1995 WL 614018, at *5 (E.D. Pa. Oct. 11, 1995) (holding that a reasonable fact-finder could conclude that plaintiff “reposed a special confidence” in defendant imposing a fiduciary duty on defendant to avoid exploiting that confidence); *Giangrante v. QVC Network, Inc.*, No. 89-8535, 1990 WL 124944, at *2 (E.D. Pa. Aug. 23, 1990) (citing *City of Harrisburg v. Bradford Trust Co.*, 621 F. Supp. 463, 473 (M.D. Pa. 1985)).

¹⁰⁸ *Id.* at 432.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*; *Wolf v. Superior Court (Disney)*, 107 Cal. App. 4th 25, 30–31 (2003). In this case the plaintiff was the author of the novel “Who Censored Roger Rabbit?” and Disney had entered into an agreement with the author to make a film based off the novel. Later, plaintiff brought a claim against Disney for breach of fiduciary duty for not providing him with owed profit participation for gross receipts of the movie and merchandising. Plaintiff argued that that Disney was a fiduciary because Disney enjoyed “exclusive control over the books, records and information concerning the exploitation of the Roger Rabbit character and the revenue and Gross Receipts Royalties derived therefrom.” The court held that a factor of confidence and trust alone was not sufficient to create a fiduciary relationship between the parties. The court also rejected the plaintiff’s claim that a fiduciary duty existed because Disney had total control over the financial books and records of the franchise.

rily stems from recent contracts that expressly disclaim any type of fiduciary duty owed to participants.¹¹¹ This is supported in *Waverly Productions, Inc. v. RKO General, Inc.*,¹¹² where the Court of Appeal rejected the argument that a fiduciary relationship existed between a film producer and a distributor, stating: “The distribution contract is an elaborate one which undertakes to define the respective rights and duties of the parties A mere contract or a debt does not constitute a trust or create a fiduciary relationship.”¹¹³ Formerly, participation contracts were typically silent on the nature of the relationship between studio and participant, but now contracts expressly disavow a fiduciary duty.¹¹⁴ Thus, the fiduciary duty argument on behalf of participants against studios does not bode well for profit participation claims today.

III. DISCUSSION

A. *The Litigation and Arbitration of Participation Disputes*

Litigation involving profit participation claims occurs frequently and is commonly hard fought.¹¹⁵ This is often so because a significant amount of money is usually at stake.¹¹⁶ Additionally, studios feel it necessary to fight participation cases harder than some other cases dealing with the same amount of monetary value, in order to send a message to participants in general, that it will be financially costly and difficult to litigate with the studios.¹¹⁷ There is an enormous shift to these types of cases being handled outside of the public courtroom nowadays.¹¹⁸ This is due to the ever-increasing amount of mandatory arbitration clauses being incorporated in studio contracts. Studios will also insist that their contracts with talent include a mandatory arbitration provision that requires arbitration to be held by the arbitration providers, such as JAMS

¹¹¹ Nessim, *supra* note 12, at 431.

¹¹² *Waverly Productions, Inc. v. RKO General, Inc.*, 217 Cal. App. 2d 721, 32 Cal. Rptr. 73 (1963).

¹¹³ *Recorded Picture Co. v. Nelson Entm't, Inc.*, 53 Cal. App. 4th 350, 370, 61 Cal. Rptr. 2d 742, 754 (1997) (as modified on denial of reh'g) (Apr. 3, 1997).

¹¹⁴ Nessim, *supra* note 12, at 432.

¹¹⁵ Gardner, *supra* note 1, at 404.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ Ronald J. Nessim & Scott Goldman, *Mandatory Arbitration Provisions Involving Talent and Studios and Proposed Areas for Improvement*, 22 UCLA ENT. L. REV. 233 (2015).

or AAA.¹¹⁹ In addition, major studios are insistent that these two provisions be non-negotiable.¹²⁰ Because nearly all the major studios supply these same provisions, it is very difficult to negotiate different terms at another major studio.¹²¹ Thus, the talent's choices are limited to either agreeing to the mandatory provisions or not working for a major studio at all.¹²²

This shift is likely due to the bias the studios felt when juries were consistently ruling for the participants. For example, Paramount produced the film, *Coming to America* (1988), starring Eddie Murphy based on a story treatment submitted by Art Buchwald. Buchwald's contract included net profit as contingent compensation.¹²³ Even though the film earned more than \$100 million at the box office, Paramount claimed that it suffered a loss.¹²⁴ Buchwald took action against Paramount claiming that the net profit definition stated in his contract was unconscionable.¹²⁵ The Los Angeles Superior Court agreed with Buchwald and awarded Buchwald \$900,000 in damages.¹²⁶ Unsatisfied with the result, Paramount appealed, but the lawsuit was eventually settled for unrevealed terms.¹²⁷ Nevertheless, the court found the following to be unconscionable: "charging interest on gross participations, fifteen percent additional overhead charges, charging interest on overhead, interest on negative cost substantially higher than the producer's cost of borrowing."¹²⁸

Since then, studios have been more conscious of the terms of profit participation in contracts. They require participants to agree to their mandatory arbitration provisions, so that these types of cases can be handled in places where they are comfortable. An example of this can be seen from the infamous debacle in 2011, where Charlie Sheen was fired from his hit show *Two and a Half Men*. Shortly after being fired, Charlie Sheen filed a \$100 million lawsuit

¹¹⁹ *Id.* at 239 (noting that JAMS is the forum that studios select the most as their dispute resolution provision in contracts between talent).

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ Marcus, *supra* note 4 (noting that the film had gross receipts in excess of \$160 million and yet it showed a net loss of \$18 million). See generally Robert W. Welkos & Terry Pristin, *Buchwald, Partner Win \$900,000 from Studio*, L.A. TIMES (Mar. 17, 1992) http://articles.latimes.com/1992-03-17/local/me-3895_1_net-profit.

¹²⁴ Sisto, *supra* note 23, at 1, 27.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

for wrongful termination against Warner Bros. and his former boss, producer Chuck Lorre.¹²⁹ Much of this lawsuit centered on whether the dispute should take place in private arbitration, rather than trial.¹³⁰ Sheen's talent agreement included a mandatory arbitration clause.¹³¹ Sheen wanted to void this provision and have this case to go to trial.¹³² However, Los Angeles Superior Court Judge Alan Goodman ultimately decided to uphold the arbitration provision in his agreement and the case was settled in binding arbitration.¹³³ Goodman, in a twenty-one page ruling, came to the conclusion that Warner Bros. Television had a valid arbitration clause in Sheen's contract, requiring him to handle the case through private arbitration rather than the public courtroom.¹³⁴ Even with high profile talent and cases such as this, it is difficult to avoid the arbitration clauses that studios lay out so carefully in their contracts.

Lawyers who represent talent have become increasingly concerned about "repeat provider/player bias" in talent versus major studio arbitrations.¹³⁵ In fact, many lawyers who represent talent are under the impression that the "choice of arbitrating versus litigating in a public courtroom is the single most important factor—perhaps even more important than the merits—in determining the outcome."¹³⁶ This concern is heightened by bigger monetary value arbitration cases, because there is smaller perceived risk that an arbitrator will side with the major studio in the smaller monetary value arbitration cases.¹³⁷ It is understandable why talent would be skeptical of going to arbitration with participation claims, when there is a perceived bias towards the studios. It is even more cumbersome for talent, when profit participation disputes involve an enormous sum and are being arbitrated in a forum where studios are likely to hold favor. However, there are ways in which both

¹²⁹ The Associated Press, *Charlie Sheen Settles 'Two and a Half Men' Lawsuit with Warner Bros., Producer Chuck Lorre*, NY DAILY NEWS (Sept. 27, 2015, 11:03 AM), <http://www.nydailynews.com/entertainment/tv/charlie-sheen-settles-men-lawsuit-warner-bros-producer-chuck-lorre-article-1.955565>.

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² *Id.*

¹³³ Anthony McCartney, *Judge Sends Sheen's 'Men' Lawsuit to Arbitration*, CNS NEWS (June 16, 2011, 1:30 AM), <http://www.cnsnews.com/news/article/judge-sends-sheens-men-lawsuit-arbitration>.

¹³⁴ *Id.*

¹³⁵ Nessim & Goldman, *supra* note 118, at 235.

¹³⁶ *Id.*

¹³⁷ *Id.*

parties can come to a happy median in solving these profit participation disputes.

IV. PROPOSAL

A. *Using Mediation to Resolve Participation Disputes*

As an alternative to jury trials or arbitration, mediation is a proper mode of solving profit participation disputes.¹³⁸ Mediations can eliminate the “repeat player bias” that the studios purportedly receive by initiating mandatory arbitration clauses and choosing JAMS as their most selected forum.¹³⁹ Further, mediation also takes away the perceived bias that studios feel talent receives in jury trials out of sympathy from jurors or judges. Therefore, mediation serves well as an opportunity for equilibrium for both parties.

Mediation includes benefits such as discarding matters clogging the court dockets and overcoming the impression that proposing mediation might be perceived as a sign of weakness by the opposing side.¹⁴⁰ Additionally, mediation is much more time and cost effective than arbitration¹⁴¹ and litigation.¹⁴² A large percent-

¹³⁸ Diane Wayne & Joel M. Grossman, *Resolving Profit Participation Disputes Presents Unique Challenges*, L.A. DAILY J. (June 21, 2012), <https://www.jamsadr.com/files/uploads/documents/articles/grossman-wayne-profit-participation-2012-06-21.pdf>.

¹³⁹ Nessim & Goldman, *supra* note 118, at 235.

¹⁴⁰ MENKEL-MEADOW ET AL., *DISPUTE RESOLUTION: BEYOND THE ADVERSARIAL MODEL* 405 (2005).

¹⁴¹ *Is Mediation a Better Choice than Arbitration?*, NEIMAN MEDIATION, <http://www.neimanmediation.com/is-mediation-a-better-choice-than-arbitration/> (last visited Jan. 22, 2016).

Resolving a dispute through arbitration is less time-consuming than going to court, but mediation is a significantly faster alternative . . . People are attracted to arbitration in part because they needn't wait for a trial date or work around a court's calendar. However, arbitration resembles a mini-trial, which can make it a slow grind. Parties wait while their attorneys compile evidence, engage in pre-hearing discovery, perform legal research, draft briefs and prepare the case. During the proceeding itself, both sides go through a long, drawn out process of trying to convince the arbitrator to rule in their favor. Once the hearing is over, parties wait while the arbitrator considers the evidence and legal arguments before issuing a ruling. Parties have no ability to speed things along. When people use mediation, their conflicts are resolved in a fraction of the time. It is not unusual for cases to be completely settled in a short session, lasting less than a day. The parties schedule their mediation for a convenient time and there is little waiting; the process isn't bogged down by arbitration protocols and presentations of evidence, and everyone is focused on settlement and works at a fast pace. All of this translates into a more efficient, streamlined process for resolving disputes . . . Resolving a dispute through arbitration is more economical than going to court, but mediation is a less-expensive alternative. Parties using arbitration are required to hire attorneys, who generally bill by the hour, and

age of entertainment companies and lawyers agree that their experiences with resolving disputes through mediation were excellent.¹⁴³

The process of mediation is one that involves a neutral third party who acts as a moderator to help both parties constructively address and possibly resolve a dispute, plan a transaction, or define the scope of a relationship.¹⁴⁴ The mediator will typically be a neutral third party,¹⁴⁵ who helps facilitate negotiation between the parties to enable better communication, encourage problem solving, and develop an agreement or resolution by consensus among the parties.¹⁴⁶ Essentially, mediation is a mechanism that allows the disputing parties to retain control over the outcome of their dispute, rather than a judge or arbitrator.¹⁴⁷ Because parties are in control of their outcomes, it is easily apparent how a perceived notion of “repeat-player bias” or “jury bias” can be avoided.

the costs add up quickly as lawyers prepare for the hearing and then present the case. Arbitrators are an additional cost. They are basically private judges and their fees can be substantial. They bill for time spent reviewing briefs, for sitting in the hearing itself and for considering the case after the hearing and rendering judgment, all of which create a large price tag. When people use mediation, they will almost always save money. A typical session is completed much faster than an arbitration, so even when attorneys are involved, the legal bills are much smaller. A party's share of the mediator's fee for even a lengthy mediation is a fraction of the cost of a battle played out an arbitration proceeding.

¹⁴² MOORE, *supra* note 75, at 204 (“The American rule is that the prevailing party in litigation does not recover their attorney fees from the other party. Thus, from the plaintiff's point of view, there is almost no risk of bringing almost any litigation against anybody, so the system has become one of legalized extortion.”).

¹⁴³ Eric Ervin, *Arbitration in the Independent Film Distribution Contract: An Independent Filmmaker's Tool to Battle Large Litigation Budgets*, 3 CARDOZO ONLINE J. CONFLICT RESOL. 2 (2002). See Gerald F. Phillips, *Survey, The Entertainment Industry is Accepting ADR*, 21 LEGAL AFF. 1 (1999).

In a survey conducted in the entertainment industry, 63% of the house counsel and 83% of the outside counsel characterized their experience with mediation as “excellent or good,” and 66% and 75% respectively reported that mediation “very frequently” resolved the dispute. Patricia Glaser, of Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, one of the pre-eminent entertainment litigators, at a UCLA conference on ADR, said, “I cannot think of any dispute that should not be mediated.”

¹⁴⁴ MENKEL-MEADOW ET AL., *supra* note 140.

¹⁴⁵ GOV'T BERMUDA, <http://www.govsubportal.com/government-gov-directory/culture-a-social-rehabilitation/human-affairs/mediation/320-who-are-mediators-and-what-are-they-trained-to-do>.

¹⁴⁶ MENKEL-MEADOW ET AL., *supra* note 140.

¹⁴⁷ *Id.* at 267.

B. *The Mandatory Mediation Clause*

An article in 1993 by Veronique Bardach, then an associate at Rogers & Wells, proposed the inclusion of a mediation clause in all entertainment industry contracts.¹⁴⁸ Since 1993, there have been many profit participation disputes,¹⁴⁹ yet, in almost all cases, entertainment industry contracts continue to include arbitration clauses rather than mediation clauses.¹⁵⁰ It is time for Hollywood to recognize the benefits of mediation and to start taking advantage of instituting mediation clauses in their contracts. This article concurs with Bardach's proposal and emphasizes the notion of how a mandatory mediation clause can be more beneficial than an arbitration clause in light of profit participation disputes.

One benefit of a mandatory mediation clause is that it allows the parties to try to reach a settlement without fear of being imposed on the parties with an unsatisfactory resolution, which can occur in arbitration proceedings. For example, in arbitration it is possible for both parties to be imposed with a binding settlement without having first try to reach an agreement. Even if both sides are unhappy with the resolution, arbitration proceedings are binding, so the settlement cannot be appealed.¹⁵¹ The inclusion of a mediation clause in a contract enables both parties to at least try to come to a settlement, with the help of a mediator, instead of battling their case in front of an arbitrator who will come to a binding result that can be unsatisfactory to one or both of the parties. In mediation, there is the potential for both parties to agree to a settlement on their own terms, and both parties can come out of the mediating process satisfied with their result.

¹⁴⁸ Veronique Bardach, *A Proposal for the Entertainment Industry: The Use of Mediation as an Alternative to More Common Forms of Dispute Resolution*, 13 *LOY. L.A. ENT. L. REV.* 477 (1993).

¹⁴⁹ E.g., Emily Carman & Philip Drake, *Doing the Deal: Talent Contracts in Hollywood*, in *HOLLYWOOD AND THE LAW* 209–27 (Paul McDonald et al. eds., 2015). See also Kate Brown, *Studios Hit with String of Lawsuits for Outdated Profit Participation Models*, *DOTTED LINE REP.* (Mar. 31, 2014), <http://dlreporter.com/2014/03/31/studios-sued-for-outdated-profit-participation-models/> (noting a series of profit participation claims for old films in recent years).

¹⁵⁰ E.g., Nessim & Goldman, *supra* note 118.

¹⁵¹ See, e.g., Lance Soskin, *Your Mediation Settlement Agreement Does Not Have as Much Legal Force as an Arbitration Decision*, *HUFFINGTON POST* (May 23, 2014, 2:42 AM), http://www.huffingtonpost.com/lance-soskin/your-mediation-settlement_b_5366660.html.

One of the hallmarks of mediation is that it is widely considered to be voluntary.¹⁵² There are those that criticize mandatory mediation because it contradicts the consensual nature of mediation ideology that supports the parties' control over both the process and the outcome.¹⁵³ One might also assume that under mandatory mediation, without equal bargaining power, the weaker parties are vulnerable to coercion, which might lead to a party accepting an unfair settlement.¹⁵⁴ However, various studies of mandatory mediation indicate that parties tend not to demonstrate concerns about harm to parties or pressures to agree to settlements.¹⁵⁵ Roselle L. Wissler conducted studies of voluntary and mandatory mediation involving various dispute types and found few differences overall in terms of how the mediations were experienced or assessed by the parties.¹⁵⁶ Further, there were no differences in the parties' descriptions of mediation sessions and opportunity to present their views, feelings of control over the process, whether disputes were truly resolved, or views of the mediators.¹⁵⁷ These studies provide an indication that counter the concern of coercion, and perceptions that mandatory mediation have a disproportionate effect over parties because of the omission of voluntariness.¹⁵⁸

An additional benefit of a mandatory mediation clause is that it shifts the focus to the parties trying to resolve their grievances together, rather than taking an adversarial disposition against each other, like when going into arbitration or even a jury trial.¹⁵⁹ For example, when a participation dispute arises, the presence of a mediation clause forces the parties into an amicable sequence of events of having phone communication, settlement conference, and

¹⁵² See Timothy Hedeem, *Coercion and Self-Determination in Court-Connected Mediation: All Mediations Are Voluntary, but Some Are More Voluntary than Others*, 26 JUST. SYS. J. 275, 276 (2005).

¹⁵³ See TAMARA RELIS, PERCEPTIONS IN LITIGATION AND MEDIATION: LAWYERS, DEFENDANTS, PLAINTIFFS, AND GENDERED PARTIES 65 (2009).

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* at 66 (noting various case studies, including divorce mediation, conducted by researcher Roselle L. Wissler, found that parties did not feel differently about voluntary and mandatory mediation).

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.* (indicating further studies by researchers Macfarlane and Keet via focus groups and interviews with over sixty lawyers, thirty-one litigants, thirteen mediators and a few judges, found overall satisfaction by parties in mandatory mediation).

¹⁵⁹ Bardach, *supra* note 148, at 487.

then mediation.¹⁶⁰ Moreover, mediation is a much quicker process than arbitration and having the clause in place from the outset enables the parties to reach a resolution in far less time.¹⁶¹ Unlike trials and arbitration where there is a contest over facts, in mediation, the subtle art of persuasion is a greater factor.¹⁶² When disputed facts are involved in cases, it slows down the process and may exacerbate the conflict. In mediation, the parties express their views to a mediator and based on those views alone, the parties come to an agreement.¹⁶³

As referenced earlier, Fox Studios is currently in the process of litigation with producer, Barry Josephson of the Fox show *Bones*.¹⁶⁴ Shortly after Josephson filed a profit participation claim against the studio, starring cast members of *Bones*, Emily Deschanel and David Boreanaz, along with author and executive producer Kathy Reichs, also filed participation claims against the studio.¹⁶⁵ When stars Deschanel and Boreanaz filed a lawsuit against Fox, the prospect of *Bones* being cancelled in its 12th season became very likely.¹⁶⁶ With the heated star cast members and executive producers fighting against the studio for their profits, it is very unlikely that they will have an incentive to shoot a new season. Had there been a mediation clause incorporated into their contracts, it is possible that this problem would never have come to fruition. According to Bardach, “most disputes average three four-hour sessions, over a two week period.”¹⁶⁷ Instead of the time it will take in the courts to determine the auditing, mediating these

¹⁶⁰ *Id.*

¹⁶¹ *Id.*; see also *Is Mediation a Better Choice than Arbitration?*, *supra* note 141 (noting how resolving disputes through mediation is a much faster alternative to arbitration and civil litigation).

¹⁶² See Patricia L. Glasser et al., *The Litigation Process-Relevant to Entertainment Litigation*, in ENTERTAINMENT LAW AND LITIGATION, 1, 89 (Charles J. Harder ed., 2014).

¹⁶³ *Id.*

¹⁶⁴ Belloni, *supra* note 71.

¹⁶⁵ Austin Siegemund-Broka & Matthew Belloni, *Bones' Stars File New Lawsuit for "Tens of Millions of Dollars" in Fox Profits*, HOLLYWOOD REP. (Nov. 30, 2015, 3:46pm), <http://www.hollywoodreporter.com/thr-esq/bones-stars-file-new-lawsuit-844237> (“Accounting statements allegedly showed Reichs’ was nearly \$90 million away from receiving profits payments, and plaintiffs Boreanaz and Deschanel received statements showing they were nearly \$100 million away from profits.’ Boreanaz and Deschanel allege they never even saw a copy of their initial profits definition.”).

¹⁶⁶ Chill Bolo, *Bones Cancelled for Season 12? Lawsuit Ends Possibility of Series Being Renewed?*, KOREAN PORTAL (Jan. 19, 2016, 10:31 PM), <http://en.koreaportal.com/articles/12323/20160119/bones-season-12-cancelled-renewed.htm> (noting that Fox executive Dana Walden, commented on the litigation and hinted at the show being cancelled with all the turmoil).

¹⁶⁷ Bardach, *supra* note 148.

claims could have resolved these issues much earlier on and the prospect of the 12th season of *Bones* being cancelled may not have come to light. The negative impact that profit participation lawsuits can have against both sides can not only have adverse effects on these parties involved, but on the viewers who enjoy those programs and would like to continue to see their favorite shows air. A mandatory mediation clause could have allowed the parties to come to terms and express their views to reach a possible settlement. However, mediation was not involved in this situation and may lead to a long-running show's demise.¹⁶⁸ Thus, a mandatory mediation clause could have several advantages over mandatory arbitration clauses. These advantages include being more time-sensitive than arbitration, being more conducive to continued relationships between the parties, and the increased likelihood that the settled terms will be satisfactory to both parties.

C. An Example of Why Mediation Should Be Used In Current Cases

An example of a current ongoing case that could have benefited from a mandatory mediation is the Frank Darabont and CAA *v. AMC Network* case.¹⁶⁹ Frank Darabont was let-go from his showrunner duties of his hit show *The Walking Dead*, which airs on the AMC Network, during the production of season two.¹⁷⁰ Darabont and his agency, CAA, filed a lawsuit against the AMC network in 2013 with claims of unpaid profit participation fees.¹⁷¹ In the complaint, Darabont alleged that AMC deprived him of his contractual entitlements to profits from the series, through the improper and abusive practice of “self-dealing.”¹⁷² Darabont’s accusation of “self-dealing” arose by “shortchanging him on contingent profit participation by producing the zombie series and then licens-

¹⁶⁸ *Id.*

¹⁶⁹ Dominic Patten, ‘Walking Dead’ Lawsuit: AMC Seeks Dismissal of Frank Darabont & CAA’s New Contract Claims, DEADLINE HOLLYWOOD (Sept. 18, 2015, 8:18 PM), <http://deadline.com/2015/09/walking-dead-lawsuit-frank-darabont-caa-amc-reply-amended-complaint-1201532002/>.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² Complaint at ¶ 1, *Darabont v. AMC Network Entertainment LLC*, 128 A.D.3d 472 (N.Y. 1st Dep’t 2015) (654328/2013); Nellie Andreeva, *Frank Darabont & CAA Suing AMC over ‘The Walking Dead’ Profits*, DEADLINE HOLLYWOOD (Dec. 17, 2013, 7:40 PM), <http://deadline.com/2013/12/walking-dead-frank-darabont-lawsuit-amc-653569/#more-653569>.

ing it to its cable network affiliate for an allegedly low imputed license fee.”¹⁷³ Because of these low imputed license fees, Darabont claimed that he was deprived of millions of dollars in profit participation.¹⁷⁴

In August 2014, Darabont amended his complaint and added an additional claim that shortly after litigation ensued, AMC inappropriately reduced his profit share.¹⁷⁵ Darabont’s new breach of contract claim is for an additional five percent of profit participation, because originally he was entitled to get as much as ten percent of profits from the series. But because he was terminated in the middle of the second season, AMC only counted him as three-quarters vested, meaning he only got seven-and-a-half percent.¹⁷⁶ Further, AMC denied him the additional two-and-a-half percent of profits as his role as *The Walking Dead* showrunner from episodes of the second season after he was fired.¹⁷⁷ Whether Darabont should be awarded participation profits is a question of whether he was employed full-time during season two of the show.¹⁷⁸ AMC contended that Darabont was not employed full-time at the end of season two, however, Darabont argued that the continued employment was not a “condition precedent” to such profits.¹⁷⁹ “It’s a wonky issue, but one with potentially millions on the line, especially if a judge or jury later finds that AMC should have imputed a larger license amount for the series to hand over to profit participants.”¹⁸⁰ Thus, it is important for contracts to specify clearly profit participation terms to prevent ambiguities such as this.

It is surprising that this lawsuit has been going on for two years. One would imagine that this case would have been settled very early on in the dispute.¹⁸¹ Darabont and CAA tried to resolve this issue, but were “fundamentally rebuffed” by AMC.¹⁸² Had both parties included a mandatory mediation clause, this litigation

¹⁷³ Eriq Gardner, ‘Walking Dead’ Creator Frank Darabont Fights for Bigger Cut of Series Profits, HOLLYWOOD REP. (Oct. 14, 2015, 12:44 PM), <http://www.hollywoodreporter.com/thresq/walking-dead-creator-frank-darabont-832156>.

¹⁷⁴ Michael Lee, *Frank Darabont Claims AMC Won’t Pay Him after Filing “Walking Dead” Lawsuit*, PIRATED THOUGHTS (Aug. 6, 2015), <http://piratedthoughts.com/frank-darabont-claims-amc-wont-pay-him-after-filing-walking-dead-lawsuit/>.

¹⁷⁵ Patten, *supra* note 169.

¹⁷⁶ *Id.*; Gardner, *supra* note 173.

¹⁷⁷ Gardner, *supra* note 173.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ Lee, *supra* note 174.

¹⁸² Andreeva, *supra* note 172.

could probably have been resolved much earlier. Furthermore, Darabont and CAA's camp were almost ruled on a motion by AMC to impose sanctions on them in 2015.¹⁸³ AMC contended that CAA had been identifying one of its senior executives, Jon Ringquist, as an in-house attorney although he is not.¹⁸⁴ AMC claimed that, during discovery, Ringquist, was provided with confidential AMC documents and that CAA had asserted attorney-client privilege to stymie the discovery of his communications.¹⁸⁵ Darabont and CAA ended up benefiting when a New York Supreme Court judge declined AMC's motion to impose sanctions.¹⁸⁶ Had Darabont and CAA opted for mediation to resolve this dispute they would likely not have run into this problem, because the discovery process would have turned out differently.¹⁸⁷

Furthermore, mediation might be very effective in handling profit participation lawsuits because they avoided a "winner takes all" type of litigation. There will be talent or studios that would not want to give away or lose a single penny, but in essence, both parties would be saving money by mediating, rather than paying for litigation that can cost more than it is actually worth. Some might claim that by making mediation mandatory, it will take away from certain parties "acting in good faith."¹⁸⁸ However, even in mandatory mediation cases, the settlement rate is nearly the same as non-mandatory mediation.¹⁸⁹ Thus, mediation might be a more sensible way of handling these disputes as opposed to arbitration

¹⁸³ Ted Johnson, 'Walking Dead' Lawsuit: Judge Declines to Rule on Motion for Sanctions Against CAA, *Legal Team*, VARIETY (Aug. 21, 2015, 2:56 PM), <http://variety.com/2015/biz/news/walking-dead-lawsuit-frank-darabont-caa-1201575908/>.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

¹⁸⁷ *Maximizing Your Mediation Session*, HESS GHERIS SOLUTIONS (Feb. 24, 2011), <http://hess-gheris.com/uncategorized/maximizing-your-mediation-session/>.

Once litigation has begun and the discovery process is underway, it is easy for parties to attribute bad motives to the other side based on litigation tactics that lawyers deem necessary to properly prepare their case. An early mediation can reduce the suspicion between the parties and allow them to find the areas of agreement and thus focus on finding solutions to the areas of disagreement. Even if an early mediation does not fully settle a case it might show the parties what more they need to learn to come back to the table for a full resolution without having to engage in protracted discovery. A mediation that is scheduled early also has the advantage of saving legal fees thus giving the parties more flexibility in settling their case.

¹⁸⁸ Jeff Rifleman, *Mandatory Mediation: Implications and Challenges*, *MEDIATE* (Dec. 2005), <http://www.mediate.com/articles/riflemanJ1.cfm>.

¹⁸⁹ Amy Lieberman, *Is Mediation a Bad Idea?*, <http://www.insightemployment.com/docs/IsMandatoryMediationABadIdea.pdf>.

and trial litigation, by saving costs and eliminating perceptions of bias.

D. *The Inadequacies of Mediation and Its Other Types*

Unlike arbitration or a jury trial, mediation is not a process that involves a third party making a binding decision; rather it is a mediated and well-rehearsed type of a settlement conference.¹⁹⁰ Thus, mediation clauses are not employed in studio and television contracts as much as arbitration clauses are because they are not binding.¹⁹¹ One of the pitfalls of employing mediation is that the parties can conduct a full mediation of the issues, without the intention of ever agreeing to a settlement, when they know they can easily appeal the outcome.¹⁹² This can lead parties to act in bad faith during the process, ultimately unaffected by the mediation order.¹⁹³ One then might logically wonder why would studios or television networks such as Fox Studios or AMC ever agree to mediation or employ mediation clauses when they can simply bypass that step to one that leads to a binding result?

Mediation is by no means limited to just one standard form. There are other variations that maintain the process of mediation, but the decision process changes.¹⁹⁴ One type, for instance, is “binding mediation.”¹⁹⁵ Binding mediation, similar to standard mediation, is a process by which a mediator is appointed and is responsible for getting the parties to settle their dispute.¹⁹⁶ In contrast to typical mediation, when the parties are unable to resolve their dispute, in binding mediation, the mediator has the ability to impose a resolution on the parties.¹⁹⁷ In essence, the mediators’ binding resolution is similar to a decision made by an arbitrator.¹⁹⁸ Hence, binding mediation might appeal to studios because it retains the same positive aspects as arbitration, because the resolu-

¹⁹⁰ Patricia L. Glasser et al., *supra* note 162.

¹⁹¹ Ervin, *supra* note 143.

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ See MENKEL-MEADOW ET AL., *MEDIATION: PRACTICE, POLICY & ETHICS* 381 (2006).

¹⁹⁵ Robert C. Leventhal, *Foley & Lardner: Between Mediation and Arbitration—Binding Mediation*, LEXISNEXIS (Aug. 30, 2011, 1:50 PM), <http://www.lexisnexis.com/legalnewsroom/insurance/b/reinsurance/archive/2011/08/30/foley-lardner-between-mediation-arbitration-binding-mediation-third-alternative.aspx>.

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

tion reached by the mediator is binding. However, binding mediation is problematic in light of participation disputes.

Although binding mediation consists of the same elements as ordinary mediation, it fails in solving profit participation conflicts because a neutral third party is still making the decision. The repeat-player bias would eventually come to fruition, because studios would ultimately be using the same mediators and forums to address the disputes. The same negative aspects that the talent side perceives when going to arbitration remain intact with this form of mediation. Talent might feel mediators hold favor to the studios, when they insistently come back to the same ones. Therefore, binding mediation is not the best approach for handling participation disputes.

E. *Best Solution to Mediation and Participation Disputes:
Strict Binding Mediation*

The best method of incorporating mediation into profit participation disputes is through a process that uses ordinary mediation where whatever resolution the parties reach is binding. For terminology's sake, this process is called "strict binding mediation." This approach differs from ordinary "binding mediation," because a mediator would help only to facilitate the parties to come to an agreement like a mediator would in a regular mediation proceeding. However, in this scenario, the mediator is not the one to impose a binding resolution on the parties. Further, one might be concerned about a party's potential ability to holdout on reaching a resolution, but under strict binding mediation, there is a strict time period of three months or a prior agreed upon time for both parties to come to a resolution before being penalized. If a party holding out exceeds the three-month time period or agreed upon time, significant fines, which would vary based on that party's wealth or assets, will accumulate against that party. These varied fines would prevent major studios or successful talent from taking advantage over the lesser-known talent or not as successful production company by waiting until the other party settles. Both parties are incentivized to reach an agreement as soon as possible.

In this setting, the parties would both have an incentive to come to the best outcome possible, because they know that whatever is agreed upon is binding. The fear of the repeat-player bias felt by talent does not exist in strict binding mediation, be-

cause a third-party neutral is not making a binding decision. Studios do not have to be concerned about the jury trial bias that talent may receive because juries are not involved in this situation. Under strict binding mediation, studios and talent are incentivized not to act in bad faith during the proceedings because both their financial stakes are on the line and whatever the terms of agreements they come to are binding. Furthermore, studios would not have to worry about needless appeals or feel that mediation is an extra step to eventual arbitration or litigation, due to the binding nature of this procedure. Therefore, it is apparent that strict binding mediation can help alleviate some of the issues that currently face profit participation disputes.

Although some might argue that the combination of mediation and arbitration bring to the forefront its best aspects, including the speed, efficiency, and consensual aspects of mediation and finality of arbitration,¹⁹⁹ it fails in resolving participation claims. The third party that makes a binding decision causes talent to perceive that the studio is receiving an unfair advantage by litigating in the same forum with the same neutral, time after time again. Strict binding mediation eliminates that perception and allows the talent to come to the proceeding, knowing that there is no bias in play. Similarly, studios can feel comfortable instituting a mandatory strict binding mediation clause knowing their litigation costs will not exceed that of arbitration, and there will be no appeals. Thus, a strict binding mediation can help solve the common dispute of profit participation in the entertainment industry.

V. CONCLUSION

Since its birth, the entertainment industry has utilized contracts to regulate a variety of industry practices that affect those involved.²⁰⁰ Early in its development, Hollywood engaged in the practice of offering participation in the profits of their films, and later, in television programs.²⁰¹ Later, studios engaged in clever ways to avoid paying participants their fair share of the profits. This included incorporating vague definitions of “profit” in contracts.²⁰² As entertainment companies started to become vertically

¹⁹⁹ MENKEL-MEADOW ET AL., *supra* note 194.

²⁰⁰ Carman & Drake, *supra* note 149, at 209.

²⁰¹ Sisto, *supra* note 23, at 21.

²⁰² *Id.*

integrated, the practice of self-dealing became more apparent and participation claims increased.²⁰³ As profit participation litigation started to weigh heavily on the studios after several significant losses in jury trials, they collectively employed mandatory arbitration provisions in their contracts.²⁰⁴ Studios found these clauses to be favorable, because they reduced litigation costs and were handled more quickly and effectively.²⁰⁵ However, over the years, talent became suspicious of studios and their willingness to mandate arbitration and felt as though there was a “repeat-player bias” in the studios favor, amongst the arbitrators.²⁰⁶ This clash of perceptions and biases still exist, and there needs to be another way to resolve these disputes where both parties can feel as though they are on even ground.

Mediation is a great tool to solve participation issues because it eliminates these notions of biases and allows the parties to reach a resolution in a friendlier and time-effective environment. At first glance, studios may not opt for initiating mediation or mandating mediation clauses. However, through “strict binding mediation,” studios can come to a resolution without fear of being appealed and being mired in a cycle of litigation. On the other hand, talent can mediate without feeling like the weaker party, knowing that the terms they discuss and agree on will be binding. Furthermore, the mediator will not be making the binding resolution, ridding any notion of repeat-player bias they feel so strongly occurs through arbitration. It is unlikely that profit participation disputes will come to an end anytime soon, so it is best for disputants to handle these conflicts in the most reasonable and fair way possible. Thus, strict binding mediation is a great answer to resolving profit participation disputes.

²⁰³ Nessim, *supra* note 12, at 406.

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.*

