LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
MONDAY, AUGUST 24, 2020

PERSPECTIVE

Is the curtain closing on TV profit participation litigation?

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For more than half a century, Hollywood film and television studios have contracted to pay high-profile actors and producers a share of the proceeds from the movies and television series they create. Known as "profit participations," some of these deals have reportedly paid out hundreds of millions of dollars. These complex arrangements are susceptible to differing interpretations and have therefore spawned countless legal disputes, first in court, and more recently in closed-door arbitrations. As a result of studios repeatedly being held liable for breach of contract and related tort claims, and recent industry consolidation giving studios added leverage in their negotiations with talent, profit participations are being scrapped in favor of stripped-down bonuses intended to reduce the studios' litigation risk. Calculating these bonuses is still subject to manipulation by the studios and, therefore, susceptible to legal disputes; however, because the dollar amount at issue is generally less than with traditional profit participations, talent may be less inclined to pursue legal actions against the studios. The lesson to talent is: negotiate to keep your traditional profit participation interest, and steer clear of the new bonus model.

Emily Deschanel and David Boreanaz, the stars of the television show "Bones," in Beverly Hills in 2011. | Shutterstock

A Brief History of Profit Participations and Related Litigation

Modern profit participation in the entertainment industry is said to have had its origins in Jimmy Stewart's 1950 "Winchester '73" deal with Universal Studios. Unable to pay Stewart's fixed upfront fee, Universal instead offered him 50% of the net profits from the film. As this compensation model became more ubiquitous in the 1970s and 1980s, so too did dubious accounting methods, called "Hollywood Accounting," that studios used to keep the talent from fully sharing in the success of productions. This led to a number of high-profile court cases, including Art Buchwald's dispute with Paramount Pictures over "Coming to America" (settled in 1992), Alan Ladd's suit against Warner Brothers in connection with "Blade Runner," "Body Heat" and "Night Shift" (resulting in a judgment that was affirmed on appeal in 2010), and a $320 million jury award for Celador International against Disney in connection with "Who Wants to Be a Millionaire" (affirmed on appeal in 2012).

Studios React by Imposing Mandatory Arbitration Clauses

In the early 2000s, many of the big Hollywood studios reacted to adverse jury verdicts by incorporating non-negotiable arbitration clauses into their contracts with profit participants to correct what the studios saw as juror bias in favor of talent. For a number of reasons, however, many on the talent side believed that the shift from court to private arbitrations — far from leveling the playing field — instead gave studios a major edge in profit participation disputes.

One frequently cited concern is repeat player bias. Many of the boilerplate studio arbitration provisions specify that a particular arbitration provider (often JAMS) will oversee disputes arising under the deal. As a result, these arbitration providers have a financial incentive to curry favor with the studios in order to retain their business. This concern is compounded by the fact that many arbitrators have an equity stake in the arbitration companies they work for. Other features of arbitration that favor studios over talent are limitations on the scope of discovery necessary for the talent to prove its claims, and arbitration agreements mandating that proceedings that would otherwise publicly reveal studio misconduct be kept confidential.

Studios Fare no Better in Arbitration

Recent participant victories have challenged the conventional wisdom that arbitration favors the studios. In *Wark Entertainment, Inc. v. Twentieth Century Fox Film Corp. et al.*, BC602287 (L.A. Super. Ct., filed Nov. 25, 2015), for example, the stars and producers of Fox's crime procedural TV series "Bones" filed a lawsuit in Los Angeles County Superior Court, alleging contract, interference and fraud claims against the Fox studio, its affiliates, and its parent company. The participants alleged both classic Hollywood Accounting as well as "self-dealing" between the Fox studio and those Fox affiliates to which it licensed the series. Regarding the claims of self-dealing, the participants alleged that Twenty-First Century Fox, the parent company of the Fox television studio, directed the studio to license "Bones" to affiliates at below-market "sweetheart" rates to artificially reduce profit payments to the participants, thereby enriching Fox and tortiously interfering with participant contracts.

Although Fox won an early victory by compelling the talents' self-dealing claims to arbitration, the arbitrator ultimately found in favor of the talent, awarding them over $178 million. Of this amount, $128 million consisted of punitive damages, which the arbitrator deemed appropriate to punish Fox for its "company-wide culture and [] accepted climate that enveloped an aversion for the truth." The punitive portion of the award was later struck by the trial court, which found that the arbitrator lacked authority to award punitive relief; the parties subsequently settled out of court on confidential terms before the participants filed their appeal.

Industry Consolidation

On March 20, 2019, Disney finalized its acquisition of Twenty-First Century Fox, including its film and television production studios, certain cable networks, and its 30% stake in Hulu. The acquisition consolidated two of the handful of traditional major Hollywood studios into one, reducing the number of potential "buyers" in the market and giving the remaining studios even greater leverage in their negotiations with talent.

Studios' Reaction to "Bones": Stop Granting Profit Participations

Shaken by the large damage awards to the talent in the "Bones" case and looking to capitalize on industry consolidation, certain Hollywood studios have responded by shifting the backend compensation goalposts yet again. This time, these studios are changing the structure of their "backend" deals to phase out profit participations entirely. In their place, they are inserting "series bonuses" where the potential financial upside to talent pales in comparison to traditional profit participation deals and places an outer limit on the potential upside of a smash-success.

The "series bonus" model typically sets forth a handful of bonuses that a participant may earn when a series meets certain benchmarks such as a certain number of seasons, awards recognition, or high audience rankings. The model purports to be clearer than a typical profit participation deal, which generally includes a lengthy and often complex definition setting forth how a participant's share is to be calculated. However, there is little reason to believe that this new model is less susceptible to studio manipulation. For example, one version circulated widely by Disney lists 12 different metrics for determining a show's audience ranking, and, as if that isn't confusing enough, goes on to state that Disney may unilaterally choose to apply additional metrics in the future at its discretion. The net result of such ambiguous and one-sided drafting is that the studios are unlikely to achieve their stated goal of minimizing disputes, though the fact that the bonuses are worth so much less than traditional profit participations may disincentivize litigation by reducing the potential upside for talent of pursuing a legal action. Talent that wants to meaningfully share in the fruits of his or her creation may therefore wish to reject the "series bonus" model and negotiate to retain the traditional profit participation interests that have proven to be so profitable in the 70+ years since Jimmy Stewart originated this form of compensation.

The authors represented the plaintiffs in the "Bones" arbitration against Fox, which resulted in the largest arbitration award ever issued in a profit participation dispute.

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