TroyGould ATTORNEYS

Gary O. Concoff
(310) 789-1326
gconcoff@troygould.com

Negotiating Contingent Interests in Motion Pictures

Gary O. Concoff

In this paper, which places primary emphasis on contingent interests in theatrical feature pictures, the author offers a practical approach to the solution of some important problems raised in the negotiation of contingent interests and distribution agreements.*

In attempting to generalize regarding contingent participations, a number of distinctions must be drawn, including:

"Major Studio" v. "Independent Producers"

Substantially based upon history and partly based upon logic, significant differences in profit allocations and definitions exist as to contingent participations granted by the so-called "major studios" and "independent producers." For purposes of this discussion a "major studio" is defined as a motion picture financier which possesses both studio production facilities and worldwide direct distribution offices or exchanges (i.e., including both as to the United States and Canada and at least in the major countries in the rest of the world). "Independent producers" are treated as all entities which obtain or provide financing for motion pictures but which do not own or provide production studio facilities or direct worldwide distribution means. That is, they obtain distribution through the use of third-party distributors or subdistributors, which may include a major studio. Obviously, there are a number of projects which are in effect jointly financed by major studios and independent producers and there are varying shades of "grey" between the "black" of the major studio and the "white" of the independent producer.

Entrepreneurial Producer Net Profit Definitions v. "Talent" Definitions

The definition of net profit participations which applies to the "entrepreneurial producer" (i.e., a producer which either finances development and/or part or all of production or "packages" and arranges for financing of the picture) and that which applies to "talent" (i.e., writers, directors, actors and others who obtain net profit participations) should be materially different. (Certainly, there is no intent by use of the word "talent" to describe those other than producers to suggest that producers are untalented; it is simply customary to refer to writers, directors and actors as "talent.") This distinction often results from the fact that part or all of the economic risk associated with a project is borne by the producer and, perhaps, part or all of the financing is being provided by the producer.

Obviously, entrepreneurial writers, directors or actors who also function as their own producers may take some of the entrepreneurial risks and/or provide financing; in this way they may thus obtain the benefit of better definitions. Further, a "producer" who acts merely as an employee without substantial entrepreneurial risk will in most cases be treated in the same manner as talent depending upon bargaining position.

Recognition of Change

The worldwide motion picture industry has changed drastically within the last 10 to 12 years, perhaps at a pace more extreme than any time since the 1980s with the advent of commercial free-television in

Europe and video worldwide and video on-demand. Note must be taken in the analysis of various issues discussed of the lag in recognition of such industry changes which warrant changes in traditional allocations and definitions of contingent participations and actual incorporation of such warranted changes in the relevant agreements.

Net Profit Participations

Allocation of Net Profit Shares. Before one considers very significant questions regarding definition, the basic issue of allocation of net profits (assuming a "fair" definition) must be considered. Traditionally, it has been the worldwide assumption that invested capital (after recoupment of 100 percent of such investment plus an interest equivalent) should receive the benefit of 50 percent of the total net profits which accrue. At times, when the availability of capital is more limited than normal, as much as 60 percent of the net profits will be allocated to invested capital. However if in the negotiation process it is recognized that, for example, distribution fees taken by a major studio or other distributor are relatively high and include a substantial profit factor — or if the allocation of net profits to particularly desirable talent is considered crucial to the financier — the net profit share allocated to invested capital might be as little as 40 percent of the total.

Assuming, for ease of discussion, that an entrepreneurial producer is arranging for financing with the source of invested capital, it is customarily the case that the producer must cover out of his remaining 50 percent of the total profit share all profit shares allocatable to talent. However, suppose that a substantial entrepreneurial producer finds it necessary in order to obtain the services of the writer, director or actors to grant as much as 30 or 40 percent of the net profit to such talent elements. In this case, even some of the major studios and often financier-independent producers or investors will agree to allow deduction of all or part of the net profit shares paid to such high level talent "off-the-top", thus resulting in a reduction of the net profit share obtained by invested capital to equal as little as 40 percent of the total. Often, the factor weighed is whether or not the remaining net profit share available to the producer is sufficient to warrant his efforts in packaging, organizing and perhaps partially financing the project.

One resulting formula (particularly when a major studio is providing finance) provides that the producer will have to bear talent profit participations out of his 50 percent share, but that he is entitled to a "floor" of anywhere from 15 to 25 percent of the profits, allowing for deduction from the investor's shares of any excess profits required and approved to be given to talent. Various sharing formulas with regard to such third-party profit participations can be employed to arrive at this "floor." In the case where the highest category of acting and sometimes directing talent is involved, gross receipts shares allocated to such talent are treated either as the equivalent of additional production costs or expressly made not subject to the "floor" of the entrepreneurial producer. It is hoped that the producer will have a right of approval with regard to the granting of such gross receipts participations.

One of the most controversial areas in net profit definitions is the inclusion in production cost of a so-called "overhead" factor

So-called "Overhead" Deductions. One of the most controversial areas in net profit definitions is the inclusion in production cost of a so-called "overhead" factor. This cost factor can range from nil to more than a quarter of the direct out-of-pocket cost of production. From an accounting standpoint, "overhead" is defined as administrative and other costs incurred by the financing entity which cannot be precisely earmarked or identified as being incurred specifically for a single picture. Thus, such cost factors may include executive and administrative salaries, department heads, administrative office rental and amortization, secretarial accounting and legal services, at times production stages, equipment and props, and other general administrative or support elements.

From a pure accounting standpoint, overhead was originally accounted for by making an estimate yearly in advance as to the likely cost of such general administrative and other indirect costs for a full yearly production schedule, allocating an estimated overhead percentage rate based on estimated aggregate direct production costs to the cost of each picture. At the end of each year, the percentage would be adjusted to the actual rate of overhead based upon the number of projects actually produced as related to the overall costs incurred in indirect areas.

Idle time for such facilities and other indirect and administrative charges would logically not comprise part of the percentage ultimately charged to each picture. However, a number of legal disputes arose over that traditional approach and the result has been the fixing of flat overhead rates which vary by studio and which never include a reduction factor for idle time. While usually not expressly stated, such overhead rates should include a factor for the risk of overbudget costs of completion equivalent to that charged by an outside completion guarantor. It is uncertain, however, whether a double charge results in the occasional case where a major studio engages an outside completion guarantor but nonetheless charges its full overhead rate.

Most major studios will allow a separate and different rate of overhead if a picture is shot on location under circumstances where stages, equipment and certain administrative elements normally provided by the studio are not used. However, such a concession must often be sought or even demanded in order to allow a reduction in applicable overhead rates.

The critical factor from a negotiating standpoint vis-à-vis a major studio, which is often overlooked, is the necessity that a precise list of the administrative and other indirect costs purported to be included or covered by the overhead percentage or other formula for determination of overhead be obtained by the profit participant. It must be agreed by the major studio that such items will not be both deducted on a direct basis and included as part of the overhead rate, thus resulting in a double deduction.

Independent producers and financiers are often able to provide definitions of net profits which do not include any overhead factor or which include a very low overhead factor. However, it should be borne in mind that when the independent producer or financier provides and takes the risk of completion itself, it is entitled to the same fee which would be paid to an outside completion guarantor (in the area of 5 or 6 percent of direct cost, perhaps allowing a rebate in the event that the picture does not go over budget) consistent with the arrangement which a completion guarantor will accept. Often the same costs which are treated as part of overhead by a major studio will be charged as direct costs by the independent producer to a single picture (and perhaps charged to more than one picture?). It does not necessarily follow that the lack of inclusion of an overhead rate means a lower overall cost, although that is usually the result. Further, one should bear in mind that the independent producer who does not have the benefit of major studio support must provide its own “department heads” and must undertake a number of functions which are provided by the studio and made easier from the producer's standpoint.

Territorial or Separate Media Advances or Guarantees. One of the most common methods of financing, relating perhaps to as many as 50 percent of the feature motion pictures produced, is the use of advances or guarantees against delivery of a completed picture, often funded by interim equity or loan financing. Suppose, for example, that as to a $10 million picture an aggregate of $4.5 million is obtained as agreed advances and guarantees payable upon delivery of the picture from territories outside of the U.S. and Canada and that a bank agrees to finance, on a discounted basis, $4 million toward the production cost of the picture, assuming that the remaining $500,000 relates to interest and other financing charges and a "discount" or corridor of comfort desired by the banking entity. The treatment of this transaction must be considered separately from the standpoint of the equity investor on the one hand and the talent or other profit participant on the other.

As to the investor, let's assume that a single investor is providing the remaining $6 million needed for production of the picture. Assuming that our hypothetical investor is neither a major studio nor distributor with respect to the U.S. and Canada, the investor will argue that he is taking a number of increased risks by reason of this arrangement. First, by hypothesis no distribution arrangement has been made with respect to the U.S. and Canada and the ultimate result may be either a poor U.S. distribution arrangement or the possibility that no significant distribution takes place. Further, the use of $4.5 million of advances from the foreign territories for production removes from the recoupment base of the investor all of those proceeds from the foreign territories licensed. Further, since the entrepreneurial producer only had to pay interest to a bank with respect to 40 percent of the cost of the picture and did not have to allocate a net profit share to the bank or banks involved, the producer stands to enhance his profit participation as to the picture overall. This would be the case if, on the normal hypothesis, the investor providing $6 million in funds would receive as his net profit share 50 percent of $6 million (his investment) divided by the aggregate $10 million cost of the picture, i.e., resulting in a 30 percent share of the net profits. A negotiation might then result in the $6 million investor obtaining a higher than normal participation in profits by reason for the foregoing arrangement.

To complicate matters further, assume that the investors include local distributors or local broadcasters or distributors, as is common in the television industry and often as to pictures initially intended for theatrical exploitation with TV use to follow. Assume further, that the advance made with respect to a number of such local broadcasters and/or distributors is greater than the normal license fee with respect to the subject territory and includes an investment factor. Under this circumstance it is common to allocate the advance by the local broadcaster or distributor between pure advance as to its license of distribution or exploitation rights and a remaining portion to investment, which would be recoupable presumably on a pari passu basis with all other investors. Formulae in this area can become complex; it is not uncommon for the local distributor/ broadcaster to obtain a percentage of net profits which is quite arbitrarily determined, but nonetheless recognizes an investment factor in the advance or guarantee provided.

A further aspect of such an arrangement is the effect of such preproduction advances and/or interim finance upon the third-party profit participant who is not an investor, e.g., talent. The sum total of all financing charges must be treated as an additional production cost in calculating such third-party participant's profit share. Once the advance or guaranty is received, it is treated as gross receipts and once paid to the bank is treated as part of the recoupment of the production costs of the picture. The effect is thus substantially a wash, except that it must be clear that the financing and other charges involved are to be treated as additional costs for recoupment purposes. However, talent participants may take the position that presale of the foreign territories involved may have the effect of limiting their upside potential and may argue that they are entitled to a larger percentage than normal. This, again, is a subject of considerable negotiation which is determined based upon the stature and bargaining power of the talent and other related factors.

Cross-Recoupment or Cross-Collateralization of Territories and Media. The standard major studio definition of net profits provides for worldwide cross-recoupment or cross-collateralization of all proceeds (to the extent included in gross receipts - see video discussion below) from all territories and media. Thus, on a cross-collateralization basis, if the aggregate of distribution and all other costs on a worldwide basis exceeds gross receipts as to all foreign territories on a worldwide basis, there will be no sums to apply to negative cost reduction. It may be the case, however, that distribution in France yields highly profitable results (e.g., say gross receipts might be $l million while local costs were only, say, $400,000) and Italian distribution resulted in a significant negative result (e.g., $250,000 in gross receipts v. $400,000 in local costs). In the foregoing case, the two territories would be cross-recouped or cross-collateralized against each other along with the rest of the world, resulting in a lowered application of the profit from the French success toward worldwide cost recoupment.

By contrast, in the non-crossed situation, if the local Italian distributor made an advance toward the picture of $200,000 he would have to take the risk of the excess of local distribution costs over the advance. Thus, both the advance from Italy and an advance plus overages from France would be applied toward recoupment of the overall costs of the picture in calculating worldwide net profits.

The foregoing represents a very substantial advantage which can be obtained in the case of independent production and distribution of a picture. However, the major studios argue that they are often more effective in distributing the picture worldwide (including in local territories outside the U.S. and as to separate media), and thus the profit participant has a better opportunity to obtain net profits by reason of major distribution notwithstanding cross-collateralization. However, particularly in recent times, it is often the case that a local distributor is as effective or more effective than the major studios in its territory and thus a profit participant may gain both the advantage of equal or better distribution and cross-collateralization in the case of the picture marketed on a territory-by-territory basis.

The foregoing analysis has resulted in difficult negotiations as to foreign distribution. In some cases attempts have been made to cause a major studio to allocate minimum "deemed" advances on a territory-by-territory basis and provide for noncross-collateralization similar to that available in the case of independent distribution. This is very difficult to achieve. However, a number of independent distributors who have U.S. and Canada direct distribution facilities but subdistribute on a territory-by-territory basis in the foreign territories will allow, and even at times offer, non-cross-collateralization as an advantage to the profit participant.

Fractionalization and Cross-Collateralization as to Media. Until recently it had been common for licenses to be made with respect to video rights (and earlier as to the U.S. and Canada and recently as to certain other territories as to pay-television), separate from theatrical and possibly even television exploitation by a distributor in the subject territory. Substantial advances can be obtained with respect to such rights separate from theatrical exploitation and the resulting "fractionalized" licensing results in non-cross-collateralization as to the advance and overages from such licenses, as against theatrical exploitation.

Great resistance has been encountered from distributors particularly in the U.S. but also in other major territories by reason of the tremendous worldwide increase in advertising and other distribution costs. Local theatrical distributors often insist upon a license of video, pay-television and free television rights as a major means of covering all or substantially all of the distribution costs now necessary to properly exploit theatrical pictures. As a result, independent video distributors have encountered increasing difficulty in obtaining independently produced pictures.

Very creative financing devices with regard to such fractionalization and cross-collateralization have evolved due to pressures on such independent video distributors. At times, for desirable pictures and particularly as to multiple picture or output arrangements, video companies will provide all or part of the anticipated print and advertising costs necessary to exploit the subject picture(s) in a local territory or worldwide, at times with arrangements for partial or full recoupment of such advances along with the local theatrical distributor supplemented by overall net profit shares.

At times, creative independent producers who have made separate non-cross-collateralized deals as to video, pay-television and even free television rights, will use partial or full cross-collateralization of advances and other proceeds from such licenses as a device to satisfy the theatrical distributor by at least partially offsetting the substantial risk of the theatrical distributor as to print and advertising costs.

Accounting for video proceeds from pictures initially distributed prior to 1980, in the light of ambiguous definitions, has resulted in extensive renegotiation and potential litigation

Proceeds from Video Exploitation. The dramatic increase in gross receipts derived from video exploitation of feature pictures worldwide, resulting in a share of gross receipts to distributors that may be in excess of 50 percent of total gross receipts from all media for theatrical feature pictures, has placed great importance on the manner in which such proceeds are included in gross receipts for purposes of net profit definitions. Accounting for video proceeds from pictures initially distributed prior to 1980, in the light of ambiguous definitions, has resulted in extensive renegotiation and potential litigation.

The following analysis seems appropriate based on the old forms. Assume, for example, that the normal net profit definition extant prior to the early 1980s indicated or implied that gross receipts should include whatever gross proceeds were received from video exploitation by the distributor (e.g., assume a “wholesale” selling price of $50 per unit received by the distributor as to a video release which sells at retail at, say, $85 per unit). After deduction of the cost of reproductions, packaging, advertising, etc. for an aggregate of, say, $10 per unit, the remaining $40 per unit remains before the distribution fee. Under the old pre-1980s, forms the remaining balance of $40 per unit would be reduced by a distribution fee, which is not clearly denominated. But assuming an average distribution fee of 33.3 percent based on the $50 wholesale selling price deemed gross receipts, a distribution fee of about $17 per unit would result. This would result in a balance creditable to the net profit participant of about $23 per unit.

Notwithstanding the foregoing analysis, many distributors have adopted a royalty basis for accounting even for pre-1980s pictures, resulting in the inclusion of 20 percent of the wholesale selling price (or 20 percent of $50, i.e., $10 per unit) in gross receipts. Renegotiation and potential disputes have accordingly resulted.

The major studios have adopted the royalty approach based in part upon the very substantial initial or start-up investment undertaken by the major distributors and other video companies worldwide in the video area. It has become the practice of most major distributors and independent video distributors to include in gross receipts a royalty usually calculated as a percent of wholesale selling price after deduction of packaging costs, taxes and certain other “off-the-top” deductions. This might result in inclusion in gross receipts of, say, 20 percent or $45-$50 (and less for discount sales) per unit based upon the above described hypothesis, resulting in, say, $9-$10b being included in gross receipts. Thereafter, a distribution fee, usually equal to the theatrical distribution fee of, say, 30 percent in the U.S. and Canada and 40 percent in foreign territories of the applicable royalty, is deducted.

Negotiation with major distributors has resulted in variances from the standard 20 percent royalty (subject to distribution fee) arrangement including the following:

- Where very strong talent is involved - a royalty as high as 35 percent might be included in gross receipts;
- Distribution fees applicable to the royalty might be reduced or eliminated;
- Calculation vis-à-vis investors might be done on a "net profit" basis, i.e., allowing for deduction only of actual reproduction, packaging and other costs and, perhaps, an overhead factor plus a negotiated distribution fee that might range from 20-30 percent as to the U.S. and Canada and 30-40 percent in foreign territories.
- A number of other compromise solutions have been reached which include elements of those described above.

Notwithstanding the difficulties of "fractionalization" of rights, as discussed above, the independent producer may be able to obtain an advance with respect to U.S. and Canadian rights as high as 25-35 percent of the negative cost of a picture. For example, if this amounted to a $4 million advance as to a picture which cost $10 million, (assuming the usually required equivalent print and ad commitment to support the theatrical release), such an advance might apply against a royalty of 20-25 percent (perhaps increased after recoupment of the advance by the video distributor). A quick mathematical calculation will reveal that unless extremely successful results are obtained, the effective royalty rate in these independent deals may be as high as 40 or 50 percent, assuming normal distribution results in the video field.

Other Significant Areas of Negotiation

Interest Recoupment. Typically, the major studio definition of net profits will provide for quarterly accounting, with accountings and payment to be made within 60-90 days after the end of each quarter. Thus, significant proceeds are received by the major studio with respect to most motion pictures in the early part of the first quarter of distribution with respect to advances or guarantees from theatrical sources, and at the early stages of the second quarter of theatrical distribution as to further proceeds and thereafter in substantial increments from video-on-demand, pay-per-view and video exploitation and later free television (possibly including a very large U.S. network license fee).

Recoupment is often calculated as of the end of the quarterly accounting period and, at times, even as of the accounting date, i.e., 60 to 90 days after the end of the quarterly accounting period. Thus, for example, if $10 million of gross receipts allocable to recoupment were received at the beginning of the second quarter of distribution, that $10 million sum would be treated as having been received at the end of the second quarter for purposes of calculating accrual of interest charged to the profit participant, resulting in a "float" from the distributor's standpoint for the balance of the quarter involved. Attempts to cause proceeds to be deemed received for purposes of the calculation of interest at the point of receipt are often difficult. One common solution accepted by certain of the majors is to provide that all proceeds of a given quarter are deemed received at the midpoint of each quarter for this purpose. This usually results in a fair calculation.

The foregoing analysis is particularly significant from the standpoint of an investor who independently funds a picture. Since he has invested and is entitled to recognition of the value of his money, a midpoint calculation solution as above-described or some other similar arrangement is imperative.

Cash Method v. Accrual Method. Sometimes based upon express language in the definition of profits and on other occasions without clear support in the net profit definition, major distributors will treat all expenses and other deductions as being deductible at the time when such expenses or deductions are incurred rather than when paid (i.e., on the accrual method). By contrast, all proceeds are treated as received on the date of actual receipt (i.e., on a "cash" basis). Obviously, the profit participant suffers significantly from this type of arrangement, and efforts to obtain consistent treatment, i.e., treatment of both expenses and receipts on either the cash method or the accrual method, will meet with success on occasion with reasonable distributors - although a favorable result from a profit participant's standpoint is not typical.

Allocations of Receipts and Expenses. Net profit definitions often do not specify the manner in which gross receipts should be allocated as between the subject picture and other pictures where so-called "package" or contemporaneous sales or licenses are made. On the other side of the ledger, the definitions are often silent as to allocation of expenses incurred with respect to a number of pictures in a lump sum. It is imperative that express provisions be included in the net profit definition, that all such allocations, both as to receipts and expenses, will be on a reasonable and non-discriminatory basis.

Unfortunately, totally objective means of obtaining such reasonable allocations are not easily definable. Such issues as the stature of cast and director, box office success on a territory-by-territory basis, total negative cost, total print and advertising expenditures and other comparative factors relating to the pictures included in a single package for licensing purposes or as to which expenses are incurred in a lump sum, require consideration. In this area, even once reasonable language is included, negotiation after the fact and after audit is often necessary, and litigation is often the result. In the U.S., in at least one case, involving "The Graduate," it has been held that an anti-trust violation may result where a picture is sold as part of a package and the result may be collection of treble damages against the distributor.

Rebates and Discounts

A number of major distributors do not allow the profit participant the benefit of rebates and discounts with respect to expenses incurred, notwithstanding that the distributor involved benefits substantially therefrom. Examples are rebates from suppliers of prints and/or duplication as to video, advertising rebates relating to broadcast and other advertising, and volume and other trade discounts. Many distributors will agree to recognize and allow credit for such rebates and discounts if such a provision is sought and clearly set forth. Other distributors take the position that such rebates and discounts are the result of the overall business operation of the distributor and argue that only the distributor should have the benefit thereof.

Audit Provisions. Audit provisions often include incontestability clauses which limit the period during which audit may be undertaken after rendition of accountings. Thus, such agreements commonly include provisions limiting audit rights to a period of 12 months after rendition of accounting statements and will usually include a provision that litigation may be commenced only within 12 months after delivery by the participant of a detailed list of objections to accountings received. Such time limitations are often overlooked and should be extended by negotiation to at least 24 months in each category. Under the law of some jurisdictions, allegations of fraud on the part of the distributor will vitiate the effectiveness of such incontestability clauses.

A separate subject which can become significant is the availability to a significant profit participant of so-called "piggyback" audit rights, i.e., the right on the part of the profit participant to undertake audit of subdistributors in the event that the primary distributor has not undertaken such audit. This can become very significant if there are ulterior motives on the part of the distributor not to undertake such audit, which motives do not benefit the profit participant. Where a major distributor has its own distribution facilities throughout the world, such substitute audit rights are not particularly significant.

However, where subdistributors are used either on a territory-by-territory basis or as to specific media, such a piggyback right becomes very significant, particularly to the large profit participant or a profit participant who is an investor in the picture.

Gross Receipts Participants – Some Critical Issues

The Subdistributor Imbroglio. Suppose that an independent producer who plans to distribute his picture based upon subdistribution on a territory-by-territory basis agrees to a gross receipt participation in favor of an actor of, say, 10 percent of the gross receipts of the pictures. As traditionally defined, "gross receipts" includes all gross film rentals from theatrical, video (see discussion below), pay and free television and all other media directly from the ultimate subdistributor, after deduction of certain limited items, such as checking costs, residuals, taxes and perhaps certain cooperative advertising and other limited costs.

Assume, in the normal pattern, that the producer, having granted a gross receipts share to an actor, licenses the picture for subdistribution in France with an advance of, say, $400,000 (used by the producer, directly or through a loan, toward production costs) against a so-called "adjusted gross" arrangement pursuant to which the local French distributor agrees that said $400,000 advance is paid against a 50 percent share to the producer of "adjusted gross theatrical receipts" (i.e., 50 percent of the proceeds after deducting from gross theatrical receipts all print and advertising costs) and a royalty of, say, 20 percent of wholesale selling price as to video and the "producer's share" as to other media after a 20 percent distribution fee.

If $l million is generated as gross film rental by the French subdistributor in France from theatrical rights and $400,000 is incurred as local French distribution costs, the independent producer would be entitled to 50 percent of the remaining $600,000 as a credit against the advance from theatrical rights; if $200,000 were generated at wholesale prices from video by the French subdistributor in France, an additional 20 percent of that $200,000, or an additional $40,000, would be creditable against the independent producer's advance. Thus, the aggregate amount creditable would be $340,000 against the $400,000 advance already received, and the independent producer would receive no further amount in addition to the aggregate advance of $400,000 at this stage. In this hypothetical, however, the 10 percent gross receipts participant would be entitled to $100,000 as to theatrical exploitation and 10 percent of whatever portion of video proceeds is deemed gross receipts under his contract. He would thus effectively receive at least 25 percent of the theatrical gross amount taken out of the French territory by the independent producer plus a large portion of the video receipts. Both the independent producer and his other investors could be considerably aggrieved by such an arrangement.

As a result of the forgoing example (and much worse examples can be given), it is customary to attempt to arrange for special calculations vis-à-vis gross receipts participants where a picture is being distributed on a territory-by-territory basis. One such arrangement would be a provision that the gross receipts participation applies only to advances and overages actually received from the territory by the independent producer. Often agents and other representatives of the actor or other gross participant find this unacceptable. Other solutions include arrangements pursuant to which, as to such territory-by-territory arrangements, the gross receipts participant receives an increased portion, say, 150 percent, of his applicable participation based on the applicable advances or overages actually received. Thus, in the foregoing example, the gross receipts participant would receive 15 percent of the advance (i.e., $60,000) and of any overages, resulting in a more tolerable arrangement vis-à-vis the producer and his investors.

Even more challenging is the treatment of the gross receipts participant when advances are used for financing of the picture. Here the advance, or even possibly loan proceeds against such an advance, would trigger a participation in gross receipts prematurely. The best device in this type of case is to treat the initial fixed compensation of the gross participant as an advance against his participation at least to an extent which avoids participation until such advances exceed the production cost.

Video Receipts. Major studios usually arrange for a separate calculation vis-à-vis gross receipts participants as to video. Thus, the participant might receive a higher than normal royalty (possibly not subject to distribution fees) as to the wholesale selling price (i.e., truly constituting the gross receipts of the distributor). If this were not the case, the normal 10 percent of gross receipts applied in the case of a customary 20 percent royalty available to the whole picture might result in the gross receipts participant receiving one-half (i.e., 10 percent of wholesale selling price v. the 20 percent royalty available to the entire picture) of the video receipts available to the picture. In cases where gross participants receive as much as 15 or even 20 percent of the gross receipts of a picture, it is even more imperative that the *royalty* be deemed "gross receipts" for purposes of calculation of the gross participation.

Contingent Fixed Deferments

The issues relating to calculation of the point at which contingent deferments become payable are substantially the same as those relating to net profit calculations. The primary distinction is that contingent deferments are fixed in amount and are usually payable prior to the payment of net profit shares. Thus, such deferments are often a means by which direct cash production costs are reduced and are payable prior to payment of net profit shares on the theory that they amount merely to deferred production costs. Some of the central issues which persist are the following:

Calculation and Payment of Multiple Deferments. It is often the case that talent, facilities and equipment providers and even the producer may be entitled to contingent fixed deferred sums payable only out of proceeds from the picture after recoupment of all production, distribution and other direct costs. Such fixed sums are usually paid on a pro rata basis pursuant to which each party or entity which holds a right to a fixed contingent deferment is paid pro rata with all other such deferments. However, at times by oversight and at other times by express and intended agreement, there may be two or even three "tiers" of contingent fixed deferments. This type of structure obviously involves difficult negotiations as among the various tiers of such deferments and can result in disputes if not carefully documented.

Contingent Fixed Deferments Out of Specific Media Proceeds. A common device which has been used in independently financed pictures is the designation of specific media out of which certain types of deferments might derive. For example, if the star of a theatrical feature picture has a particularly strong television presence, such a fixed deferment might be made available out of first pay and or free television proceeds. At times, in order to recognize some allocation of such proceeds to recoupment of the production and distribution costs, such a deferment may be made available only out of such proceeds after, say, the first $500,000 of it is allocated to cost recoupment. The issue here is to make it very clear in other net profit definitions that such a deferment is deductible in arriving at net profit calculations, a point often overlooked. It is also necessary, in such cases, to make clear the fact that such a deferment is specially carved out of an arrangement pursuant to which other contingent deferments are made payable "pro rata with all other fixed contingent deferments."

---

*This paper was originally given at the IBA/CCI conference "Les Aspects Juridiques de la Commercialisation des Oeuvres Audiovisuelles" in Cannes in 1989 and published in *Copyright World* in July 1989, and was updated in January 2007.