the problem until information is inappropriately disclosed results in little opportunity for a meaningful remedy.

Federal regulations would protect the value placed on control of PHI by attaching protection to the information itself. It is more realistic to place restrictions on what can be done with acquired information than to attempt detailed regulation of this rapidly evolving industry.209 While users should also participate in the protection of their personal information through use of the privacy settings afforded, deceptive privacy advertisement and obtuse privacy policies should not render this participation meaningless. Preemptively establishing a set of federal regulations as a benchmark for addressing these kinds of issues before they arise will help mitigate the harms that are otherwise sure to follow. Federal regulations requiring meaningful privacy disclosures and truthful advertising, establishing guidelines for use of PHI, and providing causes of action with precedential value would keep pace with reality of the evolution of online social networking.

Federal regulations protecting PHI would fill the gap in the current law, provide meaningful dispute resolution options and remedies, and delineate concrete expectations for all participants. The permanence of information posted online heightens the need for this sort of protection.210 It is all too likely that information posted will become a permanent part of an individual’s “digital” persona without the mercy of short human memory.211 Such a framework will have broad applicability as more and more interactions move toward online exchanges.

209. See supra Part IV.A.

210. See supra Part III.B.

211. Abril, supra note 19, at 75 (discussing how “the digital record has increased the stakes of privacy today. . .”).

HIT LOSERS: THE GOOD (FAITH) FIGHT FOR NET-PROFITS PAYMENTS FROM BLOCKBUSTER HOLLYWOOD PRODUCTIONS

Max Bialystock: You were saying that, under the right circumstances, a producer could make more money with a flop than he could with a hit.

Leo Bloom: Yes. It’s quite possible.

Max Bialystock: You keep saying that, but you don’t say how!

Leo Bloom: Well, it’s simply a matter of creative accounting.1 Gould: I think conservatively, you and me, we build ourselves in to split, ten percent. (Pause.)

Fox: Of the net.

Gould: Char. Charlie: Permit me to tell you: two things I’ve learned, twenty-five years in the entertainment industry.

Fox: What?

Gould: The two things which are always true.

Fox: One:

Gould: The first one is: there is no net.

Fox: Yeah . . . ? (Pause.)

Gould: And I forgot the second one.2

Neal Robin3

I. INTRODUCTION

Contracts for services on an entertainment project contain many of the same provisions as those found in any commercial venture. These contracts include provisions describing the nature of services to be performed and the compensation to be provided in exchange for those services during the course of the agreement. Sought-after Hollywood actors, directors, and producers are able to secure additional concessions from the studios that hope to gain their


3. J.D. Candidate, 2013, Case Western Reserve Univ. School of Law; Northwestern University School of Law, Law Student, 2012-13; B.A., 2007, Emory University, with departmental distinction in History. I would like to thank the attorneys whom I interviewed for their guidance in preparing this Note, as well as their clients, for giving me something to write about. And I would like to thank my family—especially my mother—for funding my education and Ashley Hartman for her patience and support.
participation on the project. For these individuals, the standard contract between Hollywood studios’ and creative talent’s provides compensation in addition to a salary in the form of “net profits.” If the entertainment project takes in more revenue than it costs to produce—after all necessary deductions are made from its budget—the creative talent will collect a percentage of the net profits as set out in their services agreement.

But most films and television series are not financial successes, leaving creative talent to collect only their salaries and move on to the next project. Back-end compensation, while an important feature of an agreement for creative talent, is not always the highest priority. However, a limited number of projects surpass the studio’s most optimistic expectations and become major blockbusters at the box office or in the Nielsen ratings. When it becomes apparent that a project will generate enough revenue to contemplate net-profits compensation, creative talent will often insist on remuneration. The process then becomes trickier, as studios resist making net-profits payments on the assertion that the project did not earn enough money according to their calculations.

In the entertainment industry, the major studios calculate and report a project’s financial condition using esoteric accounting practices that differ from those used outside Hollywood. These calculations frequently reach the conclusion that the film or television series earned zero profits for those promised compensation contingent on the project’s financial success. Creative talent—who are, in this circumstance, called profit participants—learn that they will receive diminished or no contingent compensation for a film that earns hundreds of millions of dollars at the box office or commands tens of millions of TV viewers for each new episode. Even though attorneys and talent representatives lower the creative talent’s expectations for contingent compensation at the outset, they nonetheless complain that the project has been so profitable that it cannot possibly have failed to earn enough money to distribute net-profits payments. Critics of Hollywood studios deride this method of accounting, calling it “Hollywood accounting.”

This phenomenon has a long tradition in Hollywood. For example, the film Batman earned more than $250 million at the box office and was one of the top ten grossing films of all time when released in 1989. Nevertheless, Warner Brothers, the studio that produced the film, reported a loss of $36 million. Thus, no payment of net profits was made to profit participants. When the executive producers of the film challenged their participation-accounting for creative talent, is not always the highest priority. However, a limited number of projects surpass the studio’s most optimistic expectations and become major blockbusters at the box office or in the Nielsen ratings. When it becomes apparent that a project will generate enough revenue to contemplate net-profits compensation, creative talent will often insist on remuneration. The process then becomes trickier, as studios resist making net-profits payments on the assertion that the project did not earn enough money according to their calculations.

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"Profit participant" is a term used to refer to recipients of net profits, particularly creative talent and investors in motion pictures and television series. See, e.g., *Sills & Axelrod v. Walt Disney Co.*, supra note 8 (detailing the profits and costs associated with making *Batman* in 1988), *Batman* (Warner Bros. 1989), earning roughly $250 million in worldwide box office but showing a loss of $17 million (cited in *Cubiclofs v. Walt Disney Co.*, supra note 9 (C.D. Cal. 2004) (profit participant disputes that his 50-percent share of profits amounted to zero dollars according to the studio's calculation)).

"Box office" is the total amount of money the moviegoers spent on ticket sales at the theaters.
statements, the court found in favor of the studio, rendering the producers unable to recover additional compensation. Profit participants have to surmount significant legal hurdles to recover the share of net profits they expected to earn in connection with their contracts. The studio-talent relationship is unique in that it carries duties in addition to those found in ordinary contracts. Studios take on the duty to collect revenues and distribute net profits on behalf of profit participants. Participants themselves play no role in the collection-and-distribution efforts. Thus they are beholden to studios to calculate their payments completely and properly. In addition, participants accuse studios of harnessing their superior bargaining position to play games with a project’s financial statements to the participants’ detriment. In its defense, the studios dispute this characterization of their behavior. They insist that the studio-participant relationship is merely a contract for services for which no additional duties are owed beyond those the contract sets forth. They assert that participants know precisely how their compensation is measured, since it is outlined in agreements their representatives negotiated and they themselves signed. Studios contend that, in filing suit, a participant is attempting to unwind a contract carrying unfavorable consequences, which is not a proper judicial function. In defense of this position are courts themselves, which have recognized and supported the studio’s view in high-profile cases.

Disputes surrounding net-profits payments carry high stakes. Owners of entertainment projects that achieved commercial and popular success often wish to capitalize on their popularity. They do so by licensing the intellectual property associated with the production in several media—including broadcast syndication, merchandise rights, theme-park attractions, and online distribution. Profit participants stand to earn considerable sums from these revenue streams, but only a handful of them have the patience and pocketbooks necessary to support the expense of strenuous legal battles against sophisticated and deep-pocketed studios. As of late, a growing number of agreements for creative talent contain provisions mandating arbitration to resolve disputes surrounding payments of net profits. Despite long odds, California judges and juries have recently rendered favorable decisions for profit participants, in each case finding that the studio took deliberate steps to dodge payment of net profits. The courts in Ladd v. Warner Bros. Entertainment, Inc. and Celador International, Ltd. v. The Walt Disney Company ordered studios to pay multimillion-dollar judgments because they violated the implied covenant of good faith and fair dealing by undermining the participant’s expectation of receiving net-profit compensation for their work on a successful project. But in other cases California courts have found for the studio, rejecting good-faith claims by participants where the studio entered into promotional agreements with third parties for which the studio (and thus the participant) did not earn monetary compensation. Such narrow but momentous rulings may spur creative talent to review financial statements containing suspicious numbers. In addition, recent court decisions will likely push studios to reexamine how they calculate and report on a project’s profitability.

20. Batfilm Prods., Inc. v. Warner Bros., Inc., Nos. BC 051653 and BC 001654 (Cal. Super. Ct. 1994) (finding for the studio because the claim for unfair competition was dependent on finding that “net profits” contract was unconscionable).
24. See infra note 105 (explaining fiduciary relationships in contracts).
28. See MOORE, supra note 7, at 203 (explaining that litigation is expensive and should be avoided).
33. See Ladd, 184 Cal. App.4th at 1308-12; Celador, 347 F.Supp 2d at 852-53.
34. See infra Part III(C) (providing examples of relevant case law).
35. See infra Part IV (discussing the implied covenant of good faith and fair dealing).
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The purpose of this Note is twofold. First, it examines how profit-participation agreements are structured. Second, it explains court decisions where these agreements were challenged on the bases of either breach of fiduciary duty or the implied covenant of good faith and fair dealing. Section II explains the term “net profits” and describes factors influencing a participant’s ability to earn such compensation. Section III analyzes how participants, at least initially, failed to persuade courts that the right of contingent compensation gives rise to a fiduciary relationship. It goes on to describe how courts have been backing away from this position; indeed, courts have demonstrated willingness for fiduciary-duty claims to proceed beyond the pleading stage. Section IV discusses decisions where courts found violations of the implied covenant in profit-participation agreements.

This Note concludes by suggesting a legal theory of contingent compensation that may inform parties as they decide whether to have a legal forum resolve their disputes. It suggests that a contractual right of contingent compensation should include an implied right of reasonable access to financial information and an accounting of revenues that is reasonably accurate under the circumstances. It also asserts that creative talent will struggle to convince a court that a studio impiously owes talent fiduciary duties on the basis of a contractual right of contingent compensation—unless talent demonstrates that the studio-talent relationship is legally cognizable as fiduciary. Such a finding requires more than a contractual right of contingent compensation.

II. Net Profits

“When I use a word, it means just what I choose it to mean.” – Humpty Dumpty

A. Nothing But Net: An Overview of Net Profits and Hollywood Accounting

“Net profits” refers broadly to the wealth an entertainment project has accumulated after specified expenses are deducted from its budget. As a term defined in an agreement, net profits contains no fixed meaning as a matter of law; instead, its meaning depends on what the parties bargained for in each agreement. Generally the term provides for the deduction of a project’s gross receipts—the total amount of revenue a project has generated—and certain expenses incurred in the course of production. These expenses are also defined in the contract, but are typically called “production costs,” “distribution fees,” and “distribution expenses.” But the baseline measure from which contingent compensation will be calculated can also vary by agreement. For instance, it is not uncommon for contingent compensation to be based on a project’s “adjusted gross receipts,” “gross receipts after break-even,” and the like.

Since these defined terms contain many of the same words and sound similar to each other, it is not uncommon for profit participants to misunderstand which revenue streams are included in calculations of net profits. And when profit participants complain that the participation statement contains inaccurate or incomplete payments of contingent compensation, the meaning of net profits becomes a kind of Rorschach test for opposing parties to dispute. Put simply, participants want a high figure reported while studios want to report a low figure.

Participants complain that the definition of net profits is poorly written and a nightmare to decipher once the amount is a source of dispute. Since the term lacks clarity, it invites studios to play games with the numbers; thus, studios can pay any amount of contingent compensation while maintaining fidelity to the formula set forth in the agreement. As such, every lawyer who negotiates his client’s participation agreement should fully understand how the payment is measured. Calculating back-end compensation should therefore be a matter of straightforward arithmetic. Disputes

38. See, e.g., Roman Silberfeld and Bernice Conn, The Red and the Black, L.A. LAW., May 2011, at 39 (explaining that several contractual definitions are used to explain net profits, including but not limited to, “defined proceeds,” “contingent proceeds,” “defined receipts,” “defined contingent compensation,” and “contingent bonus”). Although there is no “standard net profit participation agreement,” the contracts of major studios contain similar terms and formulae.

39. See id.

40. MOORE, supra note 7, at 9 (providing definitions)

41. Id. at 149.

42. See id.


44. See id.

45. Id.
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37. See **MOORE, supra note 7, at 7** (providing a definition of net profits).
surrounding the appropriate measure of contingent compensation have prompted a great amount of litigation. 46

1. Gross Receipts: How Studios Minimize the Amount of Contingent Compensation Owed to Participants

For Hollywood studios, any given film or television series counts only as one of many investment projects. According to Schuyler Moore, a prominent Hollywood attorney, a studio’s financial interests dictate the formula used to calculate a project’s financial condition, rather than a desire for a precise snapshot of its finances. 47 For instance, for purposes of gross receipts, studios want to accelerate the payment of expenses and delay the reporting of payments as long as possible because the time value of money makes the total cash available to make distributions less valuable. 48

Until Ladd v. Warner Bros., Entertainment, Inc., 53 studios minimized the amount of gross receipts generated by a project by allocating income away from hit films to those that were not financial successes through a practice known as “straight lining.” 50 Licensing fees derived from packaging a slate of films to license to cable companies for broadcast is a source of studio income. 51 Revenues earned from the licensing package have to be allocated to the films that formed the package. For purposes of illustration only, the blockbuster film Titanic 52 might be included in the same package as the film John Carter. 53 Despite the disparity in success, the studios, given their proximity to financial information, have the opportunity to allocate a disproportionate amount of the licensing fee to the flops to minimize the amount calculated for purposes of net-profits payments owed to participants in successful films. 54 Tactics similar to straight lining arise in the context of calculating revenues earned from the sale of home videos and DVDs. As Moore notes, the industry practice is to include twenty percent of gross receipts from such sales for purposes of paying profit participants. 55 A participant is entitled to a fraction of those earnings as the basis for calculating his payment of net profits. 56 To illustrate, if a film earns $100 from the sale of home videos, a participant entitled to five percent of net profits earns five percent of $20, not five percent of $100, reducing the prospect of contingent compensation.

2. Distribution Fee: How Studios Further Minimize the Amount of Contingent Compensation Owed to Participants

The standard contract contains language allowing the studio to deduct the cost of production. 57 For a film production, a studio does not incur expenses for use of its facilities, but will nevertheless assign excess costs for using the sound stages, equipment, etc. that is greatly in excess of the actual costs. 58 For purposes of illustration, if a film earns $20,000 in profits, the studio will deduct the cost of production, determined in the customary manner producer accounts for production cost at the time the picture is produced."


47. MOORE, supra note 7, at 149 (introducing the various methods studios use to calculate project financials).

48. Id.


50. See infra Part IV.C.

51. See infra Part IV.C

52. TITANIC (Twentieth Century Fox 1997).

53. JOHN CARTER (Disney 2012).

54. See infra Part III.B.

55. MOORE, supra note 7, at 151.

56. Id.

57. See, e.g., Silberfeld & Conn, supra note 37, at 36 (“Vertically integrated media conglomerates own most of the entities involved in the production, distribution, and merchandising of properties, so it is not difficult for them to manipulate the accountings to ensure that no contingent compensation ever will be shared with profit participants.”).

58. Joseph F. Hart & Philip J. Hacker, Less than Zero, L.A. LAW., Apr. 1996, at 34, 38 (“The [Standard Profit Definition] contains language that permits the studio to deduct the cost of production, determined in the customary manner producer accounts for production cost at the time the picture is produced.”).

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Practices that are more controversial include charging fees that bear no reasonable relation to the actual costs incurred and erroneous calculations that place productions in the red when they should be in the black. For instance, in a suit filed against Warner Brothers, the film producer Alan Ladd, Jr. claimed the studio assigned costs to the


47. MOORE, supra note 7, at 149 (introducing the various methods studios use to calculate project finances).

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production of the film Blade Runner without explanation. Upon audit, it was revealed that the studio accounted improperly for the negative cost (i.e., the cost of making the movie) of the film by charging Ladd the full amount of the production payment ($15.8 million) instead of his portion of the payment ($7.9 million).

B. Roadblocks Encountered by Participants in Obtaining an Accurate and Complete Calculation of Contingent Compensation

Creative talent are highly suspicious of how studios arrive at financial conclusions because studios negotiate transactions for licensing the intellectual property of the project and allocate net-profits payments on the basis of revenues collected and calculated internally. Talent does not have the bargaining power to negotiate changes of any material provisions of a net-profits formula. However, it is customary for studios to grant participants a limited right to audit the project's books and records. Financial statements are delivered to participants on a quarterly or semi-annual basis, reporting the project's income statement. For participants, exercising the right to audit provides an opportunity to cure reporting errors on the studio's accounting statements—but they are not provided access to every financial record.

Despite having the right to audit, inspecting a project's books and records is a time-consuming and costly endeavor. Participants who exercise their right to audit wait as long as eighteen months to gain access to financial records at a cost ranging from $20,000 to $100,000, depending on the size of the production. The auditor's findings serve as the basis of protracted negotiations to correct errors or make additional allocations to the participant. Errors that are revealed upon audit range from those that are clerical in nature—and fixed by the studio without complaint—to those that seem intentional. Yet an auditor's findings are limited, since participants are deprived of complete access to the financial records. As a practical matter, representatives of the studio and the participant negotiate a settlement for a fraction of what the participant claims to be entitled to in connection with his contract.

C. Forms of Hollywood Accounting

Hollywood accounting practices differ from those generally utilized in other commercial industries. Generally Accepted Accounting Practices (GAAP) govern the procedures of reporting costs and revenues in most commercial industries to enable a firm's board of directors to hold managers responsive to shareholders for their performance. Instead of GAAP, the film and television industries are supposed to follow the guidelines set forth in the Financial Accounting Standards Bulletin 53 (FASB 53), which encourages studios and television networks to use the accrual method of accounting in its productions.

62. It is worth noting that this arrangement is not unlike a manufacturer-distributor relationship in any other industry, where A hires B to distribute A's product. B distributes the product to X, Y, and Z. A then pays B a portion of the proceeds. Or a lessor-lessee relationship where a tenant pays his pro-rata share of utilities based on the building's total utilities bill. The tenant can audit the landlord's books if he bargains for an audit right.
63. See Stein & Harris, supra note 21, at 30 (discussing how studies employ methods to retain nearly all the power in the studio-talent relationship).
64. Moore, supra note 7, at 154-55.
65. Id.
66. Id.
67. Id.
production of the film *Blade Runner* without explanation. Upon audit, it was revealed that the studio accounted improperly for the negative cost (i.e., the cost of making the movie) of the film by charging Ladd the full amount of the production payment ($15.8 million) instead of his portion of the payment ($7.9 million).61

B. Roadblocks Encountered by Participants in Obtaining an Accurate and Complete Calculation of Contingent Compensation

Creative talent are highly suspicious of how studios arrive at financial conclusions because studios negotiate transactions for licensing the intellectual property of the project and allocate net-profits payments on the basis of revenues collected and calculated internally.62 Talent does not have the bargaining power to negotiate changes of any material provisions of a net-profits formula.63 However, it is customary for studios to grant participants a limited right to audit the project’s books and records.64 Financial statements are delivered to participants on a quarterly or semi-annual basis, reporting the project’s income statement.65 For participants, exercising the right to audit provides an opportunity to cure reporting errors on the studio’s accounting statements—but they are not provided access to every financial record.66

Despite having the right to audit, inspecting a project’s books and records is a time-consuming and costly endeavor. Participants who exercise their right to audit wait as long as eighteen months to gain access to financial records67 at a cost ranging from $20,000 to $100,000, depending on the size of the production.68 The auditor’s findings serve as the basis of protracted negotiations to correct errors or make additional allocations to the participant. Errors that are revealed upon audit range from those that are clerical in nature—and fixed by the studio without complaint—to those that seem intentional.69 Yet an auditor’s findings are limited, since participants are deprived of complete access to the financial records.70 As a practical matter, representatives of the studio and the participant negotiate a settlement for a fraction of what the participant claims to be entitled to in connection with his contract.71

C. Forms of Hollywood Accounting

Hollywood accounting practices differ from those generally utilized in other commercial industries. Generally Accepted Accounting Practices (GAAP) govern the procedures of reporting costs and revenues in most commercial industries to enable a firm’s board of directors to hold managers responsive to shareholders for their performance.72 Instead of GAAP, the film and television industries are supposed to follow the guidelines set forth in the Financial Accounting Standards Bulletin 53 (FASB 53), which encourages studios and television networks to use the accrual method of accounting in its productions.73 Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, rather than when cash is exchanged.74

62. It is worth noting that this arrangement is not unlike a manufacturer-distributor relationship in any other industry, where A hires B to distribute A’s product. B distributes the product to X, Y, and Z. A then pays B a portion of the proceeds. Or a lessor-lessee relationship where a tenant pays his pro-rata share of utilities based on the building’s total utilities bill. The tenant can audit the landlord’s books if he bargains for an audit right.
63. See Stein & Harris, supra note 21, at 30 (discussing how studios employ methods to retain nearly all the power in the studio-talent relationship).
64. Moore, supra note 7, at 154-55.
65. Id.
66. Id.
67. Id.
69. Id.
70. Moore, supra note 7, at 155 (“[A]uditors are spoon-fed limited books and records of the film company (and not of its affiliates). For example, auditors are almost never given access to the general ledger or underlying contracts that would show unreported income or rebates.”).
71. Stein Interview, supra note 67.
72. See, e.g., Silberfeld & Conn., supra note 37, at 39 (“For example, in *Celador Int'l, Ltd. v. Walt Disney Co.*, 347 F. Supp.2d 846 (C.D. Cal. 2004)), an incomplete, two-page exhibit describes ‘defined contingent compensation’ in the contract among Celador, ABC, and Buena Vista Television. The description states, in part: ‘For purposes of Defined Contingent Compensation, Participant agrees that words and phrases used in connection with Participant’s contingent participation, if any, are . . . not intended to correspond to any conventional understanding or dictionary definition of such words and terms, whether used in the entertainment industry or any other industry or business and are not intended to correspond in any way to generally accepted accounting principles [GAAP], or any other meanings thereof, which may be associated with the practices of accounting or auditing.’”).
accounting, an entity records revenues on its balance sheet when they are earned and records expenses when they are incurred.\textsuperscript{74}

But studios and participants abandon these guidelines regarding net-profits payments and instead agree to have the agreement itself dictate the method of calculation, often removing the protections shareholders enjoy through GAAP and FASB.\textsuperscript{53,75} Given considerable leeway, studios can maintain and report financial statements disclosing different sets of numbers to shareholders and participants. Attorney Bruce Belenky has explained how a studio can minimize its obligation to pay contingent compensation:

[The studio] may recognize revenue when it is actually received, while taking expenses when incurred. [That means that when a studio licenses a project to a third party, the studio] may not count the license fee as revenue until it actually receives it. Even when they receive a non-refundable advance, they might not count it as income until the time of the broadcast. Meanwhile, they count expenses as soon as they are incurred, even if they have not paid them. This mismatching of revenues and expenses allows the [studio] to delay payment to participants.\textsuperscript{76}

D. Vertical Integration

In the television industry, the consolidation of media companies into a small number of vertically integrated companies has enabled studios and television networks to produce and broadcast programs that they themselves own.\textsuperscript{77} After the repeal of the Financial Interest and Syndication Rules in 1995,\textsuperscript{78} a studio—such as Walt Disney Pictures—could acquire a television network—such as ABC—which in turn could acquire a distribution arm—such as Buena Vista Television—that designates a production company to produce and license a television show for broadcast on networks and later for syndication to cable companies that share a corporate parent.\textsuperscript{80}

Vertical integration enabled Disney to control television programs like \textit{Who Wants to be a Millionaire?}\textsuperscript{81} through subsidiary companies,\textsuperscript{82} all under a previously prohibited ownership structure.

Critics of vertical integration argue that this ownership model allows an integrated company to "dictate the financial terms of distribution and syndication because it controls the licensor and licensee of the rights in the property."\textsuperscript{83} Profit participants complain that integrated companies use leverage to structure transactions in a manner that delays, diverts, or eliminates payments of contingent compensation.\textsuperscript{84} Some profit participants have even filed suit against studios, alleging that the studio or network did not seek the highest possible licensing fee for broadcast rights as it could have obtained if affiliated companies did not sit on each side of the bargaining table.\textsuperscript{85}

E. Rising Costs of Production and Novel Forms of Payment of Contingent Compensation Reduce Probability for Net-Profits Participants to Collect Payment

Since most films and television series produced in Hollywood fail to earn a positive return on its investment, studios offer the promise of contingent compensation so talent can share in a project's financial success.\textsuperscript{86} Moore puts the matter simply: "Most films lose money!"\textsuperscript{87} In the television industry, it is customary for a network television show—one airing on ABC, NBC, CBS, or FOX—to air 100 original

\begin{footnotesize}
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\item \textsuperscript{74} Hart & Hacker, supra note 57, at 36.
\item \textsuperscript{75} Id.
\item \textsuperscript{76} Bruce Belenky, \textit{Film Studio Accounting Issues}, \textit{Belenky Law} (Jan. 19, 2012), http://belenkylaw.com/2012/01/film-studio-accounting-issues/.
\item \textsuperscript{77} See Stein & Harris, supra note 21, at 30 (describing how vertical integration allows conglomerates to control the process of producing and distributing media).
\item \textsuperscript{78} 47 C.F.R. § 73.658 (1970) (restricting the number of programs a network could own on its prime time television schedule, prohibiting networks from syndicating the programs they owned, and preventing them from sharing in profits).
\item \textsuperscript{79} See Broad. Serv.; Television Station Ownership, 60 Fed. Reg. 58, 15688 (Mar. 27, 1995) (allowing television networks to own, produce, distribute, and syndicate programs without restriction).
\item \textsuperscript{80} Id.
\item \textsuperscript{81} \textit{Who Wants to be A Millionaire?} (Valleycrest Prod. 1999). Each of the entities identified in this example was an affiliate or subsidiary of The Walt Disney Co. when \textit{Who Wants to be a Millionaire?} was produced.
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\item \textsuperscript{85} Id. at 34-35 (noting that studios have a great deal of leverage of clients in the contract negotiation process).
\item \textsuperscript{86} Id. at 32 (listing self-dealing claims brought by profit participants against media conglomerates that ultimately settled out of court).
\item \textsuperscript{87} See \textit{Moore}, supra note 7, at 13 (claiming that 80% of movies fail to recoup their production and distribution costs); Sills & Axelrod, supra note 8, at 31 (estimating the standard studio contract results in profits for the participant in less than five percent of all films released).
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episodes or more to gain access to the lucrative syndication market. Hit projects offset the losses incurred from failures, incentivizing owners to limit contingent compensation paid to profit participants. The result is a paradox. Disputes over payment of contingent compensation arise most frequently when a project is a blockbuster success, meaning it is unlikely for a studio to avoid payment by claiming that there is no pool of net profits from which to draw funds. Additionally, the likelihood that a film or television show will yield net profits has diminished as a result of rising production and distribution costs and increasing payments to high-profile creative owners. To limit contingent compensation paid to profit participants. The result is a paradox. Disputes over payment of contingent compensation arise most frequently when a project is a blockbuster success, claiming that there is no pool of net profits from which to draw funds. Outside of gross-participation agreements for megawatt celebrities, even star actors face obstacles in recouping profits. For instance, actor Leonardo DiCaprio faced this problem following the blockbuster success of Titanic. DiCaprio earned $1.8 million plus 18% of net profits in connection with the film. Yet, after it earned a total of $2 billion in global box office receipts and won the 1997 Academy Award for Best Picture, the film’s studio told DiCaprio that he did not receive a net profits payment because Titanic did not earn a profit (for his next film, DiCaprio received a guaranteed salary of $20 million). After the film Good Will Hunting earned $226 million in worldwide box office, actor Ben Affleck recalled, “We had gotten an accounting statement that said the movie was $50 million in the red, and it was just like, 100. This is fucked! You had to do some great accounting to hide net profits on that movie.”

III. FIDUCIARY DUTIES AND THE STUDIO-PARTICIPANT RELATIONSHIP

A fiduciary relationship exists where one of the parties has a professional duty to act with the utmost good faith for the benefit of the other party. The relationship is founded upon the trust and confidence reposed by one person in the integrity and fidelity of another and prohibits the duty-holder from exploiting his position for personal gain. In commercial relationships, such as those between attorneys and clients, trustees and beneficiaries, partners in a partnership, and members of a joint venture, fiduciary duties arise as a matter of law. Outside of those formal relationships, where no fiduciary relationship is stipulated in the parties’ agreement, such duties may arise by the conduct of the parties. Fiduciary obligations create a higher standard of care than those otherwise owed by the parties.

95. GOOD WILL HUNTING (Miramax 1997).

96. PETER BISKIND, DOWN AND DIRTY: PICTURES, MIRAMAX, SUNDANCE, AND THE RISE OF INDEPENDENT FILM 310 (2004) (describing how the profit participants in Good Will Hunting would have been required to pay for an audit if they wanted to contest the amount paid to them under their contingent compensation agreement).


100. Id. (discussing fiduciary relationships where “the relation and the duties involved . . . need not be of a legal character, but may be moral, social, domestic, or merely personal”).

101. See MEINHARD v. SALMON, 249 N.Y. 458, 464 (1928) (“Joint-adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty”).
episodes or more to gain access to the lucrative syndication market.\(^8\) Hit projects offset the losses incurred from failures, incentivizing owners to limit contingent compensation paid to profit participants.\(^9\) The result is a paradox. Disputes over payment of contingent compensation arise most frequently when a project is a blockbuster success, meaning it is unlikely for a studio to avoid payment by claiming that there is no pool of net profits from which to draw funds.

Additionally, the likelihood that a film or television show will yield net profits has diminished as a result of rising production and distribution costs and increasing payments to high-profile creative talent.\(^90\) In which films end up in theatres and to demand contingent compensation based on a film’s gross receipts, regardless of the film’s net profits.\(^91\) Outside of gross-participation agreements for megawatt celebrities, even star actors face obstacles in recouping profits.\(^92\) For instance, actor Leonardo DiCaprio faced this problem following the blockbuster success of Titanic. DiCaprio earned $1.8 million plus 18% of net profits in connection with the film. Yet, after it earned a total of $2 billion in global box office receipts and won the 1997 Academy Award for Best Picture, the film’s studio told DiCaprio that he would not receive a net profits payment because Titanic did not earn a profit (for his next film, DiCaprio received a guaranteed salary of $20 million).\(^93\) After the film Good Will Hunting\(^94\) earned $226 million in worldwide box office, actor Ben Affleck recalled, “[W]e had gotten an accounting statement that said the movie was $50 million in the red, and it was just like, This is fucked! You had to do some great accounting to hide net profits on that movie.”\(^95\)

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Fiduciary obligations create a higher standard of care than those between parties to an ordinary contract.\(^100\) The justification for a heightened standard of care is based on the parties’ exposure to conflicts of interest.

89. Connors, supra note 42, at 843 (noting “suspicion and resentment continue to surround the net profits formula, now derivatively referred to as “Hollywood accounting”.”)
90. Id. at 847 (analyzing the current net profits formula).
92. See Epstein, supra note 5, at 69 (noting that talent agencies increased movie star compensation by eschewing long-term contracts for single-project contracts).
94. Id.
opportunities where the fiduciary could betray the trust of the beneficiary, claiming an opportunity for himself without sharing information with the beneficiary and thereby depriving the beneficiary of the relationship benefits.102

Profit participants routinely allege that the studio-participant relationship is a fiduciary relationship extending beyond those contemplated in an ordinary employer-employee relationship.103 Profit participants argue they are entitled to heightened protections because studios take on the duty to collect revenues and distribute profits on behalf of participants, who play no role in the collection and distribution efforts.104 The profit participant relies on the studio to provide good faith and accurate profit reporting in connection with his contractual right to contingent compensation.105 The studio's exclusive control of the monies should give rise to a fiduciary relationship, because participants repose trust in the studio to provide revenue accounting.106 However, a fiduciary relationship between studios and profit participants would likely impose duties on the studio that undermine its negotiated terms in participation agreements. Profit-participation agreements are either silent on forming a fiduciary relationship or disclaim explicitly any such relationship.107

In litigation, participants often lose breach of fiduciary duty claims on the pleadings, as it is difficult to demonstrate that a studio-participant contractual relationship is more than an ordinary contract bargained for at arm’s length.108 In an ordinary contractual relationship, the parties do not owe each other any duties beyond those set forth in the contract.109 Nonetheless, some participants have achieved limited success in some circumstances in having a court recognize a fiduciary relationship between a studio and a participant.110

A. Courts Do Not Recognize a Fiduciary Relationship in an Exclusive Distribution Agreement But Suggests a Duty to Account For Revenues

Creative talent challenging their diminished or complete lack of contingent compensation base their argument for finding a fiduciary relationship on a fifty-year-old decision suggesting a duty to account for revenues earned in connection to a film's distribution. In Waverly Productions, Inc. v. RKO General, Inc.,111 a producer formed an agreement with a studio to distribute two of the producer's films around the globe and required payment of profit participation based on revenues earned from the distribution of the films.112 The distributor, RKO, sublicensed the distribution rights to foreign distributors and otherwise made sparse efforts to distribute the films.113 Waverly, the producer, sued, claiming RKO's conduct constituted a breach of fiduciary duty.114 The court rejected Waverly's claim, holding "[t]he [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."115 But the court went on to note "[i]t is clear that RKO was not a fiduciary with respect to the performance of the terms of this contract (except as to accounting for rentals received) and that arguments predicated on the assumption that it was are directed at a false issue."116

The dictum from Waverly was recognized in Recorded Picture Co. (Productions) Ltd. v. Nelson Entertainment, Inc.117 in which the court found that no fiduciary relationship existed between a film producer and distributor, and further, that no fiduciary relationship existed between a film distributor and subdistributor, who have no

102. Id. ("A trustee is held to something stricter than the morals of the marketplace."). See also Robert Flannigan, Commercial Fiduciary Obligation, 36 ALBERTA L. REV. 905, 906 (1988) ("The common characteristic of persons generally acknowledged to be fiduciaries is that they possess access to property or assets for a defined or limited purpose").

103. See Stein & Harris, supra note 21, at 33 (discussing how profit participants attempt to dispel the studios' assertions that no fiduciary relationship exists in the studio-profit participant relationship).

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109. See infra Part III.A.

110. See infra Part III.C.


112. Id. at 724-27.

113. Id. at 728 (detailing RKO's ability to sublicense distribution rights to foreign distributors under the agreement).

114. Id. at 724.

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110. See infra Part III.C.
112. Id. at 724-27.
113. Id. at 726 (detailing RKO's ability to sublicense distribution rights to foreign distributors under the agreement).
114. Id. at 724.
115. Id. at 731-32.
116. Id. at 734 (emphasis added).
privity of contract. In *Recorded Picture*, the parties disputed the amount of money owed to the producer from the sale of home videos of the film *The Last Emperor*. The producer, *Recorded Picture*, entered into a distribution agreement with the Hemdale Film Corp. that required all subdistributors to pay a percentage of the proceeds directly to *Recorded Picture*, but Hemdale did not notify Nelson Entertainment, one of the subdistributors, of this requirement. After Hemdale filed for bankruptcy, *Recorded Picture* instead of the fifty percent Nelson initially arranged in the subdistribution agreement with Hemdale. The court found that Nelson was not bound by the same terms as Hemdale because no duty to the producer to provide an accounting of proceeds existed that would give rise to an obligation to account for profits. But the court, following *Waverly*, added that a contractual relationship between Hemdale and Nelson gave rise to a "fiduciary duty to the producer to provide an accounting of proceeds received." In other words, studios find support in court decisions where an agreement grants the distributor an exclusive right to distribute films and requires him to pay a percentage of the proceeds to the owner. The parties do not form a special relationship in these instances.

In other areas of the entertainment industry, courts have recognized the requirement to pay money to a contractual partner creates nothing more than a creditor-debtor relationship. For example, in *Oakland Raiders v. National Football League*, the appellate court affirmed summary judgment granted in favor of the professional football league, holding the league's obligation to allocate payments from subdistributors.

118. *Id.* at 374 (holding for the defendant, Nelson).
119. *Id.* at 356; *The Last Emperor* (Columbia Pictures 1987).
120. *Recorded Picture*, 53 Cal. App.4th at 357 (stating the provision was put into the contract because producer "did not trust" distributor to collect payments from subdistributors).
121. *Id.* at 356.
122. *Id.* at 363 ("We decline to adopt the rule proposed by the producers—that a company must comply with a contract to which it is not a party if it has accepted even a portion of the benefits of that contract through a subsequent, separate agreement with one of the original contracting parties. Such a rule would lead to absurd consequences").
123. *Id.* at 371 n.10.
124. *See, e.g.*, Arnold Prods., Inc. v. Favorite Films Corp., 298 F.2d 540, 542 (2d Cir. 1962) (characterizing the parties' agreement as an arm's-length contract that does not rise to level of fiduciary).
125. *Id.*
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**B. A Fiduciary Relationship is Recognized Based on the Nature of the Parties' Dealings**

Participation agreements routinely disclaim the formation of any heightened relationship between the studio and the talent participant or ignore mention of it entirely. In litigation, profit participants attempt to transform breach of contract claims into tort claims alleging reliance upon the studio to report the project's revenues completely and accurately. When the studio exercises exclusive control over a project's financial information, the participant may argue that a fiduciary relationship has been formed by implication, meaning the burden of proof shifts to the studio to disprove the existence of a fiduciary relationship. Courts seldom accept such implied fiduciary-duty claims, and frequently dismiss them on the pleadings. However, on rare occasions, these fiduciary duty claims survive motions for summary judgment.

Despite disclaimers or silence in agreements, courts are willing to find fiduciary relationships where the parties' conduct gives rise to an association characterized as a partnership or joint venture. For instance, in *April Enterprises v. KTTV*, the renowned ventriloquist Paul Winchell entered into an agreement with a television station, KTTV, to produce a children's television program. The contract contained a profit-sharing provision in the event the program entered into the syndication market. Years after the program's broadcast ended, the ventriloquist discovered that the station erased tape recordings of the program, removing the program entirely from its

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122.  *Id.* at 363 ("We decline to adopt the rule proposed by the producers—that a company must comply with a contract to which it is not a party if it has accepted even a portion of the benefits of that contract through a subsequent, separate agreement with one of the original contracting parties. Such a rule would lead to absurd consequences").
123.  *Id.* at 371 n.10.
124.  *See, e.g.*, Arnold Prods., Inc. v. Favorite Films Corp., 298 F.2d 540, 542 (2d Cir. 1962) (characterizing the parties' agreement as an arm's-length contract that does not rise to level of fiduciary).
125.  *Id.*
127.  *Id.* at 592.
134.  *Id.* at 814.
135.  *Id.*
Winchell brought suit, and in its defense, KTTV pointed to a disclaimer in the agreement stating the parties did not form a joint venture; the court rejected this contention because it concluded that parties' conduct may create a joint venture. 137

The relationship between a musician and a recording house has faced similar questions regarding the creation of a fiduciary relationship. 138 In *Apple Records, Inc. v. Capital Records, Inc.*, a New York court found the extensive, decade-spanning business dealings between the recording studio and the Beatles gave rise to a special relationship of trust and confidence. 139 The court stated that the relationship "existed independent of the contractual relationship" of trust and confidence; therefore, the defendant had a duty to make payments outside of the contractual relationship. 140

A long history of business dealings involving payment obligations also gives rise to a fiduciary relationship. In *Carpenter Foundation v. Oakes*, 141 the plaintiff entrusted materials relating to the practice and historical development of Christian Science to the defendant, a close friend, to make available for "qualified" students of the religion at cost. 142 The defendant established a book business and sold materials to customers contrary to the plaintiff's stated wishes. 143 The court found the friendship forged between the parties was one of trust and confidence; therefore, the defendant had a duty to make payments contrary to the plaintiff's wishes. 144

### C. Based on Wolf, No Fiduciary Relationship Exists Between a Studio and Participant on the Sole Basis of a Right to Share Profits

Under California law, one party's exclusive control over contingent compensation does not make that party a fiduciary in the absence of other evidence. 145 In *Wolf v. Superior Court*, 146 the appellate court denied a writ of mandate sought by Gary Wolf, author of the 1981 novel *Who Censored Roger Rabbit?*, whose book served as the basis for the Disney film *Who Framed Roger Rabbit?*. 147 Wolf sought to vacate a lower court's order sustaining demurrer to Walt Disney Pictures and Television's demurrer for Wolf's claim of breach of fiduciary duty.

The dispute in *Wolf* stemmed from an agreement between Wolf and Disney. 148 Wolf assigned the rights to his novel and the Roger Rabbit characters to his studio and Disney for compensation. 149 The agreement also provided Wolf audit rights so he could gain access to the movie's books and records. 150

Wolf alleged that when he attempted to exercise his audit rights, Disney refused him access to the relevant financial records and did not disclose the nature of its promotional agreements with third parties, including compensation. 151 Wolf also alleged that Disney underreported revenues earned in connection with the exploitation of the Roger Rabbit characters, constituting a breach of fiduciary duty and the implied covenant of good faith and fair dealing. 152

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136. Id.
137. Id. at 830 ("The conduct of the parties may create a joint venture despite an express declaration to the contrary").
138. See *Rodgers v. Roulette Records*, 677 F. Supp. 731, 739 (S.D.N.Y. 1988) (declining to find a fiduciary relationship where defendant collected royalties on behalf of plaintiff in the form of royalties and licensing fees); *Cooper v. Sony Records Int'l*, No. 00 Civ. 235 (IMB), 2001 WL 1223492, at *5 (S.D.N.Y. 2001) (musician's fiduciary duty claim fails even though studio exercised exclusive control over the recordings during the agreement and promised a percentage of the proceeds from the exploitation of the recordings).
140. Id. at 57.
141. Id.
143. Id. at 788.
144. Id.
145. Id. at 798.

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146. Wolf v. Superior Court, 107 Cal. App.4th 23, 27 (2003) ("[C]ontingent entitlement to future compensation within the exclusive control of one party does not make that party a fiduciary in the absence of other indicia . . . .").
147. Id. at 25.
148. Id. See *WHO FRAMED ROGER RABBIT?* (Walt Disney Pictures 1988); see also *WHO FRAMED ROGER RABBIT?*, BOX OFFICE MOJO, http://boxofficemojo.com/movies/?id=whoframedrogerrabbit.htm (last visited Mar. 11, 2012) (*Who Framed Roger Rabbit?* was an enormous box-office success, earning more than $300 million in worldwide revenues after its release in 1988).
150. Id.
151. Id. at 27-28.
152. Id. at 28.
153. Id.
154. Id.
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\textsuperscript{136} Id.

\textsuperset{137} Id. at 830 ("[T]he conduct of the parties may create a joint venture despite an express declaration to the contrary").

\textsuperset{138} See Rodgers v. Roulette Records, 677 F. Supp. 731, 739 (S.D.N.Y. 1988) (declining to find a fiduciary relationship where defendant collected royalties on behalf of plaintiff in the form of royalties and licensing fees); Cooper v. Sony Records Int'l, No. 00 Civ. 233 (RMM), 2001 WL 1223492, at *5 (S.D.N.Y. 2001) (musician's fiduciary duty claim fails even though studio exercised exclusive control over the recordings during the agreement and promised a percentage of the proceeds from the exploitation of the recordings).

\textsuperset{139} 137 A.D.3d 50 (1988).

\textsuperset{140} Id. at 57.

\textsuperset{141} Id.

\textsuperset{142} 26 Cal. App.3d 784 (1972).

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The dispute in Wolf stemmed from an agreement between Wolf and Disney.\textsuperset{150} Wolf assigned the rights to his novel and the Roger Rabbit characters in exchange for a salary and five percent of the gross revenues earned from merchandising royalties or other exploitation of the Roger Rabbit characters.\textsuperset{151} The agreement also provided Wolf audit rights so he could gain access to the movie's books and records.\textsuperset{152}

Wolf alleged that when he attempted to exercise his audit rights, Disney refused him access to the relevant financial records and did not disclose the nature of its promotional agreements with third parties, including compensation.\textsuperset{153} Wolf also alleged that Disney underreported revenues earned in connection with the exploitation of the Roger Rabbit characters, constituting a breach of fiduciary duty and the implied covenant of good faith and fair dealing.\textsuperset{154}

\textsuperset{146} Wolf v. Superior Court, 107 Cal. App.4th 25, 27 (2003) ("[C]ontingent entitlement to future compensation within the exclusive control of one party does not make that party a fiduciary in the absence of other indicia . . . .").

\textsuperset{147} Id. at 25.

\textsuperset{148} Id. See Who Framed Roger Rabbit? (Walt Disney Pictures 1988); see also Who Framed Roger Rabbit?, BOX OFFICE MOJO, http://boxofficemojo.com/movies/?id=whoframedrogerrabbit.htm (last visited Mar. 11, 2012) (Who Framed Roger Rabbit? was an enormous box-office success, earning more than $300 million in worldwide revenues after its release in 1988).

\textsuperset{149} Wolf, 107 Cal. App.4th at 27.

\textsuperset{150} Id.

\textsuperset{151} Id. at 27-28.

\textsuperset{152} Id. at 28.

\textsuperset{153} Id.

\textsuperset{154} Id.
The court rejected Wolf's assertion that Disney owed him a fiduciary duty to account for revenues completely and accurately. Based on New v. New and Wisecr v. California Employment Commission, the Court held that the right to receive contingent compensation in the exclusive control of one party does not, by itself, make the party a fiduciary for purposes of making payments. It went on to discredit Wolf's interpretation of the opinions in Waverly and Nelson:

Wolf misapprehends the import of the Waverly court's recognition of the producer's right to an accounting of proceeds received from subdistributors. Either a relationship is fiduciary in character or not. Whether the parties are fiduciaries is governed by the nature of the relationship, not by the remedy sought. Waverly recognized simply that RKO had a duty to account, not that RKO was a fiduciary with respect to its accounting obligation.

In other words, a profit-sharing agreement may include a right to an accounting even without a fiduciary relationship, when an accounting is part and parcel to the contract. The right of an accounting, the court wrote, "can be derived not from a fiduciary duty, but simply from the implied covenant of good faith and fair dealing inherent in every contract, because without an accounting, there may be no way 'by which such a party [entitled to share in profit] could determine whether there were any profits.'"

Factors such as fairness and practicality weighed in favor of shifting the evidentiary burden to Disney to prove the relationship with Wolf was not fiduciary in character when financial information was held exclusively under Disney's control. But the court found the evidentiary burden "does not alter the contractual nature of the parties' relationship" and held that those factors "cannot serve to create a fiduciary relationship where one does not otherwise exist." Judge Johnson's dissent in Wolf argued the majority opinion left open a slim possibility for the court, if comprised of different judges, to find favorably for the participant on important procedural questions. He suggested a different panel of judges would hold that evidence put forth in support of the existence of a joint venture should be admitted before the trial court because the evidence would help determine the question of whether fiduciary duties existed as a matter of law. Sympathizing with Wolf, the dissent found it premature to dismiss the claim for breach of fiduciary duty on the pleadings. In his opinion, he wrote: "[E]vidence may emerge demonstrating that once Disney decided to make the movie and exploit the characters Wolf created, the two of them embarked on a joint venture. If so, Disney would owe a fiduciary duty to its co-adventurer even though the terms of the written contract did not define a joint venture and despite the fact Disney had managed to insert contract language asserting this was only to be a debtor-creditor relationship."

If a fiduciary duty were imposed, it would potentially discourage studios from using their superior bargaining position and transactional knowledge to manipulate the participant into accepting a deal promising a percentage of a pool of funds the studio intends to keep as low as possible. In a studio-participant relationship, "[t]he opportunity and temptation to cheat are present in the relationship fundamental fairness, the "lodestar" for analysis . . . requires shifting the burden of proof to the defendant. In such cases, the essential facts as to the contingency and the amount owed lie in the exclusive knowledge and control of the defendant, placing the defendant in a far better position to prove satisfaction of its payment obligation." (internal citations omitted).

155. Id. at 40-41.
156. 143 Cal. App.2d 372, 382 (1957) (ex-husband's contractual obligation to pay former wife a percentage of stock earnings created a debt obligation, not a fiduciary duty).
157. 69 Cal. App.2d 120 (1945) (employment contract entitling employee to 25% of future profits neither created a joint venture nor gave rise to a fiduciary relationship).
158. Wolf, 107 Cal. App.4th at 30-31. ("T[he] contractual right to contingent compensation in the control of another has never, by itself, been sufficient to create a fiduciary relationship where one would not otherwise exist.").
159. Id. at 34.
160. Id. ("The duty to provide an accounting of profits . . . is appropriately premised on the principle . . . that a party may have a right to accounting, even absent a fiduciary relationship, when such a right is inherent in the nature of the contract itself.").
161. Id. (citing Nelson, 29 Cal.2d at 751).
162. Id. at 36. ("In cases where the financial records essential to proving the contingent compensation owed are in exclusive control of the defendant, . . .")
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In other words, a profit-sharing agreement may include a right to an accounting even without a fiduciary relationship, when an accounting is part and parcel to the contract. The right of an accounting, the court wrote, “can be derived not from a fiduciary duty, but simply from the implied covenant of good faith and fair dealing inherent in every contract.”

Factors such as fairness and practicality weighed in favor of shifting the evidentiary burden to Disney to prove the relationship profits could determine whether there were any profits.

Whether the parties are fiduciaries is premised on the principle that a party may have a right to an accounting; even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting. Even absent a fiduciary relationship, when such a right is set forth in the written contract, the party may have a right to an accounting.

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Factors such as fairness and practicality weighed in favor of shifting the evidentiary burden to Disney to prove the relationship with Wolf was not fiduciary in character when financial information was held exclusively under Disney’s control. But the court found

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163. Id.
164. Id. at 37 (Johnson, J., concurring in part and dissenting in part).
165. Id.
166. Id. at 42. (“I am unprepared at this early stage of the proceedings, in the absence of evidence before the trial court, to determine no such fiduciary duty exists as a matter of law.”).
167. Id. at 39-40.
168. Id. at 42. (“There appears to be . . . a need to impose a fiduciary duty on the performance of that accounting responsibility in order to discourage Disney from taking unfair advantage of its special position . . .”)

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here just as much as in... traditional fiduciary relationships."188 Each party understands that when Disney fails to report revenues earned in connection with the sale of merchandise inspired by Wolf's characters, the result would be "less money for Wolf and more profit for Disney."189

The dissent concludes on an auspicious note for participants, stating that courts should be willing to "impose fiduciary duties on certain business relationships."197 In this case, Judge Johnson wrote that he was, "not quite prepared to determine Disney assumed a fiduciary duty to maintain honest and accurate records as to its exploitation of Wolf's characters. But [that he was] close to such a conclusion."197

Interestingly, in Ladd v. Warner Bros. Entertainment, Inc.,189 the court did not allow Ladd, the producer, to present evidence in support of his fiduciary duty claim at trial,190 even though he and the studio explicitly formed a joint venture in their original agreement.186 The joint venture agreement stipulated that Ladd would produce films that Warner would finance.186 In addition, Ladd was authorized to produce films without first obtaining the studio's approval, a right to exercise discretion and control that few producers currently enjoy.187 According to Ladd's counsel, the original agreement included language stating their relationship was special and, as a result, the length of the contract was purposefully short.187

When the agreement was terminated in 1985, Warner retained the obligation to account to Ladd pursuant to the original agreement.190

169. Id. at 41-42.
170. Id. at 42.
171. Id.
172. Id.
174. Id. (summarizing the procedural history of the case, including the fact that the trial court "granted nonsuit on Ladd's claim for Blade Runner profits. . .").
175. Id. at 1301. ("In 1979, Warner and Ladd entered into a joint venture, essentially a "mini studio" within a studio.").
176. Id. ("Ladd had control over development of movies, financing of movies, production, and distribution. Warner's role was to finance the films.").
177. Telephone Interview with John M. Gatti, Partner, Strook & Strook & Lavan LLP (Mar. 8, 2012).
178. Ladd, 184 Cal. App.4th at 1301. ("In 1985, the parties entered into a Termination Agreement, under which the parties ended their joint venture, with Warner remaining obligated to pay Ladd the profit participation called for under their earlier agreement.").

Ladd filed suit after discovering that Warner had miscounted the profits earned for the film Blade Runner.180 The court rejected Ladd's argument that the relationship was created under a joint venture relationship and, therefore, activity stemming from that relationship should be treated as a joint venture even though it was terminated.184 The duty to account is a fiduciary obligation because it was established under the original agreement.182 The judge dismissed the claim on demurrer based on the reasoning in Wolf that once the contract is terminated a joint venture no longer exists and therefore no fiduciary duties are owed.182

However, in Celador International, Ltd. v. The Walt Disney Co.,188 Judge Cooper of the Central District Court of California declined to dismiss Celador's claim for breach of fiduciary duty.188 The creators of Who Wants to Be a Millionaire? had the opportunity at trial to present evidence in support of a joint venture relationship by virtue of the conduct of the parties, even though the contract stipulated that it did not give rise to a fiduciary relationship.186 But the court went on to note that, based on Wolf, a fiduciary relationship cannot be established solely on the foundation of a right to share profits184 or on the basis of a duty to account for profits.180 Nonetheless, the jury ultimately found that Disney breached the implied covenant of good faith and fair dealing in this case and

180. Id. at 1302 ("In 2001, Ladd learned [a] Blade Runner investor . . . was receiving payments from Warner even though Warner had told Lad the movie was unprofitable. . . . Following [an] audit, Ladd filed this instant lawsuit . . . . The gravamen of the action is that Warner deprived Ladd of the bargained-for profit participation in the Termination Agreement by undervaluing Ladd's films relative to other films in television licensing packages."); BLADE RUNNER (Warner Bros. 1982).
181. See Gatti, supra note 176.
182. Id.
183. Id.
185. Id. at 853-54 (explaining the defendants' argument in reliance on Wolf, and how the present case may be distinguished by the plaintiffs' allegations of the existence of something akin to a joint venture).
186. Id. at 854 ("Defendants' arguments for the court: Nothing herein shall constitute or give rise to a partnership between, or joint ventures of, the parties..." footnote omitted).
187. Id. at 853 (noting that pursuant to Wolf "a contingent entitlement to future compensation within the exclusive control of one party does not make that party a fiduciary . . .").
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awarded a multimillion judgment in favor of the creators of the game show.  

IV. IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

This Section describes the purpose of the implied covenant and explains recent court decisions where courts have devoted the issue special attention. It concludes by arguing that the implied covenant has provided and will continue to serve as the strongest legal theory upon which participants base their claims to receive unpaid contingent compensation.

A. The Implied Covenant Protects the Unspoken Benefits a Party Stands to Gain from the Express Terms of the Contract

In every contract there is an implied duty that neither party will act to destroy or frustrate a right of the other party to benefit from the express terms of the contract. The implied covenant of good faith and fair dealing is a staple of contract law, read into contracts "in order to protect the express covenants or promises of the contract, not to protect some general public policy interest not directly tied to the contract's purpose." Accordingly, nearly every American jurisdiction recognizes this implied covenant as a matter of common law. Additionally, both the Restatement (Second) of Contracts and the Uniform Commercial Code have adopted the implied covenant. The parties cannot disclaim or limit the obligation to act in good faith by agreement.

The implied covenant is heavily litigated, but serves a narrow purpose in interpretation of contracts. In litigation, it arises in circumstances where the contract does not state how to deal with a situation and where one party exploits the silence to thwart the right of the other party to receive the promises the contract expressly provided. Since the contract does not prescribe whether the conduct at issue is forbidden or permitted, the implied covenant is used to determine if a party has acted in a manner that is unreasonable according to industry standards of conduct and, furthermore, if the party has acted in a manner it knew to be wrong. The purpose of the inquiry is to determine if the party deliberately acted to frustrate the right of the other party to receive the benefits the contract expressly provides; put differently, when the implied covenant is applied it is "read into contracts in order to protect the express covenants or promises of the contract."  

Breach of the implied covenant involves "unfair dealing, whether or not it also constitutes breach of a consensual contract term, prompted by a conscious and deliberate act the 'unfairly frustrates the agreed common purposes and disappoints the reasonable expectations of the other party." The point is to "prevent one contracting party from unfairly frustrating the other party's right to receive the benefits of the agreement actually made."
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¹⁹⁸ See infra Part IV(B).
²⁰¹ See, e.g., Sutherland v. Barclays American/Mortgage Corp., 53 Cal. App.4th 299, 314, (1997) (“Every contract imposes upon each party a duty of good faith and fair dealing . . . This duty has been recognized in the majority of American jurisdictions . . . .”) (internal quotation marks omitted).
²⁰² Report & Recommendation (Second) of Contracts § 205 (1981) (“Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”).
²⁰³ U.C.C. § 1-204 (2011-2012) (“Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.”).

¹⁹⁵ See REV. UNIF. P’SHP ACT § 103 cmt. 7 (1997).
¹⁹⁷ See generally, Thomas A. Diamond & Howard Foss, Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery, 47 HASTINGS L.J. 585, 585 (1995-96) (“Despite its widespread recognition, the implied covenant of good faith and fair dealing is shrouded in mystery.”). Cf. REPORT & RECOMMENDATION (SECOND) OF CONTRACTS § 205 (1981) (“Good faith is violated ‘even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty.’.”).
¹⁹⁸ Foley, 765 P.2d at 394.
B. The Implied Covenant Is Not Violated When a Contract Grants Complete Freedom to Perform an Act or Not

The implied covenant is not interpreted to forbid a party from acting in a manner permitted in the contract. For instance, a contract granting a party complete discretion to do something includes the right not to perform. If the conduct is within the reasonable expectations of the parties as articulated expressly in the contract, then a party "can never violate an implied covenant of good faith and fair dealing."  

Good faith and fair dealing is the kind of provision that is hard to derive generalizations from because it is very fact-specific, but case law is a rich source for describing the subtleties and variations of interpretation. In Third Story Music, Inc. v. Waits, a record company entered into an exclusive agreement with musician Tom Waits to license one of his albums and pay him a percentage of royalties earned in connection with the exploitation of the album. The agreement provided the record company "may at [its] election refrain" from marketing the album; Waits sued after the company decided against promoting the album or licensing it in any way.

The court held for the record company, finding the language of the contract granted them complete discretion to license the album and pay him a percentage of royalties earned in connection with the exploitation of the album. The court held that no breach of the implied covenant had occurred because the contract granted the record company complete discretion to license the album and that the decision against promoting it did not mean the company failed to act in good faith. To find otherwise would imply a term that contradicts an express term of the contract—something which "courts are not at liberty" to do. It is improper for courts to perform such a function except in those relatively rare instances when reading the provision literally would, contrary to the parties' clear intention, result in an unenforceable, illusory agreement.

201. Carma Developers, Inc. v. Marathon Dev. Cal., 2 Cal.4th 342, 374 ("[T]he general rule [of the duty of good faith and fair dealing] is plainly subject to the exception that the parties may, by express provisions of the contract, grant the right to engage in the very acts and conduct which otherwise have been forbidden by an implied covenant of good faith and fair dealing .... ").

202. Id. at 376 (finding that a landlord's decision to terminate lease for his own financial benefit does not violate the implied terms of the contract because the lease agreement permitted the activity and was therefore within the parties' reasonable expectations).


204. Id.

205. Id.

206. Id. at 809.

207. Id. at 808.

When the appellate court revisited Gary Wolf's campaign for additional income in the form of contingent compensation from Disney, it relied on Third Story in rendering its decision. At issue in Wolf v. Walt Disney Pictures and Television, 28 born of the same facts governing Wolf v. Superior Court 29 was whether Disney violated the implied covenant by entering into licensing and promotional agreements for which Disney did not receive monetary compensation. Wolf alleged that Disney entered into such non-compensatory agreement to avoid having to account on its financial books for additional revenues. However, the contract provided Disney "unfettered discretion . . . to license the Roger Rabbit franchise as it [saw fit]." On this basis, the appellate court affirmed the trial court's decision to sustain the demurrer that Disney did not breach the implied covenant.

The court dismissed Wolf's contention that the lower court erred in not finding it unfair for Disney to enter into agreements with third parties that do not promise Wolf any form of royalty payments. Quoting from Third Story, the court added: "It is not enough to say that without the proposed implied covenant, the contract would be improvident or unwise or would operate unjustly. Parties have the right to make such agreements ... [Wolf] was free to accept or reject the bargain offered and cannot look to the courts to amend the terms that prove unsatisfactory." To establish a cause of action for breach of the implied covenant of good faith and fair dealing, the plaintiff must show either that the defendant knew he was acting in bad faith, or that the act was improvident or unwise or would operate unjustly. Parties have the right to make such agreements. 32


211. Id. at 1107.

212. Id. at 1121.

213. Id. at 1123 ("[T]he directed verdict was still proper because no substantial evidence was presented from which a rational juror could find the covenant had been breached.").

214. Id. at 1120.


216. Id. at 1120 (citing Carma, Developers, Inc. v. Marathon Dev. California, 2 Cal.4th 342, 372 (1992) ("The covenant requires the party holding such [discretionary] power to exercise it 'for any purpose within the reasonable contemplation of the parties at the time of formation—to capture opportunities that were preserved upon entering the contract interpreted objectively.'").
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Based on the agreement at issue in *Walt Disney Pictures and Television*, the court found no evidence that it was “designed to thwart Wolf’s right to a royalty or that all, or even most, of Disney’s licensing agreements were structured to require only nonmonetary consideration.” 221

C. The Implied Covenant Prohibits a Party from Deliberately Frustrating the Expectations of the Counterparty as Expressed in the Contract

But juries and judges are sympathetic to creative talent in cases where it is alleged the studio made a fortune and would not share the profits, especially when it is established at trial that the studio took deliberate steps to ensure participants would not see a dime of contingent compensation. In *Ladd v. Warner Bros. Entertainment, Inc.*, 219 the film producer Alan Ladd, Jr. filed suit against Warner Brothers challenging the studio’s practice of “straight-lining,” where it licenses a package of films to cable companies and assigns the same value to every film regardless of the film’s value to the studio or cable company. 220 Ladd and Warner Brothers formed a joint venture in 1979 in which Ladd was given carte-blanche authority to develop and produce films as well as control their marketing and distribution. 221 Warner financed the operations but did not have final say on which movies were produced. 222 In his field, Ladd produced a series of popular movies, such as *Blade Runner*, 223 *Chariots of Fire*, 224 and the *Police Academy* franchise. 225 When the parties terminated their joint-venture agreement six years later, the termination agreement provided that the studio would continue to pay five percent of gross revenues from the licensing of the films produced by Ladd, except for *Chariots of Fire*, for which he would receive two-and-a-half percent. 226

In 1992, Warner did not include *Blade Runner* in the profit participation statement it delivered to Ladd, representing that the film did not recoup its costs and was “so far in the red [losing $19.5 million] it was not worthwhile to issue [profit] statements.” 227

Knowing the studio’s obligation to act fairly and in good faith, Ladd did not dispute the representation. In 2001, however, Ladd discovered that Warner was making contingent-compensation payments to another investor on *Blade Runner*, prompting him to exercise his right to audit. The audit revealed that the film was making money hand over fist. 228

At issue in *Ladd* was the practice of “straight-lining,” where a studio licenses a package of films to cable companies and assigns the same value to every film in the package, regardless of each film’s comparative value. 229 For instance, if a studio licenses a package of twenty films to a cable company for $20 million, the studio might then allocate $1 million for each film’s balance sheet. The $1 million is reported, in part, for purposes of making profit-participation payments. However, some films in the package might be worth $1 million or more. The participants in those films would argue that the studio deprived them of an accurate accounting by not giving a fair allocation to each film based on its relative value as part of the package. 230

Ladd challenged the straight-lining method, arguing it ignored the true value of each film and, therefore, deprived him of the share of profits he expected to earn in licensing fees. 231 At trial, a Warner Brothers executive testified that acting in good faith includes the duty to “fairly and accurately allocate licensee fees to each of the films based on their comparative value as part of the package.” 232 As a profit participant, Ladd argued the studio violated the implied covenant by assigning the same value to blockbusters as flops, since the studio is expected to report a film’s revenues truthfully and accurately. 233 Internally, Warner Brothers evaluated each film’s

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227. Id. at 1302.
228. Id.
229. See, e.g., id. at 1300 (“The gravamen of Ladd’s action against Warner is that by allocating the same portion of the licensing fee to every movie in a package without regard to the true value of each movie, Warner deprived Ladd of a fair allocation of the licensing fees to which Ladd was entitled as a profit participant.”).
230. Id. at 1303. (“The problem was that Warner allocated the same proportion of the license fee to each title in the package, irrespective of the film’s letter grade. Simon opined that in treating every movie as though it had the same value, ‘the studio was not doing its expert work, as a provider or distributor of content, in weighing the value of each of these titles . . . ’.”).
231. Id. at 1307.
232. Id. at 1306-07.
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217. Id. at 1123.


219. Id. at 1298.

220. Id. at 1301.

221. Id.


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231. Id. at 1307.

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relative value by assigning a grade of A, B, or C, an exercise that violates the duty to act in good faith. Moreover, Ladd alleged that Warner undervalued the package of films by $97 million. The jury agreed with Ladd and concluded that Warner’s improper accounting resulted in an underpayment of more than $3 million in contingent compensation. On appeal, the appellate court affirmed, holding the implied covenant obliged the studio to “fairly and accurately allocate license fees to each of the films’ net profits” (i.e., net profits) derived from the exploitation of the series by BCTV. The Disney companies tapped Valleycrest Productions—another Disney subsidiary—to handle production duties for Millionaire, including the responsibility to license the show to broadcasters.

Millionaire, the game show hosted by Regis Philbin, became an overnight success, skyrocketing to the top of the Nielsen ratings for the most-watched television show in the United States. On the heels of the show’s enormous success, ABC moved to first place in the network ratings war. Millionaire has been on the air for longer than a decade, the first three years on ABC and since airing multiple days per week in syndication. However, according to Celador, the


241. Celador, 347 F. Supp.2d at 850. (“Plaintiffs are the creators and executive producers of the television game show, ‘Who Wants to Be a Millionaire?’... Plaintiffs entered into a contract in 1998 with ABC and BVT, both subsidiaries of Defendant Walt Disney Co. wherein the parties ‘agreed to become 50-50 partners with respect to the production, distribution and exploitation of the Series in North America.’”).

242. Id. (“Plaintiffs allege that in exchange for certain rights to the concept and format of [Who Wants to Be a Millionaire?], ABC and BVT agreed to (1) pay Celador fixed compensation and 50% of Defined Contingent Compensation derived from the exploitation of the series ... .”)

243. Id. (“After the agreement was entered into, Plaintiffs allege that ABC and BVT assigned the production duties of [Who Wants to Be a Millionaire?] to their fellow subsidiary of Disney, Valleycrest Prod. Ltd.”).

244. Linda Moss, ‘Millionaire’ Rained on Cable’s May Parade, MULTICHANNEL NEWS, Jun. 5, 2000, at 30 (“The only one of the four broadcast networks to actually see a ratings increase in primetime was ABC, with lethal programming weapon Millionaire giving it a whopping 29 percent bump, to a 9.9 from a 7.7, which drove broadcast’s gains.”).

245. Id.

relative value by assigning a grade of A, B, or C, an exercise that violates the duty to act in good faith.233 Moreover, Ladd alleged that Warner undervalued the package of films by $97 million.234 The jury agreed with Ladd and concluded that Warner’s improper accounting resulted in an underpayment of more than $3 million in contingent compensation.235 On appeal, the appellate court affirmed, holding the implied covenant obliged the studio to “fairly and accurately allocate license fees to each of the films based on their comparative value as part of a package.”236 The court also noted the straight-lining method violates the implied covenant because bundling deprives the films of individual valuation.237

When a television program such as Who Wants to Be a Millionaire? becomes so popular that the program itself is a household name, it is hard to believe a studio that claims it failed to earn profits sufficient to pay contingent compensation. In July 2010, a federal jury found in favor of Celador International, the British production company that created the game show, and awarded damages of $260 million in unpaid licensing fees and $9.2 million in money owed from merchandising royalties.238 The jury also found that Disney breached its obligation to act in good faith and deal fairly with Celador when it took deliberate steps to deprive the creators of their share of contingent compensation in connection with Millionaire.239 In September 2010, a federal judge awarded the creators an additional $50 million in prejudgment interest.240

233. Id. at 1307.
234. Id. at 1303. (“With respect to damages, Simon determined Warner should have allocated an additional $97 million in licensing fees to Ladd’s films.”).
235. Id. at 1298.
236. Id. at 1300.
237. Id. (“Therefore, the record supports the jury’s determination that Warner’s straight-lining method of allocating licensing fees to profit participants breached the implied covenant of good faith and fair dealing.”).
accounting statements generated by Disney reported the show did not recoup its production costs and was running a loss of $70 million. 247

How can a fifty-per cent profit share in a popular television show, which generates millions of dollars in revenues for Disney and its affiliates, result in zero profits for its British creators? The answer lies in the way ABC and BVT orchestrated a series of backchannel transactions—without Celador’s knowledge—with Disney affiliates to shelter revenue earned by the show. For instance, Celador claimed that ABC agreed orally to license the broadcast rights in the show from Valleycrest for a per-episode fee equal to the amount of Valleycrest’s production costs on a per-episode basis. 248 The arrangement effectively eliminated Celador’s ability to receive its net-profits payments, because the amount of contingent compensation Celador would receive depended on how much in license fees Valleycrest collected from broadcasters as well as on Valleycrest’s production costs. 249

According to Celador, the arrangement between the Disney affiliates enabled Valleycrest to charge below-market licensing fees while having no effect on the profit earned by Disney itself. 250 That is largely because the contract entitled Celador to share only in Valleycrest’s profits from the show—not Disney’s. 251 In addition, it is customary in the entertainment industry for a production company to renegotiate higher license fees for enormously successful shows even though it is not mandated by the agreement. 252 The purposes of the self-dealing transactions, according to Celador, were to shelter revenue and retain profits within Disney’s control. 253

Before the jury verdict, Judge Cooper denied Disney’s motions to dismiss for breach of contract and breach of the implied covenant under an exception that allowed Celador to present evidence demonstrating the Disney companies “frustrated a benefit of the contract,” which was the benefit to receive contingent compensation from the show. 254 The court based its decision to deny Disney’s motion on evidence that Disney “failed to renegotiate contracts in a manner consistent with industry custom.” 255 and that, in making sweetheart licensing deals with affiliates, its agreements were “not fair and reasonable.” 256 Despite a provision in the contract granting ABC and BVT the right to self-deal and requiring Celador to prove that a specific deal was unfair, 257 the court acknowledged that there was sufficient evidence that this was indeed in the case. 258 In future cases, this finding will likely encourage participants to challenge accounting statements based on presumptions of fairness and equity.

V. Conclusion

The obligation to act in good faith and deal fairly with contractual partners does not prohibit a studio from acting in its interests under an agreement. Nor do fiduciary duties, which do not

252. Id. at 850-51 (citing Complaintat ¶ 14) (“Plaintiffs allege that it is the custom and practice in the entertainment industry to renegotiate higher licensing fees when a show is highly successful.”).

253. Id. (citing Complaint at ¶ 16).

254. Id. at 853.

255. Id. at 852.

256. Id.

257. Silberfeld & Conn, supra note 38, at 40 (citing Trial Exhibit No. 33, Celador, 347 F. Supp.2d 846) (provision reads that “Owner acknowledges and agrees that any agreement or other arrangement by ABC/BVT with an Affiliate or Related Party shall be conclusively presumed to be fair, reasonable and unobjectionable unless Owner shall establish that such agreement or other arrangement is on non-unique financial terms which, taken as a whole, are materially less favorable economically to ABC/BVT . . . Owner further agrees that . . . Owner’s sole and exclusive remedy [to unfavorable transactions] shall be the right to receive an adjusted accounting statement, including any additional payments that may be required.”).

258. Celador, 347 F. Supp.2d at 856 (“[It can be inferred that Defendants never intended to seek competitive bids or profitable licensing fees. Plaintiffs have sufficiently stated the basis for their allegations on information and belief.”).
accounting statements generated by Disney reported the show did not recoup its production costs and was running a loss of $70 million.\footnote{257} How can a fifty-percent profit share in a popular television show, which generates millions of dollars in revenues for Disney and its affiliates, result in zero profits for its British creators? The answer lies in the way ABC and BVT orchestrated a series of backchannel transactions—which generated millions of dollars in profits for Disney and its affiliates, result in zero profits for its British creators? The answer lies in the way ABC and BVT orchestrated a series of backchannel transactions—without Celador's knowledge—with Disney affiliates to shelter revenue earned by the show. For instance, Celador claimed that ABC agreed orally to license the broadcast rights in the show from Valleycrest for a per-episode fee equal to the amount of Valleycrest's production costs on a per-episode basis.\footnote{248} The arrangement effectively eliminated Celador's ability to receive its net-profits payments, because the amount of contingent compensation Celador would receive depended on how much in license fees Valleycrest collected from broadcasters as well as on Valleycrest's production costs.\footnote{249} According to Celador, the arrangement between the Disney affiliates enabled Valleycrest to charge below-market licensing fees while having no effect on the profit earned by Disney itself.\footnote{250} That is largely because the contract entitled Celador to share only in Valleycrest's profits from the show—not Disney's.\footnote{247} In addition, it is customary in the entertainment industry for a production company to renegotiate higher license fees for enormously successful shows even

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  \item [247.] Plaintiff's Opposition to Motion for Judgment as a Matter of Law at 13, Celador, 347 F. Supp.2d at 846.
  \item [248.] Celador, 347 F. Supp.2d at 850 (citing Complaint at ¶ 9) ("As part of the agreement with Valleycrest, Plaintiffs claim that ABC agreed orally to license the Series for an "imputed per-episode license fee equal to Valleycrest's per-episode production costs.").
  \item [249.] Id. (As a result, the network exhibition of the Series could never reach profits after production costs, distribution fees, distribution costs, overhead, interest, etc. were deducted from any gross receipts).
  \item [250.] Id. at 851 (citing Complaint at ¶ 16) ("Plaintiff alleges that because ABC and BVT are required to share the profits derived from the Series with Celador, it is in Disney's best interest, and as the parent company of ABC, BVT and Valleycrest, for the license with ABC to be less than the fair market price for the right to license the Series and for Valleycrest to inflate its production costs.").
  \item [251.] Id. ("Plaintiffs allege, Profits from lower production costs and increased revenues from the Series, which would have flowed to Celador if paid to BVT, remain instead with the Disney empire, in the form of cost savings and increased profits to Disney's affiliates.").
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though it is not mandated by the agreement.\footnote{252} The purposes of the self-dealing transactions, according to Celador, were to shelter revenue and retain profits within Disney's control.\footnote{253} Before the jury verdict, Judge Cooper denied Disney's motions to dismiss for breach of contract and breach of the implied covenant under an exception that allowed Celador to present evidence demonstrating the Disney companies "frustrated a benefit of the contract," which was the benefit to receive contingent compensation from the show.\footnote{254} The court based its decision to deny Disney's motion on evidence that Disney "failed to renegotiate contracts in a manner consistent with industry custom,"\footnote{255} and that, in making sweetheart licensing deals with affiliates, its agreements were "not fair and reasonable."\footnote{256} Despite a provision in the contract granting ABC and BVT the right to self-deal and requiring Celador to prove that a specific deal was unfair,\footnote{257} the court acknowledged that there was sufficient evidence that this was indeed in the case.\footnote{258} In future cases, this finding will likely encourage participants to challenge accounting statements based on presumptions of fairness and equity.

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arise in profit-participation agreements unless the studio-participant relationship parallels that of partners in a partnership—an arrangement that is seldom the case. So the profit participant is still at risk of being deprived of its promised share of contingent compensation when dealing with studios—unless the participant himself has the financial resources to challenge a suspicious participation statement. In these scenarios, the participant becomes a sympathetic character, someone who has little option but to repose trust and confidence in the studio to account fully and accurately his share of net profits in a successful project, but who knows the studio will fight him tooth and nail over every penny of supplemental income.

Despite the features of the studio-participant relationship, it is highly unlikely that a court will be persuaded to go against the Wolf v. Superior Court holding and declare that a fiduciary relationship exists. Its characteristics are similar to those found in relationships between manufacturers and distributors, those at the heart of commercial industries. For instance, the participant is akin to a manufacturer of intellectual property, a product that is distributed by the studio throughout the world as best it can. The parties share the proceeds of their joint efforts as previously bargained. If the distributor fails to pay money owed under the contract, it creates a debt obligation. However, a debt is not a trust and it does not create a fiduciary relationship—regardless of whether the debt is of a certain amount or is contingent on future events whose certainty is unknown. It is also true that if courts recognize fiduciary duties that studios will respond by disclaiming fiduciary duties.

Yet, courts should not dismiss breach of fiduciary duty claims too quickly. The Wolf decision left open the possibility for a fiduciary relationship to be recognized on factors other than the right to receive contingent compensation—and the participant should be given an opportunity to present evidence at trial demonstrating his additional participation statement. In these scenarios, the participant becomes a sympathetic character, someone who has little option but to repose trust and confidence in the studio to account fully and accurately his share of net profits in a successful project, but who knows the studio will fight him tooth and nail over every penny of supplemental income.

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259. 107 Cal. App.4th 25 (2003) (holding that the right to receive contingent compensation in the exclusive control of one party does not, by itself, make the party a fiduciary for purposes of making payments).

260. See Moore, supra note 7, at 154-55.

261. Downey v. Humphreys, 102 Cal. App.2d 323, 333, 227 P.2d 484, 490 (1951) ("A debt is not a trust and there is not a fiduciary relation between debtor and creditor as such.").
arise in profit-participation agreements unless the studio-participant relationship parallels that of partners in a partnership—an arrangement that is seldom the case. So the profit participant is still at risk of being deprived of its promised share of contingent compensation when dealing with studios—unless the participant himself has the financial resources to challenge a suspicious participation statement. In these scenarios, the participant becomes a sympathetic character, someone who has little option but to repose trust and confidence in the studio to account fully and accurately his share of net profits in a successful project, but who knows the studio will fight him tooth and nail over every penny of supplemental income.

Despite the features of the studio-participant relationship, it is highly unlikely that a court will be persuaded to go against the Wolf v. Superior Court34 holding and declare that a fiduciary relationship exists. Its characteristics are similar to those found in relationships between manufacturers and distributors, those at the heart of commercial industries.35 For instance, the participant is akin to a manufacturer of intellectual property, a product that is distributed by the studio throughout the world as best it can. The parties share the proceeds of their joint efforts as previously bargained. If the distributor fails to pay money owed under the contract, it creates a debt obligation. However, a debt is not a trust and it does not create a fiduciary relationship—regardless of whether the debt is of a certain amount or is contingent on future events whose certainty is unknown.36 It is also true that if courts recognize fiduciary duties that studios will respond by disclaiming fiduciary duties.

Yet, courts should not dismiss breach of fiduciary duty claims too quickly. The Wolf decision left open the possibility for a fiduciary relationship to be recognized on factors other than the right to receive contingent compensation—and the participant should be given an opportunity to present evidence at trial demonstrating his additional contingent compensation—and the participant should be given an opportunity to present evidence at trial demonstrating his additional contingent compensation. If courts find the studio-participant relationship to be fiduciary in character, the participant would be afforded substantially more bargaining power in its negotiations. Reducing the disparity of bargaining power might encourage more transparent dealings and discourage studios from manipulating accounting statements for their financial benefit. For vertically integrated companies, the prospect of owing punitive damages in addition to ordinary damages might encourage them to seek higher bids to license a successful television series from unaffiliated companies.

Juries have found that a concerted effort to deprive participants their share of net profits is acting in bad faith—and the studios’ actions in Ladd v. Warner Bros. Entertainment, Inc.37 and Celador International, Ltd. v. The Walt Disney Company38 were condemned—resulting in significant rewards in damages. These decisions and findings suggest an explicit right to contingent compensation includes an implied right to reasonable access to information and a reasonably accurate accounting of revenues. Nonetheless, it is difficult to predict outcomes based on these factors in cases where the duty to act in good faith is involved since they depend significantly on the facts of a given dispute. Determining a party has not acted in good faith depends on the size, facts, and circumstances surrounding the transaction and the particular risks and expectations of the parties when they entered into the agreement. In addition, since this area of law is so fact-specific it may be hard to render consistent applications to similar cases, as fact finders may substitute their own intuition of what constitutes reasonable expectations under the circumstances.

To illustrate, the contract in Ladd did not state how the studio would allocate fees earned by licensing a package of films.39 Ladd argued for an allocation to take into account the relative values of the individual films, whereas Warner Brothers believed it could be allocated without comparing each film’s value.40 Without a settlement, a fact finder had to make the determination. The jury concluded the studio’s method of allocation was unfair,41 but it is also possible for a different jury to have found that what the studio did was neither unreasonable according to industry standards nor was it a subjective act of bad faith to frustrate the participant’s right to receive contingent compensation.

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The facts do not lead to a predictable outcome because the implied terms of the contract do not state how to perform in a specific situation. One party can take advantage of the contractual silence to thwart the right of the counterparty to receive what is provided for expressly in the contract. Fact finders can review the same evidence and come to different legal conclusions. As a result, bringing a net profits case into a courtroom means the parties are entering into a high stakes affair where millions of dollars are on the line and an interpretation of the relevant legal doctrine does not lead to predictable outcomes. The question for both creative talent and studios is whether they are willing to roll the dice.

RECOGNIZING THE IMPORTANCE OF INTRABRAND COMPETITION IN HIGH TECHNOLOGY MARKETS: THE PROBLEM WITH LARGE RETAILERS & VERTICAL TERRITORIAL RESTRAINTS

By Kyle Colonna*

I. INTRODUCTION

The current antitrust regime places a premium on interbrand competition. Interbrand competition is competition between brands, such as Apple competing with Google in the smartphone market. Intrabrand competition is, on the other hand, competition within a brand. For example, intrabrand competition occurs when Apple stores compete with each other or when Apple stores compete with Wal-Mart stores that sell Apple products. In many instances, the

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3. See Harry McCracken, iPhone v. Android: The Smart Phone Wars Rage On, TIME (Oct. 5, 2010), http://www.time.com/time/business/article/0,8599,2023452,00.html (noting “the battle between the iPhone and Android is in its early stages”).

4. Cont'l T. V., 433 U.S. at 52 n.19 ("Intrabrand competition is the competition between the distributors - wholesale or retail - of the product of a particular manufacturer.").

5. The key to determining intrabrand competition is correctly defining the product or service the party provides. For instance, an Apple Store that sells iPhones and a nearby cellular service provider that sells iPhones is intrabrand competition. The same label, i.e., Apple, is being sold at different distributors. At the interbrand level, however, Apple and Google compete in the smart phone market. The cellular service provider is a retailer of a service. So it competes interbrand against other cellular service providers.