

BUCHWALD v. PARAMOUNT PICTURES CORP. AND THE FUTURE OF NET PROFIT

GOULD: . . . I think *conservatively*, you and me, we build ourselves in to split, minimally, 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 one¹

I. INTRODUCTION

The definition of net profit in standard Hollywood profit participation agreements² has engendered much discussion and debate since it was first introduced in 1950.³ Actors, producers, directors, and writers have criticized and derided the manner in which net profit is determined, claiming that the motion picture industry's accounting system provides a profit participant little hope of ever recovering a share of a film's net profit.⁴ Such potential participants often feel great resentment when they see

¹ D. Mamet, *Speed-The-Plow* 33 (1987) (emphasis in original).

² All references in this Comment to "profit participation agreements" are intended to connote both net and gross profit deals. For an explanation of the components and operation of net and gross profit participation deals, see *infra* notes 85-92 and accompanying text and notes 114-21 and accompanying text, respectively.

³ See *infra* note 107 and accompanying text.

⁴ Even box office stars like actor Sylvester Stallone, wary of being "at the mercy of the studio accountants," have rebelled against the current profit participation system by demanding huge "up-front" salaries instead of an uncertain share in a film's profits. Bart, *The Word of Heston is Carved in Stone*, *Variety*, Dec. 31, 1990, at 3, col. 5, 5, col. 1 [hereinafter *Carved in Stone*]. During Stallone's negotiations with MGM/UA film studios to direct and star in the film *Rocky IV*, he declared "I want mine NOW!" referring to his request for a \$15 million "up-front" fee, and thereby avoided an accountant's decision as to when his participation would kick in. *Id.* Actor Eddie Murphy has referred to net profit as "monkey points . . . because you read the financial statement and laugh like a monkey." Goldberg, *Entertainment Bar in Uproar Over 'Buchwald'*, *L.A. Daily J.*, Jan. 3, 1991, at 1, col. 6, 5, col. 4. See also Lazarus, *Ensuring a Fair Cut Of a Hit Film's Profits*, 8 *ENT. L. & BUS.* 1, 1 (1989) ("In the film business, actors, directors and producers—third-party profit participants—often cry foul when it comes to what they claim is their fair share of profits of what appears to be a hugely successful motion picture. Phrases like 'creative accounting' are used to characterize the actions of distribution companies that allegedly have siphoned off these profit participants' 'just rewards.' Indeed, the popular perception . . . is that only when a film is a megahit will there be enough profits to prevent a studio from 'hiding' all the money.").

gross profit participants reaping huge sums, while they merely obtain their "up-front" salaries.⁵ Yet, despite the unlikely prospect of a particular film actually achieving net profit, the net profit formulation and the accounting system that supports it have rarely been subjected to extensive judicial scrutiny.⁶

Buchwald v. Paramount Pictures Corp.,⁷ which centers on the 1988 hit movie *Coming to America*, provides a singular and ideal opportunity to examine Hollywood's much maligned accounting system. *Buchwald* challenges the various accounting procedures used by the motion picture studios⁸ to an extent far greater than any other case. In a precedent setting decision in Phase I of the trial,⁹ the Los Angeles Superior Court used copyright principles of access and similarity to impose contractual liability on a motion picture studio for making a film "based upon" a writer's

⁵ See Stevenson, *The Magic of Hollywood Math*, N.Y. Times, Apr. 13, 1990, at D1, col. 3, D2, col. 4 [hereinafter *Hollywood Math*] ("[T]here are almost never any net profits on films with gross-profit participants, and actors, writers, directors and others often resent watching a handful of people walk away with huge sums while they get nothing beyond their salaries.").

⁶ Most litigation centering on the net profit formula ends in settlement. See Ryan, *Life After Buchwald: Spotlight Turns to Studio Accounting Practices*, HOLLYWOOD REP., Aug. 1990, at F-26 [hereinafter *Life After Buchwald*] ("Rarely have these 'net profits' disputes ended up in court . . . points out leading entertainment attorney Barry Langberg, because a settlement is usually reached after profit participants band together to conduct an audit."). Two recent examples are the settlements of actress Jane Fonda's suit against Universal Pictures (for an undisclosed sum), and the suit by author Sidney Sheldon and actors Robert Wagner and Stephanie Powers against Columbia Pictures and Spelling-Goldberg Productions (for approximately \$5 million). Wechsler, *Profits? What Profits?*, FORBES, Feb. 19, 1990, at 38, 38-39. The validity of the gross participation deal has also been the subject of litigation. In *Alperson v. Mirisch Co.*, 250 Cal. App. 2d 84, 58 Cal. Rptr. 178 (1967), the California Court of Appeals affirmed the trial court's holding that percentage of gross receipts agreements (gross profit participation agreements) are properly deductible as costs of production (negative cost) in computing a film's net profit.

⁷ 13 U.S.P.Q.2d (BNA) 1497 (L.A. Super. Ct. 1990) (Phase I), *later proceeding*, 90 L.A. Daily J. App. Rep. 14482, Dec. 26, 1990 (L.A. Super. Ct. Dec. 21, 1990) (Phase II).

⁸ Use of the term "studio" throughout this Comment refers to a leading ("major") film company that finances, produces, and distributes films, and is involved in studio lot ownership. H. ORENSTEIN & D. GUINN, ENTERTAINMENT LAW AND BUSINESS § 9.1.1, at 9-1 n.1 (1990) [hereinafter ENTERTAINMENT LAW]. Today in Hollywood, there are seven major studios: Columbia Pictures, 20th Century-Fox, Walt Disney, Paramount, Warner Brothers ("Warner"), Universal, and MGM/Pathé (despite the fact that it no longer owns a studio lot). See *id.* Pathé Communications Corporation completed its acquisition of MGM/UA on November 1, 1990. Stevenson, *Pathe Finally Takes Over MGM/UA*, N.Y. Times, Nov. 2, 1990, at D1, col. 6. Another recent acquisition of an American film studio by a foreign company took place in December 1990, when the Matsushita Electric Industrial Company completed its takeover of MCA Inc., the parent company of Universal. N.Y. Times, Jan. 1, 1991, at 44, col. 3.

⁹ The trial is currently in Phase III, in which the court will determine the specific amount of damages to which the plaintiffs are entitled pursuant to the court's factual and legal findings in Phase II. For a discussion of the issues surrounding the determination of damages, see *infra* notes 212-18 and accompanying text.

original treatment.¹⁰ In the Phase II decision, also creating precedent, the court held that the net profit contract signed by the plaintiffs was a contract of adhesion and that various terms used to calculate net profit were unconscionable. In fact, the court boldly pronounced that "the net profit formula as written no longer exists."¹¹ Consequently, this aspect of the case may force the motion picture industry to significantly alter the terms of its standard contracts.

Part II of this Comment, after discussing the facts of *Buchwald*, examines the standard used by the court to determine the meaning of "based upon" in an express contract providing no definition of that term. Part III begins by delineating the limits of the court's holding, then explores the consequences of the decision for the future of motion picture industry contract making, and finally, attempts to find, within the parameters set down by the court's construction, a workable and sound definition of "based upon" for future contracts.

The remainder of this Comment considers the Phase II net profit issues and the Phase III damage inquiry. Part IV discusses Paramount Pictures Corporation's ("Paramount") net profit formula, examining the history of the formula and answering the question of how a film that had gross receipts in excess of \$160 million can show a net loss of \$18 million.¹² It also explores the rationale behind the net profit formula—the notion that in Hollywood, "winners" must subsidize "losers." Part V begins by explaining the grounds for the court's finding that the contracts were adhesive and that certain features of Paramount's net profit formula were unconscionable. It then examines how the court disposed of various contract interpretation issues raised by the consultation clause and turnaround provision. Part VI explores the possible ramifications of the court's Phase II decision and offers alternatives to the current net profit formula. This Comment concludes by describing the court's next inquiry in the Phase III damage portion of the litigation, and argues that the court's finding of unconscionability may actually be beneficial to the future of motion picture financing.

¹⁰ An original treatment is a detailed narrative of a proposed film, created by the writer, which outlines the story and the characters in a scene-by-scene progression. ENTERTAINMENT LAW, *supra* note 8, § 9.5.1.2, at 9-18.

¹¹ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14488.

¹² See *infra* notes 83-84 and accompanying text.

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II. *BUCHWALD V. PARAMOUNT PICTURES CORP.*—THE MEANING OF “BASED UPON” IN A MOTION PICTURE CONTRACT

A. *The Facts*

In March 1982, writer/humorist Art Buchwald¹³ sent an original treatment entitled *It's a Crude, Crude World* to producer and co-plaintiff Alain Bernheim who, later that year, brought it to an executive at Paramount.¹⁴ Paramount considered Buchwald's treatment, which it renamed *King for a Day*, as a possible project for the actor Eddie Murphy and envisioned him playing at least two roles.¹⁵ In February 1983, Paramount and Bernheim entered into a contract whereby Bernheim was to produce the film, and receive both a fee and a percentage of the net profit if Paramount acquired and produced a film from Buchwald's story idea.¹⁶ One month later, Paramount and Buchwald entered into a contract whereby Paramount optioned¹⁷ the rights to his story¹⁸ and promised him a fee and a percentage of the net profit if it produced a film “based upon” his story.¹⁹

Buchwald's treatment relates the story of a rich, despotic African potentate who comes to America on a State visit. While in the United States, he is overthrown and left destitute. After his entourage deserts him, he ends up in a Washington, D.C. ghetto, is stripped of his clothes, and eventually obtains employment as a waiter. The African potentate then falls in love with, and marries, a young American woman from the ghetto. After they get married, he becomes the “emperor” of the ghetto, and they live happily ever after.²⁰

During the development process, various events occurred which indicated a link between Art Buchwald and his story, and

¹³ Art Buchwald is a syndicated columnist whose column appears in the *Washington Post*, among other newspapers.

¹⁴ *Buchwald v. Paramount Pictures Corp.*, 13 U.S.P.Q.2d (BNA) 1497, 1497 (L.A. Super. Ct. 1990).

¹⁵ *Id.*

¹⁶ *See id.*

¹⁷ Through an option agreement, a production company acquires the right to purchase an original screenplay or an underlying property (i.e. book, play, treatment, or idea) for a specified period of time. 1 ENTERTAINMENT INDUSTRY CONTRACTS, NEGOTIATING AND DRAFTING GUIDE ¶ 1.01, at 1-3, ¶ 3.01, at 3-2 (D. Farber ed. 1991) [hereinafter NEGOTIATING AND DRAFTING GUIDE]. “The option period gives the producer time to organize the project, have a screenplay written, have a budget drawn up and determine whether the project is viable.” Singer, *Lawyers' Roles: The Film Production Business*, Nat'l L.J., Apr. 30, 1990, at 17, col. 4, 20, col. 1. For a more complete description of the option agreement, see NEGOTIATING AND DRAFTING GUIDE, *supra*, ¶ 3.01, at 3-2.

¹⁸ *Buchwald*, 13 U.S.P.Q.2d at 1497.

¹⁹ *Id.* at 1501.

²⁰ *Id.* at 1504.

Paramount, Eddie Murphy and his managers, and John Landis, the director of *Coming to America*. In 1983, Paramount began searching for potential writers and directors for the *King for a Day* project, and met with Murphy and one of his managers to discuss the project.²¹ Paramount remained in contact with Murphy's managers throughout the next two years, keeping them informed of the status of the project and sending them various versions of the ensuing outlines and scripts.²² In a studio memorandum, Paramount described *King for a Day* as the "Art Buchwald idea" that it was "now developing for Murphy."²³ Also, John Landis was described as a possible director of the "Eddie Murphy picture" *King for a Day*, and a letter was written to Landis describing the film as "intended for Eddie Murphy."²⁴ The first script was not well received. Another writer was hired and a rewrite was sent to one of Murphy's managers, who "read at least part of it."²⁵

After exercising its third option on Buchwald's treatment,²⁶ Paramount, in March 1985, abandoned the *King for a Day* project and placed it into turnaround.²⁷ Unable to successfully complete the project at Paramount, Buchwald optioned his treatment to Warner Brothers Studios ("Warner").²⁸ In 1987, Paramount began work on *Coming to America*, purportedly based on a story by Murphy, with Landis as director.²⁹

Coming to America relates the story of a pampered African prince who, upon discovering that his prearranged wife is very subservient, goes to America to find an independent American woman. Upon arrival in Queens, New York, the prince's and his friend's property is stolen and they begin living in a slum. The prince falls in love with a young American woman and gets a job at a fast-food restaurant. At the end of the film, the two are married in the prince's African kingdom and they apparently live happily ever after.³⁰

²¹ *Id.* at 1497-98. Murphy expressed immediate interest in the project. *See id.* at 1498.

²² *Id.* at 1498-1500.

²³ *Id.* at 1498.

²⁴ *Id.*

²⁵ *Id.* at 1499-1500.

²⁶ *Id.* at 1500.

²⁷ *Id.* For an explanation of what occurs when a film project is placed into turnaround, see *infra* notes 190-91 and accompanying text.

²⁸ *Buchwald*, 13 U.S.P.Q.2d at 1500. Bernheim also contracted with Warner to serve as producer. *See id.*

²⁹ *Id.* at 1500-01.

³⁰ *Id.* at 1504.

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When Warner learned of *Coming to America*, it decided to cancel its *King for a Day* project and a Warner executive cited *Coming to America* as one factor causing the cancellation.³¹ When *Coming to America* was released in 1988, Murphy received the story credit.³²

B. The Court's Construction of the Term "Based Upon"

After the release of *Coming to America*, Buchwald and Bernheim alleged that they viewed the film and "informed Paramount that [it] was in fact based upon 'King for a Day.'" ³³ Plaintiffs further alleged that Paramount told them that it would not compensate them because the studio "denied that 'Coming to America' is based upon 'King for a Day,' claiming instead that Eddie Murphy originated the story idea."³⁴ Consequently, Buchwald and Bernheim instituted suit against Paramount in November 1988, alleging breach of an express contract by the studio and advancing various tort theories of liability.³⁵

The issue in Phase I of the litigation was whether Paramount was contractually liable to Buchwald for having made *Coming to America*, which Buchwald claimed was "based upon" the treatment he had written and optioned to Paramount. The court³⁶ began its analysis by examining the language of the Buchwald-Paramount contract. In relevant part, the contract provided that Buchwald would be entitled to "'contingent consideration' . . . 'only if, a feature length theatrical motion picture shall be produced *based upon* Author's Work.'" ³⁷ The contract, however, did not supply a definition for the term "based upon." Finding little agreement among entertainment industry experts on its meaning,³⁸ the court turned to copyright infringement concepts of ac-

³¹ See *id.* at 1501.

³² *Id.* Two other individuals, who "were chosen to collaborate on the screenplay with Eddie Murphy and Arsenio Hall," were given screenplay credit. *Id.*

³³ Complaint at 9, Buchwald v. Paramount Pictures Corp., 13 U.S.P.Q.2d (BNA) 1497 (No. C-706083) (L.A. Super. Ct. 1990).

³⁴ *Id.*

³⁵ *Id.* at 1.

³⁶ Los Angeles Superior Court Judge Harvey Schneider sat without a jury. Tashman, *Buchwald Suit: Hit Picture Still Shows No Profit*, Nat'l L.J., Apr. 30, 1990, at 17, col. 1 [hereinafter *Buchwald Suit*].

³⁷ Buchwald, 13 U.S.P.Q.2d at 1501 (emphasis added by court) (quoting the Buchwald-Paramount contract). The agreement defined "Work" to include "all prior, present and future versions, adaptations and translations thereof (whether written by Author or by others), its theme, story, plot, characters and their names, its title or titles and subtitles, if any, . . . and each and every part of all thereof." *Id.* (quoting the Buchwald-Paramount contract).

³⁸ The expert opinion on the meaning of "based upon" ranged from "'created out of significant elements from the underlying materials'" to "overriding similarity to plot,

cess and similarity for guidance.³⁹

The *Buchwald* court noted that the same principles utilized in infringement cases have also been used in an "idea" case involving a breach of an express contract—specifically, "that an infer-

theme and characters." *Id.* at 1502. One expert testified that a film is "based upon" underlying material if it is "derived from and incorporated the elements" of the material. *Id.* Another stated that other factors must be considered; i.e., whether the screenplay was written with the specific elements of the story and whether there is similarity in "the basic theme" but not plot, characters and motivation, because these relate to the "development of the project," not its theme." *Id.* (citations omitted) (quoting deposition of Lynn Roth).

³⁹ As stated by Professor Nimmer, "Copyright does not protect ideas, but only the expression of ideas." 3 M. NIMMER, NIMMER ON COPYRIGHT § 16.01, at 16-2 (1990) (footnotes omitted) [hereinafter NIMMER]. Accordingly, a body of case law has developed "to strike a middle ground between the comprehensive protection of copyright on the one hand, and the complete denial of any legal protection for ideas on the other." *Id.* § 16.01, at 16-3.

In his treatise on "The Law of Ideas," Nimmer examines five theories under which ideas can be legally protected: 1) property theory; 2) quasi-contract (implied in law); 3) express contract; 4) implied contract (implied in fact); and 5) breach of a fiduciary relationship. *See id.* §§ 16.02-16.06, 16-5 to -49. Since the plaintiffs entered into express written contracts with Paramount, *see supra* text at notes 16-19, it is useful to make a brief foray into the particular requirements, or hurdles, that need to be overcome to successfully protect an idea based on an express contract theory.

Nimmer stated that "even if plaintiff can prove an express agreement, before he can establish the agreement as a legally binding contract; he must be prepared to deal with three somewhat troublesome problems—namely, consideration, the statute of frauds, and federal preemption [of state law]." NIMMER, *supra*, § 16.04, at 16-17. The *Buchwald* court did not discuss consideration; however, it can be implied, based on Paramount's promise to pay Buchwald a fixed fee and contingent consideration, *see supra* text at notes 17-19, 37, that the court followed Nimmer's view that "if in return for plaintiff's disclosure defendant promises to pay if he uses the idea and plaintiff does in fact disclose his idea, then such disclosure should constitute a valid and binding consideration." NIMMER, *supra*, § 16.04[A], at 16-18 to -19. The statute of frauds was likewise no barrier since the agreement with Paramount was reduced to a writing. *See id.* § 16.04[B], at 16-22 to -24. Finally, Nimmer gives the following analysis of federal preemption by the Copyright Act, which also provides the reason why a breach of contract action under state law is not preempted:

Preemption of state law occurs if the state law creates rights 'that are equivalent to any of the exclusive rights within the general scope of copyright as specified by section 106 in works of authorship that are fixed in a tangible medium of expression and come within the subject matter of copyright as specified by sections 102 and 103 . . . [.]' It is arguable that an idea for a literary work does fall 'within the subject matter of copyright as specified in sections 102 and 103.' Federal preemption would nevertheless seem to be avoided by a failure to meet the other preemption requirement. That is, a breach of contract action . . . is not predicated upon a right that is 'equivalent to any of the exclusive rights within the general scope of copyright . . . [.]'. This for the reason that a contract right may not be claimed unless there exists an element in addition to the mere acts of reproduction, performance, distribution or display. That additional element is a promise (express or implied) upon the part of the defendant.

Id. § 16.04[C], at 16-24 to -25 (footnotes omitted) (emphasis added) (quoting 17 U.S.C. § 301(a) (1988)). Consequently, federal preemption, in addition to consideration and the statute of frauds, did not bar Buchwald's breach of contract claim against Paramount.

For a more extensive analysis of *Buchwald*, as it relates to "the law of ideas," see Martino, *Art Buchwald: Man of Compensatable Ideas*, 1 ENT. L.REV. 191 (1990).

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ence of copying . . . arise[s] where there is proof of access to the material' with a showing of similarity."⁴⁰ Regarding access to Buchwald's treatment, the court found "no real issue" due to the abundant evidence that Murphy and his manager not only knew of the story but also discussed it with an executive at Paramount.⁴¹ Additionally, Murphy's manager read a short outline of Buchwald's treatment.⁴²

The court conducted a more extensive analysis into the issue of similarity.⁴³ The court framed the issue of similarity as follows: "Paramount's obligation to pay Buchwald arose if 'Coming to America' is based upon a *material element* of or was inspired by Buchwald's treatment."⁴⁴

The "material element" test was established in *Fink v. Goodson-Todman Enterprises*,⁴⁵ which held that the similarities between a writer's presentation and pilot script and a producer's television series were sufficient to establish a *prima facie* case that the producer had based its series on the writer's story.⁴⁶ In *Fink*, the plaintiff-writer alleged a breach of an express, oral contract in which the defendant-television producer promised the plaintiff certain compensation if it televised a series based on plaintiff's program or "any material element contained in [it]."⁴⁷ The *Fink* court determined that a "[m]aterial element" could range from a mere basic theme up to an extensively elaborated idea, depending upon what might be proved as the concept of the parties,⁴⁸ and that the search for "points of similarity" must be done both quantitatively and qualitatively.⁴⁹

The "inspiration" test derives from *Minniear v. Tors*,⁵⁰ which held that there was enough evidence for a jury to determine that

⁴⁰ *Buchwald*, 13 U.S.P.Q.2d at 1502 (citing *Golding v. R.K.O. Pictures, Inc.*, 35 Cal. 2d 690, 695, 221 P.2d 95, 98 (1950) (infringement case)). The non-copyright (idea)-breach of contract case cited by the *Buchwald* court was *Fink v. Goodson-Todman Enterprises*, 9 Cal. App. 3d 996, 88 Cal. Rptr. 679 (1970). For an examination of this case, see *infra* notes 45-49 and accompanying text.

⁴¹ *Buchwald*, 13 U.S.P.Q.2d at 1502.

⁴² *Id.* at 1503.

⁴³ "Similarity is . . . a question of fact for the trier of fact to determine." *Id.* (citing *Stanley v. Columbia Broadcasting Sys.*, 35 Cal. 2d 653, 660, 221 P.2d 73, 78 (1950)).

⁴⁴ *Id.* at 1504 (emphasis added).

⁴⁵ 9 Cal. App. 3d 996, 88 Cal. Rptr. 679 (1970).

⁴⁶ See *id.* at 1013, 88 Cal. Rptr. at 692 (stating, in a convoluted manner, that the similarities were "sufficient to preclude a determination . . . that, as a matter of law, it cannot be said that [producer] based [its] series on a material element of [writer's] program").

⁴⁷ *Id.* at 1002, 88 Cal. Rptr. at 685 (brackets in original).

⁴⁸ *Id.* at 1008 n.15, 88 Cal. Rptr. at 688-89 n.15.

⁴⁹ *Id.* at 1010, 88 Cal. Rptr. at 690.

⁵⁰ 266 Cal. App. 2d 495, 72 Cal. Rptr. 287 (1968).

the defendant corporation's television series was inspired by the plaintiff's story ideas and format.⁵¹ In *Minniear*, the plaintiff-writer alleged a breach of an implied contract by the defendant-television producer to make payment of reasonable value for the use of the plaintiff's idea for a television series.⁵²

Admitting that there were differences between Buchwald's *King for a Day* and *Coming to America*,⁵³ the *Buchwald* court observed that "where, as here, the evidence of access is overwhelming, less similarity is required."⁵⁴ Thus, the court did not need to find a great degree of similarity to arrive at the conclusion that *Coming to America* was "based upon" Buchwald's treatment. "Additionally, the court noted that "[e]ven if the similar material is quantitatively small, if it is qualitatively important . . . the trier of fact . . . may properly find substantial similarity."⁵⁵

The court concluded that a determination of similarity should be made by comparing *Coming to America* to "Buchwald's treatment as it evolved in the ['King for a Day'] scripts," not just to the original treatment.⁵⁶ Using this analytical framework, the court considered the following factors in concluding that the two

⁵¹ *Id.* at 505, 72 Cal. Rptr. at 294 ("[T]here are enough similarities in basic plot ideas, themes, sequences and dramatic 'gimmicks' between [the defendant's television series] and [the plaintiff's pilot film] for a jury to infer that [plaintiff's] ideas and format were the inspiration for [the series] . . .").

⁵² *Id.* at 497, 504, 72 Cal. Rptr. at 289, 294. The court determined that there was, in fact, an implied contract, relying on the following statement describing the circumstances in which such a contract may be found:

'[T]he assent of the writer is found in his submission of the idea or material to the producer, with the reasonable expectation of payment which can be inferred from the facts and circumstances. The assent of the producer is manifested by his acceptance of the idea or material submitted under the circumstances, a part of which is that it is reasonably understood that a professional author expects payment of the reasonable value of the idea or the material, if used, so that the conduct of the producer in accepting it implies a promise to fulfill those reasonable expectations.'

Id. at 502, 72 Cal. Rptr. at 293 (quoting *Chandler v. Roach*, 156 Cal. App. 2d 435, 440-41, 319 P.2d 776, 780 (emphasis added by court)). Implied contract theory is one of five theories under which ideas can be legally protected. See *supra* note 39.

⁵³ *Buchwald*, 13 U.S.P.Q.2d at 1504. One difference is the motivation that brought the main character to America. In Buchwald's treatment, he came to purchase weapons, whereas in *Coming to America* he came to find an independent wife. The court ruled that this difference does not preclude the court from finding that the film was "based upon Buchwald's work." *Id.* at 1506. For an additional difference, see *infra* note 57.

⁵⁴ *Buchwald*, 13 U.S.P.Q.2d at 1504. See also *Golding v. R.K.O. Pictures, Inc.*, 35 Cal. 2d 690, 695, 221 P.2d 95, 98 (1950) ("Where there is strong evidence of access, less proof of similarity may suffice.").

⁵⁵ *Buchwald*, 13 U.S.P.Q.2d at 1504 (citing *Fink v. Goodson-Todman Enters.*, 9 Cal. App. 3d 996, 1013, 88 Cal. Rptr. 679, 692 (1970) (quoting *NIMMER, NIMMER ON COPYRIGHT* § 143.12)).

⁵⁶ *Id.* at 1505 n.8 (emphasis added). The court provided two main reasons for deciding to make the comparison in this manner. First, Buchwald's contract "specifically authorized Paramount to 'adapt, use, dramatize, arrange, change, vary, modify, alter, [and] transpose . . . the Work.'" *Id.* (quoting the Buchwald-Paramount contract). And sec-

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stories were similar: 1) each involved a wealthy, pampered, and well-educated young member of African royalty; 2) both depicted their hero experiencing the realities of ghetto life; and 3) in both, the hero took a menial job and married a young American woman.⁵⁷ Other evidence the court considered included the "gimmick," in both the treatment and the film, where the hero uses a mop to foil a robbery attempt,⁵⁸ and the fact that, as contemplated during the development of *King for a Day*, Murphy portrayed multiple characters in *Coming to America*.⁵⁹ These similarities led the court to conclude that Paramount "appropriated and used a qualitatively important part of [Buchwald's] material in such a way that features discernible in [*Coming to America*] are substantially similar" to those in *King for a Day*.⁶⁰

ond, Murphy had access not only to the treatment, but also to the subsequent scripts. *Id.*

⁵⁷ *Id.* at 1504-05. The court agreed with the plaintiffs' comparison of the treatment with the film:

"Both are modern day comedies. The protagonist is a young black member of royalty from a mythical African kingdom, pampered and extremely wealthy, well-educated. They both come to a large city on the American East Coast. And they arrive as a fish out of water from this foreign kingdom.

Abruptly, finding themselves without royal trappings of money and power, they end up in the black, urban American ghetto, about as far culturally as they could ever hope to be from their pampered, royal status in their mythical kingdom. Each character abandons his regal attitudes. Both live in the ghetto as poor blacks experiencing the realities of ghetto life.

Each takes a menial job (sic) as a series of harrowing and comedic adventures in the ghetto, is humanized and enriched by his experiences. Love always triumphing overall, each meets and falls in love with a beautiful young American woman whom he will marry and make his Queen and live happily ever after in his mythical African kingdom."

Id. (quoting opening statement of plaintiffs' counsel).

With regard to the differences between the treatment and the film, the court asserted that although the main character in both stories had different traits (in Buchwald's treatment he was despotic, while in *Coming to America* he was kind and naive), an early decision was made during the development of *King for a Day* to make him more sympathetic. *Id.* at 1506. Since the court believed that *Coming to America* must be compared to Buchwald's treatment as it developed in the resulting scripts, the existence of this initial difference carried little weight. *See id.*

⁵⁸ *Id.* at 1505. The mop "gimmick," according to Buchwald, "provide[d] compelling evidence that the evolution of plaintiffs' idea provided an inspiration for 'Coming to America.'" *Id.* (citing *Minnear v. Tors*, 266 Cal. App. 2d 495, 505, 72 Cal. Rptr. 287, 294 (1968)).

⁵⁹ *Id.* The court also deemed significant the fact that Landis, the director of *Coming to America*, was aware of Buchwald's treatment, had access to it, and was considered as a possible director of *King for a Day*. *Id.* As the court stated, "Since the evidence revealed that Landis had creative input into 'Coming to America,' it is his access and knowledge . . . that is relevant to the issue of similarity." *Id.*

⁶⁰ *Id.* at 1506 (citing *Fink v. Goodson-Todman Enters.*, 9 Cal. App. 3d 996, 1013, 88 Cal. Rptr. 679, 692-93 (1970)). The Buchwald court also relied on *Weitzenkorn v. Lesser*, 40 Cal. 2d 778, 256 P.2d 947 (1953), in which the California Supreme Court overruled a lower court's decision to sustain a demurrer without leave to amend in a case where the defendants used the plaintiff's movie idea. The defendants had expressly agreed to compensate the plaintiff if they used any portion of the plaintiff's idea.

In holding that *Coming to America* is indeed "based upon" Buchwald's treatment, the court refused to accept Paramount's claim that a "substantial similarity" test should be utilized.⁶¹ The court maintained that where there is an express contractual obligation to pay for an idea, "the defendant cannot avoid . . . liability by reason of the fact [that] he did not copy more than the abstract or basis idea of plaintiff's work."⁶² Because the cases cited by Paramount did not involve express contracts with language similar to Buchwald's contract, the court asserted that such reliance was misplaced.⁶³ Finally, the court refused to extend tort liability to Paramount, finding no evidence that Paramount acted in bad faith or that it was guilty of fraud, oppression, or malice.⁶⁴

III. THE LIMITATIONS OF THE COURT'S CONSTRUCTION AND GUIDANCE FOR THE FUTURE

A. Limitations

The Phase I decision has caused some alarm that a "wave of claims" will result as "most popular movies today have similar themes."⁶⁵ The court's decision, however, will not have "broad"

Though the court found no similarity as to the form and manner of expression of the plaintiff's idea and the defendant's movie because the moral of each was entirely different, it ruled that the complaint stated a cause of action because,

[i]t is conceivable . . . that Weitzenkorn might be able to introduce evidence tending to show that the parties entered into an express contract whereby Lesser and Lesser Productions agreed to pay for her production regardless of its protectibility and no matter how slight or commonplace the portion which they used. Such evidence, together with comparison of the productions, would present questions of fact . . . as to the terms of the contract, access, similarity, and copying.

Id. at 792, 256 P.2d at 958.

⁶¹ *Buchwald*, 13 U.S.P.Q.2d at 1503.

⁶² *Id.* (quoting *NIMMER*, *supra* note 39, § 16.08, at 16-64, 65 n.58 (1990)). Professor Nimmer stated that "the copyright requirement that similarity between plaintiff's and defendant's work be 'substantial' . . . is not applicable in idea cases. If the only similarity is as to an idea then by definition such similarity is not substantial in the copyright sense." *Id.* (quoting *NIMMER*, *supra* note 39, § 16.08, at 16-64, 65 n.58 (1990)).

⁶³ *Id.* (citing *Teich v. General Mills, Inc.*, 170 Cal. App. 2d 791, 339 P.2d 627 (1959); *Henried v. Four Star Television*, 266 Cal. App. 2d 435, 72 Cal. Rptr. 223 (1968); *Whitfield v. Lear*, 582 F. Supp. 1186 (E.D.N.Y.), *rev'd*, 751 F.2d 90 (2d Cir. 1984)).

⁶⁴ *Id.* at 1507. This aspect of the decision foreshadowed the court's ruling in the Phase II inquiry into the net profit formula, in which Buchwald and Bernheim once again advanced various tort theories of liability. In considering the issue of whether Paramount and the plaintiffs were in a fiduciary relationship, the court extensively quoted its language from the Phase I decision, and ruled that the only sense in which there was a fiduciary relationship between the parties was with regard to Paramount's duty to render an accounting to profit participants. *Buchwald*, 90 L.A. Daily J. App. Rep. at 14489 (Phase II).

⁶⁵ Goldberg, *New Contract Language Likely*, L.A. Daily J., Jan. 9, 1990, at 9, col. 1, col. 3 [hereinafter *New Contract*]. Paramount's counsel, attorney Robert S. Draper, has pre-

impact because its resolution of the "based upon" issue may be limited to situations where proof of access is strong. Despite the court's admonition that the case should not be read as one concerning whether Murphy "stole" Buchwald's concept,⁶⁶ Murphy's, as well as Paramount's, access to Buchwald's story was central to the court's decision.⁶⁷ The court required less similarity between the stories precisely because the link between Buchwald's story and Paramount and Murphy was so pronounced.

Consequently, fear that the decision will result in numerous claims by disgruntled writers is unfounded. Writers seeking damages on the basis of similarity will need to prove a degree of access similar to that in *Buchwald* and at least some similarity in the story lines.⁶⁸ Although the court did not address the issue of how much access is required where there is a high degree of similarity, courts will require at least minimal access.⁶⁹ The combination of access and similarity evident in *Buchwald* is not likely to be found in many situations. Merely signing a contract containing a "based upon" provision will not provide a disgruntled writer with enough evidence to attack a similar story idea which could easily be dismissed as mere "coincidence."⁷⁰ Therefore, under a strict construction of the decision, simply showing that a story idea submitted to a studio is similar to a movie later produced will not be enough—and in most situations, that is all writers will be able to prove. Moreover, writers are not usually fortunate

dicted that if the decision is sustained on appeal, "[studios will] have to stop talking to writers about their ideas" to avoid the danger of "people . . . dragging 400 old stories out of the files to look for similarities." *Id.*

⁶⁶ *Buchwald*, 13 U.S.P.Q.2d at 1501. The court maintained that the case is "primarily a breach of contract case between Buchwald and Paramount." *Id.*

⁶⁷ The *Buchwald* court, toward the end of its discussion comparing the film with Buchwald's treatment, conditioned its holding on the access evident in the case. *See id.* at 1506-07 (quoting *Fink v. Goodson-Todman Enters.*, 9 Cal. App. 3d 1009, 1013, 88 Cal. Rptr. 679, 692 (1970)) ("Bearing in mind the unlimited access [proved] in this case and the rule that the stronger the access the less striking and numerous the similarities need be . . .").

⁶⁸ As one commentator has stated, "If Paramount had not had such obvious access to Mr. Buchwald's idea, the similarities between Mr. Buchwald's 'King For a Day' and Mr. Murphy's 'Coming to America' might have been considered a coincidence." Harmetz, *Buchwald Rulings: Film Writers vs. Star Power*, N.Y. Times, Jan. 15, 1990, at D6, col. 3, col. 5 [hereinafter *Film Writers*] (emphasis added).

⁶⁹ *See* *Golding v. R.K.O. Pictures, Inc.*, 35 Cal. 2d 690, 695, 221 P.2d 95, 98 (1950) ("[I]f the evidence of access is uncertain, strong proof of similarity should be shown before the inference of copying may be indulged.").

⁷⁰ Most films are variations of other films. *Film Writers*, *supra* note 68, at D6, col. 5. As producer Scot Rudin has stated, "Ideas are in the air. How else do you explain five movies in one year about people swapping bodies and ages: 'Vice Versa,' 'Like Father, Like Son,' '18 Again,' 'Big,' and an Italian Picture, 'Da Grande?'" *Id.* Further examples are the three films released in August 1985 that concerned adolescents conducting strange science experiments: *Weird Science*, *Real Genius*, and *My Science Project*. *Id.*

enough to enter into written agreements, but rather are covered by deal memos⁷¹ and oral agreements, which lack "based upon" clauses and thus afford writers less protection for their ideas.⁷² Additionally, the impact of *Buchwald* will be limited because Paramount's expropriation of Buchwald's idea can be viewed as an unusual, yet particularly egregious action, which would not often recur.⁷³

B. Guidance for the Future—New Contract Language?

One possible effect of the *Buchwald* decision is that studios, entering into written agreements similar to Buchwald's, will begin to define the words "based upon" in their contracts. This option, however, has its own inherent drawbacks and difficulties. The studios could attempt to protect themselves by defining "based upon" in such a way that, for a writer to prevail, he would have to prove "substantial similarity." "Substantial similarity" could be defined to include plot, character, and character motivation as factors that must be present for one story to be similar to another. By increasing the number of evaluative factors, the instances where such a finding could be made will be narrowed.

In *Buchwald*, despite the fact that the main character's motivation in *Coming to America* was dissimilar from that of the main character in *King for a Day*,⁷⁴ the court found the film to be "based upon" the treatment because of the tremendous degree of access. Yet the court only reached the question of access because there was no contractual language defining the meaning of "based upon." In the wake of *Buchwald*, if studios begin to include language that provides a broad definition of "based upon," plaintiffs will find it more difficult to prevail, regardless of the degree of access. Plaintiffs will be confronted with a situation in which they will have to fulfill numerous and rigorous requirements to satisfy the "based upon" provision. Including a broad definition of "based upon," however, has its own attendant prob-

⁷¹ A deal memo is a contract agreed to in outline form. Representatives of both sides will later structure the contract's details. VOGEL, ENTERTAINMENT INDUSTRY ECONOMICS § 4.1 (1986).

⁷² See *New Contract*, *supra* note 65, at 9, col. 2. The reason for this higher standard may be that both deal memos and oral agreements, unlike formal written contracts, are less explicit and do not contain "based upon" clauses.

⁷³ According to one account of the trial, it was a mystery to many in the entertainment industry why Paramount did not simply settle out of court. See *Life After Buchwald*, *supra* note 6, at F-26, col. 3. Art Buchwald believes that a settlement did not occur because Paramount was trying to protect its relationship with Eddie Murphy (who received sole story credit). *Id.*

⁷⁴ See *supra* notes 53, 57.

lem—lawyers and agents would likely advise writers not to enter into such a contract since they would then have little protection were a studio to expropriate their ideas.⁷⁵

A more likely effect of the *Buchwald* court's Phase I decision is that the Writers Guild of America ("WGA"), an 8,000-member-strong union, will begin to "look closely at their own routine arbitration process, whereby they determine, in conjunction with studios, the appropriate writer credits in each case."⁷⁶ In the credit allocating process for *Coming to America*, *Buchwald's* name was not even mentioned.⁷⁷ Considering the fact that Bernheim actually registered *Buchwald's* original treatment with the WGA in 1982,⁷⁸ it is clear that improvements need to be made in the credit allocating process.⁷⁹ The WGA has recently formed a committee to examine the issue of credits.⁸⁰ One course of action the committee could consider to avoid a *Buchwald*-type situation, and better safeguard writers' registered treatments and other underlying material, would be to scrutinize more closely a

⁷⁵ A further problem stems from the likelihood that a court would find such a provision one-sided and not easily justified (because it virtually precludes liability for the expropriation of an idea). Under the *Buchwald* analysis of unconscionability in Phase II, see *infra* text at note 165, it may thus be unconscionable. And depending on whether or not the studios negotiate this provision out of the contract with more than merely those who have the requisite clout, a contract with such a provision might even be an adhesive contract. For a discussion of adhesion, see *infra* notes 130-31 and accompanying text.

⁷⁶ Guider, *Writers Flex Their Muscles Thanks to Buchwald Win*, Variety, Jan. 17, 1990, at 1, col. 3, 4, col. 3 [hereinafter *Writers Flex*]. Proper credit allocation has determinative weight as to a writer's future earning power and credibility. See MULLER, SHOW BUSINESS LAW 53 (1991) ("For the writer, proper credit can mean the difference between professional stagnation and the successful progression up the hierarchy so important in the writer's career."). "The determination of a screen credit, an extremely important and volatile issue, is the subject of a special arbitration provision of the Writers Guild of America[s] Theatrical and Television Basic Agreement." ENTERTAINMENT LAW, *supra* note 8, § 9.5 n.40, at 9-17 (citing Writers Guild Theatrical Schedule A and TV Schedule A).

⁷⁷ See *Writers Flex*, *supra* note 76, at 4, col. 3.

⁷⁸ *Buchwald*, 13 U.S.P.Q.2d. at 1497.

⁷⁹ The WGA's credit allocation procedures recently came under attack in another case that involved an Eddie Murphy film. *Ferguson v. Writers Guild of America, West, Inc.*, 91 L.A. Daily J. App. Rep. 872, 875, Jan. 23, 1991 (Cal. Ct. App. Jan. 17, 1991) ("Judicial review of the Writers Guild's credits determination is restricted to considering whether the party challenging the determination has demonstrated a material and prejudicial departure from the procedures specified in the Credits Manual."). *Ferguson* involved a dispute over who should properly be credited with screenplay and story credit for the film *Beverly Hills Cop II*. *Id.* at 873. After the WGA allocated to the plaintiff shared screenplay credit and no story credit, he "petition[ed] . . . the court to . . . require[] the Writers Guild to set aside its credit determination and make a new determination giving [him] sole screenplay credit and sole story credit." *Id.* The plaintiff contended that there were various procedural defects in the credit allocation process but the court held that because he did not demonstrate that the irregularities were presented before the Writers Guild's Policy Review Board, his contentions were not "preserved for judicial review." *Id.* at 875.

⁸⁰ *Film Writers*, *supra* note 68, at D6, col. 6.

film's development process, with particular attention given to story idea development.

IV. NET PROFIT OR NET LOSS?

A. *The Meaning of Net Profit*

The chief result of Phase I of the trial was that Buchwald and Bernheim became net profit participants in *Coming to America*. The issues in Phase II involved the extent to which Buchwald and Bernheim were bound by the specific terms of their contracts with Paramount. The court's task in Phase II was to resolve various issues concerning Paramount's accounting practices and, specifically, the studio's net profit formula. Under the terms of their respective contracts with Paramount,⁸¹ Buchwald was to receive a writer's fee of \$65,000 and 1.5 percent of the net profit, and Bernheim \$200,000 and 17.5 percent of the net profit for his role as producer, if Paramount made a film "based upon" Buchwald's story.⁸² Yet Paramount maintained that *Coming to America*, which earned over \$160 million in gross revenues,⁸³ had yet to show a net profit, and that the film was running an \$18 million deficit.⁸⁴

⁸¹ Writers' agreements with studios will occasionally tie the net profit definition to that contained in a more powerful negotiator's contract. See ENTERTAINMENT LAW, *supra* note 8, § 9.5.3.1, at 9-28. Here, Art Buchwald first entered into an option agreement with Bernheim in which Buchwald agreed that his share of the net profits would be "calculated on the same basis and subject to the same conditions as net profits are calculated for [Bernheim]." Memorandum of Points and Authorities of Defendant Paramount Pictures Corporation Re Phase II Hearing on Legal and Contract Interpretation Issues at 3, Buchwald v. Paramount Pictures Corp., 90 L.A. Daily J. App. Rep. 14482 (L.A. Super. Ct. 1990) (No. C-706083) [hereinafter Memorandum of Points]. Therefore, the court's determination of the issues surrounding the net profit formula for Bernheim were likewise decisive for Buchwald.

⁸² Goldberg, *Buchwald Must Now Prove 'Net Profits'*, L.A. Daily J., Jan. 12, 1990, at 5, col. 5 [hereinafter *Prove 'Net Profits'*]. Bernheim's 17.5% net profit share was the floor established by the relevant section in his deal memo. *Buchwald*, 90 L.A. Daily J. App. Rep. at 14488. A profit participation "floor" is the "limit . . . beyond which the participant's participation cannot be reduced." NEGOTIATING AND DRAFTING GUIDE, *supra* note 17, ¶ 28.06 [1], at 28-19. A "floor" is set up so that other third party participations do not encroach on the producer's share of net profit. See *id.* Bernheim argued that he was entitled to 33.5% of *Coming to America's* net profit based on the reasoning that Paramount's alleged breach of the consultation clause (requiring that Paramount consult Bernheim on gross and net profit participations granted to third parties) entitled him to "the highest percentage of net profit permissible under . . . the Deal Memo." *Buchwald*, 90 L.A. Daily J. App. Rep. at 14488. For a discussion of the court's findings relating to the consultation clause, see *infra* notes 176-89 and accompanying text.

⁸³ "[G]ross revenues is the amount of box office receipts which is paid by the exhibitor (the theater) to the distributor of the picture." Rudell, *Analysis of Net Profits*, 119 N.Y.L.J., Jan. 27, 1984, at 1, col. 1, 2, col. 1.

⁸⁴ Goldberg, *Wide Fallout Expected From Buchwald Win*, L.A. Daily J., Dec. 24, 1990, at 1, col. 4 [hereinafter *Wide Fallout*]. For a chart describing Paramount's balance sheet for *Coming to America*, see *Hollywood Math*, *supra* note 5, at D1, col. 4. For a more precise

The standard formulation of a motion picture's net profit is the remaining balance of a distributor's gross receipts⁸⁵ after the film's distribution fees,⁸⁶ distribution expenses,⁸⁷ and negative costs (including production costs,⁸⁸ overhead,⁸⁹ interest on unrecouped production costs,⁹⁰ and gross profit participations⁹¹) are deducted.⁹² Paramount's definition is in accord:

"Net Profits" is the remainder of the revenues derived by a studio from a motion picture after deduction of, *first*, the studio's distribution fee, *second*, the studio's costs to advertize and distribute the film, and *third*, the cost of producing the movie together with [a] 15% overhead charge and accrued interest at a prescribed rate.⁹³

description of Paramount's costs and fees, see Robb, *Par to Buchwald: We're \$18-Mil in Hole*, *Variety*, Mar. 28, 1990, at 5, col. 3.

⁸⁵ A distributor's gross receipts is the aggregate of what exhibitors pay for the right to exhibit a film. Note, *A Trade-Based Response to Intellectual Property Piracy: A Comprehensive Plan to Aid the Motion Picture Industry*, 76 GEO. L.J. 417, 419 (1987) [hereinafter *A Trade-Based Response*] (examining the problems associated with foreign film distribution by American filmmakers and offering solutions to ensure that they receive just compensation).

⁸⁶ The distribution fee reimburses the distributor for its selling efforts and the maintenance of its home office and branch staff. D. LEEDY, *MOTION PICTURE DISTRIBUTION—AN ACCOUNTANT'S PERSPECTIVE* 23 (1980) [hereinafter *LEEDY*]. The distribution fee is retained in accordance with the provisions of the outside profit participant's contract. *Id.* at 22. Legal and accounting costs, as well as executive salaries, are included in the distribution fee. Sills & Axelrod, *Profit Participation in the Motion Picture Industry*, L.A. LAW., Apr. 1989, at 31, 32 [hereinafter *Profit Participation*].

⁸⁷ Advertising and publicity expenditures, spent before any film rental revenue is earned, constitute the greatest distribution expense. LEEDY, *supra* note 86, at 26. Another large distribution expense is the cost of film prints, including film reels and cans. *Id.* at 41; *Profit Participation*, *supra* note 86, at 33. Taxes (the main component of which are foreign remittance or gross receipts taxes), dues and assessments charged by the Motion Picture Association of America ("MPAA") and the Association of Motion Picture and Theatrical Producers ("AMPTP"), freight charges, payments to checking services that audit theaters, and residuals (*i.e.* payments required by various guild and union agreements) are also components of a film's distribution expense. *Id.* at 33, 54-56.

⁸⁸ Production costs include story rights acquisition, pre-production (script development, set design, casting, crew selection, costume design, location scouting, and preparation of a detailed budget), principal photography, and post-production (editing, scoring, adding titles and credits, dubbing, special effects, and synchronization of music, speech, and other sound tracks). Kells, *Behind Hollywood's Cameras: Motion Picture Accounting and Financing*, 160 J. ACCT. 140, 142 (1985).

⁸⁹ The overhead charge is a flat fee which covers the indirect costs of production by applying a contractually stipulated rate to all direct production costs. See LEEDY, *supra* note 86, at 47.

⁹⁰ The interest charge compensates the studio for its investment. *A Trade-Based Response*, *supra* note 85, at 420 n.26.

⁹¹ For a discussion of gross participations, see *infra* notes 116-20 and accompanying text.

⁹² *E.g.*, BREGGIO & HOLLANDER, *Film*, in *NEGOTIATING CONTRACTS IN THE ENTERTAINMENT INDUSTRY* 232 (J. Breggio ed. 1986) [hereinafter *BREGGIO & HOLLANDER*]; *A Trade-Based Response*, *supra* note 85, at 420; *Profit Participation*, *supra* note 86, at 32.

⁹³ Memorandum of Points, *supra* note 81, at 2-3 (emphasis in original). For a description of Paramount's standard net profit definition, see T. SELZ, M. SIMENSKY & P. ACTON, *ENTERTAINMENT LAW LEGAL CONCEPTS & BUSINESS PRACTICES* F-77-99 (1983).

Paramount treats gross participation payments as an element of negative cost.⁹⁴ Net profit participations occur at breakeven, the point where a film's negative cost (including overhead and interest) is first recouped in full.⁹⁵ Since Paramount, as is generally the case, does not recoup its negative cost until both the distribution fee and the distribution expenses are recovered, breakeven does not occur until well into the accounting process.⁹⁶

The controversy surrounding the term net profit is generated in part by the fact that, as Paramount argued, it is not profit "in the strict accounting sense."⁹⁷ Rather, it is a contractually defined formula that gives certain contributors to a motion picture a share of the bounty, or a "bonus," once the studio recovers its contractually defined share.⁹⁸ In fact, Bernheim's deal memo contained Paramount's definition of net profit and the manner in which it was to be calculated. Moreover, Bernheim could not claim ignorance of the net profit formulation as an industry practice. The evidence clearly indicated that Roger Davis,⁹⁹ Bernheim's agent, made the decision

For 20th Century-Fox's contract form defining net profit, see *NEGOTIATING AND DRAFTING GUIDE*, *supra* note 17, Form 28-1, at 28-21. For Warner's form for computing the payment of net profit, see *NEGOTIATING AND DRAFTING GUIDE*, *supra* note 17, Form 28-2, at 28-52.

⁹⁴ Memorandum of Points, *supra* note 81, at 30. The validity of this practice was upheld in *Alperson v. Mirisch Co.*, 250 Cal. App. 2d 84, 58 Cal. Rptr. 178 (1967). See *supra* note 6.

⁹⁵ BREGGIO & HOLLANDER, *supra* note 92, at 232.

⁹⁶ *Id.* at 231-32. For an excellent Comment that explains the operation of net profit participation contracts by juxtaposing a hypothetical movie deal against various contracts, see Comment, *Net Profit Participations in the Motion Picture Industry*, 11 *LOV. L.A. ENT. L.J.* 23 (1991).

⁹⁷ *Life After Buchwald*, *supra* note 6, at F-27, col. 2. See also Declarations of Defendant Paramount Pictures Corporation Re Phase II Hearing on Legal and Contract Interpretation Issues at 1, *Buchwald v. Paramount Pictures Corp.*, 90 L.A. Daily J. App. Rep. 14482 (L.A. Super. Ct. 1990) (No. C-706083) [hereinafter *Declarations of Defendant*] ("What must be kept in mind . . . is that net profit participations . . . are negotiated contractual definitions which have evolved within the motion picture industry and have little to do with real profit of a picture as measured by generally accepted accounting principles.") (quoting Nochimson & Brachman, *Contingent Compensation for Theatrical Motion Pictures*, in *LEGAL ASPECTS OF THE ENTERTAINMENT INDUSTRY: CONTINGENT COMPENSATION IN MOTION PICTURES AND TELEVISION*, 31ST ANNUAL PROGRAM 1 (1985)); *NEGOTIATING AND DRAFTING GUIDE*, *supra* note 17, ¶ 28.01, at 28-4 ("[T]hese definitions are artificially [sic] created and are not usually dependent upon any generally recognized accounting principles."); *Buchwald Suit*, *supra* note 36, at 17, col. 1 ("Profit participations in the motion picture industry are best characterized as supplemental contingent compensation . . .").

⁹⁸ In one of the briefs Paramount submitted to the court, the studio stated that "[s]ignificantly, 'net profits' is not a share of the studio's 'profits,' but instead an agreed-upon formula for defining a point at which contingent payments are to be made." Robb, *Buchwald Files For Cut of 'America' Profits As Par Counterattacks*, *Variety*, May 23, 1990, at 3, col. 1, col. 2. Studio executives claim that "it is common knowledge to those on both sides of deals that net profit arrangements rarely pay out significant sums, and that when they do, they are a bonus for a film's especially strong financial performance." *Hollywood Math*, *supra* note 5, at D2, col. 4 (emphasis added).

⁹⁹ Roger Davis is Chairman of the Executive Committee of the Board of Directors of

not to seek terms more advantageous than a net profit participation.¹⁰⁰ Davis further testified that he could not get Bernheim a better deal.¹⁰¹ Lastly, he knew of the studio's accounting practices at the time the contract was entered into and the potential that gross participations would come out of the producer's net profit share.¹⁰² This evidence seems to lend credence to Paramount's contention that considering Bernheim's "poor track record," his contract was the best deal he could obtain.

As a consequence of freely entering a contract which ultimately afforded them an unlikely chance of receiving the net profit "bonus," Buchwald and Bernheim tried to escape from under their contracts by focusing their efforts on attacking the entire contract as adhesive, individual clauses as unconscionable, and certain expenditures as excessive.¹⁰³ They also raised claims attempting to show that Paramount owed them a fiduciary duty that superseded the written terms of their contracts¹⁰⁴ and was bound by a covenant of good faith and fair dealing.¹⁰⁵ In raising these arguments, plaintiffs called into question the principal rationale underlying the motion picture industry's accounting system—that most films are financial failures and that as a result, the successes must compensate for the failures.

B. Historical Development and Economic Rationale

Prior to discussing Phase II of the *Buchwald* decision, it is useful to examine the historical development and economic ra-

the William Morris Agency. Rudell, *'Buchwald' Case Affidavits and Net Profit*, 204 N.Y.L.J., Sept. 28, 1990, at 3, col. 1 [hereinafter *Buchwald Case*].

¹⁰⁰ Memorandum of Points, *supra* note 81, at 4.

¹⁰¹ Davis testified that,

Mr. Bernheim was coming off of two unsuccessful pictures which he had produced or co-produced. . . . I made the decision not to ask for more than I asked for because to me and to him—I discussed it with him, the most important thing was to make a development deal to get him some up-front money

Id. at 5. The two previous films, *Yes, Giorgio*, starring Luciano Pavarotti, and *Purple Rain*, starring the popular music star Prince, were deemed by Paramount to be both critical and financial failures. Goldberg, *Buchwald Suit For Film's Profits In Judge's Hands*, L.A. Daily J., Dec. 7, 1990, at 1, col. 2, 5, col. 3 [hereinafter *Film's Profits*].

¹⁰² Memorandum of Points, *supra* note 81, at 6. For an explanation of how a producer's net profit share can be reduced by gross profit participations, see *supra* note 82.

¹⁰³ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14482-83.

¹⁰⁴ For a description of the court's resolution of the plaintiffs' tort argument, which was also raised in Phase I of the litigation, see *supra* note 64 and accompanying text.

¹⁰⁵ As stated by the court, plaintiffs' argument was that "Paramount breached the implied covenant of good faith and fair dealing by improperly or excessively charging a number of different items as costs on *Coming to America*." *Buchwald*, 90 L.A. Daily J. App. Rep. at 14489. The court eventually found it unnecessary to resolve this issue because it believed that "application of the doctrine of unconscionability will produce damages at least equal to damages that could be awarded for a breach of the covenant." *Id.*

tionale behind the net profit formula. Although the formula's background and basis are not central to the court's resolution of the issue of unconscionability, they help to explain the relationship between net and gross profit deals, and more significantly, the studios' position on the net profit formula.

In one of the most insightful affidavits submitted in support of Paramount, Mel Sattler¹⁰⁶ testified that the first net profit deal was struck in 1950 in actor Jimmy Stewart's contract for the motion picture *Winchester '73*.¹⁰⁷ Unable to provide Stewart with the \$200,000 to \$250,000 he usually commanded per film, Universal, in lieu of fixed "up-front" compensation, gave him a fifty percent share of the film's "net profits," defined in the contract as the point at which the film earned in gross receipts twice its negative cost.¹⁰⁸ This was the contractually defined breakeven point. The studio gave Stewart this participation to minimize its risk by immediately reducing the film's production cost.¹⁰⁹ Thus, at its inception, the net profit deal was intended to be a risk reducer for the studio because it spread part of the risk of filmmaking to the performer.

Sattler asserted that "[n]et [p]rofits' deals soon ceased being a way to share the risk of failure and instead, became a way for performers to share only the rewards of success."¹¹⁰ Agents began demanding such compensation on behalf of their clients in addition to, rather than in lieu of, their salary.¹¹¹ In essence, these demands undermined net profit's risk reducing function. The studios responded in the mid-1950s, modifying the amount of revenue needed to breakeven by increasing distribution fees and charging interest on money borrowed and advanced for production costs.¹¹² This practice had the effect of assuring the studios a larger share of the revenues.¹¹³

Today, the gross participation deal has replaced the net

¹⁰⁶ Sattler is a 43-year veteran of the motion picture industry and currently Senior Executive Consultant for MCA/Universal Studios. Declarations of Defendant, *supra* note 97, at 6.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 10.

¹⁰⁹ *Id.* at 9-10; Robb, *Buchwald, Par Experts Wrestle In Profits Bout*, *Variety*, June 27, 1990, at 3, col. 1, 3, col. 3-4 [hereinafter *Profits Bout*].

¹¹⁰ Declarations of Defendant, *supra* note 97, at 10; *Profits Bout*, *supra* note 109, at 3, col. 5.

¹¹¹ Declarations of Defendant, *supra* note 97, at 10; *Profits Bout*, *supra* note 109, at 3, col. 5.

¹¹² Declarations of Defendant, *supra* note 97, at 11; see *Profits Bout*, *supra* note 109, at 28, col. 4.

¹¹³ Declarations of Defendant, *supra* note 97, at 11; see *Profits Bout*, *supra* note 109, at 28, col. 4.

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profit deal as a risk reducer. There is a general view among studio executives that gross participation deals significantly reduce the risk that a picture will not recover its costs.¹¹⁴ This is because an actor like Eddie Murphy has the box office appeal to ensure that a motion picture will be a success regardless of how it is received by film critics.¹¹⁵ Certain individuals, depending on their box office appeal, may receive a percentage of the gross either before or after the breakeven point.¹¹⁶ Murphy's gross deal for *Coming to America* entitled him to an off-the-top share, from the first dollar received by Paramount,¹¹⁷ before Paramount started accounting for the film's costs.¹¹⁸ Landis' adjusted gross participation¹¹⁹ began, according to the terms of his contract, after a

¹¹⁴ See Goldberg, *Film Accounting Practices Detailed By Studio Insiders*, L.A. Daily J., June 22, 1990, at 1, col. 4 [hereinafter *Film Accounting*]. Paramount maintained that Art Buchwald's treatment carried little assurance that a movie produced from it would be a success and that consequently, it "did little to reduce Paramount's risks in developing, producing and distributing a picture based upon it." Declarations of Defendant, *supra* note 97, at 76-77. In comparison, Eddie Murphy's gross deal is viewed as reducing these risks because his "box-office appeal is undisputed." *Id.* at 77. Note, however, that the risk reduction that gross participation deals afford is a function of the box office star's ability to draw patrons into the theater; the net profit deal, in contrast, was originally intended to reduce risk by decreasing the amount of "up-front" compensation paid out by the studio.

¹¹⁵ *Coming to America* did not receive favorable reviews yet "is described as one of the 25 most profitable films of all time." *Film Accounting*, *supra* note 114, at 1, col. 4. It ranked third in box office receipts in 1988. *Prove 'Net Profits'*, *supra* note 82, at 5, col. 5.

Paramount contended that it is a "time-tested fact that top box office stars . . . attract larger audiences and generate more revenue." Declarations of Defendant, *supra* note 97, at 32. Incidentally, a top box office star's gross participation can translate into a large percentage of film revenue. For instance, Jack Nicholson's contract for the 1989 "blockbuster" *Batman* entitled him to a share of the film's rentals, and merchandising revenue, from which he may receive as much as \$40 million. Harnetz, *Hollywood Registers A Bonanza For 1989*, N.Y. Times, Jan. 4, 1990, at C17, col. 1. Still, it should be understood that nothing can assure box office success. See Simensky, *Determining Damages for Breach of Entertainment Agreements*, 8 ENT. & SPORTS LAW. 1, 2 (1990) (exploring the difficulties involved in assessing "reasonable foreseeability" in determining damages for the breach of entertainment agreements). As author/screenwriter William Goldman concluded from what he termed "the Heaven's Gate era," "Movies are a gold-rush business" in which a film's success can never be predicted. See W. GOLDMAN, *ADVENTURES IN THE SCREEN TRADE: A PERSONAL VIEW OF HOLLYWOOD AND SCREENWRITING* xi (1983) (emphasis in original).

¹¹⁶ Goldberg, *Studio Claims 29 of Its Films Paid Net Profits*, L.A. Daily J., July 16, 1990, at 1, col. 4. Gross profit participations create the phenomenon known as the "rolling breakeven," where gross and adjusted gross participations are fed back into a film's negative cost, thereby "continuously pushing back the point at which a picture breaks even and supposedly begins generating a profit." *Film Accounting*, *supra* note 114, at 1, col. 4 (quoting the declaration of Rudolph Petersdorf, a former business affairs executive for Desilu Productions, Universal Productions, and Warner).

¹¹⁷ Declarations of Defendant, *supra* note 97, at 34.

¹¹⁸ In "first dollar" or "true gross" deals, no deductions are permitted before the participation is determined. See *Buchwald Suit*, *supra* note 36, at 17, col. 3.

¹¹⁹ Generally, in an adjusted gross deal, guild payments (residuals), trade association dues, collection costs, advertising expenses, and film print costs are deducted from gross receipts before the participation is determined. *Buchwald Suit*, *supra* note 36, at 19, col. 1.

contractual, artificially-defined breakeven point was reached.¹²⁰ To date, Murphy and Landis have collected \$10 and \$1 million in gross profits, respectively.¹²¹

The main rationale offered by Paramount for the standard net profit contract is what Sattler referred to as the "fundamental economic underpinning" of the motion picture business: "a studio must recoup not only its investment in a successful motion picture, but also sufficient additional revenues therefrom to cover the studio's unrecovered investment on its unsuccessful motion pictures, its ongoing development program, its distribution organization, and to finance its slate of future motion pictures."¹²² In other words, those films which generate substantial revenue ("winners") function to subsidize those films which fail to make a return on their investment ("losers"), as well as providing funds for other studio needs. Sattler maintained that a studio's need to keep revenues in excess of a film's direct cost is the result of "three industry maxims": 1) most films fail to recover their production costs and distribution expenses; 2) the success of a motion picture cannot be predicted; and 3) the studio has no contractual right to ask net profit participants to share the risks attendant to a film.¹²³ By postponing the point where a studio begins sharing with profit participants until it has "recovered a significant return on its investment," the net profit deal, the studios believe, assures them the means to remain viable economic enterprises.¹²⁴

¹²⁰ Declarations of Defendant, *supra* note 97, at 34.

¹²¹ *Hollywood Math*, *supra* note 5, at D2, col. 2. The gross profit share allocated to Murphy was in addition to a \$7 million acting fee. *Film's Profits*, *supra* note 101, at 5, col. 2.

¹²² Declarations of Defendant, *supra* note 97, at 14; *Buchwald Case*, *supra* note 99, at 3, col. 3. See *Profits Bout*, *supra* note 109, at 28, col. 5.

¹²³ Declarations of Defendant, *supra* note 97, at 15. This comports with Paramount's view that a net profit deal is a bonus for those who incur none of the risks. Memorandum of Points, *supra* note 81, at 2. By introducing Sattler's testimony, Paramount was attempting to prove that "'Net Profits' deals are fair to participants, who shoulder no part of the enormous risk of developing, making and distributing a movie and have no responsibility for making the studio whole when, as is normally the case, a movie proves financially disappointing." *Id.*

¹²⁴ See Declarations of Defendant, *supra* note 97, at 15. Sidney H. Sapsowitz, a 30-year veteran of the motion picture industry who has conducted audits for profit participants and is currently a consultant, went even further to describe a studio's precarious financial position. He testified that "a studio can only survive in the long run if it is able to achieve and retain a multiple of its total investment in successful pictures and thereby offset unrecovered costs from the many unsuccessful pictures, plus the organizational overhead cost of doing business in the motion picture industry." *Id.* at 70. According to Sapsowitz, most development projects do not proceed to production. If the studios were not allowed to allocate returns from successful films to failed projects, the continuing overhead cost, which is not attributable to any particular film, would remain unrecovered. *Id.* at 72. As a consequence, Sapsowitz argued that "[a] studio could not

Inherent in Paramount's argument is the proposition that its definition of net profit should be held valid by the court because that definition is the only fair one. This proposition, however, assumes that a majority of motion pictures are failures and that as a consequence, the industry is forced to shape its accounting principles in a fashion that ensures that the studios recoup their investment.¹²⁵ Paramount's argument that the need to recoup its investment on financially unsuccessful films requires the current accounting procedures is questionable.

Paramount tried to support its view that producing films is a risky venture, which requires that winners subsidize losers, by presenting the court with the following statistics: of the ninety films released between 1978 and 1982, only thirty-four were profitable for Paramount and five of these contributed to more than fifty percent of the profits earned on all of the successful pictures during that period.¹²⁶ The *Buchwald* court, unfortunately, never reached the merit of Paramount's argument because the studio abandoned its "risky business" defense—that its net profit formula is justified by the nature of the film business—a month and a half before the date of decision.¹²⁷ Therefore, if

afford to stay in business if it did not retain a multiple of its total capital investment in a successful picture." *Id.* at 75.

¹²⁵ Sapsowitz testified that the net profit definition counterbalances the high risk of filmmaking "by enabling the studio to recover the costs (direct and indirect) and lost profit of the many unsuccessful films from the revenues generated by the few successful ones." *Id.* at 68.

¹²⁶ *Id.* at 80-81; *Buchwald Case*, *supra* note 99, at 3, col. 1.

¹²⁷ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14485. As a result, the judge dismissed the court's special master, who was appointed to examine Paramount's accounting records, because his inquiry was no longer necessary. Robb, *Judge Pares Issues in Buchwald-Par Case*, *Variety*, Nov. 12, 1990, at 4, col. 1 [hereinafter *Judge Pares Issues*]. The judge appointed the accounting expert in the first place because he believed that he could not make a determination of the allocation of risks without knowing "something about Paramount's profits." Robb, *'Unconscionability' Applies In Par Suit*, *Variety*, Oct. 22, 1990, at 4, col. 1, col. 2. Pierce O'Donnell, the plaintiffs' attorney, believes that "Paramount was deathly afraid of opening its books on its actual historic profitability in moviemaking. Since the judge appointed a special master for the purpose of examining Paramount's books and records, the only way to terminate this unprecedented public inquiry was to abandon its risky business defense." *Judge Pares Issues*, *supra*, at 4, col. 2.

There may, however, be a less cynical reason for Paramount's withdrawal of the defense. Paramount co-counsel Lionel Sobel stated that "[a]ssessing the overall profitability of Paramount Pictures is not the issue and it never has been The real issue is fairness: Were the terms fair to Buchwald and Bernheim?" Goldberg, *Paramount Claims Profitability Not an Issue in Buchwald's Suit*, L.A. Daily J., Nov. 9, 1990, at 2, col. 3, col. 4. Considering that Paramount submitted what the judge described as "hundreds and hundreds of pages arguing justification and economic necessity," it seems unlikely that profitability was never an issue in the first place. *Id.* However, Sobel also stated that profitability is not an objective standard since there are a number of methods by which the studio can determine profits. *Id.* In other words, Paramount may have simply decided that a court analysis of profitability would require an attempt to forge an objective standard, an effort which Paramount believed was impossible in the motion picture in-

Paramount decides to appeal the decision, it will be unable to reintroduce this defense.¹²⁸ In future net profit litigation, however, it may be worthwhile for a studio to pick up Paramount's trail, assert the "risky business" defense, and allow a court-appointed accounting expert to examine its books and records.¹²⁹

V. ADHESION, UNCONSCIONABILITY, AND CONTRACT INTERPRETATION ISSUES

A. Adhesion

Turning now to the Phase II decision and the contract claims decided by the court, it is first necessary to establish the elements required for a claim of unconscionability. In an analysis of the enforceability of contract provisions claimed to be unconscionable, the first step is to make a determination of whether the contract itself is adhesive.¹³⁰ A "contract of adhesion" is defined as a "standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it."¹³¹

In *Graham v. Scissor-Tail, Inc.*,¹³² the California Supreme Court determined that in a contract between concert promoter Bill Graham and musician Leon Russell's group, Graham was "reduced to the humble role of 'adherent.'"¹³³ The court's findings included the following: 1) the constitution and bylaws of

dusty since it considered net profit to be what a contract defined as net profit. See *supra* text at note 98.

¹²⁸ The California evidentiary rule authorizing a reviewing court to take evidence that relates to facts that occurred prior to appeal "does not contemplate [that] the reviewing court should take original evidence to reverse a judgment, and is not available where there is no good cause shown for the unavailability of the evidence below." *DeYoung v. Del Mar Thoroughbred Club*, 159 Cal. App. 3d 858, 863 n.3, 206 Cal. Rptr. 28, 31 n.3 (1984) (citation omitted). See CAL. R. CT. 23(b) (1990).

¹²⁹ One of the elements of substantive unconscionability is inadequate justification for a particular provision of a contract. See *infra* text at note 165. The "risky business" defense, by providing justification for the net profit formula, undermines that element and thus furnishes potent ammunition against a claim of unconscionability.

¹³⁰ See *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 819, 623 P.2d 165, 172, 171 Cal. Rptr. 604, 611 (1981) ("To describe a contract as adhesive in character is not to indicate its legal effect. It is, rather, 'the beginning and not the end of the analysis insofar as enforceability of its terms is concerned.'") (quoting *Wheeler v. St. Joseph Hosp.*, 63 Cal. App. 3d 345, 357, 133 Cal. Rptr. 775, 783 (1976)).

¹³¹ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14483 (quoting *Graham*, 28 Cal. 3d at 817, 623 P.2d at 171, 171 Cal. Rptr. at 610).

¹³² 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 604 (1981) (holding that a provision in a contract between a concert promoter and a musical group was unconscionable because it required arbitration before the American Federation of Music, of which the group was a member).

¹³³ *Id.* at 818, 623 P.2d at 171-72, 171 Cal. Rptr. at 611. The dispute centered on whether an order compelling arbitration was in error because the arbitration provisions

the American Federation of Musicians ("A.F. of M."), of which Russell was a member,¹³⁴ expressly required that members not enter into any contracts other than those issued by the union; 2) the arbitration provisions in dispute were the same as those contained in the union's form contract in use at the time the parties contracted; and 3) the defendant insisted on the "provision concerning the manner and rate of compensation [which] dictat[ed] a union forum for the resolution of any disputes."¹³⁵ As a consequence, the court reasoned that Graham was essentially forced to sign the A.F. of M. form contracts to conduct business.¹³⁶

Utilizing the California Supreme Court's decision in *Graham*, the *Buchwald* court concluded that Bernheim's deal memo contained "boilerplate" language that was not negotiated, and that other clauses of the contract were "presented to Bernheim on a 'take it or leave it' basis."¹³⁷ The *Buchwald* court made findings similar to those in *Graham*, concluding that Paramount does not freely negotiate its net profit formula but rather makes only cosmetic, not substantive, changes with talent who wield the necessary clout.¹³⁸ Furthermore, the court found that Bernheim did not possess the necessary clout to achieve a better deal.¹³⁹ Lastly, it determined that Paramount drafted the entire contract, and that both the turnaround and net profit provisions were standard form provisions.¹⁴⁰ These factors led the court to arrive at the "inescapable" conclusion that the contract between Bernheim and Paramount was adhesive.¹⁴¹ Moreover, the *Buchwald*

contained in the contract were both adhesive and unconscionable. *See id.* at 817, 623 P.2d at 170, 171 Cal. Rptr. at 609-10.

¹³⁴ *Id.* at 812, 623 P.2d at 167, 171 Cal. Rptr. at 606. "[A]ll concert artists and groups of any significance or prominence are members of the A.F. of M. . . ." *Id.* at 818, 623 P.2d at 172, 171 Cal. Rptr. at 611.

¹³⁵ *Id.* at 819, 623 P.2d 172, 171 Cal. Rptr. at 611.

¹³⁶ The court stated that "[i]n these circumstances it must be concluded that Graham, whatever his asserted prominence in the industry, was required by the realities of his business as a concert promoter to sign A.F. of M. form contracts with any concert artist with whom he wished to do business." *Id.* at 818-19, 623 P.2d at 172, 171 Cal. Rptr. at 611 (emphasis in original).

¹³⁷ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14483. The other components which were found to have been presented to Bernheim on a "take it or leave it" basis included the turnaround provision and Paramount's standard net profit participation agreement. *Id.*

¹³⁸ The court argued that if, in fact, Paramount freely negotiated its net profit formula, it would be "inundated with examples of contracts where this was done," a phenomenon that did not occur. *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.* It should be recognized that *Buchwald* and Bernheim did not have to prove that they even attempted to negotiate a more beneficial definition of net profit to show adhesion; rather, the defense was essentially given the burden of persuading the court that the contracts were negotiable. Paramount did not rise to the challenge. By failing

court, relying on *Graham*, noted that part of the contract *was* negotiated, namely Bernheim's compensation package, but stated that this did not require a conclusion that the contract was not adhesive.¹⁴²

In reaching this conclusion, the court observed that the evidence indicated that Paramount's net profit formula is a film industry standard and that similar negotiations are conducted by other studios.¹⁴³ Therefore, the *Buchwald* court's finding of adhesion regarding Paramount's net profit formula may have prece-dential impact on the net profit contracts entered into between artists and other studios.

B. Unconscionability—Procedural Issue

According to *Graham*, "[t]o describe a contract as adhesive in character is not to indicate its legal effect."¹⁴⁴ Once adhesiveness is found, a court must then determine whether the whole contract or any individual provisions were contrary to the "reasonable expectations of the weaker or 'adhering' party . . . [or

to inundate the court with instances where the form provisions were altered through negotiation, see *supra* note 138, Paramount succeeded in creating the very strong suggestion that it rarely negotiated these provisions.

¹⁴² *Id.* As the *Graham* court stated, there are circumstances where "the presence of other assertedly negotiable terms [will not act] to remove the taint of adhesion." *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 819, 623 P.2d 165, 172, 171 Cal. Rptr. 604, 611 (1981). In *Graham*, the terms that were subject to negotiation "relat[ed] to the length, time, and date of the concert and the selection of a special guest artist." *Id.* In the court's opinion, these negotiable terms "were of relatively minor significance in comparison to those imposed by [the defendant]." *Id.* (emphasis added). The *Buchwald* court presumably believed that Bernheim's negotiated compensation package, as compared to the terms of the standard net profit agreement and the turnaround provision, was of "relatively minor significance." Roger Davis, Bernheim's agent, in fact testified that "[a]s to the material, economic provisions of the standard form contract, the studio simply will not budge." *Buchwald Case*, *supra* note 99, at 3, col. 3. According to Davis, the types of net profit terms that are negotiable are usually only procedural, such as an extension of time within which the film can be audited. *Id.* at 3, col. 1, col. 2.

¹⁴³ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14483. The court also stated that it had evidence that once a studio develops a revision of the net profit formula, the other studios adopt that revision. *Id.* These findings hint at possible collusion among the studios in setting the terms of the net profit formula. The *Graham* court, in fact, addressed this concern when it described the reasons why a contract of adhesion is anathema to traditional conceptions of freedom of contract. In relevant part, the court noted:

Such contracts are, of course, a familiar part of the modern legal landscape, in which the classical model of "free" contracting by parties of equal or near-equal bargaining strength is often found to be unresponsive to the realities brought about by increasing concentrations of economic and other power. They are an inevitable fact of life for all citizens—businessman and consumer alike.

Graham, 28 Cal. 3d at 817-18, 623 P.2d at 171, 171 Cal. Rptr. at 610 (footnotes omitted).

¹⁴⁴ *Graham*, 28 Cal. 3d at 819, 623 P.2d at 172, 171 Cal. Rptr. at 611.

whether they are] unduly oppressive or 'unconscionable.'"¹⁴⁵

A threshold inquiry was whether Bernheim had a procedural right to assert unconscionability. Paramount argued that California law bars the offensive use of the unconscionability doctrine.¹⁴⁶ The studio claimed that the restriction to defensive use was an "integral and uniform" part of the common law unconscionability doctrine, and contended that if the California legislature desired to extend the doctrine's use, it would have expressly removed the restriction when it enacted section 1670.5 in 1979.¹⁴⁷ The *Buchwald* court described Paramount's position as advocating the application of unconscionability only when used by a defendant as a "shield," not when used by a plaintiff as a "sword."¹⁴⁸ The court's acceptance of such a limitation would have precluded the plaintiffs from asserting a claim of unconscionability.

The key decision utilized by the *Buchwald* court to resolve this procedural issue was the California Court of Appeals decision in *Dean Witter Reynolds, Inc. v. Superior Court*.¹⁴⁹ In *Dean Witter*, the court held that Civil Code section 1670.5¹⁵⁰ merely codified

¹⁴⁵ *Id.* at 820, 623 P.2d at 172-73, 171 Cal. Rptr. at 612. In *Graham*, the court found the disputed arbitration provision unconscionable for the following reason:

the 'minimum levels of integrity' which are requisite to a contractual arrangement for the nonjudicial resolution of disputes are not achieved by an arrangement which designates the union of one of the parties as the arbitrator of disputes arising out of employment—especially when, as here, the arrangement is the product of circumstances indicative of adhesion.

Id. at 827, 623 P.2d at 177, 171 Cal. Rptr. at 616.

¹⁴⁶ Reply Memorandum for Paramount Pictures Corp. Re *Dean Witter Reynolds v. Superior Court* and the Bar to Offensive Use of the Unconscionability Defense at 1, *Buchwald v. Paramount Pictures Corp.*, 90 L.A. Daily J. App. Rep. 14482 (L.A. Super. Ct. 1990) (No. C-706083) [hereinafter Reply Memorandum]. The California Civil Code states in relevant part:

(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

CAL. CIV. CODE § 1670.5 (West 1985).

Section 1670.5, which is the same statute as Uniform Commercial Code ("UCC") § 2-302 (although it is not limited to the sale of goods), was enacted in California in 1979. E. FARNSWORTH, *CONTRACTS* § 4.28, at 325 n.5 (1990) [hereinafter FARNSWORTH]. For the Restatement's examination of this section, see *RESTATEMENT (SECOND) OF CONTRACTS* § 208 (1979).

¹⁴⁷ Reply Memorandum, *supra* note 146, at 5. Paramount found support for this proposition from the Consumer Legal Remedies Act ("CLRA"), which allows the offensive use of the unconscionability doctrine by aggrieved consumers. Paramount argued that the California Legislature, if it had wanted to allow the offensive use of unconscionability through California Civil Code § 1670.5, would have done so affirmatively as with the CLRA. *Id.*

¹⁴⁸ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14483.

¹⁴⁹ 211 Cal. App. 3d 758, 259 Cal. Rptr. 789 (1989).

¹⁵⁰ For the relevant text of § 1670.5, see *supra* note 146.

the defense of unconscionability and did not furnish an affirmative cause of action.¹⁵¹ However, distinguishing Buchwald's and Bernheim's use of the unconscionability defense,¹⁵² the *Buchwald* court agreed with the plaintiffs¹⁵³ and concluded that the defense is not barred when it is raised in response to a defendant's reliance on a contract.¹⁵⁴

The court's disposition of the procedural issue attendant to the unconscionability defense not only enabled it to reach the substantive issues of unconscionability, but also generated a unifying principle enunciating the circumstances in which a plaintiff may allege the unconscionability defense. That principle may be stated as follows: where a defendant relies on a contract as written—when confronting a breach of contract or declaratory judg-

¹⁵¹ In *Dean Witter*, the plaintiff alleged that the defendant financial institution's practice of assessing a close-out (termination) fee upon the liquidation of his account was unconscionable under Civil Code section 1670.5. *Dean Witter*, 211 Cal. App. 3d at 763, 259 Cal. Rptr. at 791. The court held that "regardless of the identity or status of the plaintiff making the claim of unconscionability, the language of Civil Code section 1670.5 does not support the bringing of an affirmative cause of action thereunder for including an unconscionable clause in a contract . . ." *Id.* at 766, 259 Cal. Rptr. at 794.

California is not the only state that subscribes to this limitation on the unconscionability defense. According to Professor Farnsworth, post-UCC courts, like equity courts before them, have declined to entertain damage suits based on unconscionability. FARNSWORTH, *supra* note 146, § 4.28, at 327.

¹⁵² *Buchwald*, 90 L.A. Daily J. App. Rep. at 14483-84.

¹⁵³ The Buchwald camp argued that it was not making affirmative use of unconscionability but rather resisting Paramount's attempt to enforce an unjust bargain. Reply Memorandum, *supra* note 146, at 2. Plaintiffs also argued that the California Supreme Court expressly authorizes the use of section 1670.5 by plaintiffs in cases where they seek declaratory relief and damages. Robb, *Buchwald Case: Key Is 'Unconscionability'*, Variety, Sept. 10, 1990, at 20, col. 5, col. 6.

¹⁵⁴ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14484. The *Buchwald* court stated that "when the defendant relies on the contract as written, . . . then [the] plaintiff can counter with the claim [that] the provisions are unconscionable." *Id.* (citations omitted). The court based its decision on three California appellate decisions. The first decision was *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 604 (1981), where the plaintiff, who had sued for breach of contract, declaratory relief, and rescission, successfully alleged unconscionability in a situation where the defendant argued that the contract's arbitration provision was valid. The second case was *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 186 Cal. Rptr. 114 (1982), where the plaintiff-buyer, who had sued the defendant-seller for breach of express and implied warranties, successfully attacked the contract's disclaimer and consequential damage limitation provisions as unconscionable—and this too was in circumstances where the defendant relied on the contract as written. Finally, in *Perdue v. Crocker Nat'l Bank*, 38 Cal. 3d 913, 702 P.2d 503, 216 Cal. Rptr. 345 (1985), the plaintiff instituted a class action suit against the defendant bank seeking a declaratory judgment that charges assessed for the processing of checks drawn on accounts with insufficient funds were unconscionable. *Id.* at 920-21, 702 P.2d at 507-08, 216 Cal. Rptr. at 349-50. The court allowed evidence to be presented to determine whether the charges were unconscionable. *Id.* at 928-29, 702 P.2d at 514, 216 Cal. Rptr. at 356. According to the *Buchwald* court, the California Supreme Court in *Perdue* "effectively held that an affirmative cause of action for unconscionability exists if it is brought as an action for declaratory relief." *Buchwald*, 90 L.A. Daily J. App. Rep. at 14484.

ment action—the plaintiff can assert unconscionability.¹⁵⁵ Yet, such a construction places little limitation on the use of the defense. Though parties to a contract will often interpret particular provisions differently, it is unusual for them to ask a court to undermine a contract by striking it in its entirety, or in part. As a general rule, then, one can safely state that a defendant-contracting party, under a theory of freedom of contract, will usually try to convince a court to uphold the contract as it was originally written. But to avoid *Dean Witter's* seemingly restrictive holding that a plaintiff cannot bring an affirmative cause of action based on unconscionability, one need only bring a contract action under another theory, and then allege unconscionability once the defendant relies upon the written contract. Therefore, the court's construction of when a plaintiff can allege unconscionability is in reality a backdoor approach which enables plaintiffs to affirmatively argue the unconscionability defense in a contract action.

C. Unconscionability—Substantive Issues

The legislative history of California Civil Code section 1670.5 indicates that the unconscionability defense serves a dual purpose: the prevention of unfair surprise and oppression.¹⁵⁶ "Surprise" is defined as "the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms."¹⁵⁷ "Oppression" occurs when there is "an inequality of bargaining power which results in no real negotiation and 'an absence of meaningful choice.'"¹⁵⁸ These two factors have been referred to as the "procedural element" of unconscionability,¹⁵⁹ because they deal with the contracting process rather than the

¹⁵⁵ See *id.* at 14484.

¹⁵⁶ See CAL. UNLAWFUL CONTRACTS CODE § 1670.5 (West 1985) (Legislative Committee Comment at 493). See also *A & M Produce*, 135 Cal. App. 3d at 484, 186 Cal. Rptr. at 120 (stating that unfair surprise and oppression are "the principal targets of the unconscionability doctrine"). Responding to suggestions that the unconscionability defense undermines the sanctity of traditional notions of freedom of contract, one commentator stated that limits often need to be imposed to achieve "balance and basic fairness." T. QUINN, UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST ¶ 2-302[A], at 2-96 (1978). "[T]o stress freedom of contract and to overlook its limiting principles paradoxically leads to an erosion of freedom itself in that the exercise of true freedom gets limited to the powerful." *Id.*

¹⁵⁷ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14484 (quoting *A & M Produce*, 135 Cal. App. 3d at 486, 186 Cal. Rptr. at 122).

¹⁵⁸ *Id.* (quoting *A & M Produce*, 135 Cal. App. 3d at 486, 186 Cal. Rptr. at 122).

¹⁵⁹ *A & M Produce*, 135 Cal. App. 3d at 486, 186 Cal. Rptr. at 121. But see *infra* note 159 (indicating that the *Buchwald* court treated "oppression" as an element of "substantive" unconscionability).

resulting contract.¹⁶⁰

Paramount argued that because the net profit provisions contained in Bernheim's contract have existed in Hollywood for years and were well known to him, he was in no way surprised and, therefore, the provisions cannot be found unconscionable.¹⁶¹ A plaintiff, however, need not prove both "surprise" and "oppression" to successfully assert the defense. According to *Buchwald*, "the absence of surprise . . . does not render the doctrine of unconscionability inapplicable."¹⁶²

To determine whether certain provisions of Paramount's net profit formula were unconscionable, the *Buchwald* court used the unconscionability defense's "substantive" prong, which focuses on the contract itself, rather than the process leading to the formation of the contract.¹⁶³ There are various definitions of "substantive" unconscionability.¹⁶⁴ The definitions used by the court allowed it to frame its analysis as follows: whether particular provisions of Paramount's net profit formula were unconscionable depended on whether they were "overly harsh" and "one-sided" and, if that were the case, whether the studio had any justification for its practices.¹⁶⁵ Under this analysis, the following enumer-

¹⁶⁰ See Leff, *Unconscionability and the Code — The Emperor's New Clause*, 115 U. PA. L. REV. 485, 487 (1967) [hereinafter Leff]. Professor Leff "refer[red] to bargaining naughtiness as 'procedural unconscionability,' and to evils in the resulting contract as 'substantive unconscionability.'" *Id.*

¹⁶¹ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14484. The court agreed with Paramount, stating that "except perhaps for the amount of gross participation shares given to Murphy and Landis, . . . the contract provisions were not contrary to Bernheim's reasonable expectations." *Id.*

¹⁶² *Id.* The *Buchwald* court cited *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 604 (1981), as an example of a case where a contract provision was found to be unconscionable despite the absence of surprise on the part of the plaintiff. *Buchwald*, 90 L.A. Daily J. App. Rep. at 14484. *Graham*, however, did not refer to "surprise," as such. Rather, it indicated that the provision "was in [no] way contrary to the reasonable expectations of [the] plaintiff." *Graham*, 28 Cal. 3d at 821, 623 P.2d at 173, 171 Cal. Rptr. at 612. For a description of *Graham*, see *supra* notes 132-36 and accompanying text.

¹⁶³ See *supra* note 160.

¹⁶⁴ For a list of the litany of definitions put forth by various commentators, see *Buchwald*, 90 L.A. Daily J. App. Rep. at 14484-85 (quoting *A & M Produce*, 135 Cal. App. 3d at 487, 186 Cal. Rptr. at 122). One definition described substantive unconscionability as existing when there is a "reallocat[ion of] the risks of the bargain in an objectively unreasonable or unexpected manner." *Id.* at 14484 (quoting *A & M Produce*, 135 Cal. App. 3d at 487, 186 Cal. Rptr. at 122).

¹⁶⁵ *Id.* at 14487. Professor Leff has argued the "oppression" could fall into either category of unconscionability—"procedural" or "substantive"—because it could "refer to what took place between the parties at the time they entered into the contract . . . or . . . to the effect of that contract upon the complaining party." Leff, *supra* note 160, at 499. He explained that "it is not easy to think of a word better designed to leave in a state of perfect uncertainty whether the focus . . . was to be upon the contracting process or the contract." *Id.* As mentioned previously, California case law looks at "unfair surprise" and "oppression" as two aspects of "procedural" unconscionability. See *supra*

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ated practices and provisions of Paramount's net profit formula were found to be unconscionable: 1) the fifteen percent overhead charge on Eddie Murphy Productions' operational allowance;¹⁶⁶ 2) the ten percent advertising overhead charge;¹⁶⁷ 3) the fifteen percent overhead charge;¹⁶⁸ 4) the interest charge on negative cost without credit for distribution fees;¹⁶⁹ 5) the interest charge on overhead;¹⁷⁰ 6) the interest charge on gross

note 159 and accompanying text. In *Buchwald*, however, the court seems to treat "oppression" as an aspect of "substantive" unconscionability because it refers to "overly harsh" and "one-sided" results under the following heading: "Unconscionability—Oppression." Since the unconscionability defense serves a dual purpose in preventing both "unfair surprise" and "oppression," see *supra* note 156 and accompanying text, and Bernheim was in no way surprised, see *supra* note 161 and accompanying text, the only way the court could find Paramount's net profit formula unconscionable was under the rubric of "oppression." In a sense, then, the court latched on to the uncertain status of "oppression," first observed by Professor Leff, and then derived a test to determine whether the net profit provisions were "substantively" unconscionable.

This analysis comports with Leff's prediction that the ambiguity inherent in "oppression" would lead a court to find a contract provision unconscionable even where there is no surprise. See Leff, *supra* note 160, at 500 ("It was as if the [UCC] comment had said that if for some reason the aggrieved party could not effectively have objected to the provision in question, even if he knew about it and understood it, that is, even if he were not surprised, then the provision would still be destructible as unconscionable.") (emphasis in original).

¹⁶⁶ This provision was unconscionable because Paramount charged an additional fifteen percent overhead charge "on top-of" this item. *Buchwald*, 90 L.A. Daily J. App. Rep. at 14487. The court stated that this practice "results in charging overhead on overhead," and that it was unable to perceive any justification "for this obviously one-sided double charge." *Id.*

¹⁶⁷ The court determined that this charge, which "adds significantly to the amount that must be recouped by Paramount before the picture will realize net profits," was unconscionable because it was a flat charge that bore no relation to actual costs. *Id.* The court also found no justification for this charge. *Id.*

¹⁶⁸ The court found the fifteen percent overhead charge, which "yields huge profits," to be a flat fee that does not "even remotely correspond to the actual costs incurred by Paramount." *Id.* With the exception of Paramount's abandoned defense that "winners must pay for losers," the court was not able to discern any justification for this charge. *Id.*

¹⁶⁹ The court found that Paramount's practice of accounting for income on a cash basis and cost on an accrual basis "slows down the recoupment of negative costs and inflates the amount of interest charged." *Id.* This finding parallels plaintiff's argument:

If the purpose of the interest charge is to reimburse Paramount for the loss-of-use of its money until the money is recouped, one would expect the interest to stop running as Paramount recoups its outlay. But this is not the case. To the contrary, as revenue comes in, Paramount takes it into profit as a distribution fee. The full principal remains in place and interest continues to grow.

Plaintiffs' Preliminary Statement of Contentions Concerning Accounting and Damages Issues at 97, *Buchwald v. Paramount Pictures Corp.*, 90 L.A. Daily J. App. Rep. 14482 (L.A. Super. Ct. 1990) (No. C-706083) [hereinafter Plaintiffs' Preliminary Statement] (emphasis in original). The court deemed this practice "one sided" and asserted that Paramount had offered no justification for it. *Buchwald*, 90 L.A. Daily J. App. Rep. at 14487.

¹⁷⁰ Because overhead was not taken into account by Paramount to determine if costs had been recouped, the court found the interest charge on overhead to be "an additional source of unjustified profit." *Id.* The court stated that this practice was "overly harsh" and "one sided." *Id.*

profit participation payments;¹⁷¹ and 7) the interest rate charged.¹⁷²

In finding these provisions unconscionable, the court was aided by the fact that Paramount did not claim that any of the provisions were individually fair and reasonable.¹⁷³ Paramount refused to make any such arguments because it believed, and argued before the court, that Bernheim's contract must be considered as a whole and that the court was not permitted to focus on the unconscionability of individual provisions.¹⁷⁴ The court disagreed, stating that "Paramount's argument [was] totally refuted

¹⁷¹ The court found this practice unconscionable because these payments are not disbursed until there are film receipts available and, "[a]ccordingly, Paramount has not in any real sense advanced this money." *Id.*

¹⁷² The court found Paramount's practice of charging an interest rate of as much as twenty to thirty percent "one sided" because it does so "even when no funds have been laid out by [the studio]." *Id.*

Plaintiffs alleged, but the court disagreed, that the following provisions and practices were also unconscionable:

[1] [the] 15 percent overhead [charge] on [the] Murphy and Landis participation[s] . . . ; [2] [the] exclusion of 80 percent of video cassette receipts from gross receipts; [3] [the] distribution fee on video royalties; [4] charging as distribution costs residuals on 20 percent [of] video royalties; [5] [the] charges for services and facilities in excess of actual costs; [6] [the] lack of credit to production cost for reusable items retained or sold; [7] charging taxes offset by income tax credit; [8] charging interest in addition to distribution fees; [9] [the] 15 percent overhead [charge] in addition to distribution fees; and [10] [the] 10 percent advertising overhead [charge] in addition to distribution fees.

Id. at 14486. The court did not provide specific reasons as to why each of these provisions and practices were not unconscionable. Rather, it stated generally that the plaintiffs had failed to provide supporting evidence with respect to each of the challenged items. *Id.* at 14487.

¹⁷³ *Id.* at 14486. After the completion of Phase II, Paramount tried to relitigate this aspect of the case by attempting to present evidence on each of the practices and provisions that the court had found unconscionable. *'America' Judge Irked by Par Lawyer*, Variety, Feb. 18, 1991, at 18, col. 1. Paramount "maintain[ed] that it had held these arguments 'in reserve,' never arguing specific points of the net profit deal but on the reasonableness of the net profit deal as a whole." Robb, *Buchwald Lawyer Gets Caustic Over Par Move*, Variety, Apr. 1, 1991, at 4, col. 1. The studio's attorney pointed to an agreement Buchwald's attorneys allegedly wrote, which stated that if the court found particular fees and costs unconscionable, the studio could then introduce evidence as to their reasonableness. *Id.* at col. 2. The court, however, declined to reopen the case. See Voland, *Paramount Loses Key Round in Court Fight with Buchwald*, HOLLYWOOD REP., Apr. 2, 1991, at 1, col. 2, col. 3.

¹⁷⁴ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14486. Paramount argued that a court can only strike an individual contract clause where the clause is "divisible," and that the plaintiffs are not permitted to attack "financially interrelated provisions" and demand "an individual defense of each." *Id.* at 14485 (citing Memorandum of Points, *supra* note 81, at 15). In essence, Paramount did not take issue with the court's right to strike individual provisions that are *separate*—the studio seemed to concede such a right. Rather, it argued that because the provisions are not separate, but interrelated, the court could only strike the entire contract, or nothing at all. An appeals court, if it found this argument persuasive, could require an examination of whether or not the contract as a whole was fair, thus possibly resulting in a different conclusion on the issue of unconscionability.

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by the provisions of [California] Civil Code section 1670.5, which specifically permits the Court to 'enforce the remainder of the contract without the unconscionable clause' or to 'limit the application of any unconscionable clause as to avoid any unconscionable result.'"¹⁷⁵

D. Contract Interpretation Issues

1. Duty to Consult

The presence of producer Alain Bernheim as a party to the litigation raised an issue that is separate from, but concurrently related to, the plaintiffs' net profit claim. Specifically, the plaintiffs raised the question of how much power a net profit participant, who is also a producer,¹⁷⁶ should have to effect the way a production is financed. According to a clause in Bernheim's deal memo, Paramount undertook to consult Bernheim "on gross and net-profit participations granted by [Paramount] to third parties," but it also stated that "[Paramount's] decision shall be final."¹⁷⁷ Plaintiffs argued that this clause assured Bernheim that his net profit interest would not be eliminated without having a chance to review Murphy's and Landis' participation agreements.¹⁷⁸ Plaintiffs contended that Paramount should, accordingly, be barred from giving Murphy and Landis their gross participations.¹⁷⁹

Paramount argued that the clause granted it "unfettered discretion" in making decisions on executing gross participation agreements with third parties because it defined Bernheim's function as consultative rather than discretionary.¹⁸⁰ Further-

¹⁷⁵ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14486 (quoting section 1670.5). For the relevant text of Civil Code section 1670.5, see *supra* note 146.

¹⁷⁶ Bernheim was not involved in the production of *Coming to America* and it is unclear whether his deal with Paramount contemplated that he would be "executive" producer as opposed to a "line" producer or "supervising" producer. An "Executive Producer is more like the CEO or chairman of a film, with the producer as COO or president . . . The Executive Producer can find himself going back to investors and finding bodies for more cash when a film goes over budget." Rudell, *A Surfeit of Producer's Credits*, 203 N.Y.L.J., Feb. 23, 1990, at 3, col. 1, col. 2 (citing "What's an E.P.? Putting the 'Executive' into 'Producer,'" *Silver Screen, The Entertainment Investor Newsletter*, at 1, Vol. III, Feb. 1990). In contrast, "the 'line' producer or 'supervising' producer . . . controls the day-to-day production of the film." *Id.*

¹⁷⁷ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14488 (quoting the Bernheim-Paramount contract).

¹⁷⁸ Plaintiffs' Preliminary Statement, *supra* note 169, at 84.

¹⁷⁹ *Id.* at 84.

¹⁸⁰ Memorandum of Points, *supra* note 81, at 33. Paramount maintained that the consultation provision was nothing more than "a standard courtesy generally extended to producers whose net profit participations were subject to a reduction provision." Declarations of Defendant, *supra* note 97, at 118. Paramount argued that the ability of a pro-

more, it claimed that its "failure to consult was due to its good faith belief that 'Coming To America' was unrelated to the Bernheim-Buchwald project."¹⁸¹ Paramount also sounded a cautionary alarm; it warned the court that if it afforded the clause significance, and "the studio had to discuss each decision that had a potential impact on a participant's 'bottom line' with . . . profit participants," the latter would be able to interfere with, and thus "stifle production," and "movies would take years to make."¹⁸²

The court stated that the issue of how much significance should be afforded to the consultation clause was a question relating to the percentage of net profit to which Bernheim was entitled.¹⁸³ However, because the court decided to take a different path to determine the amount of damages to grant the plaintiffs,¹⁸⁴ the court concluded that it was unnecessary to resolve this issue. Still, future net profit litigants may find an analysis of this issue useful because another court may not follow the same path. Moreover, the technique that will eventually be used by the *Buchwald* court may not be sustained on appeal, thereby necessitating further inquiry into the consultation clause.

One way a court could decide this issue would be to consider seriously Roger Davis' testimony that he would have used the consultation right to attempt to get Bernheim a more lucrative

ducer to affect variations in the traditional net profit formula to his advantage is "a function of the producer's track record and the studio's interest in the project." *Id.* at 33. As a result, Paramount asked the court not to impose terms which Bernheim himself was unable to negotiate because of his own lack of bargaining power. For an explanation of Bernheim's lack of bargaining power, see *supra* note 101 and accompanying text.

¹⁸¹ Declarations of Defendant, *supra* note 97, at 104.

¹⁸² *Id.* In response to Bernheim's assertion that he was not granted the power to affect the terms of Landis' and Murphy's gross deals, Mel Sattler testified that in his 43 years in the motion picture business, he "cannot recall a lawyer or agent for a [net profit] participant asserting the right to veto a studio decision because his or her client was a 'Net Profit' participant." *Id.* Sattler asserted that "[c]onsultation provisions are placed into producer deals at the request of their agents and are fulfilled largely as a courtesy to the producer." *Id.* at 36 (emphasis added). He maintained that the Hollywood practice of giving producers little power is a "democratic ideal" because a "studio almost universally retains 50% of the net profits," whereas producers usually contract for considerably less. *Id.* at 29 n.33. Moreover, he claims that producers do not object to the reduction of their net profit share by gross participations "because they realize that the studio will not grant participations lightly and that the project will be enhanced significantly by the presence of talent that can command such compensation packages." *Id.* at 37.

¹⁸³ See *Buchwald*, 90 L.A. Daily J. App. Rep. at 14488. For a description of Bernheim's argument regarding the percentage of net profit to which he was entitled, see *supra* note 82.

¹⁸⁴ For a discussion of the manner in which the court will try to determine the amount of damages, see *infra* notes 212-18 and accompanying text.

deal.¹⁸⁵ Paramount argued, however, that it would not have willingly renegotiated Bernheim's deal.¹⁸⁶ Because the project was considered a vehicle for Eddie Murphy from the outset, and Bernheim knew that his eventual net profit participation might need to be diminished to procure Murphy's services, Paramount maintained that a consultation would not have led to a renegotiation.¹⁸⁷

Yet there is a basis on which to show that a renegotiation may have been likely. In February 1983, when Bernheim entered into his agreement with Paramount, Eddie Murphy was not the box office draw that he was in 1988 when *Coming to America* was released.¹⁸⁸ As a result, Bernheim could have no firm basis to contemplate that Murphy would achieve a gross participation of \$11 million. Consultation with Paramount in an atmosphere of Murphy's newfound star power may have had an effect on the terms of Bernheim's contract. Though Bernheim would have been unable to diminish the amount of Murphy's compensation, he could have used Murphy's newfound star power as a bargaining chip in a renegotiation of his compensation package for *Coming to America*, an option unavailable to him since he was neither consulted nor utilized in the production of the film. Since the *Buchwald* court found that Paramount was required to employ Bernheim as a producer of *Coming to America*,¹⁸⁹ the exercise of his consultation right may have thus been significant.

2. The Turnaround Provision

The turnaround provision¹⁹⁰ issues perhaps represented Paramount's best opportunity to prove that it was not obligated

¹⁸⁵ Memorandum of Points, *supra* note 81, at 36.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*; see Declarations of Defendant, *supra* note 97, at 37 ("a producer knows in advance that he will be trading his contractually allocated 'net' points to obtain the services of a proven talent").

¹⁸⁸ Murphy only became a "certifiable" box office draw at the end of 1984 when *Beverly Hills Cop*, in which he had a starring role, earned \$100 million in domestic rentals between early December and year's end. Canby, *Are We Headed for a One-Movie Future?*, N.Y. Times, Jan. 27, 1985, § 2 (Arts and Leisure), at 17, col. 1. Vincent Canby, film critic for the *New York Times*, noted that the "film's success is mind-boggling for the speed with which it has earned so much money." *Id.* at col. 4. Before *Beverly Hills Cop*, Murphy acted in two "buddy" films, *48 Hours* and *Trading Places*, both of which were included in the top ten list of highest grossing films for 1983. Grenier, *Eddie Murphy's Comic Touch*, N.Y. Times, Mar. 10, 1985, § 2 (Arts and Leisure), at 1, col. 3, 8, col. 4. Therefore, when Bernheim's deal memo was executed in early 1983, Bernheim did not have the empirical basis to gauge Murphy's box office potential.

¹⁸⁹ See *infra* note 194 and accompanying text.

¹⁹⁰ The *Buchwald* court stated that "[t]he purpose of the 'turnaround' provision is to permit a producer to take his project to another studio if the first studio is no longer interested in pursuing it, while at the same time permitting the first studio to recoup its

to compensate Bernheim, because they raised the question of whether he should have even been considered a net profit participant. The turnaround provision stated in pertinent part:

'If, prior to the expiration of the turnaround period, the project is not placed elsewhere and/or if Lender has not complied with the conditions above, including, without limitation, complete reimbursement to Paramount, then at the end of the turnaround period, Lender's rights with respect to the project shall cease and Paramount's ownership thereof and all properties and rights encompassed therein shall be absolute.'¹⁹¹

Paramount argued that Bernheim's rights to compensation ended in March 1986 when the twelve-month turnaround period ended without Bernheim setting up the project at another studio.¹⁹² The court agreed that, if the turnaround provision was considered in *isolation*, Bernheim's compensation rights did indeed appear to terminate. The court, however, held that the provision could not be judged in isolation. Relying on another provision in the deal memo, which provided that "[i]f the Picture is produced, Lender will furnish the services of Artist, who shall be employed by [Paramount] to personally render all customary services as producer,"¹⁹³ the court concluded that, in light of the decision in Phase I that *Coming to America* was "based upon" Buchwald's treatment, Paramount was required to employ Bernheim as a producer for the film.¹⁹⁴ Stating that "[i]t would make no sense to conclude that Paramount breached the agreement by failing to employ Bernheim, while at the same time concluding Bernheim's right to compensation was terminated by application of the turnaround provision," the court ruled that any ambiguity that exists between the two contract provisions must be resolved against Paramount, the drafter of the contract.¹⁹⁵

development costs if the project is undertaken by the second studio." *Buchwald*, 90 L.A. Daily J. App. Rep. at 14488.

¹⁹¹ *Id.* (quoting the Bernheim-Paramount contract).

¹⁹² *Id.* Bernheim received notice of Paramount's decision to place *King for a Day* into turnaround on March 29, 1985. Declarations of Defendant, *supra* note 97, at 126. Paramount contended that "when the turnaround period expired, Mr. Bernheim's rights in the 'King for a Day' project at Paramount were terminated." *Id.* at 128 (emphasis in original).

¹⁹³ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14488.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* (citing *Jacobs v. Freeman*, 104 Cal. App. 3d 177, 189, 163 Cal. Rptr. 680, 686 (1980)). The court also noted that one of Paramount's principal purposes for including the turnaround provision was "to recoup its costs." *Id.* This purpose was satisfied when "Paramount recovered all of its costs on *Coming to America*." *Id.*

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VI. BEYOND BUCHWALD

The court's ruling on the net profit issue may lead to an upheaval in the accounting practices of the motion picture industry. The court's conclusion that the current net profit formula no longer exists, if upheld on appeal,¹⁹⁶ will limit the types of deductions that the studios can make in determining net profit. The studios would effectively be required to redefine net profit or terminate the use of the formula altogether. The consequences of either choice, especially in the context of the current economic climate in Hollywood,¹⁹⁷ could be harmful to the studios.

At the very least, the studios may encounter a situation where potential profit participants demand a greater share of film revenue. Some Hollywood negotiators believe that the *Buchwald* decision will lead potential profit participants to demand gross profit points, despite the fact that traditionally, only major talent with the necessary clout could realistically demand a gross share.¹⁹⁸ There is no reason why the studios will capitulate to such demands, and likewise, there is every reason for them to adhere to tradition, at least with respect to off-the-top gross participation deals.¹⁹⁹ Since employing artists with little box office appeal does not reduce the risk that a film will make back its investment, studios will not want to grant gross shares to talent who contribute minimally to the overall box office success of a film.

Some attorneys, however, believe that the studios may start granting talent previously relegated to "net profit" status "rigid adjusted gross deals at higher levels of income."²⁰⁰ This could effectively achieve the same objective as the current net profit deal. By artificially defining a breakeven point where the studio is ensured a recovery of its costs plus a healthy profit *before* adjusted gross participants partake, the adjusted gross deal at higher levels of income would act as a "bonus" to talent that do not reduce the risk of filmmaking, much in the same way as the current net profit deal.²⁰¹

¹⁹⁶ Paramount stated that it would appeal the decision. *Wide Fallout*, *supra* note 84, at 1, col. 3.

¹⁹⁷ See *infra* notes 204-05 and accompanying text.

¹⁹⁸ See Alexander & Fleming, *Judge Backs Buchwald, But No Bucks Yet*, *Variety*, Dec. 24, 1990, at 1, col. 3, 62, col. 5.

¹⁹⁹ For a description of this type of gross participation deal, see *supra* notes 116-17 and accompanying text.

²⁰⁰ Kissinger, *Dealmakers Duck As Bench Hurls Wrench*, *Variety*, Dec. 31, 1990, at 1, col. 3, 61, col. 1.

²⁰¹ For an explanation of the net profit deal as a "bonus" to talent, see *supra* note 98 and accompanying text.

The studios may, in the alternative, be forced to pay talent greater fixed "up-front" compensation, rather than a combination of fixed and contingent compensation.²⁰² This would be especially so if the studios, in the wake of *Buchwald*, abandon the net profit regime altogether. Yet even a redefinition of the formula, as opposed to its total abandonment, may force the studios to pay higher fixed compensation. A redefinition, which would necessarily have to take into account the standards dictated by the court, would ensure that net profit is achieved at a much earlier point than in the past because fewer deductions would then be made. Faced with such a scenario, the studios could grant smaller percentages in a revamped net profit structure or simply avoid percentages altogether by paying only fixed compensation. The free market and financial constraints on the film industry would dictate which talent received which type of compensation. Perhaps talent with some box office clout, albeit less than those who negotiate gross profit participation deals, would be able to get the smaller percentages in a revamped structure.²⁰³ The other factor that could affect which talent get the most beneficial deals is financial constraint. Studios making films with limited budgets, and thus unable to pay higher fixed compensation, may also grant the smaller percentages.

In any event, higher fixed compensation would increase a film's negative cost, requiring a greater initial outlay of funds which, in turn, would push back the point at which a film becomes profitable for a studio. The more a film costs to produce, the more risk the venture entails. Therefore, if the studios are forced to pay higher "up-front" compensation, the filmmaking business will become even riskier, with the consequence that Hollywood may be compelled to produce fewer films.

The *Buchwald* decision, following on the heels of reports that the escalation of fees in Hollywood is beginning to drive down the profit margins of films,²⁰⁴ could be especially damaging for

²⁰² *Wide Fallout*, *supra* note 84, at 1, col. 3.

²⁰³ Clout would also be a factor in determining the higher amounts of fixed "up-front" compensation envisioned in a world devoid of the net profit deal. This is because in a free market, the amount of fixed compensation would be a function of the demand created by individual talent as a result of previous achievements and current worth. It has been suggested that "[p]erhaps the system would work far better if everyone got paid up front according to the prevailing market. Then no one would have to worry about how far the 'grosses' would 'roll' or how high those illusory studio overheads might soar." *Carved in Stone*, *supra* note 4, at 5, col. 2.

²⁰⁴ Fabrikant, *The Hole in Hollywood's Pocket*, N.Y. Times, Dec. 10, 1990, at D1, col. 3, D4, col. 3. The escalation extends from actors to technical experts, such as cameramen and editors. *Id.* According to media analyst David Londoner, this has occurred because

the studios. Diminishing profit margins compound the problems presented by a post-*Buchwald* film industry. Even before the decision was handed down, more talent became wary of gambling on profit participation deals and began demanding all of their compensation "up-front."²⁰⁵

The production of fewer films would stem not merely from additional negative cost due to higher "up-front" compensation. The main thrust of the *Buchwald* decision was that Paramount retained too much of *Coming to America's* revenue, without sufficient justification, at the expense of its net profit participants. It is likely that were the studios forced to retain less revenue, fewer films would be produced because there would be less economic incentive for studios to make them.²⁰⁶

The *Buchwald* decision may also create a whole new class of "net profit" litigants: writers, producers, and other profit participants who, dissatisfied with their share, attempt to "restructure" their participation in accordance with the "*Buchwald* rule" on the net profit formulation.²⁰⁷ The march through the courthouse door could be massive.

Even if the decision is reversed on appeal, *Buchwald* should endure as an instructive lesson to the studios that the net profit formula is looked upon with contempt by many in the Hollywood community. More importantly, however, the studios should pay heed to what *Buchwald* represents, in addition to what it explicitly states. Irrespective of how the litigation is eventually concluded, *Buchwald*, and the history of net profit, reveal that the original formulation, in its unadulterated form, operated as a risk reducer; it decreased immediate production costs by lowering "up-

of a competitive bidding war for talent among film studios. *Id.* Londoner believes that as a result, "the average profit margin of studios could fall 20 percent in the next few years, to about 9 percent." *Id.* at col. 4.

²⁰⁵ *Id.*

²⁰⁶ An executive at a major Hollywood studio said that if the decision is upheld on appeal, filmmaking will become more expensive because potential profit participants will demand a greater share of the profit. Stevens & Marcus, *Paramount Ordered to Refigure Buchwald's Fee in Movie Dispute*, Wall St. J., Dec. 24, 1990, at 12, col. 1, [hereinafter *Paramount Ordered*].

²⁰⁷ Peter Dekom, a Los Angeles entertainment lawyer, predicted a "legal nightmare" in which writers and producers sue studios for a new accounting of profits. *Paramount Ordered*, *supra* note 206, at 12, col. 1. Dekom further predicted that in response, studios may "simply abandon any pretense of net-profit participation and resort to flat, up-front payments," creating circumstances in which "[i]ndividuals with low bargaining power are likely to be hurt because the studio won't want to take the risk they are going to sue." *Id.* Still, the potential for a floodtide of litigants would be tempered by statutes of limitation.

front" compensation.²⁰⁸ The studios should glean from the decision, and the evolution of the formula, that although the original goal has long disappeared, advantages would accrue to the studios were they to return to that goal.

A decrease in current levels of negative cost could be achieved by limiting or eliminating certain deductions which the *Buchwald* court found suspect.²⁰⁹ Three items in particular were found unconscionable because they constituted flat fees bearing no relation to actual costs: overhead, advertising overhead, and interest charges.²¹⁰ The court's reasoning implies that these charges would have been proper if they were proportional to the actual costs incurred. Hence, the decision essentially requires the studios to charge a more proportional fee for each film, or eliminate certain fees altogether. It is in the studios' interest to maintain the distribution fee which represents the major component of profit for the studios,²¹¹ yet reduce or eliminate interest and overhead charges. Profit participants would then have more confidence in net profit and would thus be more willing to accept lower "up-front" compensation. To the studios, this should be a welcome occurrence, especially in a financial climate of increasing demands for higher fees.

VII. CONCLUSION

The *Buchwald* court decided to defer until the third phase of the trial the question of how to calculate the amount of damages to be awarded the plaintiffs because it believed that the facts before it were insufficient to make such determinations.²¹² The court, however, did offer some insight into the guiding principles that will be employed in this effort. First, the court stated that it would rely on Civil Code section 1670.5²¹³ "to produce an equitable result."²¹⁴ At the same time, however, the court rejected the plaintiffs' approach that would strike the unconscionable pro-

²⁰⁸ For a discussion of how net profit originally acted as a risk reducer for the studios, see *supra* notes 107-10 and accompanying text.

²⁰⁹ MPAA president Jack Valenti recently "predicted that given the present paucity of available capital and the current depressed state of the world economy, film companies will have to adopt a strong policy of fiscal 'discipline,' which would translate into 'much reduced' negative costs in 1991." Eller & Hollinger, *Valenti Foresees Prudent Spending*, *Variety*, May 27, 1991, at 10, col. 1.

²¹⁰ For the *Buchwald* court's explanation of why each of these deductions was unconscionable, see *supra* notes 166-72.

²¹¹ *Buchwald Suit*, *supra* note 36, at 19, col. 1.

²¹² *Buchwald*, 90 L.A. Daily J. App. Rep. at 14487.

²¹³ For the pertinent text of Civil Code § 1670.5, see *supra* note 146.

²¹⁴ *Buchwald*, 90 L.A. Daily J. App. Rep. at 14487. The *Buchwald* court, on June 14, 1991, clarified this statement when it concluded that it would assess the "fair market

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visions and then only permit Paramount to recover "its actual costs plus a reasonable return on its investment."²¹⁵ This approach was rejected because the court believed that the result would provide Bernheim with an inequitable windfall.²¹⁶ Second, the court stated that in determining the amount due Buchwald, it would be influenced by the fact that "Buchwald was to receive only a fraction of the net profits due Bernheim."²¹⁷ And third, the court decided that since it would be following its own path in fashioning equitable relief for the plaintiffs, it was unnecessary to resolve the issue of the precise amount of net profit compensation that was due Bernheim and Buchwald.²¹⁸

Regardless of how the damage issue is eventually resolved, the Phase I decision stands as valid precedent for the following rule: in the absence of a contractual definition to the contrary, a court will use copyright principles of access and similarity to determine if a film is "based upon" a treatment or other underlying material. If Paramount chooses not to appeal the Phase I decision, or if the ruling is appealed and upheld, the studios, to protect themselves, could attempt to include a detailed definition of "based upon" within the contract. This definition would set forth the requirements for one story to be considered "similar" to another story. Such requirements could embody not only similarity of plot and characters, which were present in *Buchwald*, but also similarity of character motivation, which the court found lacking. Had Paramount employed a definitional scheme similar to that suggested here, the court would not have had to utilize copyright law and consequently, would not have found *Coming to America* to be "based upon" Buchwald's treatment. However, whereas such a definition protects studios, it offers few safeguards to writers, and thus writers would be ill-advised to enter into contracts containing such a definition. A more likely result of Phase I is that the Writers Guild may begin scrutinizing more

value" of Buchwald's and Bernheim's contribution to the film to determine damages. *Judge Rules on Buchwald Damages*, *Variety*, June 17, 1991, at 7, col. 1.

²¹⁵ *Id.*

²¹⁶ *Id.* The court stated that "accepting plaintiffs' argument would result in Bernheim receiving a profit far beyond the contemplation of the parties at the time the contract was entered into and, apparently, far beyond the profit a producer with Bernheim's experience and track record would reasonably have been expected to earn." *Id.* (emphasis added).

²¹⁷ *Id.* at 14488. Buchwald was to receive 1 1/2 percent as opposed to the 17 1/2 to 40 percent contracted by Bernheim. *Id.*

²¹⁸ See *id.* For a discussion of this issue as it relates to the consultation clause, see text *supra* at notes 183-84.

closely the entire development process of a film to ascertain the proper credit attribution.

The *Buchwald* court's ruling in Phase II that the net profit contracts signed by a producer were non-negotiable contracts of adhesion, and that certain provisions of Paramount's net profit formula are unconscionable, if upheld on appeal, requires a response by the studios. The possible responses essentially fall within two distinct, yet interrelated categories: a response could entail a revision of the formula or, in the alternative, its complete rejection, thus rendering the net profit deal obsolete. Were the studios to embrace the former response and modify the method by which net profit is calculated, in conformance with *Buchwald*, they would likely realize worthwhile benefits that would accrue in the same proportion as the liabilities that would accompany selection of the latter. This is because a revision could create more confidence that a film will breakeven, thereby creating a negotiating climate where producers, directors, writers, and actors would be more willing to accept lower "up-front" compensation. This, in turn, would reduce production costs. A complete rejection, on the other hand, would accomplish the opposite—those who are unable to garner gross profit points would demand greater "up-front" salaries than ever before, since that would be their only form of compensation. The effect would be a steep rise in production costs.

For these reasons, a revision of the formula should be considered even if *Buchwald* is overturned on appeal. The two major problems with the current regime relate to interest and overhead charges which, as the court declared, bear no relation to actual costs incurred by the studios. Were the studios to make the net profit deal more attractive to talent by decreasing, or even eliminating, interest and overhead charges, the studios could achieve a reduction in "up-front" compensation and thus diminish immediate production costs. Continued reliance on the distribution fee would ensure the studios a return on their investment. The choice before the studios is whether they would rather return to the net profit formula as it was originally conceived—as a risk reducer which decreased immediate production costs by lowering "up-front" compensation—or continue to make deductions that discourage faith in a formula that currently offers little incentive to talent to accept less compensation "up-front." Their answer to this question will ultimately determine the future of net profit.

Adam J. Marcus