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Guest blog: The economic opportunities created by new distribution platforms have given rise to accounting practices that may be improper and deprive income participants of significant backend compensation

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A recent series of class action lawsuits has highlighted tensions over the calculation of gross receipts and contingent, back-end compensation in the motion-picture industry. This is not, however, a new issue. Studios have long been criticized for having impenetrable accounting practices and for disregarding contractual obligations in calculating the share of gross receipts owed to so-called income participants -- actors, producers, directors and others who are paid in percentages based on the total earnings of a given project.

There has also been consistent and significant disagreement over how gross receipts themselves are to be calculated. Given that contingent compensation is most often ultimately based on gross receipts, this is a key concern for income participants.

The issue has only gotten worse with studios pursuing new distribution platforms such as home video, video-on-demand and internet delivery. The economic opportunities created by these new distribution platforms have given rise to accounting practices that,

depending on the terms of the parties' agreements, may be improper and deprive income participants of significant backend compensation.

As one might expect, producers and other income participants with sufficient leverage can often address accounting issues with a few well-placed phone calls. Those whose relationships are not as highly valued, however, often have a harder time. But they are not without recourse.

All of this has led to a series of class-action lawsuits filed in California state court by producers, directors and actors against the major studios. The plaintiffs want studios to change how they calculate home video distribution earnings and to pay damages for insufficient compensation in the past. They claim studios improperly only include 20 percent of the total money earned from video distribution in the calculation of gross receipts, regardless of the video format.

In short, the plaintiffs allege studios are keeping 80 percent of the profits earned from home distribution themselves. The lawsuit notes that the 20 percent figure is an outdated figure from the days when studios did not have home-video divisions and outsourced the production and distribution of physical video units to third parties who paid the studios a flat 20 percent royalty on the revenue the units generated.

That was the amount then included in the calculation of gross receipts. The plaintiffs allege that inclusion of only 20 percent of revenues from video exploitation has continued despite the fact that the studios now have their own home video units or affiliates, allowing them to effectively capture all of the home video revenue.

The lawsuits also point out that the plaintiffs' contracts all require that gross receipts must include 100 percent of revenue derived from home video sales.

What makes these class actions more interesting than the average accounting dispute, is that they pertain to contracts entered into when home video was in its infancy. There was not a great deal of knowledge or understanding as to how home video would be exploited and whether it would be successful. In addition, as noted, the creators and owners of content were not, at the time, the distributors of home video.

The result was significant uncertainty as to how to monetize and share the profit from home video. This was only exacerbated as video distribution itself changed with the advent of technology that allowed it to be delivered directly to consumers -- at home, on a computer or on a mobile device -- by the creators and owners of content.

The motion-picture industry has been slow to adapt accounting processes that give proper weight to revenues from developing video distribution platforms. Instead, it has relied on historical practices that often inaccurately account for these new revenue streams. Also, as Netflix, Hulu and YouTube, among others, establish themselves as "go to" platforms for video consumption, content owners will search for and experiment with ways to monetize distribution over those platforms.

In doing so, they can't lose sight of obligations they may have to account for gross receipts and contingent compensation, even though many agreements do not expressly address distribution over the Internet or other new platforms.

If they are not settled, these class-action lawsuits will likely result in court decisions that guide parties as to their respective rights and obligations under contingent compensation agreements. Clarity in that regard should incentivize studios to think more proactively about how to monetize the exploitation of content through developing distribution platforms, benefitting both content owners and income participants.

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