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## Hollywood Deals: Soft Contracts for Hard Markets

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## **Hollywood Deals: Soft Contracts for Hard Markets**

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*Hollywood film studios, talent and other deal participants regularly commit to, and undertake production of, high-stakes film projects on the basis of unsigned “deal memos” or draft agreements whose legal enforceability is uncertain. These “soft contracts” constitute a hybrid instrument that addresses a challenging transactional environment where neither formal contract nor reputation effects adequately protect parties against the holdup risk and project risk inherent to a film project. Parties negotiate the degree of contractual formality, which correlates with legal enforceability, as a proxy for allocating these risks at a transaction-cost savings relative to a fully formalized and specified instrument. Uncertainly enforceable contracts embed an implicit termination option that provides some protection against project risk while maintaining a threat of legal liability that provides some protection against holdup risk. Historical evidence suggests that soft contracts substitute for the vertically integrated structures that allocated these risks in the “studio system” era.*

“Moviemakers do lunch, not contracts” – Ninth Circuit Judge Alex Kozinski (*Effects Assoc., Inc. v. Cohen* (908 F.2d 555 (9<sup>th</sup> Cir. 1990)))

“Aren’t you people ever going to come in front of me with a signed contract?”<sup>1</sup>

The Hollywood film industry<sup>2</sup> regularly enters into significant commitments under various species of incomplete agreements: oral communications, deal memoranda, or draft agreements that are revised throughout a production and often remain unsigned. These “unsigned deals” are supported by an uncertain threat of legal enforcement coupled with some prospect of reputational liability. Hollywood’s loose transactional practices challenge conventional expectations that an enforceable contract is a precondition for any significant financial undertaking. Business lawyers usually make special efforts to protect clients (and themselves) by avoiding the predicament of being potentially, but not certainly, subject to legal liability. Hollywood contracting departs radically from this prudential (and, it would seem, only rational) approach.

Existing explanations (and judicial admonishments) tend to attribute Hollywood’s contracting practices to the proclivities of actors and other talent who have little appreciation of legal matters. But these explanations are incompatible with the competitive repeat-play environment populated by the sophisticated intermediaries who negotiate and execute transactions on behalf of talent and their business counterparties in Hollywood. Consistent with this environment, I account for Hollywood’s contracting practices as a tailored response to two types of risks that are particularly salient in the film industry (and, generally, any creative goods market). These are: (i) the project risk arising from uncertainty as to the project’s likelihood of success or failure (the latter being the typical result); and (ii) the holdup risk arising from the irrecoverable and

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<sup>1</sup> Statement reportedly made by presiding judge to Warner Brothers’ counsel in litigation involving alleged breach of oral contract by Rodney Dangerfield (Schleimer 1998).

<sup>2</sup> By “Hollywood”, I refer throughout to the film (and, where specified, the television) industry based in Southern California, including the major film studios and the network of smaller entities that transact with the studios.

sequential character of investments in a film project. Transacting parties negotiate the degree of contractual formality as an implicit term that proxies for the explicit allocation of those risks in an environment characterized by high specification costs, which reduces the efficacy of formal contract, and unreliable reputation effects, which demands *some* recourse to formal contract.<sup>3</sup> Each risk category “pulls on” contractual formality—which I assume correlates positively with contractual enforceability—in opposite directions. Increasing contractual formality reduces holdup risk by supplying legal sanctions to deter opportunistic termination and renegotiation. Reducing contractual formality reduces project risk by supplying an implicit termination and renegotiation option in response to adverse information concerning the expected commercial outcome. The result is what I call the “soft contract”: a mix of legal and reputational governance situated between the standard alternatives of short-term contracting governed solely or primarily by law and repeat-play relationships governed solely or primarily by reputation.<sup>4</sup>

I focus on a segment of the film industry where unsigned deals are especially prevalent: transactions between studios or other production entities<sup>5</sup> and higher-value talent (mostly, actors<sup>6</sup> and directors), commonly known as “stars”. It might be wondered why studios and stars do not use a simpler mechanism to protect against these risks. The studio could bind talent to a long-term employment contract and shift all transactions from the “market” to the “firm”. That would constrain the holdup behavior to which the studio is exposed in single-project transactions with high-value talent and would enable the studio, a risk-neutral and well-diversified entity, to efficiently insure talent, a risk-

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<sup>3</sup> In a related contribution, Gil (2011) argues that distributors and exhibitors in the Spanish film industry endogenously select the level of contractual formalization in order to elicit new information to make ex post efficient adjustments. My argument differs in two respects: (i) I derive formalization choices from a tradeoff between holdup risk and project risk; and (ii) I contemplate that parties may select from the full possible range of formalization possibilities (and an associated range of likelihoods of enforceability).

<sup>4</sup> The concept of “soft contracts” draws on two foundational papers: (i) Goldberg (1976), who analyzed the use of flexible contractual terms to structure the process of adjusting terms in response to new information, and (ii) Klein (1996), who analyzed the interaction of reputational and legal enforcement in constraining holdup behavior. Bozovic and Hadfield (2011) and Gilson, Sabel, and Scott (2010) address these issues in the context of innovation markets.

<sup>5</sup> As used herein, “studio” refers to either the small group of “major” studios that have a full range of financing, distribution and production capacities or the larger group of independent production companies that (i) only have production capacities and must seek distribution and financing elsewhere or (ii) have some but limited in-house distribution and financing capacities (a “mini major” studio). Where necessary, I distinguish between these specific types of entities.

<sup>6</sup> Throughout I use the term “actor” to refer to both male actors and female actresses.

averse and non-diversified individual, against the risk of failure on any individual project. Hollywood mostly operated under this arrangement during the classical studio system that prevailed from the 1920s until its dissolution in the 1950s and the music industry continues to use a variant of this system. The dismantling of the studio system, and its replacement by a disaggregated network of studios, talent agencies and independent production companies, exposed the studio to increased holdup risk and talent to increased project risk and necessitated an alternative transactional arrangement by which to secure commitments in a fluid environment. The result is, in part, the transactional hybrid represented by the soft contract.

Elucidating the economic logic behind Hollywood's contracting practices yields three contributions in increasing order of generality. First, this paper contributes to the economic analysis of contracts in the film industry. Existing scholarship has analyzed exhibition contracts (Gil 2011; De Vany and Walls 1996; Kenney and Klein 1983) and profit-sharing provisions in talent contracts (Weinstein 1998; Chisholm 1997; Goldberg 1994). But there is little scholarly treatment of other features of talent contracts or the interaction between talent contracts and organizational structure.<sup>7</sup> Second, while scholars have derived contractual and organizational structures from either holdup or uncertainty alone, this paper derives those structures from a combined holdup and uncertainty problem.<sup>8</sup> Third, and most generally, this paper identifies how parties negotiate over contractual formality as a "meta term" that allocates risk in environments where neither contract nor reputation nor vertical integration provides an adequate governance structure. This framework anticipates how parties can calibrate levels of formalization as a mechanism by which to tailor risk-allocations with respect to different counterparties, assets, deal terms or different points on a transactional timeline.

Organization is as follows. In Part I, I describe the key economic features of a film project. In Part II, I describe Hollywood contracting practices and review the formal law, and hand-collected data on litigation behavior and judicial outcomes, relating to the

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<sup>7</sup> There is a small descriptive literature in specialized law reviews and practitioner journals on unsigned deals in the film industry. *See* Bogart (2004); McLaughlin (2001); Smith (2003); Bardach (1993); Kari (1993).

<sup>8</sup> I am aware of one prior contribution that derives transactional structures from a combined uncertainty and holdup problem (Hanson 1995).

enforceability of soft contracts in the film industry. In Part III, I provide an economic explanation for these contracting practices and generalize that explanation beyond the Hollywood context. In Part IV, I discuss how soft contracting may have displaced vertical integration as a risk-allocation mechanism in Hollywood film production.

## **PART I: HOLLYWOOD ECONOMICS**

Three features of the Hollywood film industry are especially salient from an economic perspective: (i) the extreme risk of a film project; (ii) the longevity and dominance of a small group of major studios; and (iii) the persistence of the star vehicle in the labor market for acting and directorial talent.

### **A. Why Only Fools Invest in Movies**

1. *Extreme Uncertainty; Skewed Returns.* Any movie is akin to a gamble with long odds: a few hits succeed spectacularly while the remainder consists of flops that generate meager or no profits. The disparity in outcomes is dramatic. From 1984 through 1996 (for the U.S. and Canadian markets), only 22% of releases were profitable; among the minority of profitable movies, 35% earned 80% of total profits; and, in the aggregate, 6.3% of all movies earned 80% of total profits (De Vany and Walls 2009).<sup>9</sup> No known metric exists by which to predict the likelihood of success or failure of a given film (De Vany 2004). This is sometimes known as the “nobody knows” property.<sup>10</sup>

2. *High Stakes.* A substantial investment is typically at stake. As of 2007, the Motion Picture Association of America reported that a major studio film had an average production and distribution cost of \$106.7 million (Motion Picture Association of America 2008). The largest blockbuster films have production and distribution budgets

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<sup>9</sup> More recent evidence finds even more extreme outcomes: Standard & Poor’s (2007) reports that approximately one in ten releases cover production costs.

<sup>10</sup> The phrase is derived from a statement by screenwriter William Goldwyn: “Nobody knows anything –Not one person in the entire motion picture industry knows for a certainty what’s going to work” (Goldwyn 1983, p. 39).

that exceed \$200 million (for example, the reported budget for *Avatar*, a major feature film released in 2009, was \$237 million).

3. *Irrecoverable Investments.* A film project proceeds along an extended timeline starting with idea conception and running through release at the box office.<sup>11</sup> At various points on the timeline, parties must make “specific” investments—that is, investments that have a lower value in any alternative use—prior to having any reliable information as to the likely commercial outcome. Absent reputational or legal constraints, these specific investments trigger exposure to holdup behavior by counterparties.

### **B. Why Studios Exist: The Inevitability of Scale**

Since the start of Hollywood, a small group of major studios have held roughly consistent market shares. In 2011, the six major studios (Sony Pictures, 20<sup>th</sup> Century Fox, Walt Disney, Paramount, Warner Bros. and Universal) accounted for 81.2% of gross domestic box office revenues (Subers 2012); in 1939, five major studios and three smaller studios released 85% of the feature films released that year (Huetting 1944, p. 87). The scale and scope of the Hollywood studio mitigate the risks of film production. A Hollywood studio does not primarily “make movies”; rather, it is primarily a vehicle for financing, promoting and distributing the films produced by independent production entities. By holding a diversified portfolio of projects and maintaining a library of past successes, the studio can generate a sufficient number of “hits” and revenue streams to make up for losses on the far greater number of “flops”. Today all the major studios are subsidiaries of media or industrial conglomerates (or, in the case of Disney, *is* a media and entertainment conglomerate)<sup>12</sup>, which can use an additional pool of products and services to further diversify project-specific risk. For the same reason, even critically successful independent production companies face chronic financial difficulties and often

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<sup>11</sup> Estimates vary: 12-to-18 months after a film is “greenlit” (that is, definitively approved) for production (Ferrari and Rudd 2006, p.15); or 12-to-24 months from development (Cones 1997, p.141).

<sup>12</sup> Current ownership structures are as follows: Sony Pictures is controlled by Sony; Universal is controlled by General Electric; Paramount is controlled by Viacom; Fox is controlled by News Corp.; Warner Bros. is controlled by Time Warner.

declare insolvency or are acquired by a major studio (Selz et al. 2009, §§1:8; 2:3; Boyle 2004, p. 176).

### C. Star Power

The star vehicle has been a consistent feature of the movie industry from its inception in the early 20<sup>th</sup> century through the present (Kindem 1982, p. 79). This feature can be derived from two sources: (i) high-quality, low-cost reproduction technologies create “winner-take-all” effects that disproportionately drive market rents to the most highly-valued performers (Rosen 1981); and (ii) consumers mitigate consumption risk by using a star as an imperfect indicator of movie quality, which drives producers, distributors, and financiers to use that same variable as a proxy for a film’s likelihood of success.<sup>13</sup> Both factors explain why major feature films typically cannot be financed without a “bankable” star cast or director and why industry participants closely follow rankings of star value.<sup>14</sup> Actors and directors in the upper echelon of those rankings represent a scarce asset for which studios compete vigorously while all others are virtually a commodity good. For 2010, the Bureau of Labor Statistics estimates that, of the nearly 100,000 members of the Screen Actors Guild (the actors’ union), only about 50 earned extraordinarily high incomes, while most other actors earned meager salaries and were unemployed for long periods of time (U.S. Department of Labor 2009). Other evidence confirms this extreme skew in talent’s fortunes. For the period 1993-95, only 58 directors directed more than one feature film released by a major studio and only three persons directed at least three such films (Zuckerman 2004); for that same period, 79.5%

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<sup>13</sup> The extent to which the presence of a star improves the likelihood of a successful release remains unresolved. Using a sample of 2000 films released from 1984 to 1996, De Vany (2004, §§ 4.3.2, 4.5.1, 4.5.2) finds that, on average, a star significantly increases a movie’s higher least revenue (that is, a star constrains the lower tail portion of the revenue distribution) and slightly increases a movie’s chance of making a profit, in each case relative to a movie without a star. This is consistent with findings that actors positively impact opening performance (Elberse 2007, p.120), as well as popular observations in Hollywood that “stars help the movie to open”.

<sup>14</sup> Currently available lists include the “Ulmer Scale”, a list of the industry’s top 1400 actors ranked by “bankability” (defined as the ability to raise “100% or majority financing” for a movie) (Ulmer 2010); *Vanity Fair*’s list of highest paid movie stars (Newcomb 2011); *Hollywood Reporter*’s “Star Power” list (based on a poll of executives at studios and independent production companies) (Mail Online 2012); the Internet Movie Database’s “StarMeter” list (based on the search behavior of users of the “IMDb.com” website, a leading online source of information in the film industry) (IMDb.com 2012a); *Esquire*’s “Box Office Power” list (based on box office revenues, as weighted by various criteria) (Shepatin 2008); and *Forbes*’ “Star Currency” list (based on industry survey) (Forbes 2012).



of all actors who acted in any film only acted in one film (Zuckerman 2004); and, for the period 1995-2001, only 30 actors appeared in two or more hit films (defined as a film that grossed \$100 million or more) (De Vany 2004, § 11.6). Remarkably, roughly the same skew in actors' fortunes was reflected by the distribution of stars' and non-stars' salaries in 1929 (Bakker 2005, pp. 67-68).

## **PART II: HOLLYWOOD CONTRACTING**

Scholars have observed (and business lawyers would not be surprised to learn) that parties use strategic ambiguity in drafting contracts (Choi & Triantis 2010, Geis 2006). Other scholars have identified settings in which parties appear to deliberately use legally unenforceable documentation (Charny 1990; Boot, Greenbaum, and Thakor 1993; Scott 2003; Macaulay 1964) or in which parties enter into preliminary agreements that set forth some, but not all, of the terms of a proposed transaction (Schwartz & Scott 2007; Ben-Shahar 2004). But scholars have not observed that parties sometimes use strategic ambiguity with respect to the *existence* of a contract itself.<sup>15</sup> Standard business law practice takes every measure to avoid this predicament.<sup>16</sup> Certainly, operating in a gray area of potentially enforceable agreements would appear to be imprudent for both client and attorney. Yet Hollywood appears to feel otherwise.

### **A. Conventional Contracting**

The timeline of a conventional transaction can be described as follows. First, after some initial discussion, the parties enter into a preliminary agreement, often called a “memorandum of understanding” or “letter of intent”, which describes the basic terms of the proposed transaction and usually states that the document is non-binding.<sup>17</sup> Negotiation of detailed terms and legal and financial diligence then proceed simultaneously. If those processes advance, the parties negotiate, draft and execute a

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<sup>15</sup> The possibility that parties may deliberately choose ambiguous levels of legal enforceability is mentioned in passing in Scott (2003 n.172). Other scholars have identified cases in which parties appear to deliberately use legally unenforceable documentation. For sources, see *infra* note \_\_\_\_.

<sup>16</sup> Personal experience as a corporate attorney. See also Perillo (1994, p. 287) (“[w]ithin the common law system, most legal professionals staunchly cling to the supreme value of certainty of result”).

<sup>17</sup> Exceptions to the “no liability” disclaimers are sometimes made with respect to confidentiality provisions or, in an acquisition transaction, “no shop” provisions barring the target firm from seeking bids from other acquirors. For further discussion, see Lake and Draetta (1994, pp. 15-16).

package of final agreements and proceed to closing of the deal (in a discrete transaction) or other forms of performance (in a “relationship” transaction). In this case, there is a clear demarcation between the negotiation period, in which there is no risk of contractual liability, and the performance period, in which contractual liability clearly operates. Once the deal is executed, parties commence performance under the assurance that all subsequent investments are governed by contractual terms that can be enforced in court.

## **B. Hollywood Contracting**

In Hollywood, the conventional transactional sequence is often not followed. Parties’ commitments are sometimes memorialized in oral, informal or unexecuted instruments that are negotiated while parties are making substantial investments in the joint project. As a result, the point at which legal liability commences (or ends) is never entirely clear.

### **1. Transaction Components**

A film project is a complex enterprise that combines inputs supplied by hundreds of different entities and individuals. The core inputs include: (i) financing; (ii) production; (iii) talent; (iv) craft and other technical personnel; (v) distribution; and (vi) theatrical exhibition. In Hollywood’s current structure, external supply predominates. Films are produced by either integrated studios who have internal distribution capacities but access externally all talent inputs and often financing inputs, or, more typically, independent production companies, who have no internal distribution or financing capacities and must access all inputs externally.<sup>18</sup> Critically, talent inputs are always accessed externally in Hollywood’s current industry structure, whether or not the procuring entity is an integrated studio or independent production entity.

### **2. Contracting Practices**

Hollywood has developed a rich menu of contracts that condition performance obligations on the occurrence of specified triggering events (for a review, see Moore 2007). For example, an outside financing agreement is usually conditioned on the

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<sup>18</sup> “Minimajor” studios fall somewhere in between this two-part dichotomy since they have some financing and distribution capacities; however, these capacities are more limited relative to a major studio.

presence of certain “attached elements”, such as a marquee star and director and conformity to a script. In other cases, however, Hollywood deviates from the conventional contracting model. Rather than conditioning performance on execution of a contract, or staging performance on the basis of a detailed schedule of conditions precedent, the parties commence performance under imperfectly specified obligations set forth in uncertainly enforceable instruments. To understand more precisely the extent to which these soft contracting practices are used in the film industry, I surveyed the practitioner and business literature, reviewed the digital archives of *Variety*, one of the industry’s two leading trade journals, and conducted interviews with different types of legal practitioners in the field.<sup>19</sup>

Much of the trade and practitioner commentary and most interviewees stated that unsigned deals are widespread throughout the industry, including deals between studios and individual producers (Bogart 2004, p.360; Rapportoni (1991); Entertainment Attorney Interview III)<sup>20</sup>; independent production companies and studio-distributors (Cones 1997, p. 35; Entertainment Attorney Interview II); independent production companies and foreign distributors (Coudert Brothers LLP 1998); and talent and managers (Cestero 2010).<sup>21</sup> In a brief filed by Warner Bros. in a recent federal appeals court litigation, the studio asserted that “many business deals are never formalized” in the entertainment industry and it is “standard” for parties to commence performance without a formalized contract (Warner Bros. 2012, pp. 3, 28-29). Unsigned deals appear to be used most consistently in the case of studio/talent transactions (Entertainment Attorney Interview II; Production Executive Interview; Studio Counsel Interview II)<sup>22</sup> and, in particular, in the case of deals between studios and higher-value talent (Studio Counsel

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<sup>19</sup> Interviewees included: (i) two senior law firm partners and a senior law firm counsel with entertainment law practices; (ii) three current or former in-house counsel at two major Hollywood studios; (iii) an entertainment attorney specializing in talent representation; and (iv) a production executive at a “minimajor” studio. For a full list of all interviews, see “References—Interviews”.

<sup>20</sup> In my research of the *Variety* archives, this seems to be a frequent source of contract formation disputes.

<sup>21</sup> Even more conventional business transactions in Hollywood appear to sometimes use the unsigned deal procedure. For example, Sandler (1997) describes the settlement of a litigation between TriStar Pictures and Reebok, in which the latter sought to enforce a product placement agreement that had been documented in an unsigned “second draft six-page deal memo.”

<sup>22</sup> In an informal conversation, an independent producer stated that shooting “always” proceeds without “paper” (that is, without executed contracts with talent). Conversation with Producer, Los Angeles, Dec. 2, 2011.

Interview III; Studio Counsel Interview I).<sup>23</sup> For reasons of analytical simplicity, I focus on this transactional category.

A 1997 *Variety* article described a typical sequence in a studio/star deal as follows: (i) an oral agreement made by an actor's agent or attorney; (ii) a deal memo; (iii) "reams of paperwork" outlining the major points; and, in a *rare* case, (iv) a "longform agreement signed by both sides" (Daily Variety 1997). Interviewees confirmed that studio/star transactions are often or sometimes not memorialized in fully-negotiated "long-form" documentation and, for part or all of the production timeline, proceed on the basis of some combination of oral commitments, short "deal memos" (Entertainment Attorney Interview II; Bogart 2004, p.363), email exchanges or other informal communication (Production Executive Interview; Studio Counsel Interviews II and III; Entertainment Attorney Interviews II, IV).<sup>24</sup> Studio in-house counsel reported that a studio will typically "green light" (that is, finally approve) a project based on incompletely specified communications with talent attorneys and a mutual understanding to subsequently negotiate and draft a fully executed long-form agreement (Studio Counsel Interview III). Studios do appear to insist, however, that talent execute a "Certificate of Engagement" assigning to the studio all intellectual property rights in talent's contribution to the project (Studio Counsel Interviews II and III; Entertainment Attorney Interviews I, III, IV).

After "shooting" has commenced, the studio and talent attorneys may continue negotiating a long-form agreement or what has been called a "creeping contract" (Dossick 1999). Three possible outcomes may then result: (i) the contract is executed during shooting (Studio Counsel Interview III), (ii) the contract is executed after shooting has been completed (Moore 2000, pp. viii, 17; Litwak 1994, p.161; Dossick 1999; Entertainment Attorney Interview I; Cleve 2000, p.109) or (iii) the contract is never executed and remains in draft form (Litwak 2009, Ch. 10; Studio Counsel Interview I; Production Executive Interview; Entertainment Attorney Interview IV). Evidence produced in litigations suggests that the path of least formalization is often selected: leading actors and directors regularly commit to, and often complete, an entire movie

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<sup>23</sup> In Daily Variety (1997), the author notes that entertainment lawyers reported that "contracts with major stars are never signed" and the "unsigned contract is the prerogative only of high-priced talent".

<sup>24</sup> For further discussion, see Kravit (2004), p. 197; Litwak (1994), pp. 160-61; Biederman et al. §2.4.

without having entered into a signed contract. Judges adjudicating studio/talent litigations repeatedly observe that the movie industry exhibits an unusual reliance on oral and unsigned agreements.<sup>25</sup> In one such case, the court stated: “Motion picture development and production operates in a unique business universe . . . Multi-million dollar film projects are developed and completed (or cancelled) on the basis of loose, artistic understandings without written, signed contracts” (Stuart 1982).

### **C. Are Soft Contracts Enforceable?**

Do Hollywood’s soft contracts give rise to a meaningful threat of legal liability? The short answer: yes. As a matter of California and New York law (the two most relevant jurisdictions), unsigned deals give rise to some level of contractual or some other liability. As compared to a fully specified and executed long-form document, however, these forms of agreement impose liability at reduced certainty and, even if liability were triggered, often support a lower measure of damages.

#### **1. Indefiniteness Doctrine**

Contractual enforceability requires satisfaction of two elements: (i) the exchange of consideration; and (ii) mutual agreement on sufficiently definite terms. The second element is at issue in the soft contracting context. Historically courts have required mutual agreement over all essential terms. On that basis, courts sometimes declined to enforce “agreements to agree” or other preliminary or incompletely specified agreements (Farnsworth 1987, pp. 220-21). Current law is more equivocal. Courts now are sometimes willing to “fill in gaps” based on a reasonableness criterion, which restores contractual completeness and can then support the standard award of expectation

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<sup>25</sup> In an unsigned deal litigation between RKO Studios (then a major studio) and an actress, a witness for the studio, a studio executive, reported that “the industry deals largely in oral deals” and that contracts are usually signed *after* a film is completed or, in rarer cases, never signed at all (Daily Variety 1952b). In a litigation between Kim Basinger (then a star actress) and an independent production company, the court found that she had acted in all but two of her previous nine films without a signed contract (in *Basinger v. Main Line Productions*, 1994 WL 814244 [Cal.App. 2 Dist. 1994]). The court observed that “film industry contracts are frequently oral agreements based on unsigned ‘deal memos.’” *See id.* In a litigation between Francis Ford Coppola and Warner Bros., the court found that Coppola, a world-famous director, had not entered into a signed contract in directing two previous films for the studio (in *Coppola v. Warner Bros.*, Appellate No. B126903 [Mar. 26, 2001][unpublished decision]).

damages. Far less frequently, courts may imply an agreement to negotiate in good faith<sup>26</sup> or, even if mutuality is not satisfied, may award reduced damages on equitable grounds such as promissory estoppel or unjust enrichment. Sophisticated parties can eliminate exposure to these sources of precontractual and extracontractual liability by stating upfront that any preliminary communications are non-binding. This simple prophylactic is standard practice in other business settings (Lake and Draetta 1994, pp. 192-93; Johnston 1999, pp. 404, 478) and proves effective when tested in litigation.<sup>27</sup> But this simple precaution is not commonly undertaken in studio/talent transactions. Effectively, entertainment lawyers choose *not* to opt out of a regime that can impose liability by the unpredictable fiat of a judge or jury.

## 2. Writing Requirement

As a matter of common law, oral agreements are enforceable so long as the consideration and mutuality requirements are satisfied. State and federal statutes of frauds sometimes impose an additional writing requirement. In California and New York, any contract that cannot be performed within one year of its “making” must be in writing and executed by the party against whom enforcement is sought (Calif. Civ. Code, § 1624(a)(1); N.Y. General Obligations Law, § 5-701). A writing is useful to a studio-plaintiff under California law, which provides that negative injunctive relief is only available in the case of personal services contracts that meet the writing requirement (Calif. Civ. Code § 3423). Federal law also provides that any exclusive transfer of a copyright interest must be in writing to be valid (17 U.S.C. § 204(a)), which explains why contracts with writers cannot proceed on an unsigned basis.

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<sup>26</sup> For the leading case, see *Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co.* (670 F. Supp. 491 [S.D.N.Y. 1987]).

<sup>27</sup> For examples, see: *Rennick HHC v. Care Inc.* (9<sup>th</sup> Cir. [1996]) (declining to enforce a “handshake” deal because other written communications included disclaimers of any legal liability prior to execution of a final written agreement); *R.D. Group, Inc. v. Horn & Hardart, Co.* (751 F.2d 69, 74 [1984]) (refusing to enforce an agreement that included all material terms, because it stated that the parties did not intend any legal liability until the execution of a complete written agreement).

### 3. Evidence: Enforcing Soft Contracts

It now remains to consider the extent to which soft contracts in the entertainment industry are likely to give rise to legal liability as an effective matter. This is a critical point. Without some reasonable anticipation of being held enforceable, soft contracts would largely overlap with certainly unenforceable reputational agreements. Without some reasonable anticipation of *not* being held enforceable, soft contracts would largely overlap with certainly enforceable formal agreements.

#### a. *Litigation Behavior*

It is difficult to assess precisely the extent to which studios and talent seek to enforce soft contracts, either formally or informally. To gain some insight into litigation behavior, I<sup>28</sup> surveyed the archives of *Variety* and (as described in greater detail below) the Westlaw and Lexis case law databases for reports of contract formation disputes between a studio (including an independent production entity) and talent (meaning, an actor, director or writer).<sup>29</sup> For the entire period starting with the inception of the Hollywood film industry through the present, a total of 67 reported “unsigned deal” disputes were identified. Of that group, (i) all but two arose after the end of the studio system (provisionally dated for this purpose as of 1947); (ii) all but two involved a formal lawsuit; (iii) in 28 cases (41% of the time), talent was alleged to be the breaching party and in the remainder, the studio or other production entity; and (iv) 21 disputes resulted in a fully-litigated proceeding ending in a court judgment or jury finding (see Apps. A; B). Considering only the period 1947-June 2012, there is on average a little more than one reported talent/studio lawsuit per year of this type. While both the total number of informal disputes and the total number of actual and proposed film projects is unknown, it can be safely asserted that studio or talent can expect to bear some legal exposure as a result of terminating involvement in a project with respect to which the parties had expressed a sufficiently firm commitment.

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<sup>28</sup> I and research assistants identified all relevant cases or press reports following my instruction. I then reviewed the identified cases and reports to confirm relevance.

<sup>29</sup> For this purpose, I targeted disputes over the existence of *any* binding agreement between studio and talent, excluding disputes over binding agreement with respect to a particular term of an agreement that the parties otherwise recognized as having been duly formed.

*b.1. Case Law Survey -- Sample; Methodology.*

To gain insight into the judicial outcomes that drive litigation behavior, I used the Lexis-Nexis and Westlaw case law databases to identify all reported decisions for the entire period from the date of each database's inception<sup>30</sup> through June 2012 in all federal courts and all New York or California state courts that involve disputes concerning the enforceability of oral agreements, deal memoranda, or other incompletely specified agreements relating to a film or television project.<sup>31</sup> Additionally, I identified all reported decisions involving the same fact pattern for the period from January 1980 through June 2012 in state courts other than New York and California.<sup>32</sup> *Appendix A* provides a complete list of all identified cases, a summary of relevant facts and holdings, and database scope.

*b.2. Case Law Survey -- Results*

Not surprisingly, a fully-litigated case in this context is an infrequent occurrence: only 37 decisions were identified for the entire period from the inception of coverage in the relevant databases through June 2012 (all but one case having occurred since 1947, which coincides approximately with the end of the "studio system"). Of the 37 cases, the

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<sup>30</sup> As a practical matter, the search could obviously only have located cases since the start of the commercial film industry in the United States. The first commercial motion picture exhibition in the United States took place in 1894.

<sup>31</sup> I included cases relating to the television industry in this survey on the assumption that judicial rulings concerning unsigned deals in television would influence expectations of parties transacting with respect to a film project. Note that I excluded cases involving "idea submission" disputes, usually involving claims by a writer or producer that a network, studio or other production company used an idea "pitched" to the network or studio.

<sup>32</sup> It would be useful to learn whether any such disputes are resolved by arbitration and, if so, whether the arbitration process provides any precedential guidance to studio/talent representatives. I am doubtful, however, whether this would shed significant additional information. First, my trade press review only identified a single reported contract formation dispute between studio and talent that was resolved by arbitration (App. A). Second, it is not clear that arbitration is typically available in contract formation disputes between studio/talent. The "Basic Agreement", which governs relationships between talent and a production entity that is a signatory to the collective bargaining agreement with the Screen Actors' Guild ("SAG"), subjects all disputes between those parties to mandatory arbitration (Screen Actors Guild 2011a). However, it is not clear that the arbitration clause would be triggered in a dispute in which one party denies the existence of a contract. A federal appeals court in a related scenario adopted a narrow interpretation of the arbitrability clause in the collective bargaining agreement between SAG and the talent agencies, holding that the clause was not triggered in a dispute involving whether certain purportedly agreed-upon amendments to the SAG/talent agreement had been agreed to (*Pastorini-Bosby Talent, Inc. et al. v. Screen Actors Guild Inc. et al.* [5<sup>th</sup> Cir. 1996] [unpublished]).



courts declined to enforce the claimed contract in 27 cases – that is, almost 73% of the time. Assuming that (i) more fully specified or more completely executed agreements are enforceable at a substantially higher likelihood (that is, substantially greater than 27% of the time), and (ii) less fully specified or less completely executed agreements are enforceable at a substantially lower likelihood (that is, substantially smaller than 27% of the time), then a soft contract represents a meaningful transactional alternative between the options of a purely formal or purely informal contract.<sup>33</sup> While the small sample size limits the ability to draw any definitive conclusions, it is supportive of the view that soft contracts offer a meaningful but insecure source of legal liability. The distribution of outcomes, and underlying grounds, are summarized below.

**Table I: Final Judicial Determinations Involving “Contract Formation” Issues in Film and Television Projects**

Outcome	Total	Grounds for Non-Enforcement			
		Oral Agmt Only	State statute of frauds	Federal statute of frauds	Indefiniteness
<b>Enforce</b>	10	8			
<b>Not Enforce</b>	27	11	3	7	13

*b.3. Case Law Survey -- Evaluation*

Since at least the late 1940s, California courts have held that legal enforcement can—but will not certainly be—triggered by the typical Hollywood contracting sequence: “Handshake, Start Production and (Maybe) Work Out the Details Later”. In a 1948 decision involving an alleged oral agreement between a director and a studio, a California court observed that the fact that a “formal written agreement to the same effect is to be prepared and signed does not alter the binding validity of the oral agreement” (in *Columbia Pictures Corp. v. De Toth* (87 Cal. App. 2d 620, 629 [1948])). This principle sometimes prevails. In a 1994 decision involving Kim Basinger (then considered star

<sup>33</sup> This assumes that plaintiffs’ success rates with respect to “contract formation” issues in breach-of-contract litigation involving fully-executed agreements are significantly greater than 35%. That seems a reasonable assumption in any well-functioning system of private law.

talent) and an independent studio, a jury found that Basinger had entered into a binding personal services contract based on oral conversations, an unsigned deal memo and five drafts of a long-form agreement (in *Basinger v. Main Line Productions*, 1994 WL 814244 [Cal.App. 2 Dist. 1994]). However, entering into a fully executed and highly specified long-form agreement would support a higher degree of enforceability relative to any oral or written agreement that is unexecuted or exhibits a lower degree of specificity. That assertion is supported by the case law survey described above: in more than 70% of the sample of identified cases, courts declined to enforce insufficiently formalized agreements. A recent example is provided by a litigation in 1998 between the director, Francis Ford Coppola, and Warner Bros., in which the court refused to recognize a purported agreement relating to a Pinocchio-themed film (*Coppola et al. v. Warner Bros., Inc.* (L.A. Sup. Ct., Case No. BC 135198 [1998])). Parties that elect to participate in transactions under incompletely specified agreements therefore operate in a “no man’s land” that is neither fully within nor fully outside contract law. In a business where nobody knows if a film will succeed (and most ultimately do not), it is often the case that nobody knows if a particular transaction is being undertaken pursuant to a legally enforceable contract.

### **III. AN ECONOMIC ACCOUNT**

In this Part, I provide an economic rationale why studio and talent sometimes prefer ambiguously enforceable over certainly unenforceable or certainly enforceable agreements when entering into a joint film project. Soft contracting practices are a prudent response to a challenging environment characterized by three major features: (i) high holdup risk and project risk, (ii) high specification and enforcement costs, which reduce the efficacy of formal contract; and (iii) positive but weak reputational constraints, which demand some recourse to formal contract.

#### **A. Existing Explanations**

Existing explanations for Hollywood’s loose contracting practices include: (i) ignorance or recklessness; (ii) timing pressures to commit rapidly to a transaction; and (iii) reputational pressures. Ignorance or recklessness is implausible: both studios and

talent are represented by experienced agents, lawyers and other advisors who operate in a competitive market. Timing explanations are unpersuasive for several reasons: (i) sophisticated law firms routinely prepare complex agreements for high-stakes transactions in other fields in a matter of days<sup>34</sup>; (ii) entertainment lawyers draft and negotiate highly specified contracts to govern financing and other transactions; and (iii) timing considerations would not bar converting unsigned deals into executed long-form documents during the course of production. Reputational factors, however, have considerable merit in a relationship-based industry such as Hollywood. This is the explanation provided for the use of legally unenforceable contracts observed in other repeat-play settings (Charny 1990; Boot, Greenbaum, and Thakor 1993; Scott 2003; Macaulay 1964) and will play an important role in the ensuing analysis. But a reputation-based explanation falsely anticipates that Hollywood would avoid the expense of contractual documentation altogether or, at least, incur the small cost of avoiding exposure to legal liability. In the following discussion, I proceed as follows: first, I propose an account of Hollywood contracting without addressing reputation effects; second, I complete that account by integrating reputation effects into the analysis.

## **B. Risk Categories**

Any film project operates under two fundamental risks: project risk and holdup risk. Project risk tends to burden talent most heavily while holdup risk tends to burden the studio most heavily. Any viable transactional structure for film production must protect against these risks.

### *1. Project Risk*

Project risk takes two forms: (i) reputational loss and out-of-pocket financial loss in the event of project failure and (ii) opportunity costs in the form of forfeited revenues or reputational gain on another project that enjoys a superior commercial or critical outcome. In absolute terms, an integrated studio has the greatest investment at stake; however, in relative terms, individual talent and, to a lesser extent, an independent production company, have a far greater proportion of their resources invested in a single

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<sup>34</sup> Based on author's experience as a corporate lawyer.

production and, most importantly, have a far greater undiversified investment in any individual project. Talent's major asset is reputational capital: that is, the perceived ability to improve the likelihood of box-office success. Successful releases add to talent's reputational capital, which translates into the ability to demand higher compensation (what the industry calls a "quote") on future projects; unsuccessful releases detract from it, which reduces talent's market value and the compensation that talent can demand in subsequent projects (Litwak 1994, pp.211-12).<sup>35</sup> As an individual, talent cannot diversify investments of his or her reputational capital to hedge against the risk of failure on any individual project and there is no outside market for insuring against that risk. Moreover, any actor constitutes a finitely-lived asset with an accelerated depreciation schedule: an actor tends to have a short window in which to monetize his or her perceived value<sup>36</sup> and a single flop may cause irrevocable injury to career prospects. By contrast, an integrated major studio—and, indirectly, its conglomerate parent—is an infinitely-lived entity that can hedge against project risk by holding a portfolio of projects that are in various stages of development and often financed by outside investors (Boyle 2001).

## 2. *Holdup Risk*

Holdup risk refers to a party's ability to expropriate the value of nonsalvageable investments made by another party in a joint project. Once one party has made an irrecoverable sunk investment in the joint project, the non-investing party can hold up the investing party by refusing to perform, subject to renegotiation of the project's terms to the non-investing party's advantage. In the studio/talent relationship, the studio is especially exposed to holdup by higher-value portions of the talent pool. The reason is two-fold: (i) a star is a difficult-to-replace asset, due both to the scarcity of high-value talent and the necessity of reshooting in the event a star withdraws from a film; and (ii) the studio makes a disproportionate sunk investment in a film project. Aside from the opportunity cost of an actor's time dedicated to a specific project, an actor's reputational

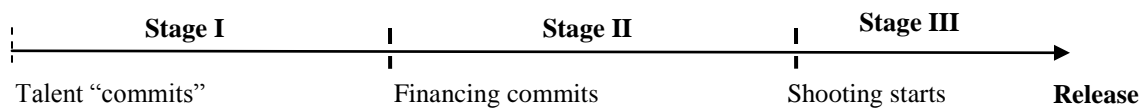
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<sup>35</sup> Note that actors' compensation is widely known in Hollywood as a result of information-sharing among agents and executives at competing studios (Brouwer & Wright (1990, p.61)).

<sup>36</sup> For historical evidence showing that actors' earning potential peaks at a relatively early age, see Bakker (2005, pp. 67-68).

capital is not specific to any particular film project (and even the opportunity cost of time can be avoided if the actor’s agent can locate an alternative project for the same time-window); by contrast, the studio makes irrecoverable investments in inputs assembled specifically for a particular project. In particular, the studio’s holdup risk increases sharply at two critical points on the production timeline.

**Figure I: Production Timeline**



*a. Pre-Production*

The studio is exposed to holdup risk as soon as it enters into agreements with outside investors to finance a particular film. Financing commitments are typically predicated on the presence of “essential items” such as a marquee star or director. In the event the star withdraws from the film, the studio may have breached a representation made to outside financiers (Studio Counsel Interview III), who may then be able to withdraw their commitment (or fulfill their commitment subject to renegotiated terms).<sup>37</sup> Absent concerns of reputational or legal liability, a star can demand a renegotiation premium just short of the increased cost of capital that would be borne by producers in the event the star withdrew from the project.

*b. Production*

Once production starts, the talent’s holdup leverage increases dramatically. The studio has now made a difficult-to-reverse investment in selected talent and other inputs required for a film production. That predicament drives higher-value talent to continue the renegotiation process during production: talent attorneys demand more perquisites and other improved terms (while typically refraining from renegotiating the “money

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<sup>37</sup> In a well-known litigation involving Kim Basinger and an independent production company, the latter argued that the actress’ departure from the film caused the company to lose some of its outside financing commitments (*Basinger v. Main Line Productions*, 1994 WL 814244 [Cal.App. 2 Dist. 1994]).

terms” (Entertainment Attorney Interviews I, II) or, at least, the fixed compensation (Entertainment Attorney Interview III)). The same rationale drives the behavior of stars who appear in a series of films and threaten not to return for a sequel without an additional retention payment (Studio Counsel Interview I). Excluding the threat of reputational or legal liability, the star can demand a renegotiation premium equal to the increased costs associated with retaining substitute talent and reshooting the film.

### C. Conventional Solutions

The conventional mechanisms of reputation and contract provide substantial but incomplete protection against holdup risk and project risk.

#### 1. Reputation

It is sometimes asserted that contracts have limited relevance in Hollywood because the studios and talent are subject to reputational sanctions for deviating from prior commitments. But a reputation-based explanation must assume that talent’s or the studio’s commitment is self-enforcing even in the absence of contractual liability. That requires assuming that no party will walk away from a film project because doing so would curtail the star’s expected profits on all future projects or, in the case of a studio, would harm its ability to recruit the highest-value talent for future productions. Such optimism would be naïve to a significant extent. Hollywood is not usually depicted as a paragon of good-faith behavior (if anything, some would say quite the opposite!). The Hollywood trade press reports, and my survey of the *Daily Variety* archives identifies, multiple cases of apparently opportunistic actions: studios substitute actors during development contrary to prior commitments, producers delay moving forward with a project but keep actors indefinitely “on call”<sup>38</sup>, actors withdraw from projects shortly prior to the commencement of shooting, and studios occasionally terminate actors or directors even after shooting has commenced.<sup>39</sup> The Screen Actors Guild even maintains

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<sup>38</sup> This type of behavior prompted a lawsuit by Sharon Stone (a star actress) against producers in connection with the film, *Basic Instinct 2*. Due to allegedly missed opportunities attributable to delays in production, she claimed \$100 million in damages. The suit was settled out of court (IMDB.com 2012b).

<sup>39</sup> This action precipitated litigation by Raquel Welch (a star actress) against MGM for allegedly wrongful termination from the film, “Cannery Row”, ultimately resulting in a \$10 million damages award

a website listing reported incidents in which studios and production companies reneged on “pay or play” commitments to compensate actors irrespective of whether the actor’s services were actually used (Screen Actors Guild 2011b). While reputation effects are clearly important in a relationship-based market such as Hollywood, it would be naïve to expect that those effects consistently induce conformity to prior commitments.

This mixed performance may reflect the fact that Hollywood exhibits some, but not all, of the characteristics of the small-knit environments in which reputation-based transacting has been most convincingly documented.<sup>40</sup> Hollywood is at best a *relatively* small world populated by firms and individuals that do business with each other repeatedly: six major studios, three major talent agencies, a handful of “mini major” studios, a larger number of independent production companies, a small group of high-value talent, and a much larger group of lower-value talent consisting of tens of thousands of actors. Membership in even the most concentrated portions of this transactional landscape can be unstable. While studios and talent agencies have a long life, independent production companies, individual producers, and actors may often have short careers (Litwak 1994, pp. 228-29).<sup>41</sup> Hence no transacting party can safely assume that any given counterparty is a repeat player with a rational interest in preserving reputational capital. Even repeat players may rationally deviate from a general pattern of good-faith behavior to avoid an extremely large one-time loss or to capture an exceptionally large one-time gain. Since an exceptional hit is an infrequent occurrence and an exceptional loss is a frequent occurrence, the temptation to abandon a losing project in favor of a more promising project may overcome reputational considerations. While reputation exerts some disciplining force, it does not provide a complete governance solution.

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against the studio for damage to the actress’ reputation (in *Welch v. Metro-Goldwyn-Mayer Film Co.*, 254 Cal. Rptr. 645 [Cal. App. 2d 1989]).

<sup>40</sup> For well-known examples, see Greif (1993); Bernstein (1992).

<sup>41</sup> Out of a sample of 2,430 film productions released between 1965 and 1980, 64% of film producers made only one film (together constituting 38% of the total sample) and approximately one of every two directors had only credit during the relevant period (Faulkner & Anderson 1987).

## 2. *Contract*

In a world of zero forecasting, specification, and enforcement costs, the holdup problem disappears and any initial allocation of project risk is secure over all possible circumstances, subject only to the insolvency of a breaching party. Even if we relax the perfect foresight assumption, contracting parties will still costlessly adjust terms to secure a mutual gain in a zero transaction-cost environment. Real-world markets depart to various degrees from that idealized environment: the future is hard to anticipate, contract drafting and negotiation is costly, renegotiation is costly, litigation is costly, and courts make errors. In the talent/studio context, two well-known constraints impede the ability of formal contract to protect against the holdup risk and project risk inherent to a film project: specification costs *ex ante* and enforcement costs *ex post*.

### a. *Specification Costs*

Any studio/talent contract (or any contract for that matter) provides some aggregate level of protection against project risk and holdup risk. Critically, those two risk-minimization objectives demand drafting solutions that run in opposite directions: minimizing project risk usually demands more contractual flexibility; minimizing holdup risk usually demands less.<sup>42</sup> Flexible excuse provisions protect against project risk by providing opportunities to terminate or renegotiate contractual obligations in response to adverse information concerning project outcomes as compared to alternative opportunities (or, to say the same thing, positive information concerning alternative opportunities as compared to the existing project). In studio/writer contracts, this is achieved through option clauses that give a studio the right to develop a writer's script or idea within a certain period of time, after which it reverts back to the writer's control (indicating that the studio has failed to receive sufficiently positive information concerning project value). Conversely, rigid obligational provisions protect against holdup risk by making it difficult to reopen agreed-upon terms—in the best (but unobtainable) case, a provision that preemptively forbids any modifications to the

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<sup>42</sup> For a similar assumption, see Athias and Saussier (2010).



original contract.<sup>43</sup> In the “studio system”, studios were substantially protected against holdup behavior by talent through suspension clauses—effectively, a form of negative injunctive relief—that extended the term of the contract for any period in which talent refused to play an assigned role.<sup>44</sup> Today studio/talent contracts (when enforceable) provide some protection for *talent* against holdup by the studio through “pay or play” provisions that guarantee a fixed payment irrespective of whether or not the actor’s services are used on the relevant project.<sup>45</sup>

Efficient contract design selects a level of rigidity—that is, a mix of excuse and obligational provisions—that minimizes aggregate expected losses from holdup risk and project risk. Given informational and forecasting constraints, any actual contract is prone to exhibit excessive or insufficient rigidity relative to the efficient design. These constraints may be especially severe in the case of a film project: an idiosyncratic enterprise that requires the coordination of multiple creative and non-creative inputs, involves performance criteria that are often difficult to define in a verifiable manner, and is subject to multiple possible contingencies that are specific to each project. In particular, two design errors can be expected to occur. First, the parties may enter into an excessively rigid contract that overprotects against holdup risk, and underprotects against project risk, by failing to provide a sufficiently generous termination right or some other mechanism for adjusting terms in light of changed circumstances.<sup>46</sup> Second, the parties

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<sup>43</sup> This is an unobtainable objective because even a provision banning modification can itself be waived by the contracting parties. Even where it still applies, the common law “preexisting duty rule” barring enforcement of contractual modifications (which is justified as protection against holdup risk) can be avoided by the exchange of new (and nominal) consideration.

<sup>44</sup> See *infra* notes \_\_\_ and accompanying text.

<sup>45</sup> In practice, these agreements (when they are signed) provide little protection for talent until just prior to, or shortly prior to, the commencement of shooting. That is because they are usually conditioned on a “final approved bonded budget”, which will never arise in the case of a film that is not made (Moore 2000, p. 179; Studio Counsel Interview II). Similarly, pay or play provisions granted to directors are usually only triggered after a variety of conditions have been met, including approval by the studio of the final screenplay and engagement by the studio of the principal cast on a pay or play basis (Appleton and Yankelevits 2010, pp. 103-04).

<sup>46</sup> It might be objected that even the most rigid contracts cannot block mutually efficient adjustments in response to changed circumstances since parties will rationally ignore existing terms in order to extract mutual gains from renegotiating an existing agreement in favor of a more efficient arrangement—which will either reprice the project (if the project will then still result in a mutual net gain) or terminate it (if the project will always result in a mutual net loss). Nonetheless there remains a meaningful difference between informal contracts and non-renegotiation-proof formal contracts. The reason is that renegotiation of any certainly enforceable contract will inherently operate to the advantage of the party that is favored by circumstances with a stronger negotiating position; by anticipation, that contingency reduces incentives to

may enter into an excessively flexible contract that underprotects against holdup risk, and overprotects against project risk, by failing to bar all forms of opportunistic behavior or providing an overly generous termination right that shifts the costs of unforeseen contingencies to one party in a manner inconsistent with initial expectations. In both cases, the resulting contract design deviates from the efficient optimum and fails to minimize aggregate losses from holdup risk and project risk ex post, thereby reducing participation incentives ex ante.

b. *Enforcement Costs*

Even implausibly assuming that studio and talent representatives can overcome or mitigate these obstacles to efficient contractual design, those parties will still face significant enforcement obstacles. Given the inherent imprecision of contractual language, the allegedly breaching party may argue that any breach is excused by the fact that the plaintiff had failed to fulfill certain material obligations.<sup>47</sup> Even assuming breach can be shown without difficulty, the plaintiff may still be unable to obtain full expectation damages if it cannot adequately demonstrate lost profits, in which case damages will be limited to verifiable out-of-pocket reliance costs.<sup>48</sup> For the studio in particular, there are additional obstacles to enforcing a contract against individual talent: (i) the studio cannot obtain a remedy of specific performance to compel talent to perform<sup>49</sup>; (ii) the studio cannot seize and liquidate the talent's "human collateral"; and (iii) the studio can only obtain a negative injunction to bar talent from working for

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invest ex ante (Gilson, Sabel and Scott 2010). Moreover, any such efficient ex post adjustment may be blocked by transaction costs (in particular, the costs of bargaining over the distribution of any savings generated by a proposed adjustment), informational asymmetries, strategic behavior, precedential considerations (on the part of the studio, for example, who may have a long-term incentive in "acting tough" and thereby protecting its specific investments in film projects), agency costs, or other bargaining obstacles. For further discussion, see Scott (1987), pp. 2010, 2019-2021, 2044-45.

<sup>47</sup> In a recent litigation involving the singer Beyonce and a video production company, the singer claimed that her withdrawal from the production was justified because the production company had allegedly failed to meet certain financing requirements that were a condition to her continued participation (Gardner 2011).

<sup>48</sup> See, e.g., *Skirball v. RKO Radio Pictures, Inc.* (134 Cal. App. 2d 843 [1955]), in which the court found a breach of an oral agreement to acquire literary property from a producer and retain a producer's services to make a motion picture but refused to award the agreed-upon contingent compensation due to the lack of certainty as to the film revenues, and instead awarded fixed compensation plus the reasonable value of the literary property.

<sup>49</sup> Calif. Civ. Code §3423 prohibits specific enforcement of a personal services or employment contract.

another production during the contract term if the contract is in writing and the actor's services are deemed to be of a "unique" character.<sup>50</sup> Additionally, for both studio and talent, initiating formal legal action can impose significant long-term costs: (i) in the case of the studio, it can suffer a large cost due to disclosures of talent's compensation or other sensitive information in the course of discovery or trial<sup>51</sup> or reputational injury in the labor market; and (ii) in the case of talent, he or she can suffer a career-ending reputational injury to the extent that all future employers decline to offer job opportunities given demonstrated litigiousness. To be sure, the threat of contractual liability for breach poses an *in terrorem* effect that may exert some deterrent force (in part due to the cost of defending against even a meritless claim); however, it is far from a complete solution to counterparty opportunism.

#### D. Unconventional Solution: Soft Contracts

Neither reputation nor contract alone provides an adequate solution to the holdup risk and project risk inherent to film production. To secure participation by talent and studios in a film project, Hollywood sometimes uses an intermediate mechanism: namely, the soft contracting mechanisms that would be imprudent in other environments.

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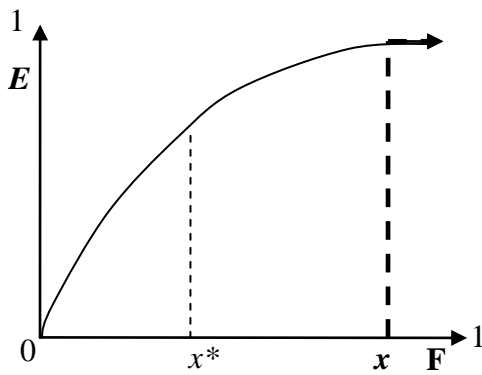
<sup>50</sup> Under California law, negative injunctive relief is only available in personal services contracts "where the promised service is of a special, unique, extraordinary . . . character" (Calif. Civ. Code § 3423). For a case denying injunctive relief on this ground, see *Motown Record Corp. v. Brockest* (160 Cal. App.3d 123 [1984]). There are additional obstacles to enforcing a contract against talent: (i) talent can raise litigation costs by claiming that his or her manager or agent did not have the authority to bind the actor (a California court denied a breach of contract claim against actress Pamela Anderson in part on this ground, when she allegedly violated a commitment to appear in a film, in *Private Movie Co., Inc. v. Pamela Anderson*, (L.A. Sup. Ct. Case. No. BC 136805 [1995])); and (ii) if, as is typical, an actor contracts with the studio through a "loan-out corporation", the actor can increase litigation costs by compelling the studio to petition the court to pierce the corporate veil. Studios attempt to preclude this strategy by demanding that talent produce an "inducement letter" whereby the employee covenants to satisfy the loan-out corporation's obligations. However, this is not always successful. See, for example, *Great Entertainment Merchandise, Inv. v. VN Merchandising, Inc.* (1996 WL 355377 [S.D.N.Y. 1996]), in which the court found that the defendant performer was not liable for certain monetary obligations of the loan-out corporation to the plaintiff because the inducement letter only required that he meet his concert performance obligations; *Main Line Pictures, Inc. v. Basinger* (No. B077509, 1994 WL 81244 [Cal.App. 2 Dist. 1994]), in which the appellate court found that the trial judge had committed reversible error by failing to instruct the jury that liability could only be imposed on the defendant actress if she were found to be the "alter ego" of the loan-out corporation that had purportedly entered into an agreement with the production company.

<sup>51</sup> This factor often causes studios to settle quickly (Beck 1988).

### 1. *Contractual Formality and Risk Management*

Legal and economic scholars, as well as contract law jurisprudence, divide promissory expressions into those that are enforceable in contract and those that are not. As a practical matter, however, contractual enforceability is more precisely viewed in continuous terms as a probabilistic outcome the likelihood of which is a positive function of contractual formality.<sup>52</sup> Formally, this can be rendered as follows:  $E = f(F)$ , where  $E$  denotes the likelihood of being held enforceable in court ( $0 \leq E \leq 1$ ), and  $F$  denotes the level of formalization ( $0 \leq F \leq 1$ ). Transacting parties select the value of  $F$  (and hence,  $E$ ) by investing more or less effort in formalization. Retaining a Wall Street law firm to draft and negotiate a detailed acquisition agreement requires hundreds of expensive attorney-hours; scribbling on a napkin in a Beverly Hills restaurant is virtually costless.

**Figure II: Formalization Effort and Contractual Enforceability**



Let's suppose that (i)  $x$  represents the level of formalization at which there is complete certainty that a court will enforce the contract ( $E = 1$ ), and (ii) at any point below  $x$ , there is complete certainty that a court will *not* enforce the contract ( $E = 0$ ). If that were the case (as is assumed in most contracts scholarship), then formalization effort would follow the step function depicted by the dashed line in the Figure above: where  $F < x$ , all formalization efforts are wasted since the likelihood of enforcement is zero; where  $F > x$ , all efforts are again wasted since there are no marginal gains in the

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<sup>52</sup> Enforceability also requires the exchange of "consideration". This is not much of an omission: nominal values, or even nominal recitals of consideration, are usually considered sufficient to satisfy this requirement.

likelihood of enforcement. But this does not track contracting practices in Hollywood (or in many other environments), where parties regularly select values of  $F$  that lie well below  $x$  (for example,  $F = x^*$  as shown above). The continuous function shown above reflects this behavior. Provided that courts at least sometimes enforce contracts where  $F < x$ , transacting parties may rationally select  $F = x^*$  if the cost of an incremental increase in formalization effort beyond that point would exceed the incremental benefit in the form of increased enforceability.<sup>53</sup>

This approach has been developed extensively in the economic analysis of contract interpretation, which asserts that parties will rationally underinvest in specification efforts in order to economize on the sum of specification costs *ex ante* plus dispute-resolution costs *ex post* (Posner 2005). I take the marginalist approach to contractual specification to its logical extreme. Parties may radically underinvest in specification efforts in order to endanger contract formation and thereby generate an implicit termination option that is exercisable at a certain cost and within a certain range of circumstances. Exercise of the implicit termination option is achieved by withdrawing from the project (or, in the case of a studio, canceling the project or terminating talent) subject to payment of the exercise price,  $p = d + l$ , where  $d$  denotes the expected damages award (or settlement payoff in lieu of damages) and  $l$  denotes the expected litigation and other dispute-resolution costs to be incurred as a result of such action.<sup>54</sup> To illustrate, suppose an actor has made a “low- $F$ ” commitment to appear in a particular film: that is, he has entered into an uncertainly enforceable commitment that implies a positive but limited penalty in case of termination.<sup>55</sup> The absence of a reliable legal instrument to secure that commitment provides the actor with an implicit termination right that will be

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<sup>53</sup> This has an interesting normative implication for optimal formalization requirements in contract law. To the extent underformalized transactions are efficient, then some deviation from bright-line formalist standards for contract formation may be justified in order to enable those transactions. Geis (2006, p.1664) makes a similar observation, noting that parties’ use of strategic ambiguity in the drafting of contracts (which sometimes advances efficiency) depends on courts’ willingness to fill in gaps in contracts that suffer from indefiniteness. Ben-Shahar (2004) provides a specific methodology by which courts could provide some level of enforceability for incompletely specified agreements. Schwartz & Scott (2007) provide a rationale for limited enforceability of preliminary agreements in which parties agree on some but not all terms prior to making initial investments.

<sup>54</sup> For simplicity, I am ignoring the reputational cost of exercising the implicit termination right. Later I build reputation effects back into the analysis, which bolsters the arguments set forth above.

<sup>55</sup> For convenience, the following discussion analyzes the performance/breach decision from the perspective of talent. The same results would apply if analyzed from the perspective of the studio.

exercised whenever the actor believes that  $g > p$ , where  $g$  denotes the actor's expected incremental gains on an alternative project as compared to the expected gains on the existing project. At the same time, it is the *presence* of even an insecure legal instrument that generates a positive exercise price for electing to terminate, which induces the actor to perform even within a certain range of circumstances in which he anticipates incremental gains by moving to an alternative opportunity (that is, where  $g > 0$  but  $g < p$ ).

This is shown graphically below. The presence of an uncertain legal penalty generates positive values for  $d$  and  $l$ , which together constitute the exercise price,  $p^*$ , for electing the termination option. Expected incremental gains fall short of the exercise price until the point on the 45-degree line where  $g^* = p^*$ . From the talent's perspective, we can now anticipate three outcomes under a soft contract:

- (i) *Voluntary performance* ( $g < 0$ ): Talent conforms to an existing commitment irrespective of any expected legal penalty.
- (ii) *Involuntary performance* ( $0 < g < g^*$ ): Talent conforms to an existing commitment even though he or she would not have had an independent incentive to do so in the absence of expected damages and legal costs.
- (iii) *Termination* ( $0 < g > g^*$ ): Talent terminates to capture incremental gains on an outside opportunity even after taking into account expected damage payments and legal costs.

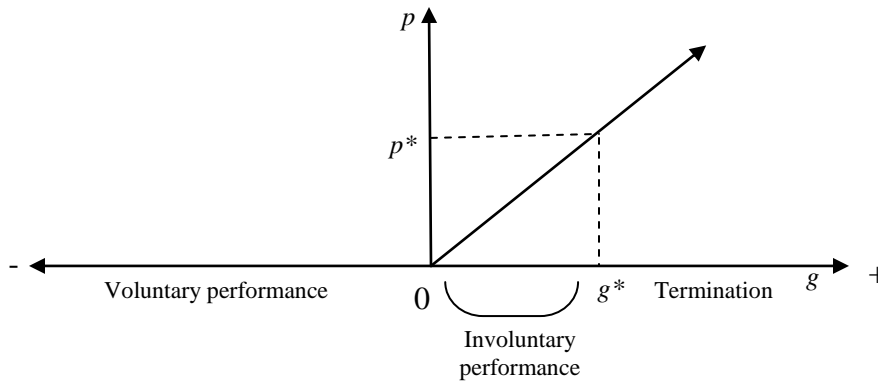
In lieu of termination, talent may extract a continuation payoff from the studio equal to the difference between the contract price and the outside "market" price, less the expected exercise price that talent would otherwise pay to terminate (i.e., the talent is paid a settlement amount equal to  $g - p$ ).<sup>56</sup> Effectively, talent commits to perform except

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<sup>56</sup> The studio will make that payment so long as it is less than (i) the expected cost the studio will incur in locating a substitute for the star or canceling the project *plus* (ii) the expected amount recoverable from the star in the event of litigation (net of legal fees). Given that the costs of locating substitutes for higher-value talent are likely to be high, and the collectible net damages in the event of litigation against an individual star are likely to be low, it can be expected that the star's termination option will routinely operate as a renegotiation option. This appears to be the case. Continuation payoffs are a regular feature of talent/studio relationships governed by soft contracts: studios provide stars with "perks" and other additional benefits that are negotiated in the course of production (Entertainment Attorney Interview II).

in the case of sufficiently high-value outside opportunities, in which case either (i) the studio will receive a termination payout and talent will avoid the remaining opportunity costs from continued performance, or (ii) the studio will adjust talent’s compensation or other non-monetary terms to cover part of talent’s opportunity cost from continued performance. In both cases talent still enjoys a net gain equal to  $g - p$ .

**Figure III: Behavioral Effects of a Soft Contract**



The mix of performance and termination (or renegotiated performance) outcomes implied by a soft contract determines transacting parties’ aggregate exposure to the holdup risk and project risk attendant to the relevant project. Precisely, assigning different values to  $g^*$  (which is a function of the value of  $p$ )—that is, the threshold value at which a party will rationally breach—shifts these risks among the studio and the actor: higher values inflate project risk but reduce holdup risk while lower values have the opposite effect. The critical observation is that minimizing each type of risk tends to demand different levels of contractual enforceability and therefore different levels of contractual formality—precisely the same relationship observed earlier between those same risk categories and the level of rigidity in a formal contract. While a hard contract allocates risk explicitly—that is, it designates the value of  $p$ —through a mix of excuse and obligational provisions, which demands a large investment in specification costs subject to a high likelihood of forecasting error, a soft contract allocates risk implicitly by selecting a reduced level of formalization, which demands a small to nominal investment

in specification costs. Holdup risk declines as  $F$  increases, since non-breaching parties can more credibly threaten suit (and hence, can more credibly demand damages or injunctive relief<sup>57</sup>) against an opportunistic counterparty. But increasing  $F$  increases project risk: the studio expects to incur a greater cost if it withdraws in response to adverse information concerning the expected project outcome or the expected performance of a particular actor or director. Project risk declines as  $F$  declines, since a party can exit from a losing transaction—or demand a renegotiation payoff to reflect a valuable outside option—with reduced risk that the counterparty will bring suit, will do so successfully, or will be able to credibly demand damages as a result of any claimed breach.<sup>58</sup> But there is a price for increased flexibility: as  $F$  decreases, holdup risk increases. Illustrating this risk, talent attorneys sometimes resist execution of a long-form agreement in order to preserve leverage on negotiating open deal points (Daily Variety 1997)<sup>59</sup> and even explicitly recommend that clients seek to avoid liability by asserting that no contract ever existed and “being uncooperative” in order to “renegotiate the terms that really concern you” (Ardi and Lobel 1986).

There is an obvious objection to the foregoing. It may be asked why parties would not choose to replicate the flexibility of a soft contract at a higher level of certainty by entering into a certainly enforceable contract with an appropriately discounted breach penalty, an appropriately defined *force majeure* clause, or some type of renegotiation mechanism. Hollywood uses these types of contingent contracting instruments in other contexts so it could presumably use them in talent/studio relationships. It therefore

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<sup>57</sup> Holding constant the absolute level of damages, I assume that higher levels of contractual enforceability imply higher expected monetary penalties for breach (and *vice versa* as contractual enforceability declines). Non-breaching parties are more likely to sue and can expect to incur lower costs in demonstrating contract enforceability and persuading a court to impose damages, which means that breaching parties expect to pay higher amounts in order to avoid or halt litigation with a settlement payout. Conversely, lower levels of contractual enforceability imply lower expected monetary penalties for breach (which approach zero in the case of a purely informal commitment), which means that breaching parties expect to pay lower amounts in order to avoid or halt litigation with a settlement payout.

<sup>58</sup> For a similar view, see Klein (1996, pp. 448-49), who notes that parties can more cheaply opt out of a non-formalized contractual understanding “if market conditions deviate substantially from expectations.”

<sup>59</sup> This was the fate of Warner Bros. in a litigation involving Francis Ford Coppola, who used the lack of a fully-executed long-form agreement to argue in a lawsuit (successfully) that he was free to “shop” to other studios a project originally developed in partnership with Warner Bros (in *Coppola et al. v. Warner Bros., Inc.* (L.A. Sup. Ct. Case No. BC 135198 [1998])). In that case, Warner Bros. executives testified having great difficulty in obtaining written confirmations of oral commitments from talent attorneys (Schleimer 2001).



follows that those hard contracting instruments must fail a marginal cost-benefit test in talent/studio relationships and other transactional settings in which parties prefer softer forms of commitment. A hard contracting instrument only presents a preferred alternative if (i) the value attributed to any incremental improvement in the security of any ex ante risk allocation exceeds (ii) the increased investment in specification effort required to achieve that improvement. In early to medium-stage creative transactions, this tradeoff tends toward low formalization: most film projects are shelved or abandoned in the development stage, in which case all “sunk” legal investments would be forfeited; by anticipation, it is often not worth it “to lawyer up” (Entertainment Attorney Interview I).<sup>60</sup> Even in later-stage creative transactions, specification investments may yield limited enforcement return for considerable specification costs: for example, parties face high costs in specifying performance criteria and the circumstances under which a party may unilaterally terminate its involvement under a *force majeure* or similar clause. Degrading contractual enforceability achieves two objectives: (i) it saves on the costs incurred in crafting tailored termination, break-up fees and other similar mechanisms to adapt contractual obligations to changes in circumstances; and (ii) it provides a limited termination option that delivers a level of certainty that could not be improved through more formal contracting at a net expected gain.

## 2. *Reputation Effects*

The proposed explanation for Hollywood contracting is still not entirely satisfactory. If implicit termination options substitute for explicit termination options at a net transaction-cost savings, then why do participants in other types of Hollywood transactions—or any other business setting for that matter—ever enter into a fully signed-up deal? The answer is two-fold. First, explicit termination options will be used when specification costs are sufficiently low—or more precisely, when the enforcement return on specification effort is sufficiently high. Second, explicit termination options will be used when counterparties do not have sufficient reputational capital to pledge against

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<sup>60</sup> See Caves (2003, p.113) (citing studio executive stating that the studio receives 10,000 treatments and pitches yearly, puts 70 to 100 projects into development, and makes only 12 films); Goldwyn (1983, p. 92) (noting that a studio announced that it had 183 projects in development and asserting that, of those projects, “maybe ten, at the outside, will ever happen”).

nonperformance. The second factor can be folded into the first: in transactions involving parties with a rich stock of observable reputational capital, parties can economize on specification costs by substituting reputational constraints for legal constraints; the opposite effect holds true in transactions involving unknown or otherwise non-credible parties. This broad understanding of specification costs anticipates correctly the circumstances in which Hollywood appears to prefer hard over soft contracting. In the case of transactions involving outside investors and lower-value talent, Hollywood appears to prefer hard contracting instruments: in both cases, the counterparty may lack sufficient reputational capital and, in the case of a financing deal, performance actions can be specified using verifiable criteria at a reasonable cost. In the case of transactions involving high-value suppliers of creative inputs, Hollywood often uses soft contracting instruments: in these cases, performance actions cannot be specified using verifiable criteria at a tolerable cost and both parties hold rich observable stocks of reputational capital. To be clear, these reputation effects are not sufficiently strong to dispense with any use of formal contract as is the case in other reputation-governed environments—any such assertion would be inconsistent with the parties’ significant investments in contractual documentation and failure to take simple precautions to avoid legal exposure. However the presence of *some* reputation effects allows those parties to avoid having to invest in achieving the highest levels of contractual formalization.

*a. Deterring Overtermination*

The absence of a certainly enforceable agreement imposes an important risk: opportunistic or uninformed parties can abuse the termination option embedded in a soft contract by withdrawing from the joint project in a manner inconsistent with the implicitly agreed-upon risk allocation. This would be equivalent to talent withdrawing from the project in cases not involving sufficiently high-value outside opportunities. The result is an excessively flexible contract that overexposes the studio to holdup risk *ex post* (or more precisely, exposes the studio to a level of holdup risk that was not reflected in the original deal terms) and, by anticipation, would compel parties to incur additional specification costs *ex ante* or forego the transaction altogether. Reputational liability for certain (but not all) withdrawal actions preserves the threshold point—that is, the

threshold value of opportunity costs from continued participation ( $g^*$ )—at which talent rationally terminates (or credibly seeks to renegotiate) further participation in the project. This can be illustrated by the following example. After the studio has commenced shooting, any high-value talent in a lead role should rationally hold up the studio for additional compensation in an amount almost equal to the studio’s entire expected profit on the film. In practice, nothing close to this extreme form of holdup behavior is observed: talent attorneys renegotiate perquisites following production but refrain from renegotiating “money items” (Entertainment Attorney Interview II) or terms relating to the fixed compensation (Entertainment Attorney Interview III). This social restraint—which, once shooting has started, largely confines the star’s renegotiation demands to non-price terms—limits the studio’s expected holdup payments to talent and enables the parties to enter into the project at a low level of formalization and a large savings in transaction costs.

*b. Detering Undertermination*

The presence of even an uncertainly enforceable agreement imposes another important risk: non-terminating parties can contest exercise of the termination option through legal action or resist “reasonable” settlements to preempt or resolve any such legal action, even if the option is exercised in a manner that is consistent with the implicitly agreed-upon risk allocation. The result is an excessively rigid contract that overexposes talent to project risk *ex post* (or more precisely, exposes talent to project risk that was not reflected in the original deal terms), which, by anticipation, would compel parties to incur greater specification costs *ex ante* or forego the transaction altogether. Reputational penalties against *non*-terminating parties inflate the cost of using legal action “aggressively” to contest exercise of the termination option or to reject “reasonable” settlement payouts offered by the terminating party (or the terminating party’s new employer) in lieu of any legal damages. By anticipation, those reputational penalties preserve the threshold point—that is, the threshold value of opportunity costs from continued performance—at which a party may terminate involvement in a joint project, subject to delivery of an appropriate payout to the non-terminating party. Consistent with this assertion, studios do not consistently bring legal action against a

high-value actor who terminates participation in a film project (Entertainment Attorney Interview III), as illustrated by several reported cases where stars withdrew from a film shortly prior to shooting but the studio took no legal action against them (Brennan and Boyer 1994). Even in cases where a lawsuit is initiated or threatened, the survey of trade reports indicate that the parties often resolve the matter by agreement and put an end to any further litigation (see *App. A*).<sup>61</sup>

## **E. Beyond Hollywood: Formalization as a Deal Term**

### *1. Hollywood as a Model*

I began by treating Hollywood's predilection for soft contracting as an anomaly. But if the proposed economic rationale for Hollywood's relaxed contracting practices is correct, then those practices may not be a *non sequitur*. Any industry that shares the characteristics of the film industry—severe uncertainty, high holdup risk, high specification costs, high enforcement costs, and positive but limited reputation effects—should be expected to adopt soft contracts and related forms of ambiguous commitment, at least where vertical integration is a more costly transactional option. That presumptively includes virtually all capital-intensive portions of the creative industries, which share similar informational constraints, risk characteristics and sequential investment structures (Caves 2002). Other industries may exhibit those characteristics in lesser intensities and exhibit ambiguous contractual practices. The use of precontractual agreements reportedly characterizes some construction (Chakravarty and MacLeod 2006), technology transfer, project finance, and infrastructure and natural resource projects, in which complexity, uncertainty and multiple parties necessitate prolonged negotiating periods concurrently with performance in lieu of the discrete offer/acceptance sequence contemplated by classical contract law (Lake and Draetta 1994, p.54). Soft contracting instruments with dubious enforceability even appear in conventional business

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<sup>61</sup> Interestingly, one trade commentator has suggested that the unusually aggressive litigation response to Kim Basinger's withdrawal from a film (in the well-known litigation, *Basinger v. Main Line Productions*, 1994 WL 814244 [Cal.App. 2 Dist. 1994])) was undertaken because the counterparty was a small production company experiencing financial difficulties (Kari 1993), which corresponds to an "end-game" scenario where a party loses its rational incentive to preserve long-term reputational gains by avoiding litigation.

environments: merchants exchange letters of credit with documentary defects that endanger their enforceability (Mann 2000); merchants enter into requirements contracts that are known to have dubious enforceability (Macaulay 1963); rail-freight carriers and shippers use informal legally unenforceable contracts to implicitly alter regulatory constraints (Palay 1985); parent firms sometimes issue “comfort letters” or “keepwell agreements” in support of the financial obligations of a subsidiary (DBRS 2010); and underwriters commonly issue “best efforts” commitment letters to an issuer in connection with an initial public offering (Lake and Draetta 1994, pp.14-15). In refusing to enforce an unsigned LLC agreement under the statute of frauds, the Delaware Chancery Court observed that private equity funds sometimes use oral agreements and “roughly-outlined unsigned arrangements or draft agreements” in lieu of definitive LLC agreements documenting manager profit participations (*Olson v. Halversen*, C.A. No. 1884-VCL, 2008 WL 4661831 (Del. Ch. Oct. 22, 2008), *affirmed* 986 A.2d 1150 (Del. Ch. Ct. 2009)). Those oral instruments are apparently so vital that, within a year, private equity funds had successfully lobbied the Delaware legislature to reverse the Chancery Court’s ruling by providing that the statute of frauds does not apply to those agreements (77 Del. Laws ch. 287 [June 10, 2010]).<sup>62</sup>

Hollywood star/studio interactions represent only a sliver of the total universe of contracting relationships. But its lessons extend over a broader range of contracting environments. Most fundamentally, star/studio contracting illustrates the manner in which the level of contractual formalization, and the associated level of legal enforceability, can operate as a proxy for an explicit allocation of risk at a transaction-cost savings relative to a more fully formalized contract. That proposition implies that parties will settle on different formalization levels—specifically, will select different points between purely informal and purely formal contracting—to achieve different risk-allocation outcomes at the lowest transaction cost. Precisely, the selected value of  $F$  will reflect transacting parties’ heterogeneous relative valuations of project risk and holdup risk, as adjusted by each party’s relative bargaining power at any moment in time. The parties may place different values on those risks at different points in the production timeline or with respect to different deal terms, assets or counterparties. As a result,

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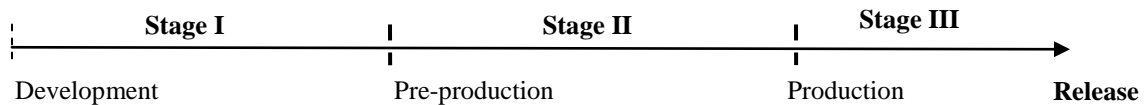
<sup>62</sup> For discussion, see Milbank, Tweed, Hadley & McCloy LLP (2008).

parties may contract (and re-contract) with respect to the same transaction, or with respect to different terms within the same transaction, using instruments having different levels of formalization<sup>63</sup>—in each case, the *form* of contract being one of the substantive deal terms on the table.

## 2. *Formalization Changes in Hollywood Contracting*

If we apply this framework to the studio-talent context, we can account for observed changes in the level of formalization both within a single transaction over time and across different transactions and counterparties. In particular, we can anticipate that soft contracting will tend to be displaced by “harder” forms of contracting as (i) the parties’ sunk investment in the project increases, and (ii) as parties’ observable stock of reputational capital decreases. In particular, we can account for differences in degrees of formalization across the production timeline (shown below), taking into account differences in reputational capital across counterparties.

**Figure IV: Production Timeline**



*Stage I: Development.* Both studio and talent place a high value on being able to withdraw in the event unfavorable information is received (as reflected by the fact that most projects in development never proceed forward<sup>64</sup>), place a low value on contractual protection against holdup given limited sunk investment, and therefore agree on a low level of contractual formality in the form of an oral agreement or unsigned deal memo. This is equivalent to writing a fully formalized contract with a high degree of flexibility—e.g., a broadly-defined walkaway right and a low breakup fee.

<sup>63</sup> Ben-Shahar (2004) provides anecdotal evidence that parties sometimes phase transactional commitments, resolving some deal points and leaving others open for negotiation.

<sup>64</sup> See *supra* note \_\_\_\_.

*Stage II: Pre-Production.* The studio places increased value on contractual formality to secure its “talent package”, especially if outside financing is predicated on the presence of that element. However, for the same reason, high-value talent prefers to maintain contractual informality in order to maintain a walk-away threat and extract concessions from the studio.<sup>65</sup> Even in high-value talent/studio transactions, studios insist that talent execute a “Certificate of Engagement” (Studio Counsel Interview II; Entertainment Attorney Interviews I, III), which assigns to the studio all of the talent’s intellectual property rights in the film production and thereby protects against the most salient holdup threat. The studio may sometimes feel comfortable proceeding at a reduced level of formalization given the star’s large stock of reputational capital, which reduces the studio’s holdup exposure.

*Stage III: Production.* The studio places an extremely high value on contractual formality since it has now made a large sunk investment in talent and other assets. But, for the same reason, it now will have even greater difficulty obtaining a formal commitment from the biggest stars. Given the studio’s predicament, the talent continues to prefer contractual informality in order to extract concessions from the studio as production proceeds and the studio’s specific commitments accelerate even further. Given that the studio has no credible termination threat against a high-value star, the star has limited holdup risk and therefore limited demand for contractual formality; by contrast, this is not true of lower-value talent, who is more easily substitutable and may fear holdup by the studio and therefore prefers to enter into a fully formalized agreement.

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<sup>65</sup> It might be thought that one of the major studios would exert a holdup threat over the star at this stage given that the actor may have forfeited other opportunities during the relevant time period and there are few other employers. This is only true to a limited extent, for two reasons: (i) while there are a small number of studios, there is a larger number of “minimajor” production companies and an even larger number of independent production companies for whom the star may be able to secure employment; and (ii) the studio’s outside financing may have committed to the project based on the studio’s having committed to a particular star. Note that this is not always true, however, in the case of an independent production company, which lacks both the financial and reputational capital to credibly commit against acting opportunistically once the star has committed to the project. That explains why stars apparently do insist on a signed agreement when performing for an independent production entity (Entertainment Attorney Interview II).

These expectations approximately track observed market practice. Major studio counsel reported that studios prefer to enter into fully executed agreements with talent as a general matter but higher-value portions of the talent pool prefer unsigned deals and sometimes successfully resist this demand and defer finalization of a long-form contract until some point during production (Studio Counsel Interviews I, III) (or, as other interviewees reported, defer finalization indefinitely (Entertainment Attorney Interviews I, II)). Counsel also reported that a studio only “feels comfortable” entering into unsigned deals with the highest-value talent (Studio Counsel Interview I). The very reason why the studio strongly prefers an executed agreement prior to the start of shooting induces high-value talent to resist executing any such agreement. Doing so would forfeit holdup opportunities once production commences while delivering little value in the form of protection against opportunism by the studio, which has few holdup opportunities and no credible termination threat given the limited pool of substitute talent. Hence, star actor Charlton Heston boasted that he had never started production on a film with a signed completed contract (Heston 1993)—meaning, he always had sufficient market value and reputational capital in order to preserve his in-production renegotiation option and had little reason to fear being held up by the studio. Lower-value talent lacks a star’s reputational capital: as a result, she cannot credibly commit against holding up the studio and, for precisely the same reason, she fears being held-up by the studio; hence, in that case, both talent and the studio agree to incur the specification costs required to achieve a high level of formalization prior to the start of shooting.

### **III. Why Not Integration?**

Sequential investment, severe uncertainty, high specification costs, and mild reputation effects are hardly unique to the movie industry. Those contracting conditions are often resolved through a simpler alternative to soft contracting: namely, vertical integration that eliminates arm’s-length transactions altogether. That well-known solution follows a basic principle of transaction-cost economics: when it is too costly to use contractual mechanisms in order to protect transacting parties from holdup risk, one party may acquire the other party and replace contract with the hierarchical fiat of an



employment relationship.<sup>66</sup> Vertical integration also provides a solution to project risk: the studio, which is the more efficient risk bearer, can insure talent against the risk of any individual project failure by diversifying that risk across a portfolio of projects and revenue streams.

This is not a hypothetical option. In the decade between 1910 and 1920, silent-movie stars enjoyed bargaining power that translated into increasing salaries<sup>67</sup> and creative control. This process culminated in 1919 with the formation of the United Artists studio by Charlie Chaplin, Mary Pickford and other star actors and directors (Kindem 1982). The “studio system” that subsequently dominated Hollywood during the 1920s and flourished until the late 1940s limited these stars’ rent-seeking opportunities by integrating backwards into the talent pool. Studios signed talent to multi-year or multi-picture contracts of varying lengths, with the most secure being a multi-year (usually seven-year) contract that guaranteed fixed compensation during the contract term, subject to the studio’s option to renew the contract at an escalating salary at 6-month or 12-month intervals (Kindem 1982, p. 84). To discourage talent from acting uncooperatively, any actor who refused to perform in a particular project would be “suspended” and the missed time added to the term of the contract (Schatz 2010). The latter clause is effectively a pre-agreed negative injunction designed to mitigate the holdup threat that persists in even the most highly formalized contractual relationship.

The studio system is often if not usually described as a naked exercise of bargaining leverage by the studios in order to “exploit” actors and other talent. It certainly represented a transfer of rents from stars to studios, who largely suppressed per-project bidding for talent’s services that would have taken place in an open market.<sup>68</sup> But the studio system arguably represents an efficient solution to (i) holdup risk—to which the studio is disproportionately exposed throughout much of the production timeline; and (ii) project risk—to which talent is disproportionately exposed due to his or her limited diversification capacities. The transactional security of a long-term employment

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<sup>66</sup> For the canonical sources, see Williamson (1975); Klein, Crawford, and Alchian (1978).

<sup>67</sup> See Bakker (2005), p. 59, who cites evidence that, in 1915 and 1916, 75% of the average budget of a studio film starring Mary Pickford, then one of the leading female stars, was constituted by her salary.

<sup>68</sup> More precisely, the studios conducted per-project bidding by “loaning out” contract actors to other major studios but retaining all rents accrued as a result.

arrangement protected the studio against opportunistic renegotiation by a star during production<sup>69</sup> and allowed the studio to reallocate talent to other projects within the studio's portfolio at a nominal transaction cost. In return, talent received up to seven years of income that was shielded from the vagaries of any individual movie's commercial performance, thereby protecting the actor from the project risk associated with any individual production, which was shifted to the studio (clearly the efficient risk bearer).<sup>70</sup> Put differently: talent purchased protection from the downside risk of project failure in exchange for forfeiting any claim on upside gain in the case of project success (and, implicitly, forfeiting holdup opportunities to extract additional compensation during the course of production and the remaining term of the employment contract).

It is by now well-documented that this description is too simple: some of the highest-value stars either entered into profit-sharing contracts with the studios (Weinstein 1998, pp. 88-89) or engaged in uncooperative behavior to extract improved terms<sup>71</sup> and, in anticipation of both outcomes, studios sometimes voluntarily increased stars' compensation even prior to the mandatory escalation provided by the renewal option.<sup>72</sup> From a contract theory perspective, this type of behavior is unsurprising: given that the studio bore positive litigation (and presumably, reputational) costs, a high-value actor could induce renegotiation simply by withholding performance or otherwise acting uncooperatively. This finding does not rebut the interpretation of the studio system as an efficient substitution of long-term contracting for spot market contracting. As more nuanced understandings of the firm/market dichotomy recognize, holdup risk persists to some extent even within the confines of the integrated firm (Freeland 2000). For actors

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<sup>69</sup> For a similar observation, see Chisholm (1993).

<sup>70</sup> For similar views, see Zuckerman (2004). It might be wondered whether the studio contract really offered talent any security given that it provided for a one-way renewal option exercisable at six and twelve-month intervals by the studio. While that certainly limits the extent to which the studio system protected the actor against income variance, even the shortest period (six months) exceeds the typical duration of a per-project movie contract (typically, a few months). Historical commentary indicates that some actors expressly elected long-term contracts over freelance work precisely in order to achieve income security (Kemper 11).

<sup>71</sup> Some of the most famous stars used this strategy, including James Cagney (Schatz 2010, pp. 138-39), and Bette Davis (Schatz 2010, pp. 218-220). In other cases, actors bought out their contracts in order to sign with another studio (who paid the buyout fee) (Shipman 1993, pp. 130-36).

<sup>72</sup> These increases were often tied together with entry into a new long-term contract, thereby providing the studio with access to the actor's reputational capital for a longer period of time but at a split more advantageous to the actor (Zuckerman 2004).

situated at the very highest end of the talent distribution, the studio system may have represented a bad deal: it offered protection against project risk at an exorbitant cost—namely, the inability to capture any upside through profit participation rights or to trigger open bidding for a star’s services on each individual project.<sup>73</sup> Assuming a star has accumulated some financial reserves and expects a steady flow of employment opportunities, he or she demands less insurance against income loss and is willing to exchange some exposure to project downside (through a reduced guaranteed salary component) in exchange for more exposure to project upside (through some form of revenue or profit participation).

Given that the studio system appears to provide an effective and simple mechanism for alleviating holdup risk (borne mostly by the studio) and project risk (borne mostly by talent), it might be thought that soft contracting is a second-best alternative as a result of some legal obstacle to engaging actors in long-term employment contracts. But there is no legal bar to the use of long-term contracts by the film industry. The landmark decision by the California Supreme Court, *De Havilland v. Warner Bros. Pictures* (67 Cal. App.2d 255 [1944]), prohibited only the use of suspension clauses, on the ground that these clauses could extend an employment contract indefinitely, but not the use of long-term contracts generally. The statutory provision applied in the *De Havilland* decision to invalidate suspension clauses explicitly *allows* long-term service contracts up to a maximum of seven years (Calif. Labor Code § 2855), which is further supported by the fact that California specifically provides for injunctive relief to stop breach of a (written and signed) personal services contract relating to services of a sufficiently “unique” character (Calif. Civ. Code § 3423).<sup>74</sup> Consistent with that language, the studios continued to make some use of long-term contracts for more popular stars into the 1950s and 1960s (Kindem 1982, p. 80), television networks regularly bind talent to long-term contracts, and record labels have consistently used long-term contracts, sometimes

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<sup>73</sup> The gains available to stars who broke their contracts with the studios were substantial. When employed on a long-term basis by Warner Bros., Bette Davis received \$143,000 a year, or about \$30,000 per film; when Warner Bros. “loaned her out” to MGM, it charged a fee of \$385,000 (Albert 1999). The spread between those figures represents the rent captured by Warner Bros. under the studio system.

<sup>74</sup> Interestingly, the California legislature adopted this special exception to the previous blanket prohibition on injunctive relief at the same time that it extended the previous limit on the term of personal services contracts (1919). These changes supplied the legal infrastructure for the studio system: long-term employment contracts supported by the threat of negative injunctive relief against breaching parties.

supplemented by suspension clauses (Selz et al. 2009 §6:3). If a Hollywood studio wished to do so today, it could revive the studio system under California law subject only to the statutory limit of seven years (or it could enter into contracts under the laws of New York or another state that does not impose any term limit<sup>75</sup>, an opportunity sometimes exploited by the record industry (Weinstein 1995)). This is evidenced by the fact that studios sometimes *do* enter into multi-picture deals with high-value actors and directors, thereby partially recreating the talent side of the studio system on an *ad hoc* basis.

Economically inclined historians agree on a simple reason why the studio system disappeared (on the upstream talent side): it became too expensive (Schatz 2010; Caves 2002, pp. 94-95). The advent of television, which converted movie-going from a near-daily to a weekly or monthly activity (between 1946 and 1956, average weekly attendance at movie theatres declined from 90 million to 46 million (Stuart 1982)), dramatically reduced the volume of product demanded by the market, which made it unprofitable for the studio to bear the overhead cost associated with retaining a standing pool of creative and technical personnel (Schatz 2010).<sup>76</sup> Within a few years, the major studios substantially dismantled their formerly integrated structures based on long-term employment contracts (Stuart 1982, p. 294).<sup>77</sup> The transactional price for the dismantling of the studio system was steep: studios and talent were now compelled to operate outside the shelter of the firm in an environment characterized by high specification costs and holdup risk throughout the production timeline. It may not be coincidental that the figure of the talent agent rises into prominence as the studio system headed into decline (Caves

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<sup>75</sup> California law appears generally to honor the choice of foreign law in employment contracts, subject to the state's policy against enforcing non-compete provisions. See, for example, *Sarmiento v. BMG Entertainment* (C.D. Cal. 2003), upholding choice of New York law in contract between a California composer and music director; *Hopkinson v. Lotus Development* (N.D. Cal. June 21, 1995), upholding choice of Massachusetts law in an employment contract; *Flake v. Medline Industries* (E.D. Cal. 1995) (June 22, 2011), upholding choice of Illinois law to govern an employment contract.

<sup>76</sup> At the same time, the consent decrees issued in the 1948 *Paramount* litigation (*United States v. Paramount Pictures, Inc. et al.*, (334 U.S. 131 [1948])) compelled the studios to divest ownership of theatres and limited the studios' contractual freedom in licensing packages of films to exhibitors, which exposed studios to greater risk that they would be unable to find exhibitors for a release (Stuart 1982, p. 260).

<sup>77</sup> Other commentators date the demise of the studio system to the World War II period. Gomery (1986, pp. 9-10) observes that, as of 1945, only 261 of the 1054 members of the Screen Actors Guild who "received feature billing . . . were under exclusive contract to a major studio".

2002, p. 98; Lindsey 1977): increased transaction costs invite entry by specialized intermediaries who can reduce those costs or exploit an open-bidding environment to extract rents for clients. For all but the higher reaches of the talent distribution, there is another price: the dismantling of the studio system exposes talent to project risk in any individual film and a lower level of income security.

Standard transaction-cost economics would anticipate that the decline of integrated structures (analogous to the “firm”) in Hollywood would give way to the spot contracting mechanisms of the “market”. This is only partially true. In the wake of the studio system’s demise, Hollywood appears to have adopted a mix of hard and soft contracting mechanisms that do not fit neatly under the “market” rubric. Historical evidence suggests that the soft contract takes on greater prominence in Hollywood roughly coincidentally with the decline of the studio system. The surveys of reported litigation and case law described earlier found only one court decision, and one other reported dispute, relating to a contract formation dispute in connection with a film project prior to 1947—precisely the time at which the studio system began to unravel under the external cost pressures and legal interventions described above.<sup>78</sup> Moreover, those two cases arose in the early 1920s, right at the inception of the studio system era. As the studio system begins to unravel in the late 1940s, reported litigation involving contract formation issues in studio/talent relationships emerges with greater frequency and continues through the present day. (App. A). While merely suggestive, the historical incidence of “contract formation” litigation is consistent with an organizational narrative where informal contracting, and attendant holdup problems, appear just *prior* to the start of the studio system, which then seeks to resolve those contracting difficulties through the simple solution of vertical integration; conversely, as the studio system unravels, those same problems reappear.

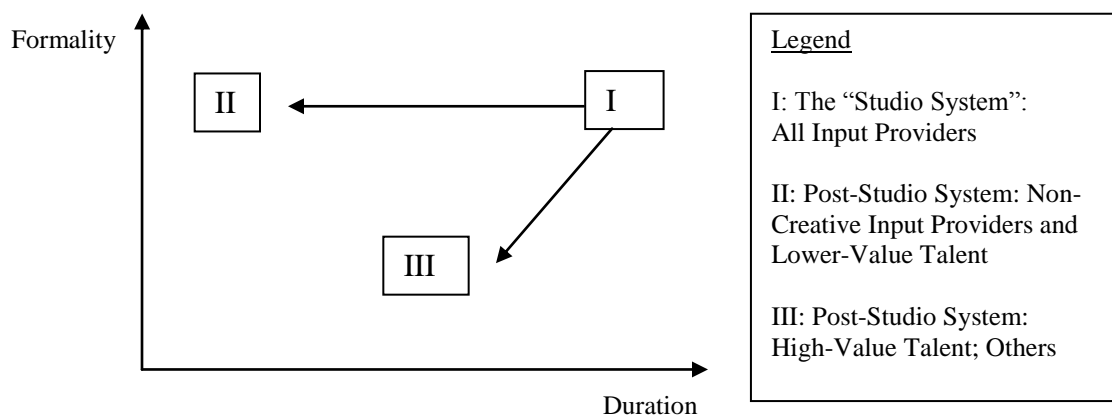
These shifts in transactional form do not appear to be accidental and lend support to a proposition that deserves further empirical inquiry. If the demise of the studio

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<sup>78</sup> A California state court litigation in 1936 involved the famous movie actor, James Cagney, concerning an oral agreement with respect to the number of films in which Cagney had agreed to perform (Daily Variety 1936). However, this dispute (and other disputes at the time between studios and major stars) did not contest the existence of a legally binding agreement between talent and the studio, as distinguished from disputes over the interpretation of specific terms or whether specific terms had been breached.

system inflated the holdup risk and project risk to which studio and talent were exposed in any individual film project, then studio and talent—or more specifically, the repeat-play representatives of studio and talent—may have responded by adopting an intermediate transactional arrangement that lies between the dichotomous alternatives of firm and market. Since the demise of the studio system, Hollywood has evolved a transactional model in studio/star relationships (and, in more irregular fashion, in other settings) that falls somewhere in between the triplet constituted by three canonical transactional forms: (i) long-term formal contracting; (ii) repeated informal contracting driven solely or primarily by reputation; and (iii) short-term formal contracting. Exploiting the two vectors of duration and formality, these transactional options, and the Hollywood alternative, can be depicted as shown below. The old studio system primarily operated in *region I*: long-term formal contracting, interrupted by periodic renegotiations in the case of the highest-value stars. The unraveling of that system appears to have pushed transactions between studios and the general class of input providers into two transactional alternatives. Transactions between a studio and non-creative input providers (and lower-value creative input providers) tend to operate in *region II*: short-term formal contracting. Transactions between a studio and high-value creative input providers (as well as some other parties) tend to operate in *region III*: a boundary zone characterized by substantially incomplete formal instruments supported by repeat-play reputational constraints (which are represented by a medium-term durational vector).

**Figure V: A Transactional Typology of Film Production**



## **Conclusion**

Hollywood contracting provides the most salient illustration of a typical mode of ambiguous commitment situated between the alternatives of reputation and contract. The ubiquity of soft contracting in Hollywood and elsewhere suggests that it promotes an efficient purpose. In certain transactional settings, ambiguous contracts implement an efficient allocation of holdup risk and project risk in an environment where any alternative governance structure, ranging from formal contract to reputation to vertical integration, cannot achieve a superior expected outcome net of transactional costs. Hollywood dealmakers are neither reckless nor imprudent. Rather, their transactional choices reflect an assessment of the marginal net value of increased specification effort in an environment in which formal contract has limited but positive efficacy, reputation effects are powerful but unreliable, and integration is no longer economically feasible. The result is the soft contract: a hybrid instrument that lies between the formal world of single-shot contractors protected by law and informal communities of repeat players constrained by reputation.

**Appendix A:****Reported contract formation disputes involving talent and film “studios”<sup>79</sup>***Legend:*

*T* = talent; *S* = studio (or other production entity or individual producer)

*O* = Oral; *W* = written

Year	Parties (T/S)	Film (Actual or Proposed)	Type of Agmt	Party in Alleged Breach	Litigation Outcome
1923	A. Jolson/D.W. Griffith	His Darker Self	O	T	Enforced
1924	D. Collins/Bennett et al.	Queen of the Flat Top	O	S	Unknown
1947	Johnston/20 <sup>th</sup> C. Fox	The Clock Struck Twelve	O	S	Enforced
1948	De Toth/ Columbia Pictures	N/a (long-term contract)	O	T	Enforced
1949	Mason/Rose	N/a (series of movies) <sup>80</sup>	W	S	Not enforced
1950	N. Algren/Roberts Prods. Inc.	The Man with the Golden Arm	O	T	Unknown
1950	B. Davis/Ramon Romero	Mrs. Lincoln	O	T	Unknown
1952	Werker/M. Briskin, Morjay Prods. et al.	Cry Tough	O/W	S	Unknown
1952	Unidentified actress/RKO	Not specified	O	S	Unknown
1955	Skirball/RKO	Appointment in Samarra	O	S	Enforced
1955	H. Lloyd/California Pictures Corp.	Mad Wednesday	O	S	Remanded
1956	B. Donlevy/Carthy Prods.	King of Hearts	O	T	Unknown
1956	S. Hayden/Warner Bros.	Tension at Table Rock	O	S	Unknown
1957	C. Heston/Warner Bros.	Darby’s Rangers	Unknown	S	Settled
1958	K. Briggs/MGM et al.	High School Confidential	O	S	Unknown
1958	Holden/Paramount	The Horse Soldiers	O	T	Not enforced
1959	K. Frings/United Artists et al.	Two for the Seesaw	O	S	Unknown
1959	Carter/Milestone	Operation Mad Ball	W	S	Not enforced
1960	R. Parrish/Omat Prods.	Brotherhood of Evil	O	S	Unknown
1961	J. Landis/J. Gentile	Tragedy in a Small Town	O	S	Unknown <sup>81</sup>
1963	B. Breen/S. Goldwyn	Porgy & Bess	O	T	Not enforced
1963	C. Odets/MGM	The Actor	O	S	Unknown
1964	A. Quinn/United Artists	The Magnificent Seven	O	S	Not enforced
1964	Boyd/T. Mann, Benton Film Prods.	The Unknown Battle	O	S	Unknown
1965	D. Murphy/ G. Conway et al.	This Hero Breed	O	T	Unknown
1968	F. Dunaway/O. Preminger	Hurry Sundown	O	T	Settled

<sup>79</sup> Except as indicated below, all disputes identified through the Lexis-Nexis and Westlaw databases or the *Variety* digital archives. All disputes involve filing of lawsuit except in two cases as indicated. Any suit for which the outcome is indicated as “enforced” or “not enforced” indicates that a court or jury reached a final determination, in which case the dispute is referenced in App. B. Sources for all other items can be found under “References—General and Trade Press Sources”. The search was restricted to contract formation disputes involving talent (writer, director or actor) and a studio (including any type of production company or individual producer). I excluded: (i) talent/studio disputes involving claimed contracts relating to a particular term of their purported agreement but without raising any doubt as to either talent’s commitment to perform, or studio’s commitment to retain talent’s services, in general in the relevant project; and (ii) “idea submission” disputes involve allegations by a writer or producer that a studio or other production entity misappropriated an “idea” pitched to the studio or production entity. For brevity, not all parties’ names are always listed.

<sup>80</sup> Joint venture to form production company.

<sup>81</sup> WGA arbitration.



Year	Parties (T/S)	Film (Actual or Proposed)	Type of Agmt	Party in Alleged Breach	Litigation Outcome
1968	P. Lawford/Embassy Pictures and Paramount	Something Beginning with M	O	T	Unknown
1968	E. Taylor, R. Burton/J. Blaustein	Taming of the Shrew	O	T	Dismissed
1969	E. Silverstein/Warner Bros.	Nobody Loves a Drunken Indian	O	S	Unknown
1971	M. von Sydow, L. Ullman/MGM	Man's Fate	O	S	Unknown
1972	J. Palance/S. Peckinpah et al.	The Getaway	O	T	Unknown
1973	N. Montex/20 <sup>th</sup> Century Fox	Che	O	S	Dismissed
1976	F. Dolan/Columbia	Ann Carver's Profession	O	S	Unknown
1984	M. Steenburg/MGM	Roadshow	O	S	Settled
1986	F. De Felitta/Polygram	Sea Trial	O	S	Unknown
1987	R. Dangerfield/Warner Bros.	Caddyshack II	O	S	Settled
1988	B. Lancaster/Columbia	The Old Gringo	O; W	S	Unknown
1989	A. Pacino/E. Kastner, Cinema Corp.	Carlito's Way	O	T	Unknown
1989	B. De Palma, O. Litto/Orion Pictures	Dressed to Kill	O	S	Unknown
1989	Pickney/Valente-Kritzer	Callenetics	O	S	Not enforced
1991	E. Lloyd/Orion Pictures	Mermaids	O	S	Settled
1991	Garcia Marquez/Roth	Love in the Time of Cholera	W	T	Not enforced
1992	J. Mattson/De Laurentis Productions	Milk Money	O	T	Unknown
1992	H. King/Inspiration Pictures	Romola	O	S	Settled <sup>82</sup>
1992	R. Mulcahy/Davis-Panzer Prods.	Highlander III	O	T	Unknown
1993	Konigsberg/Rice	The Mummy	O	T	Not enforced
1993	K. Basinger/Main Line	Boxing Helena	O	T	Enforced
1993	A. Bening/Samuel Goldwyn Co.	The Playboys	O	T	Settled
1993	J. Milius/Price Entertainment	Texas Rangers	O	S	Unknown
1993	W. Goldberg/T Rex Prod. Co.	T. Rex	O	T	Settled
1995	P. Anderson/Private Movie Co.	Hello, She Lied	O	T	Not enforced
1997	J. Travolta/Mandalay Entertainment	The Double	O	T	Settled
1997	J. Foster/Polygram	The Game	O	S	Unknown
1997	F. Dunaway/L. Persky	Master Class	O	S	Settled <sup>83</sup>
1998	M. Myers/Universal	Dieter	O	T	Settled
1998	F. Coppola/Warner Bros.	Pinocchio	O; W	T	Not enforced
2000	Rappaport/Buske	Fabulously Fit and Famous	O	S	Not enforced
2001	S. Stone/unnamed production co.	Basic Instinct 2	O	S	Suit withdrawn
2002	T. Kaye/Flashwork Prods.	Victim of Deceit	O	T	Dismissed
2002	Lombardo/Mauriello	Mother and Child	W	S	Enforced
2003	Rai/Unidentified studio	The Rising	O	T	Settled <sup>84</sup>
2007	B. Pitt/Universal	State of Play	O	S	Settled <sup>85</sup>
2007	J. Goodman/Constantin Films	Pope Joan	O	T	Settled
2008	Hansen/Geisler	Desperadoes	W	S	Not enforced
2009	Shade/Gorman	American Heroes	W	S	Not enforced

<sup>82</sup> Settlement is assumed based on information that plaintiff-director (who claimed breach by studio) directed the film. See [www.imdb.com/title/tt0015289/](http://www.imdb.com/title/tt0015289/)

<sup>83</sup> Dunaway & Sharkey 1998.

<sup>84</sup> No lawsuit filed; hence, I assume a settlement.

<sup>85</sup> No lawsuit filed. Parties resolved dispute once acceptable replacement for Pitt was found (Baz 2009).

<b>Year</b>	<b>Parties (T/S)</b>	<b>Film (Actual or Proposed)</b>	<b>Type of Agmt</b>	<b>Party in Alleged Breach</b>	<b>Litigation Outcome</b>
2010	Fiat Risus (R. Williams)/Gold Circle	Cop Out	W	T	Not enforced
2012	Fraser/Moyer et al. <sup>86</sup>	Not specified	W	S	Pending

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<sup>86</sup>

Gardner 2012.

## Appendix B: Published or other reported judicial decisions involving contract formation disputes in film and television projects<sup>87</sup>

### Legend:

*O* = oral agreement

*W* = written agreement (deal memos, letter agreements, unsigned long-form agreements; faxes)

*Def.* = definite (certainty, agreement on all material terms)

*Indef.* = indefinite (uncertainty, lack of agreement on essential terms, vagueness)

Case (Year)	Type of Agmt	Parties; Transaction	Enforced?	Grounds	Governing Law <sup>88</sup>
<i>D.W. Griffith Co. v. Jolson</i> (1923, probably New York state court) (N.Y. Times 1924)	O	Studio/actor	Y	Def.	NY
<i>Johnston v. Twentieth Century Fox Film Corp.</i> , 82 Cal. App. 2d 796 (Cal. Ct. App. 1947)	O	Writer/studio (use of book title in movie)	Y	Def.	CA
<i>Columbia Pictures Corp. v. de Toth</i> , 87 Cal.App.2d 620, 624 (Cal. Ct. App. 1948)	O	Studio/director	Y	Def.	CA
<i>Mason v. Rose</i> , 176 F.2d 486 (2nd Cir. 1949)	W	Actor/studio (joint venture to form movie production company)	N	Indef.	England/ CA
<i>Skirball v. RKO Radio Pictures</i> , 134 Cal. App. 2d 843 (Cal. Ct. App. 1955)	O	Producer/studio	Y	Def.	CA
<i>Paramount Pictures Corp. v. Holden</i> , 166 F.Supp. 684 (C.D. Cal. 1958)	O	Studio/actor	N <sup>89</sup>	No injunctive relief for oral contracts.	CA

<sup>87</sup> Databases (Lexis-Nexis): “All Federal, New York, and California (from start of databases coverage through June 30, 2011); “All Federal and State except for New York and California (January 1, 1980-June 30, 2011)”. Note that these databases generally do not cover state trial courts, which usually issue unpublished or otherwise unreported opinions. Search terms identified fully litigated cases that (i) primarily involved a film or television production and (ii) addressed the enforceability of an oral or written agreement (excluding cases that addressed only the enforceability of a particular term in an otherwise enforceable oral or written agreement and cases that involved “idea submission” scenarios). Also, some unpublished but fully litigated cases were added that were identified through supplemental searches in Westlaw or other sources.

<sup>88</sup> Choice of law refers to state law as selected in a claimed written contract, state law as designated by the court in the case of a claimed oral contract or claimed written contract that does not specify governing law; and federal law in the case of a claimed violation of Section 204(a) of the Copyright Act.

<sup>89</sup> The court declined to rule on the existence of a binding contract (which was remanded to the lower court), but also declined to issue an injunction against the actor working for another employer during the contract term due to the absence of a written agreement. I therefore treat this outcome as the functional equivalent of the court having declined to enforce the claimed contract.

Case (Year)	Type of Agmt	Parties; Transaction	Enforced?	Grounds	Governing Law <sup>90</sup>
<i>Carter v. Milestone</i> , 170 Cal. App. 2d 189 (1959)	W	Writer/producer	N	Indef.	CA
<i>Breen v. Samuel Goldwyn Co.</i> (1963) (Times Daily 1963)	O	Director/producer	N	Not stated	CA
<i>Anthony Quinn v. United Artists et al.</i> (Santa Monica Superior Court, 1964) (Daily Variety 1964)	O	Actor; studio	N	Indef.	CA
<i>Metro-Goldwyn-Mayer, Inc. v. Scheider</i> , 43 A.D. 2d 922 (NY App. 1974)	O	Studio/actor (TV pilot with option to produce TV series)	Y	No statute of frauds violation.	NY
<i>Sawyer v. Sickinger</i> , 47 A.D.2d 291 (N.Y. App. 1975)	O	Producer/producer (option to acquire rights to direct film)	N	Statute of frauds	NY
<i>Jilley Film Enterprises, Inc. v. Home Box Office, Inc.</i> , 593 F. Supp. 515 (1984)	W; O	Producer/network	N	Statute of frauds; indef.	NY
<i>Winston v. Mediafare Entertainment Corp.</i> , 777 F.2d 78 (2nd Cir. 1985)	W; O	Agent/producer (finder's fee for sale of movie rights)	N	No intent to be bound.	NY
<i>Valente-Kritzer Video v. Pinckney</i> , 881 F.2d 772 (9th Cir. 1989)	O	Producer/writer (right to sell movie rights to studio)	N	Statute of frauds	Fed.; CA
<i>Effects Ass'n, Inc. v. Cohen</i> , 908 F.2d 555 (9th Cir. 1990)	O	Video effects firm/producer	Y	Implied nonexclusive license	Fed.
<i>Roth v. Garcia Marquez</i> , 942 F.2d 617 (9th Cir. Cal. 1991)	W	Producer/writer (sale of option to develop film)	N	Indef; agreement to agree	CA
<i>Geoquest v. Embassy Home Entertainment</i> , 229 Ill. App. 3d 41 (1992)	O	Producer/videocassette distributor	N	Def.	Illinois

<sup>90</sup> Choice of law refers to state law as selected in a claimed written contract, state law as designated by the court in the case of a claimed oral contract or claimed written contract that does not specify governing law; and federal law in the case of a claimed violation of Section 204(a) of the Copyright Act.

<b>Case (Year)</b>	<b>Type of Agmnt</b>	<b>Parties</b>	<b>Enforced?</b>	<b>Grounds</b>	<b>Governing Law</b>
<i>Konigsberg Int'l v. Rice</i> , 16 F.3d 355 (9th Cir. 1993)	O	Producer/writer	N	Statute of frauds	Fed.
<i>Main Line v. Basinger</i> , 1994 WL 814244 (Cal.App 1994)	O; W	Studio/actor	Y	Def.	CA
<i>Trimark Pictures, Inc. v. August Entertainment, Inc.</i> , No. B089266 (Cal. App. 1996)	W	Producer/distributor	N	Statute of frauds	Fed.
<i>Private Movie Co., Inc. v. Pamela Anderson, L.A.</i> Sup. Ct. Case. No. BC 136805 (Oct. 10, 1995)	O	Studio/actor	N	Indef.	CA
<i>Coppola et al. v. Warner Bros., Inc.</i> , L.A. Sup. Ct. Case No. BC 135198 (July 12, 1998)	O; W	Director/studio	N	Indef., statute of frauds	CA; Fed.
<i>Radio TV Espanola S.A. v. New World Entm't, Ltd.</i> , 183 F.3d 922 (9th Cir. 1999)	W	Broadcast network/production company	N	Statute of frauds	Fed.
<i>Rappaport v. Buske</i> , 2000 WL 1224828 (S.D.N.Y. Aug. 29, 2000)	O	Actor/producer	N	Indef.; lack of intent to be bound.	NY
<i>Lombardo v. Mauriello</i> , 2002 Mass. Super. LEXIS 399 (2002)	W	Writer/producer	Y	Def.	Mass.
<i>Zenga v. Brillstein-Grey Ent't</i> , 2003 Cal. App. Unpub. LEXIS 10427 (2003)	O	Producer/studio	N	Indef.	CA
<i>Baer v. Chase</i> , 392 F.3d 609 (3d Cir. 2004)	O	Producer/consultant (TV series)	N	Indef.	NJ
<i>Portman v. Zoetrope, Corp.</i> , 2005 Cal. App. Unpub. LEXIS 4093 (2005)	W	Producer/producer	N	Indef.	CA
<i>In re My Left Hook, LLC; Lemon v. Lapin</i> , 403 F.3d 1041 (9th Cir. 2005)	W	Production company/financiers	N	Indef.	CA

<b>Case (Year)</b>	<b>Type of Agmnt</b>	<b>Parties; Transaction</b>	<b>Enforced?</b>	<b>Grounds</b>	<b>Governing Law</b>
<i>Lyrick Studios, Inc. v. Big Idea Prod.</i> , 420 F.3d 388 (5th Cir. 2005)	W	Studio-distributor/production company	N	Statute of frauds	Fed.
<i>Network Enters. v. APBA Offshore Prods.</i> , 427 F. Supp. 2d 463 (S.D.N.Y. 2005)	O; W	Cable network/producer (broadcast of sports event)	Y (agreement to negotiate in good faith)	Intent to be bound	NY
<i>Hansen v. Geisler</i> , 2008 NY Slip Op. 33266U (S. Ct. N.Y., N.Y. Cty., Dec. 4, 2008)	W	Writer/producer	N	No consideration.	NY
<i>Weinstein Co. v. Smokewood Entm't Group, LLC</i> , 664 F. Supp. 2D 332 (S.D.N.Y. 2009)	O	Studio/producer	N	Statute of frauds; lack of intention to be bound	Fed; NY
<i>Shade v. Gorman</i> , 2009 U.S. Dist. LEXIS 8554 (N.D. Cal. 2009)	W	Videographer/studio	N	Disclaimer of intent to be bound	CA
<i>Fiat Risus v. Gold Circle Films</i> , L.A. Superior Ct. (Feb. 5, 2010)	W	Actor (Robin Williams); production company	N	Indef.	CA
<i>Trademark Properties, Inc. v. A&amp;E Television Networks</i> , 422 Fed.Appx. 199 (4 <sup>th</sup> Cir. 2011) (unpublished)	O	Creator; television network	Y	Def.	NY
<i>Swan Media Group v. Staub</i> , 841 F.Supp.2d 804 (S.D.N.Y. 2012)	W	Media group; actress	N	Indef.	NY

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## **Interviews**

Studio Counsel I, former in-house general counsel at major studio, Los Angeles, February 8, 2011 (“Studio Counsel Interview I”)

Studio Counsel II, in-house counsel at major studio, Los Angeles, various dates in February-December 2011 (“Studio Counsel Interview II”)

Studio Counsel III, in-house counsel at major studio, Los Angeles, August 29, 2011 (“Studio Counsel Interview III”)

Production Executive, major independent studio, Los Angeles, various dates in February-December, 2011 (“Production Executive Interview”)

Entertainment Attorney I, senior counsel with entertainment practice at major law firm, Los Angeles, May 31, 2011 (“Entertainment Attorney Interview I”)

Entertainment Attorney II, law firm partner with entertainment practice, Los Angeles, June 2, 2011 (“Entertainment Attorney Interview II”)

Entertainment Attorney III, law firm partner with entertainment practice, Los Angeles, November 23, 2011 (“Entertainment Attorney Interview III”)



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Entertainment Attorney IV, law firm partner with entertainment practice, Los Angeles,  
July 19, 2012 (“Entertainment Attorney Interview IV”)