

## Hollywood Labor Unrest Looms on the Digital Horizon

by Gregory J. Hessinger and Julie E. Liebenberg

In the digital age, it is good to be a consumer. Gone are the days when entertainment fare could only be accessed through the tightly controlled distribution outlets of movie theaters and a handful of broadcast television networks. Today, exciting new technology makes it possible for film and television fans to download or stream content to an array of devices – laptops, iPods, cell phones. There seems to be almost no limit to the explosion in digital distribution. However, from the standpoint of the studios and networks that produce and distribute that content, the excitement that comes with new possibilities is tempered by the threat that those possibilities pose to existing business models. Every day, studios and networks grapple with the frightening dilemma of devising ways to exploit these potential new revenue streams without cannibalizing existing businesses.

But nowhere does the anxiety level run higher than within walls of the powerful labor unions that represent actors, writers and directors in Hollywood. Already, a fierce battle is being waged over the way that talent should be compensated for various forms of digital distribution, despite the fact that virtually nobody is actually making a profit yet. With both the studios and the guilds strongly defending their respective positions and guild contracts up for renegotiation, the prospects for labor strife are undeniably real.

At the center of the digital debate is the question of residuals, a contractual form of profit sharing that compensates talent for the use of their work in supplemental markets or the reuse of that work in the original medium. Authors and publishers, of course, have already had their day in court over similar issues in the context of the copyright laws in *Tasini v. The New York Times*. But the film and television industries are unique because of the collective bargaining agreements and the copyright laws are not implicated since even authors cede their copyrights to producers under the various

film and television agreements. Under the residual structure in these industries, when a feature film is distributed beyond the primary market of theatrical release, the creative talent receives a share of the gross receipts as that picture is licensed for use in broadcast television, cable, pay television, DVDs, and so on. For television programs, talent receives an even sweeter deal, as residual payments for television replays are fixed amounts, rather than a percentage of the producer's gross receipts. Of course, when these formulas were originally negotiated, nobody could have predicted the various forms of digital distribution on the horizon today. Now, the parties must either find a way to reach agreement on the appropriate application of existing formulas to digital distribution or negotiate an entirely new scheme.

The battle over digital downloads was joined in February 2006 when ABC announced that it would make episodes of certain television programs available for download and would pay residuals related to those downloads based on the residual model for DVDs. This model, created in the 1980s during the early stages of the home video market, provides that distributors set aside 80 cents of every wholesale dollar earned before splitting the remaining 20 cents with the various talent guilds. Over the past decade, as the home video market has grown exponentially, union dissatisfaction with this formula has escalated, reaching a boiling point in 2004 as the parties came to the brink of an industrywide strike. Ultimately, the studios were successful in both averting a strike and rebuffing the unions' assault on the DVD formula, as health and pension benefits took higher priority. In their retreat, however, union leaders loudly proclaimed their intention to renew the battle.

In response to ABC's announcement, the Screen Actors Guild (SAG) issued a statement accusing ABC of violating its collective bargaining agreement

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and stating that the DVD formula should not apply to the new digital download platform. Although not explicitly stated, SAG has apparently adopted the position that the more lucrative formula for pay television should apply, rather than the DVD provision. Both the West and East branches of the Writers Guild of America (WGA) agree. Patric Verrone, President of WGA West stated, "We will not stand by while the industry creates business models that leave us out of the mix." Undeterred, the other networks have all followed with their own announcements of various experimental downloading and streaming models, with no mention of paying residuals.

Aside from issues of contract interpretation under the current labor agreements, the conflict is further exacerbated by the fact that the studios vehemently protest the unions' characterization of the DVD formula as unfair or inadequate. The facts appear to support the studios' perspective, as guild members received an estimated \$570 million in DVD residuals alone last year. That represents a 159% increase over the \$220 million paid just ten years ago. Even more significant is the fact that in the past 20 years, the studios have seen their revenue pie completely inverted so that the two-thirds revenue share that used to represent box office receipts has been reduced to just over one-third, while the revenues attributable to supplemental markets (including DVDs) now constitute two-thirds of the total revenue pie. That means that the studios are now paying residuals on two-thirds of their revenues instead of one-third. Or, put another way, a residual structure that was built upon a profit-sharing concept now yields a result where many motion pictures begin paying talent residuals before the studio sees a dime in profit. One can only imagine the reaction of a studio executive watching a \$200 million film go into the tank and then waking up to read quotes of Hollywood labor leaders decrying the unfairness of a system in which their members will collect residuals on a project that has lost significant dollars for the studio.

One possible solution to both the long-simmering dispute over DVD residuals, and the dispute over the nascent new media markets would be to redefine the residual formulas so that the computation is based upon net profits, rather than gross receipts. After all, it is the essence of a capitalist system that the party that assumes the risk of loss stands to realize the benefit of gain.

The residual structure embodied in the guild contracts is a unique exception to that rule – a parallel example would be a homeowner's receipt of an annual invoice from the carpenters' union for the continued enjoyment of his or her home. That would be an unthinkable concept for most, but longstanding cultural norms in Hollywood dictate that creative talent must share in the profit they help create. That will not change, but having the contractual models conform to notions of profit sharing, rather than revenue-sharing without risk, would appear to be long overdue. Nick Counter, President of the Alliance of Motion Picture and Television Producers, the studios' bargaining arm, seemed to evince just such a mindset in an interview with the Hollywood Reporter back in April, when he said: "If the guilds are prepared to examine the entire residual structure, then the studios will welcome them to the table." He noted further that the studios "should not have to pay residuals until they recover some profit."

If the guilds do strike, it would not be the first time that technology was the cause of an entertainment industry shutdown. In 1960, threatened by the growth of the television medium, actors struck over payments for movie reruns on television. And in 1980, actors struck again over compensation for pay television and home video.

While there is still a year before the expiration of the WGA contract (actors and directors follow eight months later), the long lead time required for film production means that in the absence of an agreement months before the expiration date, it is conceivable that the industry will grind to a halt in a so-called "de facto" strike, because no studio can responsibly commence production on a film without the certainty that it can be completed. Studios are reportedly already ramping up to stockpile material in anticipation of either a "de facto" or an actual strike.

While labor discontent sounds a perpetual drumbeat in Hollywood, this upcoming round of negotiations appears particularly daunting. Logic would dictate that all parties would be best served by allowing the digital platform to define and establish itself before subjecting the industry to a wrenching work stoppage over profits that don't yet exist. Unfortunately, history demonstrates that Hollywood is not always governed by logic and reason. Strong leadership and cool heads on both sides of the table will be required to reach a fair and equitable resolution in such a challenging climate.