Hollywood Studios Rewriting Pay System for Their Talent

A switch from handing over of a movie's initial revenue aims to stem production losses.

By John Horn, Times Staff Writer

Think of it as Hollywood's version of a salary cap.

With moviegoing declining and production costs skyrocketing, studio executives are taking a harder look at the industry's most cherished and costliest perk: first-dollar gross profit.

The practice of giving A-listers first dibs on a studio's box-office take has long allowed the industry's top actors, writers and producers to grab the bulk of a movie's total receipts well before a studio has earned back its investment. But what's been good for the likes of Tom Cruise and Steven Spielberg has become increasingly problematic for studio executives.

In a move that some leading talent agents say would have been unthinkable just a few years back, studios are now placing a hard cap — usually about 25% — on how much of a film's revenue will be split with the talent. A growing number of studio deal makers also are eliminating the old pay system on a broad spectrum of projects, suggesting instead that actors, directors and producers essentially become financial partners in a movie's making.

The upshot of these new deals, which are called cash break-even, is simple: If the film is a hit, the directors, lead actors, writers and others will enjoy an even richer payday, but only after the studio has recouped its investment. If it's a bomb, the studio will be spared the ignoble task of cutting bonus checks on a money-losing dog.

"The economics are evolving in the movie business," said Adam Goodman, production chief at DreamWorks SKG. "Everybody has to recognize that."

The new formula is being used in deals for several upcoming features, including Walt Disney Co.'s big-budget "Pirates of the Caribbean" sequels and Steven Soderbergh's $30-million, black-and-white World War II drama "The Good German," which stars George Clooney.

Disney's dealings on its "Pirates of the Caribbean" movies dramatize why the new formula makes sense for the studios. It will cost Disney some $600 million to make and market the next two "Pirates" films, the first of which comes out this summer. For example, if Disney were to pay star Johnny Depp, director Gore Verbinski and producer Jerry Bruckheimer under the old formula, the studio would pocket only about 70 cents on every dollar coming in.

"The budgets [of big movies] are just too high," said Disney production chief Nina Jacobson, who declined to comment on the "Pirates" deal. "You can find yourself, under a traditional first-dollar gross deal, writing huge checks while you are bleeding. It just doesn't seem fair. It feels great to be writing checks in success. But it kills you to be writing checks in failure."

Talent agents and show business lawyers are skeptical of the shift. They fear the new contract terms are another way for the studios to amass more profit for themselves while sharing fewer proceeds with the people who actually dream up and make the movies. After all, Hollywood studios have a reputation for getting
creative with their bookkeeping.

Peter Nelson, an entertainment industry lawyer whose clients include Peter Jackson of "King Kong" and Andrew Adamson, the filmmaker behind "The Chronicles of Narnia: The Lion, the Witch and the Wardrobe," worries that the new compensation formula is more an accounting ruse than a true partnership.

"The studios have made a fine art out of creating contract definitions that have no relation to reality," Nelson said. "These definitions just create new profit streams for the studios."

He notes that even though studios complain that mid-priced dramas have become the most financially risky productions, the studios are pushing for the new pay formula on high-budget franchise films.

"If the middle movies are the ones where the studios are getting hurt, why aren't the studios pushing for cash break-even on those movies, rather than on the big movies, where they are theoretically making most of their money?" Nelson asked.

The new formula is one of many strategies that Hollywood is employing to improve its movie margins as it grapples with growing costs, declining ticket sales and slowing growth in ancillary markets, such as DVD sales. Warner Bros., for example, has enlisted Wall Street investors to split the budgets on some of its priciest productions, including "Batman Begins" and "Superman Returns."

The speed in which Hollywood's deal-making sands are shifting is evident when it comes to writer-director Nancy Meyers and her movie "Holiday," which is due out this Christmas.

When it comes to big romantic comedies, Meyers enjoys one of the best track records in town, putting her in the elite club of first-dollar gross directors. Her last three films — "Something's Gotta Give," "What Women Want" and "The Parent Trap" — were hits, grossing a combined $373 million in U.S. theaters.

But when Sony Pictures looked at Meyers' latest film’s budget and its star-laden cast (Cameron Diaz, Jack Black, Jude Law and Kate Winslet), the studio worried that if it paid everyone his or her going rate, "Holiday" would have to have to be a blockbuster — grossing at least $200 million — before Sony would see a dime. (Studios typically split movie ticket revenue with theater chains.)

So the studio, the director and the actors all settled on the new formula. Under the film's reworked contract, Sony will not pay out any gross profit until the studio has recouped its production, marketing and distribution costs, which are estimated to be more than $100 million.

"If the studio wins, the talent wins," said Bob Osher, chief operating officer of Sony's Columbia Pictures.

Moviemaking deals that include profit sharing have a rich and storied history, dating to a pact negotiated by legendary talent agent Lew Wasserman for Jimmy Stewart that guaranteed the actor a percentage of the returns of the 1950 movies "Harvey" and "Winchester '73."

In the ensuing years, various actors were given a share in a movie's revenue. But as the studios became more creative with their accounting, people sharing in a film's "net profit" often discovered that even mammoth blockbusters had somehow become money losers on a studio's books, as was the case with "Batman" and "Forrest Gump."

During the rise to power of Michael Ovitz and Creative Artist Agency in the 1980s, a larger number of performers and filmmakers were contractually entitled to first-dollar gross, meaning the studios had to share every dollar that passed through the studio tills.

Today, the spreadsheets of studio executives contain as many iterations of the new compensation formula as there are brands of bottled water. Some of the deals allow the studios to charge for inflated overhead, interest and distribution fees (as opposed to their actual costs for such services), although the best deals for talent do not. Some contracts mandate that a studio count all of a movie's video revenue toward its recoupment, rather than the usual 20% that is returned to the bottom line.

Rich Klubeck, an agent at United Talent Agency, said the new deal structures might help studios manage costs and make more daring movies.

"The bargain is the studio takes a lot less risk," Klubeck said. "And everyone who makes the movie enjoys a bigger [profit participation] if it succeeds."
Recasting the bottom line

Studios increasingly are steering top-drawer actors and filmmakers away from Hollywood’s established compensation system, known as first-dollar gross. The new pay formula, called cash-break-even, allows studios to recoup their costs before sharing revenue with a film’s creative talent. Here’s an illustration of how the two plans work.

**First-dollar gross method**
- Gross revenue to studio: $250.0 million
- Profit shared with filmmakers and cast at 25% of that revenue: -$62.5 million
- Studio gross revenue: +$187.50 million
- Total cost of making the movie: -$190.0 million
- Studio bottom line: -$2.5 million

**Cash break-even method**
- Gross revenue to studio: $250.0 million
- Studio payback for cost of making the movie: -$190.0 million
- Net revenue for filmmakers, cast and studio: +$60.0 million
- Payments to filmmakers and cast at 50% of net revenue: -$30.0 million
- Studio bottom line: +$30.0 million

*Source: Times research*