

Who's Afraid of Digital Downloads?

NOT LONG AGO, I HAD A BITTERSWEET EXPERIENCE. I discovered that the DVD of a client's television show had completely sold out on the very day the DVD was released. Naturally, I was thrilled for my client (and just the tiniest bit for me). But as I stood in my local video store trying to resist the jumbo bag of M&Ms and watching everyone from preteen girls to WWII vets request the DVD, I felt a little burned. Some of you already know why: Under the current home video royalty agreement (under which DVD sales are categorized) 80 percent of the wholesale revenues for the sale of the DVDs will be excluded from my client's profit participation, meaning that my client's profit participation will be based only on 20 percent of wholesale revenues. In addition, after distribution fees, distribution expenses, dues, and assessment are deducted, what began as a back-end profit participation based on a 20 percent royalty will likely be reduced to a profit participation based on a royalty of 10 percent to 12 percent.

But the problem with the current home video royalty arrangement is not limited to sales of DVDs. Our clients and their respective guilds are on the frontier of a new set of issues, which are the unfortunate legacy of an unusual concession the guilds made for what was then "unknown and untested" video technology. We have reached the point where the demand of that technology—which now includes video iPods, Blackberries, and cell phones—for content such as my client's is exploding.

Unfortunately, there are no appropriate formulas in the respective contracts between SAG, WGA west, WGA East, DGA, AFTRA, and IATSE and the studios or networks that specifically cover residuals for new delivery systems such as digital downloading to a video iPod. I am afraid that the digital downloads residuals could be paid at the outdated home video royalty based on 20 percent of sales, a formula that has haunted the guilds for almost 25 years.

The origins of the 20 percent of sales formula can be traced back to the 1970s, when Andre Blay, the owner of Magnetic Video, negotiated with 20th Century Fox to license Fox's feature film library on Betamax. The negotiations between Fox and Blay covered manufacturing, packaging, marketing, and the risk of starting a new industry. The parties agreed that Blay would pay Fox a royalty of 20 percent of sales. Eventually, all the studios adopted the 20 percent royalty for the license to their libraries, and contracts were rewritten to limit reportable home video revenue to 20 percent of wholesale revenues. Accordingly, guild residuals were paid on only 20 percent of wholesale revenues—purposefully excluding 80 percent of the revenue from calculations. In 1982, when it could cost \$40 to manufacture a single copy of a video, this was reasonable. Today, as the actual video manufacturing cost has been reduced to \$3, it is obsolete.

The most recent chapter in the new-technology drama dates from the October 2005 introduction of the video iPod, which Apple hopes

will for do for the digital download of video what the iPod has already achieved for music. Through its iTunes store, Apple hopes to offer individual episodes of different television shows. Initial video offerings include the popular ABC series *Desperate Housewives* and *Lost*, with episodes available the day after their initial broadcast for \$1.99 each—with virtually no distribution costs. In addition, on April 10, 2006, ABC announced that it plans to test online streaming of four shows on its Web site, ABC.com. This service, which includes interactive advertisements, will be offered free of charge.

The Writers Guild of America west believes that the proper for-

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mula for compensating writers is the existing residual agreement for pay television, a rate that is four times that of the home video rate. The pay television residual agreement entitles the WGA and the DGA to 1.2 percent of the entire distributor's gross, while SAG gets 3.6 percent, and IATSE receives 5.4 percent. However, in February 2006, ABC announced—as the guilds feared—that it would pay digital download residuals at the lower home video rate, instead of the pay TV rate. No big surprise here. In response to ABC's decision, the presidents of the respective guilds promised various actions, including "arbitration," "filing claims," and aggressively pursuing "all legal options at our disposal."

Although the digital download residual is only one debate, it is to a large extent, the first debate in what will likely be marathon negotiations. And I am afraid, because, in reality, what is truly being determined is not just the digital download issue, but the extent to which creative talent will be allowed to participate in current—and future—profits. More to the point, the true issue lurking beneath this negotiation and its outcome—which will most likely result in protracted negotiations, arbitration, or even the potential S-word (shame on you if you weren't thinking "strike")—is the manner in which creative talent will be valued and compensated in the rapidly expanding new technologies. This is not a fight that the guilds can afford to lose. Much is at stake, and the guilds cannot create a precedent—as they did with home video—that could haunt them for another quarter century or longer. ■

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