

CREATIVE ACCOUNTING REVISITED

By Mark Litwak

Several recent cases have provided insight into creative accounting disputes and the rights of profit participants to contest inaccurate reporting. One case concerns the *Columbo* television series, a show in the 1970s created by William Link and Richard Levinson. The program starred Peter Falk playing a disheveled bumbling detective who outwits the bad guys who always underestimate him. The series began in 1971 and was a hit both in the United States and abroad having been broadcast in forty-four countries. The heirs of the creators say it took 45 years for them to receive their first accounting report for the series. The statement was issued in November 2016 along with a check for \$2.3 million. In 2017, they sued Universal claiming they were due much more.

Profit participants often complain that distributors engage in creative accounting to deny them their rightful share of profits. One of the ways that distributors may seek to avoid payouts is by including time limits that require profit participant to audit and contest a statement promptly or waive their right to contest it. If the participants do not audit and make a claim, they may be barred from contesting the accounting later. Essentially the studio is imposing a shortened statute of limitations on the participant. It is common for distribution contracts to require that participants must contest a statement within two years of it being issued or waive their right forever to challenge it. This imposes a dilemma on participants because audits can be costly, and the participant does not really know if any additional revenue will be recovered with an audit. If a participant prematurely pays for an audit that reveals no shortcoming in monies owed the participant, the participant has to bear the cost of the audit. An audit can cost thirty thousand dollars or more for a major studio film. So even if the audit exposes some irregular accounting that generates a modest return, it may not be worth the cost.

In the *Colombo* lawsuit, the parties' agreement provided that the studio would provide statements twice a year except that there was no obligation to provide statements if no payments were due. By not supplying statements for 45 years, the studio represented that no profits were due. When a statement was finally issued, the plaintiffs' attorney promptly objected and sued.

The plaintiffs alleged that they had not discovered facts indicating that they were being shortchanged until they received that first statement. Last March, a jury decided that the plaintiffs did not unduly delay their lawsuit and also found that Universal had improperly taken certain distribution fees it was not entitled to.

The court then referred the matter to referees to analyze income and expenses and determine what was due. Last July, the referees reported that the plaintiffs were shortchanged some \$36 million and added another \$41 million in interest for the delay in payment. The amount wasn't as much as the \$100 million plus that the plaintiffs claimed they were due, but it was a significant sum nevertheless.

In another case, Wind Dancer Production Group sued Disney in 2013 for unpaid profits derived from the Tim Allen series *Home Improvement*.^[i] The series has reportedly generated \$1.5 billion for Disney.^[ii] The profit participation agreement provided that, "Each statement shall be deemed conclusively correct and binding on Participant as to the transactions reflected therein for the first time on the expiration of a period . . . of 24 months after the date sent." Since *Home Improvement's* debut in 1991, the producers exercised their right to audit Disney's books six times.

At trial, the judge dismissed the case because of an "incontestability" clause. A California appeals court, however, overruled that decision and decided that the trial court should have considered whether Disney should be prevented from asserting incontestability because it had a practice of delaying audits and only allowing one audit at a time. Appellate justice Laurie Zelon wrote in her opinion that:

"The law is clear, however, that notwithstanding a provision in a written contract that expressly precludes oral modification, the parties may, by their words or conduct, waive the enforcement of a contract provision if the evidence shows that was their intent. Accordingly, the no-oral-modification clause in the profit participation agreement did not preclude Disney from waiving other provisions in the agreement that were made for its benefit, including the time limitations in the incontestability clause. It also did not preclude Disney from orally agreeing to toll the limitations period for the Audit 4 and 5 statements that are the subject of this action while those audits were pending."

The *Wild Dancer* decision illustrates how a party's conduct can result in a

waiver, despite the existence of a no-waiver provision in the parties' agreement. [\[iii\]](#) In this case, the relevant issue was whether a contractual limitations period was waived by either: (1) oral and unsigned tolling agreements; or (2) Disney's practice of permitting the exercise of rights that should have been "time-barred." The contract contained a no-oral-modification provision and an "anti-waiver provision" whereby "a failure to enforce a contract term in one instance shall not be deemed a waiver of that term in another instance."

Despite provisions precluding oral modification and waiver, the *Wild Dancer* court reiterated that "the parties may, by their words or conduct, waive the enforcement of a contract provision if the evidence shows that was their intent."

The plaintiffs were seeking more than 40 million in damages plus interest. This past January, the suit was settled by the parties for an undisclosed sum. [\[iv\]](#)

[\[i\]](#) *Wind Dancer Prod. Grp. v. Walt Disney Pictures*, 10 Cal. App. 5th 56 (Cal. Ct. App. 2017).

[\[ii\]](#) Eriq Gardner, *'Home Improvement' Profits Lawsuit Against Disney Revived by Appeals Court*, The Hollywood Reporter (Mar. 22, 2017, 2:18 PM), available at <https://www.hollywoodreporter.com/thr-esq/home-improvement-profit-participation-lawsuit-disney-revived-by-appeals-court-988108>

[\[iii\]](#) *Wild Dancer Prod. Grp.*, *supra*, 10 Cal.App.5th at 80-83.

[\[iv\]](#) Ryan Faughnder, *Disney settles lawsuit over 'Home Improvement' profits*, Los Angeles Times (July 24, 2019, 12:50 PM), available at <https://www.latimes.com/entertainment-arts/business/story/2019-07-24/disney-settles-lawsuit-over-home-improvement-profits>