Domestic film distribution: theatrical, video release

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Film distributors generally advance all marketing and distribution costs, and if the film is considered desirable the distributor may pay an advance or minimum guarantee to the filmmaker. If a film bombs and the distributor can't recoup the advance or guarantee, the filmmaker does not have to return the advance. If the advance is sufficiently large to repay the investors the cost of production, then the filmmaker has effectively transferred the risk of losing money to the distributor. This is a desirable but increasingly rare outcome these days.

There are myriad avenues for a filmmaker to take to get his or her film released theatrically. A rent-a-distributor deal or "service" deal is when the producer bears the marketing costs of releasing a film theatrically. Traditionally distributors bear these costs whether the title is one they produced or acquired from an independent producer. With a service deal, the producer is essentially renting the distribution apparatus of the distributor and bearing all costs. The distributor charges a reduced fee, perhaps half of the traditional 35 percent theatrical distribution fee but avoids advancing any out-of-pocket expenses. The producer assumes all financial risk.

Such a deal can make sense if a distributor has an open slot in its release schedule because full time permanent employees must be paid even if there is nothing for them to do. Why would a producer bear that risk? First, they may not have a choice; only a small portion of independent films are able to secure a theatrical release. Second, a filmmaker may want a theatrical release because it gets the film more attention. For example, the New York Times simply will not review a film unless it opens theatrically in New York. A theatrical release - even if unprofitable itself - can enhance the revenues from other media.

Another method used to get a picture into theaters is the "four wall deal." This is an arrangement directly with the theater owner. Here the filmmaker rents the theater from the exhibitor and takes the financial risk that is normally assumed by both the distributor and the exhibitor. The filmmaker in turn gets to keep all the box office receipts - or lose a lot of money.

Similarly, while there are many formulas for home video deals, most fall within three patterns. The first is one that allows the distributor to retain a percentage of gross receipts as a distribution fee, and to recoup certain designated marketing expenses from film revenues, with the remaining balance, if any, paid to the filmmaker. This is a "standard" distribution deal, although there is nothing standard about it except for how to calculate the distributor's fee. Another type of deal, sometimes referred to as a "50/50 net deal," allows the distributor to first recoup its expenses from gross receipts off the top, and then share the remaining amount 50/50 with the filmmaker. A third type of deal is known as a royalty deal, where the filmmaker gets a percentage of the wholesale price of every DVD sold. That percentage is negotiable, but often in the range of 20-25 percent. Here all expenses incurred are irrelevant in calculating the filmmaker's share because they are borne by the distributor.

Domestic distributors usually insist on cross collateralizing expenses among media. If there is a loss on the theatrical release but a net gain on television, then the revenue and expenses are pooled.

So what is best for a filmmaker? That depends on how much revenue is generated, the amount of expenses, whether they are capped, and the size of distribution fees. Consider three different scenarios.

First, suppose $1,000,000 is generated in gross receipts from sales and rentals of DVDs. Gross receipts in home video means wholesale revenues received, less any returns. If the suggested retail price of a DVD is 20 bucks, the wholesale price would be about half or approximately 10 bucks.

Under a standard distribution deal with a 25 percent distribution fee, and recoupment of up to $100,000 in expenses, the filmmaker would receive $650,000. Under a 50/50 net deal, the filmmaker would receive $450,000. Under a royalty deal with a 20 percent royalty, the filmmaker receives $200,000.

So it appears a standard deal is the best choice. All else equal, what if the film only generated $200,000 in gross receipts? Now the filmmaker would receive $50,000 under the standard distribution deal, $100,000 under a 50/50 net deal, and $40,000 under a royalty deal. In this case, the 50/50 net deal is the best choice for the filmmaker.

Now consider a third scenario with only $100,000 in gross receipts. Here the filmmaker receives zero under either a standard deal or the 50/50 net deal. But under a royalty deal, the filmmaker receives $20,000. The fact that distribution fees and expenses have outweighed the limited amount of gross receipts is irrelevant in a royalty-type deal, because the filmmaker gets 20 percent of the wholesale price, no matter what fees and expenses are incurred. Moreover, under a royalty deal, there is little room for a distributor to engage in creative accounting. Once you determine how many units were sold, and determine the price at which they were sold, a simple calculation tells the producer what she is due. Most creative accounting disputes concern whether expenses deducted are legitimate or not. This is immaterial in a royalty deal, since expenses are not counted in calculating the producer's share of revenue.

Each of these deals could be the best choice under certain circumstances and the worst choice under other circumstances depending on how much revenue is generated. This is why it is important for the filmmaker to pencil out the numbers before deciding which formula is best. Most deals are more complicated to assess because they cover multiple media and the distributor's fee varies by media (i.e., 35 percent for theatrical, 25 percent for broadcast television). Moreover, domestic distributors usually insist on cross collateralizing expenses among media. If there is a loss on the theatrical release but a net gain on television, then the revenue and expenses are pooled. The distributor is thus allowed to recoup its theatrical loss from television revenue. Particular care must be taken when the home video arrangement is a royalty deal which does not allow deduction of expenses. These royalties should not be offset against expenses incurred in other media.

Home video sales are on consignment, meaning the buyers can return any product for a 100 percent refund. And at times, large volumes of DVD's are returned. Therefore, most distributors insist on holding back some revenues as a reserve to make sure they don't pay the filmmaker a share of revenue that evaporates if there are a lot of returns. Sales of DVD copies of films are dominated by mass merchants such as Wal-Mart, Best Buy and Target. However, only a few companies have a direct relationship with Wal-Mart and therefore many other companies have to go through an intermediary like Anderson Merchandisers.

Let me offer one final piece of advice. Filmmakers should never sign a short form deal memo to be followed by a long form contract. Once you sign a deal memo you have may a binding contract with the distributor and when the long form arrives if you do not like some of the provisions you have a big problem. If the distributor refuses to make the changes you want, you have a deal but not necessarily spelled out with the terms you want. Your options are not good. You can't easily disavow the deal memo yet you may not want to proceed forward without certain terms in the long form. A short deal memo is short because many customary terms are left out. By agreeing to the short form you are agreeing to the deal without knowing all the parameters and terms proposed by the distributor. So you should insist on going directly to a long form. If you are unable to work out all the terms to your satisfaction, you can walk away with all your rights retained. Many distributors try to get filmmakers to commit to a short form deal memo because it is easier to negotiate. If and when the long form arrives, the filmmaker can't easily walk away. The short form often does not include such provisions as a detailed audit and accounting clause. If there is a dispute between the filmmaker and a distributor, a judge will not insert terms that the court thinks are fair. The contract is only those terms agreed upon by the parties.

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