



INTERNET DISTRIBUTION: The Promise and the Pitfalls

By Mark Litwak, Attorney at Law

Over the past year a flood of new companies have been launched intending to stream motion pictures over the Internet directly to consumers. Such companies as AtomFilms, Sightsound.com and Ifilm are trying to stake out their turf and become major players in what is expected to be a billion-dollar industry.

"The Internet is an incredible platform for filmmakers," says Robert Faust, founder of the L.A. Independent Film Festival and now president of MediaTrip.com, a startup company that distributes film, music and original programming over the Internet. "I think the Internet will break the bottleneck for artists . . . it allows for something we used to have in theatrical distribution, which is word-of-mouth. Today, [traditional distribution] is all about opening weekend. But the Internet allows an audience to find a film."

There is no doubt that the Internet has the potential to fundamentally change distribution patterns. In the rush and excitement to exploit this new medium, however, many filmmakers and distributors may not have fully considered the legal and economic consequences that arise from Internet distribution. Not wanting to be left out of a potential bonanza, film buyers often request that "Internet" rights be included when they license a film. Indeed, such powerhouse companies as CLT-UFA, a large pan-European buyer of films, demands Internet rights and will not license a film without them. "Internet rights have become a real deal breaker," laments one top sales agent.

"This is the hottest topic now," says Kathy Morgan, newly elected Chairman of AFMA, the trade association that represents independent distributors. "Everybody is asking questions about it. It occupies a great deal of our members' time in all our meetings. We have four different committees that are dealing with different facets of Internet distribution."

The grant of Internet rights raises a number of new and interesting issues that need to be carefully considered. First and foremost, a distribution agreement needs to define the term "Internet rights." Is the distributor merely trying to sell home video copies of motion pictures

via the Internet? If so, the right granted is in the nature of a home video right—the Internet is just being used to market cassettes or DVDs. If you grant such a right, some problems may arise. Will the grant to an Italian company permit it to sell video cassettes to a buyer who logs onto the Internet from France? If so, might this conflict with your grant of home video rights to a French distributor?

Another "Internet right," is the right to promote and advertise a motion picture over the Internet. Take the widely reported success of the Blair Witch producers in building an audience for their film with a web site, a tactic that no doubt will be widely emulated. The right to promote a film over the Internet is an expansion of the existing rights distributors acquire to advertise and promote a motion picture. Typically, these clauses are written in broad terms, granting the distributor the right to promote a film in any and all media. Such a grant should cover Internet promotion.

A third "Internet right" is the right to distribute a motion picture via streaming media. Here the distributor is not selling a cassette, the distributor is actually transmitting the motion picture over the Internet so that it can be viewed on a computer monitor. This has been called "Netcasting," and is akin to broadcasting except that the Internet is the means of transmission, instead of signals broadcast over the air. Today, most computers connected to the Internet cannot display motion pictures with a broadcast quality image. The picture is often restricted to a small portion of a computer screen and the action appears jerky. That is because most computers are connected to the Internet with relatively slow modems. However, growing numbers of computer users are upgrading their connections with DSL lines, cable modems and other technologies that promise greater bandwidth. Moreover, new technological advances are improving picture quality. In the next few years an increasing number of computer users will be able to watch movies on their computers with a viewing experience comparable to television. Thus, the Internet will enable film owners to distribute movies directly to the end user, bypassing the traditional intermediaries such as the broadcast networks, home video retailers and cable operators.

While the potential of Internet distribution is exciting, its economic viability is unproven at this time. Keep in mind that traditional distributors perform an important marketing function that an Internet distributor may not be able to fulfill. It's wonderful to be able to put your film up on the Internet, but how do you get consumers to visit your web site and view your film?

While Internet distribution is of questionable profitability, there is no doubt that the distribution of your film over the Internet can jeopardize agreements with traditional distributors. If HBO has paid you a large fee to premiere your film on its service, how do you think this cable channel will react upon discovering that you are simultaneously distributing your movie over the Internet? If a film is to be marketed over the Internet, when does it make most sense for the Internet window to occur? Should Internet distribution come before or after a home video release?

"I think Internet distribution will work around the current model," says Bruce David Eisen, Executive Vice President of CinemaNow.com, an Internet company owned principally by Trimark Pictures. "The natural progression for the future—the next five to ten years—will probably be a theatrical window followed by a home entertainment window which will be a

composite including PPV, home video, pay cable and free TV." Under such a system, the licensee would buy PPV rights and then be allowed to distribute via any media including cable television, Internet and satellite distribution. Eisen predicts that this one "home entertainment window," might be split into two parts: pay-per-view and free exhibition.

Because of the legal uncertainties involved in Internet distribution, and because Internet distribution can enable copyright infringers to pirate a film worldwide with a few clicks of a mouse, in my opinion it is prudent for filmmakers to hold onto their Internet rights until the dust settles. Eisen would disagree: "I urge filmmakers to grant Internet rights now, and not warehouse them. What it does is gets them in the game now, gets their film out there, gets their name out there. It gives them an understanding of the business that they can only have by participating in the business. In five or ten years when Internet distribution is making real money, they will not be coming into the business cold."

Those filmmakers who want to be trailblazers should consider the following issues in negotiating a license of Internet rights:

EXCLUSIVITY: Will the grant of rights be on an exclusive or nonexclusive basis? There are a number of different sites attempting to distribute films over the Internet. At this time it is not clear which companies will prosper and which ones will crash and burn. If you grant exclusive rights to a company that goes out of business, your Internet distribution rights will be an asset of the company and may be tied up in bankruptcy proceedings. It may take considerable effort and expense on your part to reacquire those rights. Consequently, it is a good idea to have the Internet distributor grant you a security interest so that you will have preference over unsecured creditors. Make sure to register the security interest to perfect your rights.

TERRITORY: Territory becomes an almost meaningless term when applied to Internet distribution. Anyone with a computer anywhere in the world can log onto the Internet and download data from computer servers wherever they are located. The expense of shipping a product internationally becomes irrelevant when the product is Netcast. Even if you attempt to limit an Internet distributor to selling products in one country, how can they or you monitor distribution outside their territory? A partial solution might be to limit the grant of Internet rights to distributing the film in a certain language (without subtitles), thereby making the film less likely to be downloaded in countries where that language is not spoken. While this might deter the unauthorized distribution of a German-language film in India, for instance, it would not deter German-speaking residents of Austria, Switzerland or Poland from enjoying the film. Of course, many of the most-popular films are in English, which is spoken in many lands. The wide dissemination of American and British films have built a worldwide audience for these movies.

Another solution may lie with blocking technology. "Every user has an IP address which indicates which country the computer user is coming from," explains Bruce David Eisen. "When CinemaNow gets a request from an address outside the U.S., we will not deliver the movie [outside the U.S.] if distribution is restricted."

Piracy is by no means the only concern. Distributing a film worldwide subjects one to the laws of many different nations. What if your film is downloaded by computer users in India and the

content of the film violates censorship laws there? Since there is no local distributor with the knowledge and incentive to comply with local regulations, are you exposing yourself to potential civil and criminal liability? As a practical matter, it may be difficult for a prosecutor in a foreign land to obtain jurisdiction over you. Nevertheless, if one day you visit such a country, you might find yourself the subject of legal proceedings.

Many producers erroneously assume that if an American producer makes an American film, American law will always determine ownership and rights to the film. This is not the case. Copyright laws are applied territorially. This means French law applies in France to both French authors and to the exploitation of American authors' work in France. And French law differs from American law in many respects.

Under French law, for example, an author is granted certain "moral rights" including the rights of integrity and paternity. These rights are perpetual, inheritable, and inalienable. Thus, the heirs of an artist could object to the use of an ancestor's work, even if that work's copyright has expired. In *Huston v. Turner Entertainment*, the late American director John Huston was determined by a French court to be the author of the American film *THE ASPHALT JUNGLE*. Under American law Huston's employer was considered to be the author.

INSURANCE: Some Errors and Omissions Insurance carriers claim that they now cover liability arising from Internet distribution. Review your policy carefully. Some policies exclude coverage unless this use is specifically mentioned in an endorsement to the policy.

ROYALTIES: No standard has been established as to how to divide revenue from Internet distribution. A popular model for Internet companies is to give information away for free, and generate revenue from the sale of advertising and ancillary services. If your movie is being given away for free, or for a nominal sum, and the Internet distributor retains revenue from advertising, then you are not receiving much if anything for your film. Even if you are entitled to share in ad revenue, how is your share determined? Do you share equally with less worthy films? If you grant Internet rights to a traditional film distributor, and that distributor has in turn licensed your movie to an Internet distributor, do you share in the revenue received by the Internet distributor, or do you only share in whatever revenues are remitted to the traditional film distributor?

The deals that have been concluded to date are all over the spectrum. The Broadcast.com deal to license 50 Trimark titles was part of a broader pact in which Broadcast.com acquired a \$4 million dollar stake in Trimark. Sightsound.com acquired a limited 30-day pay-per-view Internet window to

Artisan Entertainment's movie *PI* in a straight licensing deal. MovieFlix.com offers about 150 features acquired from indie distributors. The company pays a one-time license fee. The site is advertiser supported and sells movie memorabilia. Apparently, ancillary revenue is treated as the cyberspace equivalent of the theater concession stand with all revenues reserved to MovieFlix.com. CinenmaNow doesn't pay a one-time license fee but shares advertising and sponsorship revenue with filmmakers.

RESIDUALS: If a producer licenses a film for distribution over the Internet, is he liable for

residual use payments to the guilds and unions? Should Internet distribution be considered just another kind of pay television which falls within the scope of the current guild agreements? Or should Internet distribution be considered a distinctly different media, and consequently the guilds receive nothing until and unless they successfully negotiate for a piece of action?

MUSIC RIGHTS: Many films have licensed music for inclusion on their soundtracks. The contracts may not have granted the filmmaker the right to distribute the music over the Internet. Internet transmission is considered a public performance, and thus ASCAP, BMI and other performing rights societies may be due fees for Internet distribution of music.

GRANT OF RIGHTS: Do you have the authority to grant Internet rights? If your movie was acquired from a producer, did the producer obtain such rights from underlying property owners such as the screenplay writer? Note that many contracts don't explicitly grant "Internet" rights because when the contracts were drafted no one was thinking in terms of the Internet as a distribution media. Arguably "video-on-demand" rights would encompass distribution over the Internet.

Whether a producer has the right to exploit a movie over the Internet will often turn on the language in the contracts that the producer used to acquire rights to works incorporated in the film. The case law in this area is confusing and somewhat contradictory. In one line of cases, the courts assume that a licensee may use a property in any manner that appears to fall within the scope of the contract granting those rights. In these decisions, the courts assume that a grant of rights covers new uses or new media if the words conveying the grant are susceptible to that interpretation, even if such new uses are not specified. Thus, an assignment of motion picture rights to a play has been held to include the right to broadcast the film on television, even though television did not exist at the time the contract was made. In another line of cases, the courts assume that a grant of rights only extends to those uses that are clearly within the scope of the rights conveyed.

In *Cohen v. Paramount Pictures Corp.*, a composer granted to a production company the right to use his music in the film *MEDIUM COOL*. The grant included the right to use the composition by means of television, including exhibition by pay television and subscription television. The contract reserved to the composer all other rights. When Paramount began to distribute the film in the form of video cassettes, the composer sued on the grounds that his prior grant of rights did not include exhibition by home video. The Ninth Circuit Court of Appeals agreed.

If, after reviewing the complex issues involved in Internet distribution, you remain inclined to license Internet rights, consider the following: many companies requesting Internet rights have yet to distribute anything over the Internet and they may be completely unable to exploit these rights in the near future. Such companies may be warehousing your rights in the hope that they will become valuable some day. That day may not be soon. It bears noting that Artisan Entertainment's Netcast of *PI* attracted an on-line audience of only 100.

If you must grant Internet rights, try to obtain a reversion clause so that these rights will return to you if they are not exploited in a timely manner. You could provide, for example, an initial grant of Internet rights for a year, and if the distributor returns to you \$5,000 of Internet

revenue, the term would be automatically extended.

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