

## Business Valuations: Stallone Fights Studio's Accounting Methods

**Accounting issues take center stage** in a recent dispute involving Sylvester Stallone's production company, Rogue Marble, and Warner Bros. Entertainment.

The lawsuit charges Warner Bros. with breach of contract, unfair business practices and accounting fraud in connection with the revenues from the 1993 movie *Demolition Man*. Stallone seeks "full accounting" of revenues from the film, plus interest and damages. The suit doesn't yet specify damages, because Rogue Marble isn't "presently aware of the exact amounts of damages resulting" from the studio's alleged wrongdoing.

However, the Oscar-nominated actor, writer and director — who's famous for his roles as Rocky Balboa and John Rambo — has a bigger fight in mind: His lawsuit alleges that "motion picture studios are notoriously greedy." And he wants them to account in a timely and open manner for amounts owed to actors, writers and filmmakers that are contingent on a film's performance.



Here are the details of this high-profile case, along with an explanation of how its lessons about contingent consideration extend beyond Hollywood.

### Case Facts

In 1992, Warner Bros. entered into an artist loan-out agreement with Rogue Marble for the services of Sylvester Stallone in *Demolition Man*, a sci-fi action film that also starred Wesley Snipes and Sandra Bullock. The loan-out agreement granted Rogue Marble certain percentages of the film's total defined gross after the amount exceed certain levels. Specifically, the contract granted:

- 15% of the gross when it exceeded \$125 million,
- 17.5% when it exceeded \$200 million, and
- 20% when it exceeded \$250 million.

The court filing doesn't specify damages. But the plaintiff alleges that *Demolition Man* achieved at least \$125 million in defined gross from box office, video, DVD and blue ray sales. So, the lawsuit claims that Rogue Marble should have received at least \$18.75 million (15% of \$125 million).

For several years, Warner Bros. allegedly refused to account to Rogue Marble on the film's performance. When Rogue Marble requested an accounting, the studio finally sent a letter in January 2015, claiming that the film had a deficit of roughly \$67 million as of September 30, 2014.

Rogue Marble challenged this accounting. In April 2015, Warner Bros. subsequently paid roughly \$2.8 million to Rogue Marble based on an actual profit participation statement for the period ending September 30, 2014.

That statement was only one page and didn't contain any details for the figures presented. Warner Bros. continues to benefit from retail sales of the film today, Rogue Marble alleges, and states that "it is owed additional contingent compensation on the film."

## To Be Continued

Warner Bros. hasn't yet responded to Rogue Marble's summons. But the allegations highlight important implications for anyone who enters into an agreement to receive (or make) contingent payments based on the performance of another entity.

For example, sellers of a business interest might agree to earn out payments based on the buyer's ability to meet certain performance benchmarks. Or the owner of intellectual property might agree to royalty payments contingent on sales based on the use of the intellectual property rights.

When agreeing to any form of contingent consideration, it's important to:

1. Clearly define accounting terms (for example, "margin," "profits" or "value" may have many different meanings).
2. Provide a timeline for reporting financial results (for instance, calling for quarterly or year-end results to be provided no later than three months after the end of the accounting period).
3. Require the results to be audited or reviewed by an independent, outside accounting firm.

If Rogue Marble takes its fight to court, the parties will likely hire financial experts to interpret the terms "defined gross" and "profit participation statement," to audit or review Warner Bros. accounting records, and to estimate damages based on the records that Warner Bros. provides during discovery.

But the dispute might have been avoided entirely if the parties had a more solid agreement in place — and the studio had been more forthcoming in accounting for the film's performance.

Whether in the course of drafting an agreement or in the estimation of damages related to unintended consequences, contingent consideration provisions can have a material impact on valuation. Gryphon Valuation Consultants has specific experience in analyzing the value ramifications of such conditions precedent.

*(Rogue Marble Production, Inc. v. Warner Bros. Entertainment, Inc. and Does 1-20, Case No. BC-657271, Sup. Ct. Ca.).*

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