Appendix B

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

ART BUCHWALD, et al., Plaintiff, v. PARAMOUNT PICTURES CORPORATION, etc., et al., Defendants.		No. C 706083 TENTATIVE DECISION (SECOND PHASE)

I. PRELIMINARY STATEMENT

In the first phase of this case, this Court ruled that Paramount's film *Coming to America* was "based upon" the screen treatment written by plaintiff Art Buchwald. In the second phase of the case, the Court has been presented with numerous issues, including whether: (i) The contract between plaintiff Bernheim and Paramount is a contract of adhesion; (ii) the contract, or any provision thereof, is unconscionable; (iii)

the relationship between Bernheim and Paramount was that of co-venturers; (iv) Paramount owed a fiduciary duty to Bernheim; and (v) conduct on the part of Paramount breached the implied covenant of good faith and fair dealing. The Court has also been presented with the task of interpreting other contract provisions, including the so-called "consultation" clause; the "turnaround" provision; and paragraph D.2.b. of the Bernheim Deal Memo.

II. THE CONTRACT

In order to understand the issues presented to the Court in this phase of the proceeding, it is important to identify the components of the contract that present those issues. These components are:

1. The February 24, 1983, Deal Memo (consisting of six pages) entered into between Alma Productions, Inc. (Alain Bernheim's loan-out company)[1] and Paramount;
2. The so-called "turnaround" agreement (consisting of three pages);
3. Additional Terms and Conditions (consisting of six pages); and
4. Paramount's standard net profit participation agreement (consisting of 23 pages), with two attachments relating to royalties.

III. DISCUSSION

A. *Contract of Adhesion*

A "contract of adhesion" "'signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.' (Citation omitted.)" *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 817 (1981). As the Court in *Graham* stated:

> "Such contracts are, of course, a familiar part of the modern legal landscape, in which the classical model of 'free' contracting by parties of equal or near-equal bargaining strength is often found to be unresponsive to the realities brought about by increasing concentrations of economic and other power. They are also an inevitable fact of life for all citizens—businessman and consumer alike. While not lacking in social advantages, they bear within them the clear danger of oppression and overreaching. It is in the context of this tension—between social advantage in the light of modern conditions on the one hand, and the danger of oppression on the other—that courts and legislatures have sometimes acted to prevent perceived abuses." (*Id.* at 817–818)

In the present case, the Court finds that Bernheim's compensation package, as set forth in the Deal Memo, was negotiated by Bernheim's agent and Paramount's representative, as were other provisions of the Deal Memo not relevant to this case. The Court finds, however, that the "boilerplate" language of the Deal Memo was not negotiated.

The Court further finds that the "turnaround" provision, the Additional Terms and Conditions, and the net profit participation agreement were not negotiated. With respect to the latter three parts of the Bernheim-Paramount contract, there is not the slightest doubt that they were presented to Bernheim on a "take it or leave it" basis. Indeed, the evidence reveals that Bernheim did not have the "clout" to make a better deal.

It is true Paramount has submitted evidence that it freely negotiates its net profit formula with the talent with which it deals. The Court is not impressed with Paramount's evidence. To the contrary, the Court concludes plaintiffs have proved by a

[1] In this Tentative Decision, for ease of reference, Bernheim will be referred to as the contracting party.

preponderance of the evidence that Paramount negotiates its net profit formula with only a relatively small number of persons who possess the necessary "clout," and even these negotiations result in changes that are cosmetic, rather than substantive. Indeed, if, as Paramount contends, it freely negotiates with respect to its net profit formula, the Court presumes it would have been inundated with examples of contracts where this was done. Succinctly stated, this has not occurred.

The evidence also discloses that the entire contract was drafted by Paramount and that the "turnaround" and net profit participation provisions were standard, form provisions. Indeed, there is evidence in the record that Paramount's net profit formula is standard in the film industry. Further, there is evidence in the record to support the conclusion that essentially the same negotiations are conducted at all studios and that when one studio revises a provision of its net profit formula, that revision is adopted by the other studios.

The above factors lead to the inescapable conclusion that the Bernheim-Paramount contract is a contract of adhesion. The fact that a portion of the contract was negotiated, i.e., Bernheim's compensation package in the Deal Memo, does not require a different conclusion. In *Graham, supra*, the Court held that the contract before it was a contract of adhesion, even though some of the terms were negotiated between the parties. (28 Cal.3d at 807)

B. *Unconscionability*

In *Graham, supra*, the Court stated:

> "To describe a contract as adhesive in character is not to indicate its legal effect. It is, rather, 'the beginning and not the end of the analysis in so far as enforceability of its terms is concerned.' (Citation omitted.) Thus, a contract of adhesion is fully enforceable according to its terms (citations omitted) unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise.
>
> "Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. (Citation omitted.) The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if consistent with the reasonable expectation of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' (Citations omitted.)" (28 Cal. 3d 807 at 819–820)

1. *Unconscionability—Sword or Shield*

Before addressing the issue of whether the Bernheim-Paramount contract, or any provision thereof, is unconscionable, it is necessary to discuss several contentions advanced by Paramount. First, relying primarily on *Dean Witter Reynolds, Inc. v. Superior Court*, 211 Cal. App. 3d 758 (1989), Paramount argues that plaintiffs are impermissibly using the doctrine of unconscionability as a "sword." Paramount claims that Civil Code section 1670.5,[2] as interpreted by *Dean Witter*, permits the doctrine to be utilized only as a "shield," i.e., by a defendant who has been sued. The Court does not agree.

In *Dean Witter* the plaintiff brought a class action attacking certain fees charged by

[2] Civil Code section 1670.5 provides in pertinent part as follows: "(a) If the Court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the Court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result."

Dean Witter. Three of plaintiff's causes of action were the subject of defendant's petition for writ of mandate: The first cause of action for unfair competition; the third cause of action for unconscionability under Civil Code section 1670.5; and the fourth cause of action for unconscionability under the Consumer's Legal Remedy Act (CLRA). (*Id.* at 763)

In *Dean Witter* the Court of Appeal held, *inter alia*, that no affirmative cause of action for unconscionability was created by Civil Code section 1670.5. In reaching this conclusion the Court found that section 1670.5 merely codified the defense of unconscionability and did not support an affirmative cause of action based on that doctrine.

In the present case, plaintiffs have not violated the holding in *Dean Witter* by bringing an affirmative cause of action based on the doctrine of unconscionability. Rather, plaintiffs have raised the doctrine of unconscionability in response to Paramount's reliance on the contract between the parties as written. Several California appellate decisions support the use of the unconscionability doctrine in the manner in which plaintiffs seek to use that doctrine in this case.

In *Graham v. Scissor-Tail, Inc., supra*, plaintiff sued for breach of contract, declaratory relief and rescission. Defendant attempted to invoke the arbitration provision contained in the contract. Plaintiff claimed, however, that this provision was unconscionable. The Court not only permitted the plaintiff to assert the unconscionability doctrine, but found the arbitration provision unconscionable and struck it.

In *A & M Produce Co. v. FMC Corporation*, 135 Cal. App. 3d 473 (1982), the buyer of a tomato processing machine sued the seller for breach of express warranties, breach of implied warranty of fitness for a particular use and misrepresentation (although this last cause of action was dismissed by plaintiff at trial). The contract sued upon contained both a disclaimer of warranties and a limitation on the buyer's ability to recover consequential damages. Plaintiff attacked both of these provisions as unconscionable, after the defendant relied on the contract between the parties as written. Both the trial and appellate courts agreed and struck the unconscionable provisions.

In *Perdue v. Crocker National Bank*, 38 Cal. 3d 913 (1985), plaintiff claimed that his bank's "non-sufficient funds" charges were unconscionably high. He alleged five causes of action: (i) declaratory relief (that the signature card was not a contract authorizing non-sufficient funds charges); (ii) declaratory relief (that the non-sufficient funds charges were unconscionable); (iii) damages for unjust enrichment; (iv) to enjoin unfair and deceptive practices; and (v) to recover the difference between the non-sufficient funds charges and the bank's actual expenses (incurred in processing an NSF check).

Although the trial court sustained the bank's demurrer to all causes of action, the Supreme Court reversed on the second and third causes of action and reversed with leave to amend on the first and fourth causes of action. By validating plaintiff's second and third causes of action, the Supreme Court effectively held that an affirmative cause of action for unconscionability exists if it is brought as an action for declaratory relief and that unconscionable fees may be recovered under the rubric of unjust enrichment.

A careful review of *Dean Witter, Graham, A & M* and *Perdue* reveals no inconsistency. To the contrary, the following conclusions can be gleaned from these cases:

1. A cause of action for damages based on the doctrine of unconscionability (in the absence of a CLRA-type statute) is impermissible. *Dean Witter Reynolds, supra.*

2. A plaintiff may commence an action, even one for damages, based on the implicit assumption that the unconscionable provision does not exist. *A & M Produce, supra* (cause of action for breach of warranty; *Graham, supra* (suing in civil court, rather than arbitrating); *Perdue, supra* (suing for unjust enrichment).

3. In the kind of cases described in paragraph 2, when the defendant relies on the contract as written, e.g., *A & M Produce, supra* (disclaimer of warranty); *Graham, supra* (arbitration clause); *Perdue, supra* (bank rules allowing non-sufficient fund fees), then

plaintiff can counter with the claim the provisions are unconscionable. It also appears that a plaintiff may bring a cause of action for declaratory relief to have a contract provision declared unconscionable, without violating the principles enunciated in the cases referred to above. (*Perdue, supra*)[5]

To summarize, in the present case plaintiffs have not attempted to allege a cause of action based on the doctrine of unconscionability. To the contrary, plaintiffs have alleged three causes of action for breach of contract in which they seek damages. Paramount, by contrast, seeks to defend against plaintiffs' contract damage claims by invoking the provisions of the agreement between the parties as written. Plaintiffs, as is permitted by the cases referred to above, have countered by claiming certain contractual provisions are unconscionable. The Court finds that plaintiffs' use of the doctrine of unconscionability comports with the decisions in *Graham, supra; A & M Produce Co., supra,* and *Perdue, supra.*

2. *Unconscionability—Surprise*

Paramount also argues that the provision of the net profit formula cannot be found to be unconscionable because similar provisions have existed in the film industry for years and that all of the provisions were well known to Bernheim. In other words, Paramount argues the contract provisions, particularly the provisions of the net profit formula, cannot be unconscionable because Bernheim was in no way surprised by them.

It is no doubt true that the prevention of surprise is one of the two principal purposes of the doctrine of unconscionability. *A & M Produce Co., supra,* at 484. " 'Surprise' involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms." *A & M Produce Co., supra,* at 486. It is equally true that, except perhaps for the amount of gross participation shares given to Murphy and Landis, Bernheim was not surprised by the provisions of the contract in question in this case, i.e., the contract provisions were not contrary to Bernheim's reasonable expectations.

The absence of surprise, however, does not render the doctrine of unconscionability inapplicable. Indeed, in *Graham, supra,* the trial court specifically found that the plaintiff was not surprised by the contract provision that was being attacked as unconscionable. (28 Cal. 3d at 821) Nevertheless, the trial court found the provision unconscionable and the California Supreme Court affirmed.

3. *Unconscionability—Oppression*

The other principal target of the unconscionability doctrine is oppression. *A & M Produce Co., supra,* at 484. " 'Oppression' arises from an inequality of bargaining power which results in no real negotiation and 'an absence of meaningful choice.' " *A & M Produce Co., supra,* at 486. This has been referred to as the procedural aspect of unconscionability. (*Id.,* at 486)

Unconscionability also has a substantive aspect. In *A & M Produce Co., supra,* the Court stated:

> "Commercial practicalities dictate that unbargained-for terms only be denied enforcement where they are also *substantively* unreasonable. (Citations omitted.) No precise definition of substantive unconscionability can be proffered. Cases have talked in terms of 'overly harsh' or 'one-sided' results. (Citations omitted.) One commentator has pointed out, however, that '. . . unconscionability turns

[5] The Court's analysis also appears to be consistent with the decision in *Cowin Equipment Co., Inc. v. General Motors Corporation,* 734 F.2d 1581 (11th Cir. 1984), another case relied upon by Paramount. In *Cowin* the Court held that unconscionability can be used to counter an affirmative defense but cannot be used as a "sword of restitution." (*Id.* at 1583)

not only on a "one-sided" result, but also on an absence of "justification" for it' (citation omitted), which is only to say substantive unconscionability must be evaluated as of the time the contract was made. (Citation omitted.) The most detailed and specific commentaries observed that a contract is largely an allocation of risks between the parties, and therefore that a contractual term is substantively suspect if it reallocates the risks of the bargain in an objectively unreasonable or unexpected manner. (Citations omitted.) But not all unreasonable risk allocations are unconscionable; rather, enforceability of the clause is tied to the procedural aspects of unconscionability (citation omitted) such that the greater the unfair surprise or inequality of bargaining power, the less unreasonable the risk allocation which will be tolerated." (Citation omitted.) (*Id.* at 487)

4. *Unconscionability—All or Any Provision of the Contract*

There is no question that the law relating to the doctrine of unconscionability permits a court to strike down an entire contract or any provision thereof. Indeed, Civil Code section 1670.5, quoted in footnote 2 hereof, so provides. See also *Perdue, supra*, at 925–926.

Paramount, while apparently recognizing the above quoted law, argues that it would be impermissible to apply the unconscionability doctrine to this case. As the Court understands it, Paramount's argument has two prongs. First, Paramount argues that a court may strike an unconscionable clause of a contract only where that clause is "divisible." (Memorandum of Points and Authorities of Defendant Paramount Pictures Corporation Re Phase II Hearing on Legal and Contract Interpretation Issues, filed July 24, 1990, at p. 15) (hereinafter referred to as "7/24/90 Memo.") Paramount contends that in the present case, plaintiffs are impermissibly attacking "financially interrelated provisions" and demanding "an individual defense of each." (*Id.*) Second, relying on a number of so-called "price" cases, Paramount argues that "profitability is not relevant to unconscionability." (Letter from Paramount's counsel dated October 10, 1990, attached to Notice of Filing Prior Correspondence to Court, filed November 9, 1990)

Addressing the last argument first, it is apparent that the events that occurred at the November 8, 1990, hearing in this case have rendered Paramount's second argument moot. A little discussion of the history of this case is required in order to validate this conclusion.

In many documents filed with the Court prior to November 8, 1990, Paramount argued that its net profit formula was justified, and indeed required, in order to permit it to remain in business. For example, in the Response of Defendant Paramount Pictures Corporation to Plaintiffs' Preliminary Statement of Contentions, filed May 21, 1990 (hereinafter referred to as "5/21/90 Memo"), Paramount argued:

> "In agreeing to underwrite what it could thus anticipate to be a $66.5 million investment, Paramount alone bore the risk that the Picture (sic) would not be produced or, if produced, would not commercially succeed and that its investment would be lost. In contrast, Bernheim and Buchwald risked nothing. Not surprisingly, Paramount obtained from Buchwald and Bernheim, as it does in varying degrees of all net participants, the right to attain gross receipts in excess of its direct out-of-pocket costs before it began sharing those receipts with participants. This simply reflects an attempt by the studio to balance the enormous economic risks attendant to motion picture production by insuring that the studio will reap a fair portion of the rewards resulting from a commercial success. As a means for compensating for an allocation of risks in the motion picture industry that places all the uncertainties on the studio, Paramount's contracts with Bernheim and Buchwald are not unconscionable. . . ." (at 12)

Similarly, in its 7/24/90 Memo Paramount stated:

"As forty years of studio-talent bargaining has established, a studio is entitled to a return commensurate with the risks of movie-making. *Otherwise, it could not remain a viable business.* (Citations omitted.) There is nothing unfair or unreasonable about how the 'Net Profits' formula strikes this balance. . . .

"The level of return allowed to Paramount under its 'Net Profits' formula is more than offset by the risks that the studio alone takes. As plaintiffs' experts readily conceded, 'Net Profits' participants bear no risk; if a film flops, participants have no obligation to take up the shortfall and their up-front fee is guaranteed. (Citations omitted.)

"In contrast, the studio's risks are enormous. When it signed the Buchwald and Bernheim contracts, Paramount assumed the risk that, despite substantial script development costs (nearly $500,000), the picture might never be made and that, even if made, the picture would not make money. Paramount spent $40 million to produce 'Coming to America' and committed another $35 million to an advertising and a promotional campaign with no assurance that a single theater admission would be sold. (Citation omitted.)

"The risk of failure in the motion picture business is ever-present, immense, and unmitigable. . . ." (Emphasis added.) (at 19–21)

The Court interpreted the above quoted statements of Paramount, and many others like them, to mean that Paramount was attempting to justify its net profit formula on the ground that this formula was necessary for Paramount's survival. Indeed, when Paramount's counsel stated, "[o]therwise it could not remain a viable business" (7/24/90 Memo at 19), the Court understood Paramount to mean what its counsel had stated.

It was because Paramount argued that its net profit definition was justified by the exigencies of the film industry that the Court decided to appoint its own accounting expert, pursuant to Evidence Code section 730. Indeed, the November 8, 1990, hearing was scheduled for the specific purpose of defining the tasks to be performed by the Court's expert. This would have included, of course, an examination of Paramount's books and records to determine the accuracy of Paramount's representation with respect to its profitability, the number of films that make and lose money, and whether it was necessary for successful films to subsidize unsuccessful films.[4] Remarkably, it was at this same hearing that counsel for Paramount abandoned the argument that Paramount's net profit formula was required by the nature of the motion picture business.

Paramount's abandonment of its "justification" argument rendered inquiry into Paramount's profitability moot and the appointment of the Court's expert unnecessary. This abandonment also renders inapplicable the so-called "price" cases relied upon by Paramount. These "price" cases were submitted to the Court, according to Paramount, to establish the point that "profitability" is not relevant to unconscionability." (October 10, 1990, letter, *supra*, at p. 1) Since Paramount no longer seeks to

[4] So long as Paramount maintained its net profit formula was justified by the nature of the motion picture industry, the Court felt an inquiry into Paramount's profitability was necessary and proper. In effect, Paramount was arguing that the net profit formula was justified in order to properly allocate the risks between Paramount and Bernheim, Paramount's position being that it bore substantially all of the risks. The Court reasoned that if Paramount's representations as to its profitability were untrue, i.e., if it really ran no meaningful risk because of the profit structure of its business, then its argument that the net profit formula was justified would fall by its own force. The Court concluded it was required to engage in an allocation of risk analysis because, as noted in *A & M Produce Co., supra,* "[a] contract is largely an allocation of risks between the parties, and therefore . . . a contractual term is substantively suspect if it reallocates the risks of the bargain in an objectively unreasonable or unexpected manner." (135 Cal. App. 3d at 487)

defend its net profit formula on the ground it is justified by the nature of its business, it is clear Paramount's profitability is irrelevant to the determination of whether the contract involved in this case is unconscionable.

As indicated above, Paramount also argues that the Court may not strike down all or any portion of the net profit definition because that definition is part of the entire compensation package between Paramount and Bernheim. Paramount further argues that it would not have paid Bernheim as much "up-front" money if it had known many of the components of the net profit formula would be invalidated, and that Bernheim will reap a windfall if the Court finds unconscionable portions of the net profit formula.

Paramount's argument is based on the proposition that the dispute between the parties is one over price. The Court is not convinced that this is the case. However, even if Paramount is correct, it is "clear that the price term, like any other term in a contract, may be unconscionable." *Perdue, supra,* at 926. In fact, in *Perdue* the Court stated:

> "The courts look to the basis and justification for the price (citation omitted), including 'the price actually being paid by . . . other similarly situated consumers in a similar transaction.' (Citation omitted.) The cases, however, do not support defendant's contention that a price equal to the market price cannot be held unconscionable. While it is unlikely that a court would find a price set by a freely competitive market to be unconscionable (citation omitted), the market price set by an oligopoly should not be immune from scrutiny. Thus courts consider not only the market price, but also the cost of the goods or services to the seller (citations omitted), the inconvenience imposed on the seller (citation omitted), and the true value of the product or service (citation omitted)." (38 Cal. 3d at 926–927)

In the present case, the Court has already found the Bernheim-Paramount contract to be adhesive. Moreover, it is clear, as the Court has already found, that contractual relations between certain talent and studios, at least talent such as Bernheim who lack the "clout" of major stars, do not take place in a freely competitive market. Rather, it is clear that if a talent such as Bernheim wishes to work in the film industry, he must do so on terms substantially dictated by the studio. This is particularly true with respect to the net profit formula contained in the contract involved in this case. As previously indicated, Paramount simply does not negotiate with respect to its net profit formula with talent such as Bernheim.

Additionally, Paramount's argument that it would be unfair if the Court found any part of the net profit formula unconscionable is based on the faulty premise that the only thing that mattered to Bernheim was the "up-front" money. While it is true Bernheim's agent, Roger Davis, testified that "up-front" money was important to Bernheim, he also testified that the other important consideration was "to get the project developed into a form where it could be made the basis of a motion picture." (Davis depo at 54) Presumably, Bernheim wanted to make a picture so that he could profit from it. (See Davis depo at 33; see also Youngstein depo at 121–122)

Moreover, Paramount's argument that net profits represented a relatively insignificant part of Bernheim's total compensation package flies in the face of other evidence in the record. For example, in his Supplemental Declaration, Carmen Desiderio, Paramount's Vice-President of Contract Accounting, testified that Paramount had paid more than $150 million in net profits over the past 15 years, using the net profit formula contained in Bernheim's contract, or one similar to it. Additionally, Paramount itself admitted in its 7/24/90 Memo, at 25, that " 'Net Profits' are a valuable form of contingent compensation, not the 'cruel hoax' that plaintiffs insinuate." Indeed, *Paramount*'s "turnaround" provision provides for *Paramount* to receive net prof-

its in the event Bernheim was successful in convincing another studio to make a film based on Buchwald's treatment. (Bernheim Deal Memo, at p. 2)

Further, the doctrine of unconscionability would be rendered nugatory if a contracting party could escape its application by negotiating some monetary provisions, while at the same time imposing unjustifiably onerous provisions with respect to other contract provisions. Yet, that is precisely what Paramount argues is permissible.

Paramount has referred the Court to four cases[5] which, it is contended, supports Paramount's position that the Court may not strike down certain provisions of its net profit formula while enforcing the remainder of the contract with Bernheim. Paramount's argument is totally refuted by the provisions of Civil Code section 1670.5, which specifically permits the Court to "enforce the remainder of the contract without the unconscionable clause" or to "limit the application of any unconscionable clause so as to avoid any unconscionable result." Moreover, none of the four cases relied upon supports Paramount's argument, and at least one refutes it.

In *York*, *Sykes* and *Chow* the respective courts did not address the question of whether a provision of a contract may be struck as unconscionable, while the balance of the contract is enforced. Indeed, if either of the two out-of-state cases had answered that question in the negative, the result would have been contrary to the express provisions of Civil Code section 1670.5.[6]

Furthermore, the other California case cited by Paramount, *IMO Development*, at least by implication refutes Paramount's argument. In *IMO Development*, the Court specifically held that a contract cannot be partially rescinded, i.e., a party cannot seek to rescind part of a contract and seek enforcement of the remainder. The Court in *IMO Development* never addressed the doctrine of unconscionability because it had never been pled. The language utilized by the Court strongly suggests, however, that if unconscionability had been pled, the result under that doctrine might well have been different than the decision reached on the issue of partial rescission. The Court in *IMO Development* stated:

> "What *IMO* does allege is that its *consent* was obtained by economic duress. Business or economic duress '. . . exists when threats to business or property interests by way of coercion and/or wrongful compulsion are present.' (Citation omitted.) *That, however, is not tantamount to a showing of unconscionability. In other words, the presence of a supposed unconscionable contract provision, such as would admit to differential enforcement, does not logically provide for differential rescission.*" (Emphasis in original.) (*Id.* at 460)

In sum, the Court concludes that there is nothing about the contract involved in this case, or the circumstances surrounding its execution, which precludes the Court from addressing the issue of whether certain component parts of the net profit definition are unconscionable. The next issue that must be addressed is the appropriate manner of applying the doctrine of unconscionability to the contract involved in this case.

5. *Unconscionability—The Doctrine Applied*

Plaintiffs have challenged as unconscionable a number of provisions of Paramount's net profit formula. The challenged provisions include: 15 percent overhead on Murphy and Landis participation; 15 percent overhead on Eddie Murphy Productions operational allowance; 10 percent advertising overhead; 15 percent overhead; interest on

[5] These cases are *York v. Georgia-Pacific Corp.*, 585 F. Supp. 1265 (N.D. Miss. 1984); *Sykes v. Perry*, 162 Kan. 365 (1947); *IMO Development Corp. v. Dow Corning Corp.*, 135 Cal. App. 3d 451 (1982); and *Chow v. Levi Strauss*, 49 Cal. App. 3d 315 (1975).

[6] *Chow, supra*, was decided before Civil Code section 1670.5 was enacted. It is obvious, therefore, that the Court in that case could not have considered the applicability of that section.

negative cost balance without credit for distribution fees; interest on overhead; interest on profit participation payments; the interest rate not being in proportion to actual cost of funds; exclusion of 80 percent of video cassette receipts from gross receipts; distribution fee on video royalties; charging as distribution costs residuals on 20 percent video royalties; charges for services and facilities in excess of actual costs; no credit to production cost for reusable items retained or sold; charging taxes offset by income tax credit; charging interest in addition to distribution fees; 15 percent overhead in addition to distribution fees; and 10 percent advertising overhead in addition to distribution fees.

Paramount has never argued that any of these provisions are individually fair and reasonable. Rather, as has been indicated, Paramount has argued that the Bernheim-Paramount contract must be considered as a whole, that that contract is fair and reasonable and, therefore, the Court is not permitted to focus on individual provisions of the net profit formula to determine if such provisions are unconscionable. As discussed above, the Court rejects the argument that it is impermissible for it to focus on individual provisions of the net profit formula.

Plaintiffs, by contrast, have presented evidence which they argue supports their position that each of the challenged provisions are unconscionable. The Court is not persuaded that plaintiffs have sustained their burden of proof with respect to *each* challenged item. In fact, with respect to a number of challenged items it appears plaintiffs would like the Court to make a finding of unconscionability based upon the mere description of the item and without supporting evidence. This the Court is not prepared to do. However, with respect to a number of provisions plaintiffs have sustained their burden of proving such provisions are "overly harsh" and "one-sided." *A & M Produce Co., supra*, at 487. Indeed, in light of Paramount's "all or nothing" approach to unconscionability, plaintiffs' evidence stands unrefuted.

The Court finds the following provisions of Paramount's net profit formula unconscionable for the reasons indicated:

1. *Fifteen Percent Overhead on Eddie Murphy Productions Operational Allowance.* The Court finds this provision unconscionable because an additional 15 percent charge is made for overhead "on top of" this item. In effect, this results in charging overhead on overhead. The Court is able to perceive no justification for this obviously one-sided double charge and Paramount has offered none.

2. *Ten Percent Advertising Overhead Not in Proportion to Actual Costs.* This flat overhead charge, which has no relation to actual costs, adds significantly to the amount that must be recouped by Paramount before the picture will realize net profits. Again, the Court is able to discern no justification for this flat charge and Paramount has offered none.

3. *Fifteen Percent Overhead Not in Proportion to Actual Costs.* Paramount's charge of a flat 15 percent for overhead yields huge profits, even though the overhead charges do not even remotely correspond to the actual costs incurred by Paramount. In this connection it should be observed that although Paramount originally contended that this charge was justified because "winners must pay for losers" (Sapsowitz Deposition at 65), this justification was abandoned by Paramount during the November 8, 1990 hearing held in this case.

4. *Charging Interest on Negative Cost Balance Without Credit for Distribution Fees.* Paramount accounts for income on a cash basis, while simultaneously accounting for cost on an accrual basis. This slows down the recoupment of negative costs and inflates the amount of interest charged. The Court finds this practice to be "one-sided" in the absence of a justification for the practice.

5. *Charging Interest on Overhead.* Paramount receives revenues in the form of distribution fees and overhead charges, neither of which are taken into account in determining whether costs have been recouped. This results in "interest" becoming an addi-

tional source of unjustified profit. The Court finds this practice to be "overly harsh" and "one-sided," and thus unconscionable.

6. *Charging Interest on Profit Participation Payments.* Paramount charges the payments made to gross participants to negative costs. In fact, these payments are not paid until the film has derived receipts. Accordingly, Paramount has not in any real sense advanced this money. Nevertheless, Paramount charges interest on gross participation shares. This is unconscionable.

7. *Charging an Interest Rate Not in Proportion to the Actual Cost of Funds.* Paramount charges an interest rate which can be as much as 20 to 30 percent (Zimbert Deposition at 172), even when no funds have been laid out by Paramount. This is a one-sided, and thus unconscionable, provision.

In sum, the Court concludes that the foregoing provisions of Paramount's net profit formula are unconscionable. The conclusion that these provisions are unconscionable is by no means the end of the analytic trail. While this conclusion does actuate the Court's powers under Civil Code section 1670.5, it remains to be decided how those powers should be invoked.

As noted in *A & M Produce Co., supra,* "unconscionability is a flexible doctrine designed to allow courts to directly consider numerous factors which may adulterate the contractual process." (135 Cal. App. 3d at 484) Similarly, in *Frostifresh Corporation v. Reynoso,* 274 N.Y.S. 2d 757, 759 (1966) the Court stated that paragraph 2–302 of the Uniform Commercial Code, upon which Civil Code section 1670.5 is based, gives "the courts power 'to police explicitly against the contracts or clauses which they find to be unconscionable.' "

This Court interprets the cases dealing with the doctrine of unconscionability as authorizing the Court to use its powers under Civil Code section 1670.5 to produce an equitable result. Indeed, "equitable" would appear to be the antithesis of "unconscionable." In *Graham v. Scissor-Tail, Inc., supra,* the Court specifically recognized that the doctrine of unconscionability involves "a principle of equity applicable to all contracts generally— . . . that a contract or provision, even if consistent with the reasonable expectation of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' " 28 Cal. 3d at 820. See also *Slaughter v. Jefferson Federal Savings and Loan Association,* 361 F. Supp. 590, 602 (D.C.D.C. 1973), in which the Court, after concluding the provisions of a contract were unconscionable, stated that in such circumstances "[t]he Court has broad discretion to fashion relief appropriate to the situation presented. . . ."

Since it is the task of the Court to achieve an equitable result, the question before the Court is: What decision is necessary in order to produce such a result? Plaintiffs answer this question by arguing that Bernheim is entitled to receive the compensation provided for in paragraph D.2.b of the Bernheim Deal Memo, after all of the unconscionable provisions are stricken and after permitting Paramount to recoup its actual costs plus a reasonable rate of return on its investment. Counsel for Paramount, although specifically asked by the Court during oral argument on December 6, 1990, stated he had no position with respect to this issue in light of his view that the Court could not determine that individual provisions of the net profit formula were unconscionable.

After careful consideration, the Court has concluded plaintiffs' approach must be rejected because it does not produce an equitable result. There are a number of reasons for the Court's conclusion.

If the Court were to strike all of the challenge provisions of the net profit formula that it has found to be unconscionable and permit Paramount only to recover its costs, plus a reasonable rate of return, the result would be an inequitable windfall to Bernheim. Stated another way, accepting plaintiffs' argument would result in Bernheim receiving a profit far beyond the contemplation of the parties at the time the contract

was entered into and, apparently, far beyond the profit a producer with Bernheim's experience and track record would reasonably have been expected to earn.

The Court believes it does not have sufficient facts to fix the amount that Paramount should be required to pay Bernheim in this case. The Court intends, therefore, to defer to the third phase of this trial the amount of damages to which Bernheim is entitled and the manner in which such damages should be calculated. The Court anticipates that expert testimony may be required. Further, the Court desires to hear argument from counsel concerning these issues, particularly with respect to the factors that the Court should consider in arriving at an equitable award. Although counsel for Paramount has heretofore declined to take a position with respect to these issues, the Court assumes that, in light of the views expressed by the Court herein, counsel will now proffer Paramount's position.

The Court also desires to emphasize that its focus in the third phase will be on awarding damages to Bernheim which are fair and reasonable, but which will not result in Bernheim receiving a windfall, i.e., an award far beyond the reasonable expectations of the parties when the contract was executed.

The Court also intends to defer ruling on the amount to which Buchwald is entitled until after the amount due Bernheim is fixed. The Court observes, however, that under the contracts as written, Buchwald was to receive only a fraction of the net profits to which Bernheim would have been entitled (1½ percent for Buchwald; 17½ to 40 percent for Bernheim). The Court will in all likelihood be influenced by this fact in setting the amount due Buchwald.

C. *The Juxtaposition of Unconscionability and the Consultation Clause*

Paragraph D.2.b of the Bernheim Deal Memo contains the so-called "consultation clause." That clause provides that Bernheim "will be consulted on gross- and net-profit participations granted by PPC to third parties, but PPC's decision shall be final."

Bernheim contends that Paramount breached the consultation clause by not consulting with him. Paramount argues that the consultation clause is not significant since Paramount retained the right to make the final decision with respect to granting gross- and net-profit participations. The Court finds it unnecessary to resolve this dispute.

If Bernheim is correct, the result would be that he is entitled to receive 33.5 percent of the net profits on *Coming to America* under the net profit formula contained in the contract as written. This conclusion follows from Bernheim's position that, by reason of Paramount's breach of the "consultation" clause, he is entitled to the highest percentage of net profit permissible under paragraph D.2.b of the Deal Memo and Bernheim's concession that that highest percentage is 33.5 percent. If Paramount is correct, the result would be that Bernheim is entitled to receive only 17½ percent of net profits (the floor established in Section D.2.b of the Bernheim Deal Memo) under the net profit formula contained in the contract as written.

In the preceding section of this Tentative Decision, however, the Court has concluded that a number of provisions of the net profit formula as written are unconscionable. The Court has also determined that it will follow a different path in arriving at equitable compensation for Bernheim and Buchwald in light of such unconscionability. Since, pursuant to the Court's ruling, the net profit formula as written no longer exists, it makes no difference whether Bernheim or Paramount is correct with respect to the percentage of net profits to which Bernheim is entitled. This factor also makes Paramount's alleged breach of the consultation clause irrelevant.

D. *The "Turnaround" Provision*

As indicated above, one of the component parts of the contract between Paramount and Bernheim is the so-called "turnaround" provision. The purpose of the "turnaround" provision is to permit a producer to take his project to another studio if the first studio is no longer interested in pursuing it, while at the same time permitting the first studio to recoup its development costs if the project is undertaken by the second studio. (Hahn Declaration, paragraph 19; Sattler Declaration, paragraph 53; Denman 6/28/90 Deposition at 55) Insofar as is pertinent to the present case, the "turnaround" agreement provides:

> "If, prior to the expiration of the turnaround period, the project is not placed elsewhere and/or if Lender has not complied with the conditions above, including, without limitation, complete reimbursement to Paramount, then at the end of the turnaround period, Lender's rights with respect to the project shall cease and Paramount's ownership thereof and all properties and rights encompassed therein shall be absolute."

The facts with respect to the application of the "turnaround" agreement to the present case are these: In March 1985 Paramount purported to give notice that it was abandoning the project that had been inspired by Buchwald's treatment. In May 1985 Paramount permitted its option with respect to the Buchwald material to expire. Paramount contends that since Bernheim failed to set up the project at another studio within the 12-month period ending in March 1986, the "turnaround" agreement extinguished any obligations Paramount had with respect to Bernheim.

It is true, as Paramount argues, that if the "turnaround" provision is considered in isolation, it would appear Bernheim's rights to compensation ended in March 1986. The vice of Paramount's argument is that the "turnaround" provision cannot be considered in isolation. Paragraph D.1 of the Bernheim Deal Memo provides, in pertinent part, that "[i]f the Picture is produced, Lender will furnish the services of Artist, who shall be employed by PPC to personally render all customary services as producer."

The Court has already concluded that the picture was made, i.e., that *Coming to America* was "based upon" Buchwald's treatment entitled "King for a Day." In light of this conclusion, it is clear Paramount was required to employ Bernheim as producer on *Coming to America* and that Paramount breached its contract with Bernheim by failing to do so. It would make no sense to conclude that Paramount breached the agreement by failing to employ Bernheim, while at the same time concluding Bernheim's right to compensation was terminated by application of the "turnaround" provision.

In reality, and the Court so finds, it was never contemplated that the "turnaround" provision would apply in a situation such as is presented by the facts of this case. Moreover, to the extent that there exists an ambiguity by reason of the existence of paragraph D.1 and the "turnaround" provision, it is clear that such ambiguity must be resolved against Paramount as drafter of the agreement. Civil Code section 1654; *Jacobs v. Freeman*, 104 Cal. App. 3d 177, 189 (1980).

Finally, the Court observes that one of the important purposes, perhaps the most important purpose of the "turnaround" provision, from Paramount's perspective, was to permit it to recoup its costs in the event Bernheim placed the project at another studio. In the present case that purpose has been satisfied since it is too clear to doubt Paramount has recovered all of its costs on *Coming to America*.

E. *The Co-Venturer and Fiduciary Duty Issues*

Bernheim contends that he and Paramount were co-venturers and that Paramount owed a fiduciary duty to him. With one exception to be discussed below, the Court is unable to agree with either of these contentions.

Whether or not the relationship between parties is that of co-venturer is essentially

a question of fact. *Nelson v. Abraham* 29 Cal. 2d 745, 750 (1947). Few, if any, of the features that usually characterize a joint venture are present in this case. Bernheim did not have a right at all times to inspect and copy the purported venture's books and records (*Milton Kauffman v. Superior Court*, 94 Cal. App. 2d 8, 17 (1949)) and Paramount had pervasive control over the purported venture. Moreover, while there was an agreement between Bernheim and Paramount with respect to the sharing of profits (but not losses) (see *Howard v. Societa Di Unione, etc.* 62 Cal. App. 2d 842, 848 (1944)), Paramount retained the virtually unlimited power to determine whether Bernheim ever received any profit. The factors present in this case do not point to the existence of a joint venture between Bernheim and Paramount.

The Court is also unable to find the existence of a fiduciary relationship between Paramount and Bernheim, except with respect to Paramount's duty to render an accounting. *Waverly Productions v. RKO General, Inc.*, 217 Cal. App. 2d 721 (1963). In fact, the Court disposed of Bernheim's fiduciary duty claim in the Statement of Decision that was issued in the first phase of this case. In its Statement of Decision the Court stated:

"In addition to their contract claims, plaintiffs have advanced several tort theories of recovery, namely, bad faith denial of existence of contracts, bad faith denial of liability on their contracts, tortious breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, fraudulent concealment by a fiduciary and constructive trust. The obvious reason plaintiffs have asserted tort causes of action is to recover punitive damages since, absent such damages, the Court is able to discern no difference between any tort damages plaintiffs might recover and their contract damages.

"The Court has concluded, as indicated, that *Coming to America* was based upon Buchwald's treatment. The Court is unable to find, however, any tortious conduct on the part of Paramount or any of its representatives. In order to award punitive damages to plaintiffs, the Court would be required to find by clear and convincing evidence that defendant was guilty of fraud, oppression or malice, as those terms are defined in Civil Code section 3294. While the Court rejects Paramount's contention that *Coming to America* is not 'based upon' 'King for a Day,' the Court is unable to conclude that Paramount's conduct was in bad faith, let alone fraudulent, oppressive or malicious. Accordingly, while plaintiffs are entitled to recover on their breach of contract claims, the Court finds the defendant is entitled to judgment on plaintiffs' tort claims." (Statement of Decision (First Phase) at 33–34)[7]

In light of the Court's finding that Paramount's conduct was not tortious, the issue of whether a fiduciary duty existed between Bernheim and Paramount and, if so, whether Paramount breached that duty has been rendered moot. As indicated, however, the Court does find that a fiduciary duty exists with respect to Paramount's duty to render an accounting. *Waverly Productions v. RKO General, Inc., supra.*

F. *The Covenant of Good Faith and Fair Dealing*

Plaintiffs argue that Paramount breached the implied covenant of good faith and fair dealing by improperly or excessively charging a number of different items as costs on *Coming to America*. Paramount has countered by arguing that plaintiffs will be given the opportunity to challenge these costs in the third (damage) phase of this trial.

In a preceding section of this Tentative Decision, the Court has ruled that a number

[7] In the same Statement of Decision the Court did indicate that "depending on the evidence adduced during the accounting phase,the possibility exists that Paramount's accounting practices may make the imposition of tort damages appropriate." Statement of Decision (First Phase) at 34.

of provisions of Paramount's net profit formula are unconscionable. The Court also indicated that it intends to fashion relief that will produce an equitable result in this case. In light of the Court's ruling, it appears to the Court that application of the doctrine of unconscionability will produce damages at least equal to damages that could be awarded for a breach of the covenant. The Court finds it unnecessary, therefore, to determine whether a breach of covenant has in fact occurred.

If a statement of decision is requested with respect to this phase of the trial, it shall be prepared by counsel for plaintiffs. This Tentative Decision shall be the statement of decision unless within ten days either party specifies controverted issues or makes proposals not covered in the Tentative Decision. Rule 232, Cal. Rules of Court.

DATED: December 21, 1990.

HARVEY A. SCHNEIDER
Judge of the Superior Court