

CHAMELEON NETWORK

Chameleon Network is a producer and distributor of motion picture films. It specializes in action adventure films popular with males, mostly in the teen and young adult market. While it has only been in business for seven years, it has produced several moneymaking hits as well as many more minor "B" films that are shown on cable networks and through the Internet.

Chameleon Network has recently completed the production of five new films. This set of five films contains one film ("Ultimate Adventures") that marketing research indicates will be a top box office hit. The other four (UA II, UA III, UA IV, UA V) are "filler" films that will be bundled with the hit and licensed to theaters for exhibition. To receive access to the hit, theaters must agree to show all films a minimum number of times.

In July 2018, Chameleon Network entered into an exclusive contract with Spotlight Theaters, Inc. (Spotlight), a large theater chain with approximately 490 theaters across the United States. This contract provided in part as follows:

Agreement. Spotlight is granted the right, license, and permission to display the five films listed herein during the contract period. In consideration of this contract, Chameleon Network will receive:

1. A contract (arrangement) fee of \$6,000,000, payable \$3,000,000 upon contract signature and \$3,000,000 on September 1, 2018.
2. \$600 for each film showing in each location.

Contract period: The contract period shall be the six months commencing on September 1, 2018.

Limitation on screenings: Spotlight agrees to show Ultimate Adventures no more than 42 times per theater and the four accompanying films (UA II, UA III, UA IV and UA V) no fewer than 18 times each per theater.

Exclusivity: Spotlight shall have exclusive screening rights during the contract period. Chameleon Network acknowledges that an integral inducement in consideration of the contract is Spotlight's interest in being the sole source, without competition from other theaters in the market, during the contract period.

At the signing of the contract, Spotlight paid \$3,000,000 of the \$6,000,000.

Spotlight sent checks to Chameleon Network for \$3,000,000 on September 1, 2018, and \$6,489,000 on January 20, 2019, along with an audited statement detailing the number of showings as of December 31, 2018. The following is a summary of that information:

Film	Number of Showings	Amount Due
Ultimate Adventures	8,490	\$5,094,000
UA II-V	2,325	1,395,000
	10,815	\$6,489,000

In March 2019, Chameleon Network received a demand notice from Spotlight that all monies previously paid were to be returned or they would file a lawsuit. In their letter, they enclosed a newspaper clipping

from a movie theater in Toronto, Canada that was advertising the set of five films for showing the second week of February 2019.

Required

Write a report using the report writing guide from the course website.

In preparing your report remember to review LDC financial accounting concept 8 (understanding the timing of revenue recognition), and business law concept 1 (offer and acceptance of contracts; enforcement of contracts: interpreting the parties' intent).

Note: To the extent that you may recognize any antitrust issues (which we would not expect) please ignore them for purposes of this analysis.

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Accounting Concepts Film Sales Financial Accounting Standards Board (FASB) – FASB codification paragraph 926-605-25-1

An entity may enter into a sale agreement or licensing arrangement for a film. A sale occurs when the entity transfers control of the master copy of a film and all of the associated rights that go along with it (that is, an entity sells and gives up rights to a film). An entity shall recognize revenue from a sale or licensing arrangement when all of the following conditions are met:

- a. Persuasive evidence of a sale or licensing arrangement with a customer exists.
- b. The film is complete, and in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery.
- c. The license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale.
- d. The arrangement fee is fixed or determinable.
- e. Collection of the arrangement fee is reasonably assured.

If an entity does not meet any one of the preceding conditions, the entity shall defer recognizing revenue until all of the conditions are met.

Financial Accounting Standards Board (FASB) – FASB codification paragraph 926-605-25-19

In certain licensing arrangements that provide for variable fees, a customer guarantees and pays or agrees to pay an entity a nonrefundable minimum amount that is applied against the variable fees on a film or films that are not cross-collateralized. In such arrangements, the amount of the nonrefundable minimum guarantee is considered fixed and determinable, and the entity shall recognize the minimum guarantee as revenue when it has met all of the other conditions of paragraph 926-605-25-1.

Business Law Concepts Interpretation of Contracts

General Rules of Construction

Courts look to contracts to determine the parties' obligations. Most of this is based on the language of the agreement, however sometimes there are issues not mentioned or ambiguously addressed in a contract. What to do if there is a dispute about a topic not addressed (or ambiguously addressed) in the contract? Courts follow general rules in construing contracts called "rules of construction." Some of these rules are articulated in cases, some are intuitive but few are codified in statute. It makes it difficult, sometimes, for business people to make business decisions. The more you understand how courts tend to approach contractual disputes, the more effective you will be at managing resources. Here are a few rules of construction that may apply to Chameleon Network. Think about how they affect your analysis of the case. Use them (cite to specific sources) in your analysis of the case.

Courts Seek to Preserve, Not Invalidate Agreements

Courts in general try to preserve contracts, even if there is a flaw in the agreement. There are important reasons for this: courts want parties to a contract to rely on the contract. Business would be harmed if everyone who entered a contract thought that with a sharp enough lawyer they could find some defect that would get the contract invalidated. Commerce relies on the premise that parties will do what they have agreed to do, and that if not, there will be some remedy at law. If you need an illustration of this point, think of any country in which political power, wealth or corruption mean that getting legal rights enforced depends on your political clout rather than on the law. Look at how much foreign investment gets made in such countries. Look at the overall wealth of the citizens of such countries. It is not hard to conclude that the American legal system, despite its flaws, helps the economy by ensuring that the judicial system enforces legal rights.

This brings up an important point with students studying business law: there is a tendency to seize on any contractual defect and conclude that entire agreements are not binding. This is a serious error. For one thing, it's sloppy; sometimes students are concluding that contracts are not binding in order to avoid completing their analysis (e.g. "They didn't mention xxx! That's wrong! There's no contract!"). Some of it is naïve: there are few contracts that do not have some ambiguities; invalidating all of them would mean that there were virtually no legally binding agreements. Some of it is well-intentioned but overzealous: when you first learn about business law even good students often want to apply it literally. Avoid this tendency and recognize that only in cases where courts conclude that the parties never, truly, agreed will they invalidate a contract based on missing or ambiguous contractual terms. Courts are not "contract police" rather "contract enforcers."

Here are some references that should aid your analysis:

In *DeSantis v. Wackenhut Corp.*, 793 S.W.2d at p. 677, the court observed that "the most basic policy of contract law . . . is the protection of the justified expectations of the parties. The parties' understanding of their respective contractual rights and obligations depends in part upon the certainty with which they may predict how the law will interpret and enforce their agreement."

"The law does not favor but leans against destruction of contracts because of uncertainty; it will, if feasible, so construe agreements as to carry into effect (the) reasonable intention of parties if that can be ascertained." *Bohman v Berg* (1960) 54 Cal 2d 787.

Courts Construe a Contract's Meaning to be Consistent with the Parties' Intention

The central rule of contractual analysis is to interpret based upon the parties' intent on entering the agreement. It is central to legal analysis to recognize that courts do not enforce agreements based upon what the judge thinks is fairest, "right" or best. The judge was not a party to the agreement and his or her opinion is irrelevant on this issue. Instead, interpret contracts to most consistently enforce the parties' reasonable expectations. The judge's job (and your job in this assignment) is to figure out what the parties intended and to interpret the contract consistent with that intent.

Here is some authority for this proposition:

The contractual meaning "is determined by objective manifestations of the parties' intent, including the words used in the agreement, as well as extrinsic evidence of such objective matters as the surrounding circumstances under which the parties negotiated or entered into the contract, the object, nature and subject matter of the contract, and the subsequent conduct of the parties." *Morey v. Vannucci* (1998) 64 Cal.App.4th 904, 912.)

"The fundamental goal of contractual interpretation is to give effect to the mutual intention of the parties. The mutual intention to which the courts give effect is determined by objective manifestations of the parties' intent, including the words used in the agreement, as well as extrinsic evidence of such objective matters as the surrounding circumstances under which the parties negotiated or entered into the contract; the object, nature and subject matter of the contract; and the subsequent acts and conduct of the parties." 1 Witkin Summary of Cal. Law, Contracts (9th ed. 1987) § 684, pp. 617-618.

"A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful." Cal. Civ. Code § 1636.

Missing or Ambiguous Terms

Contracts are interpreted as they were apparently intended by the parties at the time the contract was created. If the parties' intent can be determined, courts will supply missing terms or clarify ambiguities. They will not, however, insert terms to create an agreement where none, really, exists.

Here are some relevant references:

"A contract extends only to those things concerning which it appears the parties intended to contract. Our function is to determine what, in terms and substance, is contained in the contract, not to insert what has been omitted. We do not have the power to create for the parties a contract which they did not make and cannot insert language which one party now wishes were there." *Levi Strauss & Co. v. Aetna Casualty & Surety Co.* (1986) 184 Cal. App. 3d 1479, 1485-1486.

"However broad may be the terms of a contract, it extends only to those things concerning which it appears that the parties intended to contract." Cal. Civ. Code § 1648.

"If parties had concluded (a) transaction in which it appears they intend to make contract, (the) court should not frustrate their intention, if it is possible to reach fair and just result, though this requires choice among conflicting meanings and filling of some gaps left by parties." *Rivers v Beadle* (1960) 183 Cal App 2d 691.

Plain Meaning

This is not a trick. It is just common sense. Interpret contractual language consistent with commonly understood definitions and interpretations of its language.

Here is a source for this statement:

"The paramount consideration is the intention of the contracting parties'. . . as it existed at the time of contracting, so far as the same is ascertainable and lawful.' This intention must be ascertained from the words used, after taking into consideration the entire contract and the circumstances under which it was made. The words used in a contract must be given their ordinary meaning, unless there is evidence that the parties intended to use them in a unique sense or to give the words some different meaning." *Moss Development*, 41 Cal.App.3d at p. 9.