YOU CAN’T SELL THAT: UNDERSTANDING THE ECONOMIC CONSEQUENCES OF PENDING CALIFORNIA ASSEMBLY BILL NO. 437

Abstract: Proposed legislation in California (Assembly Bill No. 437) aims to prohibit actors from voluntarily selling something they are willing to sell—contractual exclusivity. In this BULLETIN, we demonstrate that the proposed California legislation will reduce the compensation to actors, either directly by prohibiting compensation for exclusive arrangements or else by increasing the cost of enforcing contracts. We also show the incentives of producers and talent to waive or renegotiate exclusivity agreements are aligned if an outside opportunity does not materially interfere with the producer’s business. Proponents of the contract restrictions offer no plausible justification for legislative interference in standard business practices. Accordingly, the bill is not in the interests of California employees, California employers, or society at large.

I predict future happiness for Americans, if they can prevent the government from wasting the labors of the people under the pretense of taking care of them.

— Thomas Jefferson

I. Background

When an actor is hired to appear on a series, film, or other audio-visual entertainment format, it is common for the producer (employer) and the talent (employee) to enter into an exclusive agreement. Avoiding scheduling conflicts is an obvious motivation for such agreements, but
there are others.\textsuperscript{1} Audiences might be confused and less interested in a production if an actor simultaneously plays a villain in one show and a hero in another or plays two highly similar characters in competing films.

Exclusive arrangements between producers and talent are \textit{voluntary}, so additional compensation is required to convince actors to agree to these terms.\textsuperscript{2} Put simply, the actor has something to sell that a producer is willing to buy. Under current law, the free market determines the price—based on factors including the value to the actor of the role, the prominence of the actor, and the benefits to the producers of an exclusive arrangement.

While the price for any particular exclusivity agreement can be difficult to know in advance and will vary with the circumstances, it is clear from evidence in other areas that it can often be quite high. In advertising, for example, public reports indicate that an actor would be paid an additional 25\% of her compensation to forgo appearing in a commercial for a non-competitive good, and an additional 200\% for a blanket non-appearance stipulation for non-competitive products.\textsuperscript{3} Exclusivity arrangements for showrunners/writers also often come with extremely large price tags—at times running into the millions or even hundreds of millions of dollars for


\textsuperscript{3} See, e.g., Staff Writers, \textit{What to Know About Commercial Contracts + How Much You Can Expect to Make}, BACKSTAGE (December 11, 2019) (“Coca Cola definitely does not want you advertising for Pepsi, but they also decide they also don’t want you as the face of a wireless provider. If agreed to, they would be required to pay an additional 25 percent of your fees for this non-competitor contract stipulation. If they also want to make sure you don’t show up in a commercial for a restaurant chain, that’s another 15 percent for a second non-competitive product. A third non-competitive product requires an additional 10 percent, and then 200 percent for anything beyond that.”) (available at: https://www.backstage.com/magazine/article/sag-aftra-commercial-contract-rules-69641).
prominent figures. These figures suggest that producers often see a very large material benefit to exclusive arrangements.

California State Assemblyman Ash Kalra (D, 27th Assembly District) is the author of legislation (California Assembly Bill No. 437) to prohibit actors from selling exclusivity to producers. While excluding commercial advertising, the bill prohibits employment contracts that prevent an actor or writer "from working for multiple employers unless the [producer] can show that the other employment would pose a direct scheduling conflict or the [producer] can show that it would materially interfere with the [producer’s] business." As is increasingly common and disturbing in modern legislative efforts, the bill puts a thumb on the scale greatly limiting the impact or applicability of these supposed limitations since it is the producer who must demonstrate that the exclusive arrangement “materially interferes” with the producer’s business, raising the cost of doing business and enforcing contracts (something we analyze below). California Bill AB-437 is an evolution of the failed Free Artists from Industry Restrictions (AB-1385 and AB-2926) from the last legislative session that covered audio-visual entertainment and the music industry. Research demonstrates that those earlier iterations would reduce the liberty of artists to sign enforceable contracts, thereby reducing wages and investment in talent and threatening the viability of the entertainment industry in the state.

In this BULLETIN, we analyze AB-437’s assault on actors’ contracting liberty. To do so, we model a negotiation between a producer and a talent (i.e., an actor). The two parties may or may not enter an exclusive arrangement with respect the talent’s participation in other programs. We show, as expected, that the talent must be compensated for an exclusive deal, so wages are higher when such arrangements are possible. We further show that banning exclusives, as proposed in the AB-437, reduces wages for (and probably employment of) talent workers. Likewise, the higher contract enforcement costs and overall uncertainty caused by the “materially interferes” provision also reduce the talent’s compensation. We also demonstrate that exceptions to an exclusive arrangement (i.e., where a talent worker under an exclusive agreement seeks to take on

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an additional project) are unproblematic with respect to low-damage exceptions—the incentives of the producer and the talent are aligned and mutually beneficial waivers or renegotiation will routinely be accomplished, and no policy intervention is required. California’s AB-437 will harm actors and producers—and ultimately viewers and the State’s film, television, and streaming economy—despite claims to the contrary.

II. The Basic Economics of a Contract

The analysis of contracts and contract terms is an important application of the economics of incentives and information. As pointed out by Salanie (2005), contracts allow for far more nuanced interactions between agents than can the price system alone. In general, when the goods or services to be exchanged are not simple commodities, and efficiency requires efforts by one or both parties which they cannot otherwise credibly commit to perform, the availability of contracting allows economic agents to obtain optimal results. However, the ability of contracting to perform this important function depends, inter alia, on the agents’ abilities to write a contract that provides the proper incentives to both parties, and the availability of credible enforcement of the terms of the contract in the event of a breach. In principle, the legal system governing contracts should provide this foundation.

The current proposal in California (AB-437) would radically change the legal environment facing talent workers and their employers by prohibiting exclusive contracts. Such exclusive contracting is relatively common now and normally governed by terms set forth by SAG-AFTRA (the Screen Actors Guild, an artists’ labor union), and this circumstance reflects the willingness and desire of both sides to enter such arrangements. Because both parties have voluntarily adopted exclusive contract terms—when they could have freely agreed to a non-exclusive arrangement—the California proposal can be expected to have a major impact on the contracting parties. Economic analysis strongly suggests this impact will be bad.

In their prescient analysis of the classic economic problem of bilateral monopoly, Blair, Kaserman, and Romano (1989) point out that, as a general matter, two parties entering a voluntary contract have an overwhelming incentive to achieve the maximum joint benefit from the agreement: their only dispute arises over how the gains from efficient cooperation should be shared. The terms of the contract are the means by which both the efficient result is obtained and the gains are distributed. AB-437 will prohibit (or at least strongly discourage) the parties from executing an efficient contract whenever efficiency requires exclusivity, which seems to often be the case given that exclusivity is common in the industry. This problem arises because efficiency requires more than just an agreement over wages. In the analysis of Blair, et al. (1989),

the roles of both price and quantity are vital: both parties will agree on the optimal level of the relevant activity (the “quantity”), and then use price as a means of sharing the resulting gains. A lack of recognition of this fact by many economists led to faulty analyses of the problem in many textbooks although, as they authors point out, the basic economic insight goes back at least to Bowley (1928).

These considerations are immediately relevant to the threat raised by AB-437. An exclusive contract can assure the contracting party that the efforts of the counterparty (the quantity) will be optimal (i.e., joint benefits will be maximized). Payments to the talent worker are the means by which gains are shared. When unforeseen events render exclusivity suboptimal ex post, the parties are free to renegotiate the terms for their joint benefit, which we believe to be common. Because a grant of exclusivity is costly to the worker (i.e., it forecloses certain types of future work), the talent is compensated in the contract for the obligation. When exclusive contracts are barred, this no longer occurs, reducing the talent worker’s compensation.

III. Economic Model

The effects of a near ban on exclusive contracts can be analyzed in a simple model of a contract between a producer and a talent worker in which the talent worker may, with some probability, receive a valuable subsequent opportunity. The contract terms under both the current system, and the proposed regime that disallows exclusive contracts, can be derived and compared. We provide such an analysis using tools common in economics.

We model the negotiation between a producer and the talent as a Nash game. Let $\theta$ be the probability of another conflicting opportunity arising during the term of the contract; $V$ be the value of the talent to the producer in the absence of a conflicting performance; $d$ be the damage done to the producer if the talent works in the conflicting production; $c$ be the compensation the talent will receive for the conflicting show if it materializes; and let $w$ denote the agreed upon contract wage for the talent if there are no restrictions in the contract regarding conflicting opportunities. Finally, let $w_r$ denote the agreed contract wage for the talent if the contract restricts performances in conflicting opportunities (exclusivity). The expectation is that the talent must be compensated for an exclusive arrangement.

In the Nash model, contract wages are determined by maximization of a “Nash product”:

$$\max_{w} \left\{ (V - \theta d - w)(w) \right\}, \tag{1}$$

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9 A.L. Bowley, Bilateral Monopoly, 38 ECONOMIC JOURNAL 651-59 (1928).
with an equilibrium wage of,

\[ w^* = \frac{1}{2} (V - 0d). \]  

(2)

Under the exclusive arrangement, the maximization problem,

\[ \max_w \{ (V - w_r)(w_r - \theta c) \}, \]

renders the equilibrium wage,

\[ w_r^* = \frac{1}{2} (V + \theta c). \]

(4)

These wages (payments) from the producer to the talent reflect the talent’s compensation under an unrestricted and an exclusive contract, respectively. So, as expected, \( w_r^* > w_r^* \). Hence, the talent will be compensated for agreeing to a restricted (exclusive) contract. But when is the expected utility (benefit) of the restricted contract \( (T_r^*) \) greater than the expected utility of the unrestricted contract \( (T^*) \) for the talent? In other words, when would the talent worker prefer the exclusive arrangement? The answer is,

\[ T_r^* > T^* \iff w_r^* > w^* + \theta c \iff \frac{1}{2} (V + \theta c) > \frac{1}{2} (V - 0d) + \theta c \]

\[ \iff d > c. \]

(5)

Hence, the talent *ex ante* prefers a restricted contract if and only if the potential conflicting opportunity generates more damage to the production than the compensation he or she would receive for the conflicting production. The willingness of the talent worker to enter the restricted arrangement depends on the size of potential outside compensation and the consequences of working on the outside project for the producer.

Next, we consider the preferences of the counterparty. When is the expected return from the restricted contract \( (P_r^*) \) greater than the expected return from the unrestricted contract \( (P^*) \) for the producer?

\[ P_r^* > P^* \iff V - w_r^* > \theta (V - d - w^*) + (1 - \theta) (V - w^*) \]

\[ \iff w^* + \theta d > w_r^* \iff \frac{1}{2} (V + \theta d) > \frac{1}{2} (V + \theta c) \]

\[ \iff d > c. \]

(6)
Thus, we conclude that the producer also only prefers a restricted contract when the damages from a conflicting production opportunity are going to exceed the potential compensation for the talent. The ex ante contract preferences are perfectly in alignment:

\[ T_r > T^* \Leftrightarrow P_r > P^* . \]  

(7)

This is an important and relevant point, and it reflects the basic insight discussed above: both parties prefer the contract that maximizes the total benefits of the transaction. Although most observers may believe that the producer and the talent worker have fundamentally incompatible goals, that belief is incorrect: regardless of how the gains are shared, everyone would prefer that the greatest profits be realized. In some cases, obtaining the greatest profits possible will require exclusivity because it provides certainty and allows greater investment and longer-term commitments by the producer and supports production of multi-season or multi-film products.\(^\text{10}\) By committing to the producer’s project in this way, the talent worker makes it possible for the producer to realize the full value \( V \) and is duly compensated for doing so.

Producers and talent workers are generally intelligent, or intelligently represented, individuals, and the current contracting experience reflects the uncertainties of creative work. As the prior analysis showed, existing contracts even including those that contain exclusivity provisions implicitly permit talent to engage in low-damage outside opportunities, since both parties (producer and talent) prefer a contracting relationship that permits conflicting performances if the damage is sufficiently low.\(^\text{11}\) Unfortunately, the proposed California legislation appears to limit exclusivity clauses through the addition of vague language that is likely to increase enforcement costs in the case of high-damage conflicting performances. If this is correct, then the new rules would likely result in a reduction of wages for the talent in future contracts, and thus reduce their welfare. This complication is worth examining.

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\(^\text{11}\) Even under exclusive arrangements, actors may be free to work on a variety of projects without violating an exclusivity provision including commercials, voice-over work, or guest-starring roles on TV series. K. Basin, THE BUSINESS OF TELEVISION (2018); J.L. Smith, PERK POINTS: Publicity Services, Approval Rights, Exclusivity, and Approvals are Often Key Elements of a Deal Between Actors and Studios, LOS ANGELES LAWYER (May 2015) (available at: https://www.lacba.org/docs/default-source/lal-back-issues/2015-issues/may2015.pdf).
We can illustrate the reduction in future contract wages by positing a simple distribution of potential conflicting productions. Assume that there are probabilities \( \theta_L \) and \( \theta_H \) of conflicting productions that result in damages of \( d_L \) and \( d_H \). We will assume that the potential conflicting productions compensate the talent by the payment \( c \), and the damages are ordered so that \( d_L < c < d_H \). Based on the prior analysis, there would be no enforcement of exclusivity regarding the low-damage conflicting production, but there would be an incentive by the producer to restrict the high-damage conflicting performance. Let us assume there is an enforcement cost of \( e \). The contract wage would be determined by the maximization of the Nash product:

\[
\max_{w_e} \left\{ (V - \theta_L d_L - \theta_H e - w_e)(w_e - \theta_H c) \right\}
\]

\[
= \frac{1}{2} \left[ V - \theta_L d_L + \theta_H (c - e) \right].
\]

Hence, an increase in enforcement costs will theoretically decrease the expected compensation of talent \( \left( w^*_e > w_e^* \right) \). The larger the enforcement costs created by legal attempts to neuter remedies for breach in exclusive contracts, the greater the reduction in talent compensation will be.

**IV. Practical Implications**

Exclusivity is a product supplied by actors and valued by producers. California’s AB-437 is, in effect, a prohibition on the ability of actors to sell the product and be compensated for it. As such, the wages of the talent will be lower. Also, even if an exclusive contract is signed, the vague “materially interfere” language introduces uncertainty that will deter some contracts and raise the cost of enforcement and again limit overall work and reduces wages. Plainly, AB-437 will reduce the wages of actors and interfere with the production of audio-visual entertainment in California (though some subset of this work might move elsewhere).

There are several arguments often used (or else implied) to support the proposed legislation. First, proponents of the bill may be concerned that actors are not able to protect their own interests and negotiate sensible or beneficial contracts. The argument is weak. We assume in our analysis that talent workers are rational and aware of the implications of exclusive arrangements, or else they are advised or represented by rational agents. Irrational behavior is ultimately unprofitable and self-defeating, and although human beings are not infallible, they have the capacity to learn over time and to protect their own interests. While we lack data on the subject, anecdotally actors are frequently and perhaps universally represented by professionals when negotiating deals of significant scope in which exclusivity is an issue. And we are unaware of any evidence presented by the bill sponsors to establish that actors are so irrational or unable to protect their own interests that state intervention is required.

Second, while in the increasingly distant-past of broadcast television, production schedules were well-defined, sponsors observe that today production schedules are more fluid and may
span many more months that in the past. This change places increasing demands on the schedules of actors, and theoretically creates more opportunities for conflicts. But such changes have no impact on the ability of the parties to reach a deal; the value and probability of outside opportunities and potential future conflicts are fully incorporated into the negotiation over exclusivity and the price producers must pay for it. Over time, contracts will incorporate the realities of modern television. To the extent sponsors worry about actors subject to longer-term exclusives signed in the past when schedules were more fixed (though by law they may not exceed seven years in California), such concerns are completely unaddressed by AB-437. Also, contract renegotiation is common when conditions materially change, and waivers and contract modification are not uncommon in the entertainment industry.

Third, some parties argue that exclusivity ignores the short career life of some actors (similar concerns attach to athletes, for instance). Again, even if true such claims do not support a ban on exclusivity; a ban that will simply reduce artist wages during the life of their career however long or short. Actors with a limited time to work simply adjust their wage bargaining to reflect this fact. An actor with such concerns can reject an exclusive arrangement or demand more compensation for it. The whole point of contracting is to address such concerns.

In our view, the theoretical analysis suggests how the inevitable litigation over the “materially interfere” provision might play out if AB-437 is enacted into law. In low-damage cases, which are situations that plausibly do not materially interfere with the producer’s business or the value of a film, television, or streaming project, the incentives of the producer and the talent are aligned with respect to waivers, which will be routinely granted. Indeed, in many cases, outside work will benefit the producer by heightening the actor’s public profile and increasing interest in their joint work, again suggesting waivers will routinely occur. If a waiver is not granted, however, then the implication is that the waiver would materially interfere with the producer’s business or devalue the project. In those cases, the right to deny a waiver may feel harmful to the actor whose opportunities are limited; but without the protection of a (paid for) exclusivity provision, the project likely wouldn’t even have been undertaken given the reality of these high damage risks. Indeed, when compensation is granted for an exclusive arrangement and a waiver is denied, this circumstance is, in itself, evidence of material interference.

A court decision along these lines might make AB-437 moot and limit the harm caused by the legislation. Still, the uncertainty and unpredictability regarding the application and

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13 Id.

14 O.E. Williams, L. Lacasa, and V. Latora, Quantifying and Predicting Success in Show Business, 10 NATURE COMMUNICATIONS 1-8 (2019).
interpretation of these vague standards will still depress work and wages for actors. As we demonstrate above, the litigation costs related to contract enforcement will also reduce the wages and opportunities available to actors.

V. Conclusion

Enforceable contracts are the foundation of the American economy. Contracts permit flexible arrangements that address, to the extent possible, foreseeable events, and often allow for waivers or renegotiation for unforeseeable events. In the entertainment industries, contracts often include exclusivity provisions that limit professionals from working on competing and non-competing projects. Forgoing outside opportunities is costly, so additional compensation for exclusivity is required, and some evidence suggests this additional pay is substantial.

Proposed legislation in California aims to significantly curtail the use of exclusive contracts for actors working in audio-visual entertainment. The effects are predictable—under the bill’s provisions, agreements between producers and talent will be less valuable, so the wages of actors will be lower, either through the loss of compensation for exclusivity or else the cost of enforcing an agreement. Justifications for legislative interference in well-established contract practices in the industry have no merit; all such concerns may be addressed directly in negotiations. In fact, the incentives of producers and talent are aligned if an outside opportunity does not materially interfere with the producer’s business. It is not in the interests of talent workers, producers, or society at large to hamper efficient contracting in the audio-visual entertainment industry.