Starlet
Role of Representative of Trafalgar Studio

By Michael Benoliel and Yibao Zhao

Trafalgar Studio was established in London in 1984 by a group of film directors and producers. Its main mission is to produce high quality films by giving film directors more artistic freedom than is typically available from Hollywood studios. Trafalgar Studio recently concluded a deal with Charles Chancellor, an accomplished British independent and Oscar winning film director, to produce a new film titled, *The Space Between*. Chancellor would very much like the award winning actress, Talia Montgomery, to play the lead role.

Talia Montgomery, who is British, has been living in Hollywood for three years. Before moving to Hollywood, she received good reviews for a small part in the Hollywood film titled, *The Flying Sword*, directed by John Stone, an accomplished Hollywood director. Upon Ms. Montgomery’s arrival in Hollywood, Stone introduced her to the J. R. Talent Agency with whom she has a five-year exclusive representation contract. Talia’s first big role in Hollywood was a role in *The Bike Rider*, which was also directed by John Stone. Ms. Montgomery received two acting awards: the London Foreign Critics Circle Film Award in the Best Supporting Actress category; and the Los Angeles Film Critics Association award in the Best Supporting Actress category for her role in this film. Currently Ms. Montgomery is said to be both in demand and extremely selective. It is unknown whether she has pending offers, or if her agent is in negotiations with other studios.

Director Charles Chancellor saw Ms. Montgomery’s performance in *The Flying Sword* and in *The Bike Rider* and made her his top choice for the female lead in his upcoming film. Trafalgar’s financial analyst evaluated Ms. Montgomery’s potential added value to *The Space Between* to be a minimum of $6 million. Chancellor’s second choice for the female lead in this film is Ms. Margaret Fleming, who signaled she would very likely accept an offer of a fixed salary of $4,250,000.

Talia Montgomery’s agent contacted the Representative of Trafalgar Studio expressing an interest in negotiating a package contract for Talia to appear in *The Space Between*. Talia’s agent mentioned three issues: a fixed salary; a bonus if Talia wins an acting award for this film; and a percentage of the revenues from the film’s merchandising sales. The Representative of Trafalgar Studio, without making a commitment, agreed to consider a package deal, and asked for an offer from Montgomery’s agent. It was sent the next day: (1) a fixed salary of $5,800,000; (2) a bonus of $4,190,000 if Talia wins an acting award; and (3) 10% of the film’s revenues from merchandising sales.

The first issue, a fixed salary, is simple and straightforward. The second issue, a bonus, if Talia Montgomery wins an acting award, requires an assessment of the probability that she will win an award. The third issue, a percentage of the revenues arising from merchandising sales, requires an assessment of the film’s potential revenues from merchandising sales if Talia Montgomery does or does not win an acting award.

Appreciating the value of due-diligence, the Representative of Trafalgar Studio asked the research department to investigate: (1) the likelihood of an actor or actress winning an acting award within five years of winning a previous award; and (2) the average revenues from merchandising sales when an actor or actress wins and does not win a consecutive acting award in an espionage, suspense, or action film over the past 50 years.

The research department generated the following information: “Based on a search of all the motion pictures produced in the last 50 years, the likelihood of an actor or actress winning consecutive acting awards in a span of five years is two percent. As to the second issue of revenues from merchandising sales in espionage, suspense, or action films produced in the last 50 years, the data show the following:
When an actor or actress won a consecutive acting award, the average revenues from merchandising sales were $8 million. However, if the actor or actress did not win such an award, the average revenues from merchandising sales were $1 million."

Armed with this information, the Representative of Trafalgar Studio met with the head of the European business division of Trafalgar Studio. Together they agreed that Trafalgar Studio would not offer Talia Montgomery a contract that would exceed $4.5 million in expected value. Next, the Representative of Trafalgar Studio developed the following four proposals.

<table>
<thead>
<tr>
<th>Deal Issues</th>
<th>Proposal 1</th>
<th>Proposal 2</th>
<th>Proposal 3</th>
<th>Proposal 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Salary (FS) in millions</td>
<td>$1.74</td>
<td>$1.97</td>
<td>$2.16</td>
<td>$2.41</td>
</tr>
<tr>
<td>Percentage of Merchandising Sales (PMS)</td>
<td>20.00%</td>
<td>25.00%</td>
<td>15.00%</td>
<td>5.00%</td>
</tr>
<tr>
<td>Bonus (B) in millions</td>
<td>$1.43</td>
<td>$2.08</td>
<td>$9.01</td>
<td>$6.54</td>
</tr>
</tbody>
</table>

You are to take the role of the Representative of Trafalgar Studio and negotiate with the Agent for Talia Montgomery. You wish to maximize the interests of Trafalgar Studio which you can do by minimizing the expected value of a deal. You are not limited to negotiating the above four proposals. If you wish, you may create additional proposals or bring up new ideas, provided that they include the original three issues: A fixed salary; a bonus, if Talia wins an acting award; and a percentage of the film’s revenues from merchandising sales. However, the original three deal issues may have a value of zero, for example, no bonus (value of zero) or no percentage of the film’s revenues from merchandising sales (value of zero).

There are four documents in your packet:
1. Confidential Role Instructions for the Representative of Trafalgar Studio.
2. Appendix A: How to Calculate Expected Value.
3. Appendix B: Example of How to Calculate Expected Value.
4. Term Sheet [To Keep].

If you reach an agreement:
1. Complete the term sheet and keep it.
2. Calculate the expected value of Trafalgar Studio.
3. Complete a contract together with the agent for Talia Montgomery. Give one copy to the instructor and keep the other copy for yourself.
Appendix A. How to Calculate Expected Value

Variables

Fixed Salary (FS).

Percentage of Merchandising Sales (PMS).

Bonus (B)

Constants

$8,000,000  The average revenue from merchandising sales when an actor or actress wins a consecutive acting award.

$1,000,000  The average revenue from merchandising sales when an actor or actress does not win a consecutive acting award.

0.02  The probability that an actor or actress will win a consecutive acting award (2%).

0.98  The probability that an actor or actress will not win a consecutive acting award (98%).

Formula

\[
EV = FS + PMS \left[ (8,000,000 \times 0.02) + [(1,000,000 \times 0.98)] + [(B \times 0.02) + (0 \times 0.98)] \right]
\]
Appendix B. Example of How to Calculate Expected Value

Proposal’s Variables

Fixed Salary (FS): $2,750,000
Percentage of Merchandising Sales (PMS): 5%
Bonus (B): $1,500,000

Constants

$8,000,000 The average revenue from merchandising sales when an actor or actress wins a consecutive acting award.

$1,000,000 The average revenue from merchandising sales when an actor or actress does not win a consecutive acting award.

0.02 The probability that an actor or actress will win a consecutive acting award (2%).

0.98 The probability that an actor or actress will not win a consecutive acting award (98%).

Calculating the Proposal’s Expected Value

EV = FS + PMS [(8,000,000 * 0.02) + (1,000,000 * 0.98)] + [(B * 0.02) + (0 * 0.98)]

EV = 2,750,000 + 0.05[(8,000,000*0.02) + (1,000,000*0.98)] + [(1,500,000*0.02) + (0*0.98)]

EV = 2,750,000 + 0.05(160,000 + 980,000) + 30,000

EV = 2,750,000 + 57,000 + 30,000

EV = $2,837,700

The total expected value is: $2,837,700.
Term Sheet [to keep]

We, the Agent for Talia Montgomery and the Representative of Trafalgar Studio have agreed to the following terms:

Fixed salary: $ ________________________________

Percentage of merchandising sales: ________________________________

Bonus: $ ________________________________

Other terms (if any): ________________________________