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Introduction

Lionel S. Sobel

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A million dollars used to be a lot of money, and still is for most purposes. Making movies is not one, however. Major motion pictures frequently cost $30 million and more today, before prints and ads. By comparison, a $1-million movie is truly a small-budget affair. Little wonder, then, that many motion picture producers are as involved as Wall Street investment bankers in matters of high finance. Indeed, the arrangements made to finance the production of some movies are as creative and artistic in their own way as the movies themselves.

It would be an exaggeration to say that there are as many ways to finance movies as there are movies made, but there are many. Trade papers and industry jargon divide all of these ways into two broad categories: "studio" financing and "independent" financing.

STUDIO FINANCING

For many producers, the ideal deal is one with a studio. There are nine "studios" in the United States today: Columbia, Disney, MGM/UA, Orion, Paramount, TriStar, 20th Century Fox, Universal and Warner Bros. The traditional studio deal is one in which a studio pays for the development, production and distribution of a movie. The producer receives a fee for services rendered and an interest in the movie's profits (as defined in the producer's contract) if there are any. The studio acquires the right to distribute the movie worldwide and in all media in exchange for a distribution fee. The studio also is entitled to recoup all of its distribution expenses as well as all of the money it spends producing the movie, plus interest and studio overhead. Additionally, the studio is entitled to an interest in the movie's profits if there are any.[1]

The advantages to a producer from a deal of this sort are many. For those movies that make it out of development and into the production stage, financing and distribution are assured. Administrative support and office space are provided by the studio. A negotiated producer's fee is

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1. *See, e.g.*, Jay S. Kenoff & Richard K. Rosenberg, *Producer Contracts, in* 1 ENTERTAINMENT INDUSTRY CONTRACTS 9-1 (Donald C. Farber ed., 1991).

paid whether or not the movie is profitable, and there exists a chance to participate in profits if the movie is sufficiently profitable. With financing assured and administrative support provided, the producer is free to concentrate on the creative aspects of the movie.

On the other hand, there is a price to be paid for the studio deal. Distribution fees, interest rates and overhead charges are likely to be at the high end of the scale for most producers. Studio production costs may be greater than the cost of obtaining similar goods and services from non-studio sources. Also, studio executives participate in the creative as well as the administrative aspects of motion picture production — participation which the producer may not relish.

INDEPENDENT FINANCING

Many producers are unable or choose not to obtain single-source financing from a studio. They are known as "independents," and for them, the task of raising funds is a key part of their job. Funds for independent film production are available from several sources, though in practice, few if any of those sources are sufficient by themselves to pay the entire cost of a movie. As a result, independent producers become as adept at assembling packages of financing as they are at packaging talent and literary property.

Independent film financing packages contain several elements: presale and negative pick-up contracts, loans, investments, and completion bonds. This Symposium is devoted to a series of articles that explores the often complex legal and business issues that surround the creation of such packages.

NEGATIVE PICK-UPS AND PRE-SALES

A negative pick-up deal is one in which a distributor acquires the right to distribute a completed motion picture that has been fully financed by someone other than the distributor itself. In the jargon of the industry, the movie's "negative" is complete and ready for the making of prints, and the distributor "picks up" the negative (along with the distribution rights to it) in exchange for a promise to pay the producer a share of the film's rentals. In a deal of this sort, the producer's share of film rentals is what is left after the distributor takes its distribution fee and has recouped its distribution expenses (including the cost of prints and advertising).

Originally, negative pick-up deals involved already-completed motion pictures. Negative pick-up deals of this sort were not truly sources of production financing, because production expenses had to be incurred before these deals could be made.[2] Several years ago, however, distributors began to make negative pick-up deals as early as the script stage,[3] and thus negative pick-ups became one variety of pre-sale.[4]

Arnold Kopelson — an Academy Award-winning producer, as well as a lawyer — provides an experience-informed look at the intricacies of pre-sale financing in his article *One Producer's Inside View of Foreign and Domestic Pre-sales in the Independent Financing of Motion Pictures.*[5] He reviews the history of pre-sales, explains how they work, comments on the advantages and the pitfalls of pre-sale financing, and suggests methods for avoiding the pitfalls. The article concludes with Mr. Kopelson's views on the future of pre-sales — a future he says is "bright."

LENDER FINANCING

Even if a producer makes enough pre-sales to cover the movie's anticipated budget, there still may be little or no money in the producer's bank account. This is because pre-sales and pick-ups usually do not yield much money, beyond a relatively small advance, until the movie is finished and delivered. In the meantime of course, the producer needs money for salaries, travel, equipment, costumes, and all of the other things that must be purchased and paid for while a movie is in production. Producers get the cash from lenders and investors.

In the movie business, some actors, directors, writers and properties are said to be "bankable." To the uninitiated, the implication is that "bankable" elements will enable a producer to borrow production funds from a bank, but that implication is not correct. Neither banks nor any other lender will loan production funds on the strength of even the most

2. Robert A. Geary, then Senior Vice President of Business Affairs for Orion Pictures, Presentation at UCLA Extension Program entitled "Financing Film Production: Raising Funds Through Pre-sales, Negative Pick-ups, and Investor Financing" (Apr. 28, 1984).

3. Diane Maddox, then Director of Film Acquisitions for Warner Bros., Presentation at UCLA Extension Program entitled "Financing Film Production: Raising Funds Through Pre-sales, Negative Pick-ups, and Investor Financing" (Apr. 28, 1984).

4. In his article for this Symposium, Arnold Kopelson distinguishes negative pick-ups from pre-sales. *See* Arnold Kopelson, *One Producer's Inside View of Foreign and Domestic Pre-sales in the Independent Financing of Motion Pictures,* 12 LOY. L.A. ENT. L.J. 1, 4 (1991). On the other hand, Jill Mazirow Eshman uses the term "negative pick-up" to describe what producers do when they "pre-sell" distribution rights. *See* Jill Mazirow Eshman, *Bank Financing of a Motion Picture Production,* 12 LOY. L.A. ENT. L.J. 87, 87 (1991). When a distinction is made between the two terms, it is likely that "negative pick-up" is used to describe a transaction in which a producer sells worldwide distribution rights for all media to a single distributor, while "pre-sale" transactions are those in which a producer sells distribution rights to several different distributors on a country-by-country and/or media-by-media basis.

5. Kopelson, *supra* note 4.

"bankable" elements, because bankable elements are not by themselves collateral. What is the case is that bankable elements enable producers to make negative pick-up deals or pre-sales, and banks will lend against future-payment commitments contained in pick-up and pre-sale agreements.

Bank loans for motion picture production differ signficantly from real estate and auto loans. Jill Mazirow Eshman, an attorney in the entertainment division of a bank that makes movie loans, explains exactly how they are done — from fees to documentation — in her article *Bank Financing of a Motion Picture Production.*[6]

INVESTOR FINANCING

While pre-sales and lenders may provide much of the money needed to produce a movie, most independent productions require investor financing as well, for a variety of reasons. As Mr. Kopelson's article explains, a producer must have certain elements in place — a screenplay, a distinguished director, a bankable actor and a budget — before potential buyers will consider making pre-sale offers. Ms. Eshman's article points out that banks require executed pre-sale contracts as collateral, in order to make loans. Thus, some money is necessary at the outset of a movie project in order to line up the essential elements that will result in pre-sale contracts and then production loans. Moreover, investor financing also is necessary if the budget cannot be fully funded by pre-sale advances and loans.

To raise money from investors, an independent producer may form a limited partnership. The producer becomes the general partner, and the investors become limited partners. In exchange for their investments, the limited partners receive pro rata portions of the limited partnership's share of the movie's profits.

The formation of a limited partnership for the purpose of financing an independently-produced movie looks simpler than it actually is. Indeed, trade papers frequently contain ads in their classified sections which appear to solicit just this sort of investment. As a legal matter, however, the formation of such a limited partnership raises complex issues involving federal and state securities laws. In fact, it is virtually certain that many if not most producers who place ads for investors in the trade papers inadvertently violate federal and state securities laws by doing so. This is because the sale of limited partnership interests (as well as all other kinds of "securities") must be registered under federal law

6. Eshman, *supra* note 4.

with the Securities Exchange Commission and/or qualified under state law with the California Department of Corporations (and/or the corresponding official of any other state in which the partnership interest is offered) — unless the sale is exempt.

While there are exemptions that are relevant to movie producers, structuring and documenting the sale of movie investments so that they are exempt requires the expertise of a knowledgeable securities lawyer. Furthermore, the anti-fraud provisions of the securities laws are always applicable, so that a detailed prospectus or offering circular is necessary in virtually every case.

The legal intricacies of forming motion picture limited partnerships, and selling partnership interests, are unraveled by securities attorney John W. Cones in his article *Feature Film Limited Partnerships: A Practical Guide Focusing on Securities and Marketing for Independent Producers and Their Attorneys.*[7] The article is a mini-treatise in itself on securities law, and especially on the "Regulation D" exemption from federal registration that is of greatest importance to independent movie producers. Mr. Cones' article is a step-by-step guide in the finest tradition of continuing legal education publications, and also a cautionary tale for those lawyers and producers new to the entertainment industry who may have thought (or hoped) that entertainment law is mostly deal-making, rather than law. If limited partnership interests are going to be sold to anyone outside of the producer's own family, Mr. Cones shows that entertainment lawyers get as caught up in regulations as any of their colleagues with clients in other industries.

Some people may invest in motion picture limited partnerships simply to participate in the glamour and excitement of the entertainment industry. Most, however, expect (or at least hope) for a cash return on their investments. In *Financial Guidelines for Investing in Motion Picture Limited Partnerships,*[8] Professor L.M. Farrell applies principles of finance (and mathematics) to movie investments and shows how the potential return on a movie investment can be calculated, from the limited partner's perspective.

COMPLETION BONDS

All of the financing methods used by independent producers are

7. John W. Cones, *Feature Film Limited Partnerships: A Practical Guide Focusing on Securities and Marketing for Independent Producers and Their Attorneys,* 12 LOY. L.A. ENT. L.J. 19 (1991).

8. L.M. Farrell, *Financial Guidelines for Investing in Motion Picture Limited Partnerships,* 12 LOY. L.A. ENT. L.J. 127 (1991).

based on a common assumption: that the producer will complete, on time and especially on budget, the very movie that is promised to the producer's pre-sale customers. If a producer were to go over-budget and run out of money before the movie were completed, the entire financial package would tumble like a house of cards. To protect against this possibility, all of those who advance production funds to independent producers — investors, lenders, and distributors — require something called a "completion bond."

A completion bond is an agreement by which a bonding company guarantees a movie's financiers that if the movie goes over budget before it is finished, the bonding company itself will pay whatever money is necessary to complete the movie, or will repay the financier's money in full. Completion bonds are issued by several companies, all of them backed by major insurance companies.

Completion bonds are of course more complex and more difficult to get than auto or fire insurance. Mark C. Phillips' article, *The Role of Completion Bonding Companies in Independent Productions*,[9] explains what completion bonds are, who issues them, and how they are obtained.

In addition to covering the business and legal aspects of completion bonding, Mr. Phillips points out a potential paradox faced by independent producers who must obtain completion bonds in order to secure their financiers. The paradox is this: many producers seek independent financing in order to retain greater creative independence than might be possible if they were to use studio financing instead; yet, the risks assumed by completion bond companies are such that they too insist on a measure of creative control — control which some producers went "independent" to avoid.

CONCLUSION

Each year, half or more of all movies released in the United States are produced by independents, rather than by major studios. Financing their production is a major and complex part of the task of getting them on the screen, and it is a part in which lawyers play an essential role. Most of the law with which these lawyers work does not appear in advance sheets or even statute books. It is reflected in unpublished contracts and unwritten industry practices.

This Symposium makes available invaluable information and insights about this fascinating slice of entertainment law.

9. Mark C. Phillips, *The Role of Completion Bonding Companies in Independent Productions*, 12 LOY. L.A. ENT. L.J. 97 (1991).