

Film Beat

Chasing Money

HOW TO ATTRACT CAPITAL TO YOUR MOVIE BY THINKING LIKE AN INVESTOR

By Mark Litwak

Mark Litwak is a veteran entertainment and multimedia attorney. His practice includes work in the areas of copyright, trademark, contract, multimedia law, intellectual property, and book publishing. Litwak also functions as a Producer's Rep, assisting filmmakers in the marketing and distribution of their films. He is Chairman of Reelplay.com an Internet site for the buying and selling of motion picture rights.



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Most filmmakers begin their careers by persuading one or more private investors to back them. Indeed, unless you are a Kevin Costner or a Barbara Streisand, there are limited alternatives open to you. It is rare for a distributor to back a first-time filmmaker. Banks will not lend you money without substantial collateral. Loans based on pre-sales are difficult because territory buyers typically insist on packages with name-actors from a director with a track record. That leaves most filmmakers looking to mom, dad and whatever they can scrape up from friends, relatives and Mastercard. While such resources have financed many a film, nowadays the bar has been raised as to what is considered marketable. With the glut of independent films available, most buyers won't even consider acquiring a film unless it 1) is shot on 35mm stock with name-talent, or 2) wins an important film festival.

Thus filmmakers are being forced to raise increasingly large sums of money to produce more expensive films with name-actors. Perhaps when digitally-shot motion pictures gain wider acceptance, production costs will decline. At the moment, however, there is a large pool of producers chasing a small pool of name-actors. This competition has driven up the price of talent, even for low-budget indie films.

As an attorney who represents both film investors and filmmakers, I have found that investors generally have a limited understanding of how films are produced, marketed and distributed. Likewise, filmmakers often don't understand how to structure their proposal in a way that makes it attractive to an investor.

In order to give filmmakers insight into the thinking of investors, let me offer you my checklist for investors who are contemplating a film investment. This checklist is designed to help investors protect themselves from unprofessional or unscrupulous filmmakers and distributors. It is my belief that if a filmmaker understands the investor's perspective, the filmmaker will be better able to address these concerns. This checklist is condensed; the full checklist is available on my web site: www.marklitwak.com. So let's look at things from the investor's point-of-view:

CHECKLIST FOR FILM INVESTORS

DUE DILIGENCE: Thoroughly investigate the reputation and track record of any filmmaker with whom you contemplate doing business. No contract can adequately protect you against a scoundrel. Speak to filmmakers and investors who have done business with a candidate. Check court records to see if the filmmaker or his company has been sued.

FULL DISCLOSURE: Federal and State security laws are designed to protect investors. Offerings to the public generally require prior registration with the SEC or a state agency. Usually private placements are limited to persons with whom the offeror has a pre-existing relationship. Even if registration is not required, the anti-fraud provisions of the security laws require that the offeror make full disclosure of all facts that a reasonably prudent investor would need to know when deciding whether to invest. The information disclosed should include a detailed recitation of all the risks involved in developing, producing and marketing a movie. Avoid any offering that appears to violate this requirement by making less than full and truthful disclosure.

TRACK RECORD: Do not back a filmmaker or production team that does not possess the proven skill needed to make a professional-looking movie. Avoid first-time filmmakers unless you are absolutely

As a result, the ability to woo investors has become a critical skill — one that is not taught in film school, and is rarely discussed in industry seminars or publications. Perhaps the best preparation for an aspiring filmmaker would be to attend business school and learn the intricacies of high finance. Even if you didn't pay much attention during class, you would graduate with a bunch of eager MBAs who several years later would be prime candidates to invest in your films. Better yet, go to Dental School.

Of course, most filmmakers hate to even think about fundraising. As "artists," they would prefer that someone else deal with the somewhat unsavory task of asking for money. Filmmakers without a godfather, rich uncle or willing spouse are forced off their pedestals to beat the bushes for cash. Most underestimate how difficult it is to raise money. Joel and Ethan Cohn spent an entire year raising funds to make "Blood Simple." First they produced a slick trailer. Then they contacted everyone they knew who could potentially invest. Many of their friends who promised to back them didn't come through when the time to cut the check arrived. But the Cohn brothers were shrewd networkers. Even those persons who were unable or unwilling to invest were asked to refer them to other prospects. Whenever they talked to someone who expressed any interest in the project, they would visit them and exhibit their trailer.

The Cohn brothers learned that the motivation for people to invest in film has little to do with the financial merits of the project. As will be discussed later, film is a lousy investment. There are no special tax breaks and the risk is tremendous. There are many reasons people invest in film, but the primary reason is that they are attracted to the glamour of the film business. If you think raising money for film is difficult, just imagine trying to convince investors to back you in your cinder block business.

People invest in films because they think making a movie will be exciting and fun. They may be turned on by the enthusiasm and passion of the filmmaker. They might want to rub shoulders with the "stars." They may have a special interest in the topic. They may seek to impress their friends by inviting them to a screening of "their" film. They may desire an "executive producer" credit, a role for their niece, or the worst hidden agenda, a starring role for themselves.

Your prime prospects are middle-class professionals: doctors, lawyers, dentists, etc. Most working-class folks can't afford to buy a \$10,000 unit in your limited liability company. Wealthy individuals are difficult to solicit unless you have a pre-existing relationship with them. Moreover, the rich tend to surround themselves with investment advisors. These gatekeepers are financially conservative types immune to stardust. They analyze investments on strictly financial terms, and under such criteria, movie proposals fair poorly.

The ideal investor is a doctor who makes several hundred thousand dollars a year and has substantial assets. He can afford to lose his entire investment in your film and the loss will not affect his lifestyle. This year instead of going to Las Vegas for a week and blowing ten grand, he is going to give it to you in the hope that it will be a more entertaining venture, it certainly won't be less of a gamble. The worse type of investor, and one that should always be avoided, is the retired schoolteacher who invests money she needs for her retirement.

You should know that film investments have a bad reputation, and deservedly so. There are instances where financiers have been cheated and lost their entire investment. Consequently, investors who have been burned, or those who have heard horror stories about film investments, may simply refuse to consider film-related investments. You will need to be persuasive and have your act together if you hope to raise funds. You need to convince prospects that film can be an intelligent investment for a portion of their portfolio. While film investments are risky, the potential return from a hit can be enormous. Not only can the film earn revenue from box office receipts, but there are many ancillary sources of income. These sources include revenue from television, home video, merchandising, music publishing, soundtrack albums, sequels and remakes.

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TRACK RECORD: Do not back a filmmaker or production team that does not possess the proven skill needed to make a professional-looking movie. Avoid first-time filmmakers unless you are absolute convinced they have the ability to make a professional-looking film. You are safer backing filmmakers who have made shorts, television movies, commercials, music videos, or industrial films. Partner with people of integrity who bring the skills, expertise and resources to the endeavor that you lack.

IDENTIFY THE POTENTIAL MARKET FOR THE FILM: There is a very limited market, and modest potential revenue, to be earned from short films, documentaries, black-and-white films, and foreign language pictures. Distributors and exhibitors are prejudiced against motion pictures shot on videotape. They prefer films shot on 35mm stock, although quality film shot on 16mm or Super16 mm stock can obtain distribution. The trade festivals do not exhibit motion pictures on videotape.

Certain themes, topics and genres can be difficult to sell. Religious-themed pictures can easily offend audiences. Cerebral comedies can be difficult to export because their humor may not translate well. Film with a great deal of violence may be shunned by European television, which is a prime market for independents. Films with explicit sex may not pass censorship boards in certain countries.

Independent films without name-actors are difficult to sell. Of course, name recognition varies around the world. The star of an American television series may be a big name in the United States but unknown abroad. On the other hand, some actors have large followings abroad yet are relatively unknown in the United States. There are several publications that can be consulted to determine the commercial appeal of actors. The Ulmer Guide (julmer@primenet.com) surveys financiers, sales agents and other industry insiders. Also, the Hollywood Reporter (213) 525-2087 publishes its "Star Power" guide.

AVOID DIRECTORS WHO DON'T CARE ABOUT THE AUDIENCE: The director of the film is the key person who will determine whether the final product is marketable. If a filmmaker shows little concern about making a movie with audience appeal, you can expect

the film whose exhibition will be limited to the family and friends of the filmmaker. This is not to say that the only films you should invest in are low-brow fare like "Dumb and Dumber." A well-made "art" film like "Elizabeth" can win awards and make a handsome return on investment. Filmmakers should give some thought beforehand as to the nature of the film's intended audience. I once watched a wonderful "Lassie" type film spiced with four-letter words uttered by one character. I explained to the filmmaker that his film would never sell in the family market because of the vulgar language and it was too soft a story to appeal to teens and adults. The film was never distributed.

CONGRUENCE OF INTERESTS: It is best to invest in an endeavor where everyone shares the same risk and rewards. A filmmaker who takes a large fee from the production budget may financially prosper from a picture that returns nothing to the investor. It is better to back a filmmaker willing to work for a modest wage and share in the success of the endeavor through deferrals or profit participation. An investor can take some comfort investing in a motion picture on the same terms as a producer or distributor, where all parties recoup at the same time. Beware of investing in a project where other parties benefit when you lose.

UNDERSTAND THE PARAMETERS OF A FAIR DEAL: Usually, investors are entitled to recoup some of their investment from first revenues before payment of deferrals or profits. Many times investors are allowed to recoup 110% or more of their investment in order to compensate them for loss of interest as inflation. Profits are declared after payment of debts, investor recoupment and payment of deferrals. Profits are generally split 50/50 between the producer(s) and the investors. Thus, investors who provide 100% of the financing are entitled to 50% of the profits. Third-party profit participants (e.g., the writer, director and star) are paid from the producer's half of net profits.

OBTAIN ALL PROMISES IN WRITING: Don't ever accept oral assurances from a producer or distributor. If they promise to spend \$50,000 on advertising, get it in writing. If there is not enough time to

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draft a long-form contract, ask for a letter reiterating the promises. Retain copies of all correspondence, contracts and any promotional literature. If a filmmaker makes fraudulent statements in order to induce you to invest, you will have a much stronger case if his statements are in writing.

Avoid filmmakers who make handshake deals. Such individuals may neglect to obtain the necessary contracts needed to fully secure ownership to their motion picture. In order to have a complete chain of title to a film, one needs to secure written contracts with many parties including actors, writers and music rights owners. Filmmakers who fail to pay attention to such legal niceties lack the professionalism needed to succeed.

SECURE AN ARBITRATION CLAUSE: Provide that any contractual disputes be subject to binding arbitration, rather than litigation, with the prevailing party entitled to reimbursement of legal fees and costs. Arbitration is usually a quicker, more informal, and less expensive method of resolving disputes than litigation. The parties and the arbitrator typically gather in a meeting room. Each side is given an opportunity to present documents and witnesses. The rules of evidence do not apply. Parties may be represented by counsel, or they may choose to represent themselves. Usually disputes are resolved within a matter of months.

INTEREST ON LATE PAYMENTS: Remove any incentive for a producer or distributor to hold onto your money. Courts may not award pre-judgment interest to a prevailing party, unless there is a provision in the contract providing for such interest. Thus, if you become embroiled in a dispute with a distributor who is unlawfully holding onto \$100,000 owed you, and after four years of litigation you win the case, the court may award you \$100,000 in damages without interest. During those four years the distributor could invest your money and reap the profits. Under such circumstances the distributor has an incentive to delay payment.

COMPLETION BOND: A completion bond is issued by a completion guarantor which is an insurance company that insures the production against budget overruns. Before issuing the policy, the completion bond company will closely review the production personnel, script and budget and assess whether they think this team of individuals can bring in this script within the shooting schedule and proposed budget. The completion bond company usually is quite diligent in its review because if the film goes over budget, the bond company is financially responsible. Having a completion bond should give investors some comfort. They know that if the budget is inadequate to complete the film, the investors will not confront the dilemma of either putting up more money or owning an unfinished film.

TAKE AN ACTIVE ROLE: As a shareholder in a corporation, or limited partner in a partnership, an investor has very limited control over the management of the enterprise. In the past, investors who wanted limited liability had to be willing to pay the price of accepting limited control. With a Limited Liability Company (L.L.C.), however, an investor can be one of the managers of the enterprise yet maintain limited liability. Thus, the investor can have a vote on critical decisions such as approval of the script, cast, budget, and distribution agreements. By being actively involved in the production, an investor will be better able to monitor the performance of the filmmaker and discover problems while there is time to remedy them.

MAKE SURE FUNDS ARE SPENT ON PRODUCTION: During fundraising, it is common for the filmmaker to set up an escrow account to hold investor funds. The money stays in the escrow account until the filmmaker raises the minimum necessary to produce the film. If the filmmaker cannot raise sufficient money, the funds in escrow are returned to the investors. By depositing money in an escrow account, investors are protected because they know none of their capital will be spent unless and until all the money needed to produce the film

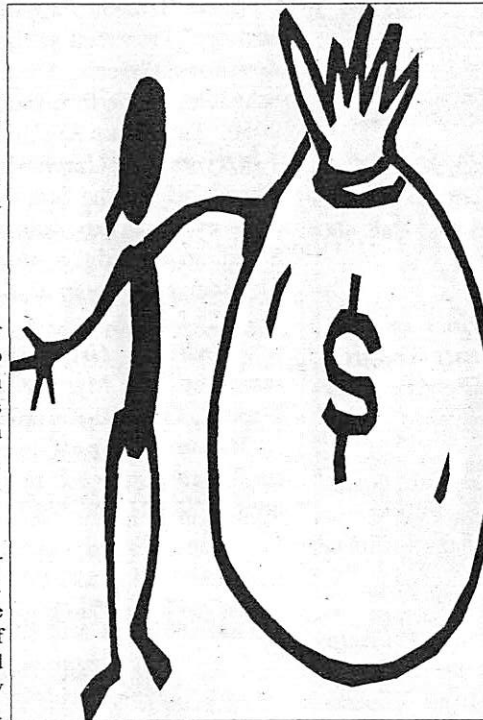
The lab access letter should include language permitting the filmmaker to receive copies of all invoices or reports disclosing the nature and amount of duplication performed. Some filmmakers insist that the laboratory ship all copies directly to the territory buyers.

OBTAIN AND REGISTER SECURITY INTERESTS: A security interest gives the secured party rights in designated collateral. A bank, for instance, has a security interest in the form of a mortgage when it disburses a home loan. If the house is sold, the bank loan must be repaid from the proceeds. In the movie and television industry, film lenders may want to secure their financial interests by obtaining a security interest in certain collateral, such as the film negative and master materials.

Likewise, investors may want to make sure the filmmakers they back protect their rights by having distributors grant the filmmaker or production entity a security interest. The collateral here is the proceeds derived from exploitation of the film. By having a security interest, the filmmaker will have superior rights to unsecured creditors. If a distributor goes bankrupt, its assets will be auctioned off to pay the distributor's creditors. One of the distributor's assets may be the right to distribute your film, and any revenue generated from this right. If the filmmaker has a security interest, then proceeds derived from it will be paid to the filmmaker first, as a secured creditor, before payment is made to the distributor's unsecured creditors (e.g., the office supply store).

It is important not only to have a written security agreement, but also to record it. The distribution agreement should have a clause granting the filmmaker a security interest. A separate long and short form security agreement is also signed by the parties, as well as a UCC-1 form which is signed and recorded with the Secretary of State where the collateral or distributor is located. The security interest should also be recorded with the Copyright Office at the Library of Congress in Washington, D.C. If you are not knowledgeable about security interests, it is advisable to retain an attorney to assist you.

DON'T INVEST MORE THAN YOU CAN AFFORD TO LOSE: Investing in a film is a highly risky endeavor. If a film doesn't appeal to audiences, or is not marketable, one's investment can be completely lost. Unlike some other products, you cannot discount the ticket price of a film and expect a line to materialize outside the box office. Moviegoers will not watch bad films even if they are offered for free. Consequently, investors should never invest more than they can afford to lose. □



Now Shooting... in Arizona!

- "Traffic" a major motion picture starring Michael Douglas films in Nogalis.
- Film House recently shot a :30 commercial for Leo Burnett, USA and their client Proctor & Gamble. Joe Beechler,

Lee Majors, and Robbie Knievel shot all their wrap around scenes at the Great Scott Studios for the pilot "Hollywood Stunts."

- "Imposter" starring Gary Sinise, Vincent D'Onofrio, Madeleine Stowe and Mekhi

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After funds are disbursed for production, there should be a system of checks and balances to ensure that all monies are properly spent and accounted for. A budget and cash flow schedule should be approved beforehand. Production funds should be placed in a separate segregated account and not commingled with the filmmaker's personal funds. All checks withdrawing funds from the account should be signed by two individuals. Investors may want to insist that one of the signatories is a trusted person selected by the investors.

OBTAIN AN EXPERIENCED ADVISOR: Have an experienced entertainment attorney review all documents. Make sure the filmmaker has adequate representation as well. Filmmakers may be very capable in the arena of production, and yet be unsophisticated in business matters. Filmmakers can be badly taken advantage of if they attempt to negotiate a distribution deal without assistance. Since the investor generally shares in the revenue paid to the filmmaker, if the filmmaker gets screwed, the investor suffers.

A skilled attorney or producer rep who represents many filmmakers may have added clout in negotiations. Such a person is aware of what distributors pay for films, and the concessions they are willing to make. By virtue of the attorney's or rep's relationships with festival directors and acquisition executives, attention can be drawn to a film that might otherwise get lost in the shuffle.

PROTECT THE MASTERS: The filmmaker or production company should retain possession of all master elements. Original film negatives, video masters, sound masters, artwork, still photos and slides should not be delivered directly to a distributor. Instead, the distributor should be given a lab access letter permitting the distributor to order copies of the film to fulfill orders.

There are numerous reasons why a producer should retain possession of master elements:

1) Masters may be irreplaceable. If lost or damaged, the producer will incur a substantial expense to replace them, if they can be replaced.

2) In the event of a dispute, it is best for the producer to control the materials. If the distributor has defaulted, for instance, the filmmaker may have a right to terminate the agreement and seek a new distributor. The filmmaker will need access to the materials, however, in order to make delivery to a new distributor.

3) If the initial distributor goes bankrupt, the filmmaker will not want to have to go to court to extricate materials from bankruptcy proceedings.

4) Several distributors may need access to the materials. Typically, independent filmmakers enter into multiple distribution deals. Often, one deal is concluded with an international distributor (a.k.a. foreign sales agent) to distribute the film outside North America, and one or more deals may be made with a domestic distributor for distribution in the United States and Canada. The best solution, when dealing with multiple distributors is to place the materials in a professional laboratory. Each distributor is granted a lab access letter enabling the distributor to order copies.

5) One can discourage cheating by keeping masters in a laboratory and having the lab report to the filmmaker how many copies have been duplicated. Suppose that at the end of one year, the lab reports that ten film prints have been made. The producer report only indicates eight sales. This is a red flag alerting you that sales may have been made that were not reported. Most filmmakers would not know if their film had been licensed in Malaysia. Distributors do not order copies of films without an order in hand. Typically, they receive full payment for the film before they manufacture a duplicate and ship it.

Situations for the past Hollywood stunts.

- "Imposter" starring Gary Sinise, Vincent D'Onofrio, Madeleine Stowe and Mekhi Phifer, produced by PK Productions, shot in Phoenix at the Arizona Science Center.
- Arizona-based independent film, "Greasewood Flats" has been postponed until the fall in order to accommodate of the their name actors.
- Optimo Advertising and Small But Mighty Films shot a Spanish language commercial for Arizona Tobacco Education and Prevention Program.
- A trailer for the low-budget indie "Soul Searchers" is being shot by Sarber Productions.
- "Cooking's A Drag" a pilot produced by Scott Weiner, shot here in Arizona.



ENTERTAINMENT LAW RESOURCES

WWW.MARKLITWAK.COM



A COMPREHENSIVE WEB SITE FOR FILM, TELEVISION AND MULTIMEDIA PRODUCERS MAINTAINED BY MARK LITWAK, ATTORNEY & PRODUCERS

- *Legal Insights for Entertainment and Multimedia: A Periodic Newsletter
- *Filmmaker's Bill of Rights
- *Breaking Into Show Biz
- *Contract Law As A Remedy For Story Theft
- *Movie Merchandising
- *Protecting Film Investors
- *Obtaining Music For A Motion Picture Soundtrack
- *Copyright Registration of Scripts & Films
- *Dealmaking Tips for Film and Television: The Acquisition/Distribution Agreement
- *The Film Distribution Deal: Tactics and Strategy
- *International Co-Production Checklist
- *International Subsidy Organizations
- *Self-Defense for Filmmakers
- *Distribution and the Indie Filmmaker
- *Script Annotation Guide
- *Entertainment Industry Banks
- *Insurance & Completion Bond Companies
- *Negotiating the Electronic Publishing Agreement
- *Publishing Agreement Checklist
- *Copyright Registration of Multimedia Works
- *Copyright Notice for Multimedia Works
- *Legal Roadmap for Multimedia Productions