Film Financing Overview

A Practical Guidance® Practice Note by
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This practice note provides an overview of film financing. It covers the customary ways in which motion pictures are financed, including studio financing, pre-sale bank loans, tax and in-kind incentives, and public and private offerings. The private placements section includes discussion of exemptions for intrastate offerings (17 C.F.R. § 230.147), Regulation D, Blue Sky Laws, and 504 (17 C.F.R. § 230.504) and 506 (17 C.F.R. § 230.506) offerings. Completion bonds, pay or play provisions, and crowdfunding are also explained. The note concludes with steps counsel can take to protect the interest of clients investing in motion pictures and the role of security interests in the context of film financing.

Topics discussed in this practice note include:

- Studio Financing
- Bank Loans Based on Pre-sales
- Domestic Tax Incentives
- In-Kind Incentives
- International Tax Incentives
- Public Offerings
- Private Placements
- Exemptions for Private Placements
- Completion Bonds
- Pay or Play
- Crowdfunding with Donations
- Crowdfunding Investments
- Protecting Investors
- Obtaining and Registering a Security Interest

Arranging financing for film projects is often difficult even for experienced producers. Unlike many other products, no one can really predict the potential success of a film, and therefore, there is always significant financial risk with any production. Most films are not financially successful endeavors.

Most projects will be owned by a special purpose or single purpose vehicle (SPV) that is typically a corporation or a limited liability company. These entities are created to insulate the assets of the producer, any parent company, and the financiers from liability. Insurance companies also prefer a new entity that has no liabilities from past activities. The SPV will contract with cast, director, crew, investors, any guilds, and distributors.

For related practical guidance, see Motion Picture Production Agreements and Documents, Loan Agreement (Financing Motion Picture) and Laboratory Pledgeholder Agreement (Financing Motion Picture).

Studio Financing

For experienced producers with a track record, the easiest path is often to present a package of script, principal actors, director, and budget to a major studio such as Warner Brothers, with a request that they finance the project. If the studio says yes, keeping in mind that only a small percentage of the projects pitched are approved, the studio will provide the entire budget. The film will be fully financed, and the budget will include a production services fee of approximately 10% to compensate the producers for their services. Producers may also be able to negotiate bonuses, deferments, and profit participation. The studio will own the movie and usually will have the right to make changes and control the final cut of the film. Major streamers like Netflix also enter into such production deals.

In this scenario, there is minimal financial risk to the producer because the studio is providing the entire budget. Moreover, there will be a contingency line of about 10% of the budget to cover any unanticipated overages. There may also be a completion bond to insure completion. If you are a producer with a track record, this may be the quickest way to fund your project. But many aspiring producers cannot get in the door to pitch their projects to a major studio or streamer.

Negative Pickup Deal

A negative pickup deal is a variation of studio financing. The studio guarantees payment of the budget on delivery of the film for a fixed amount. The producer needs to finance the production and is paid on delivery of the film. This scenario is similar to a pre-sale agreement of foreign rights, as explained below. "Negative" refers to film negative, which often does not exist today as many films are now shot on a digital medium.

Bank Loans Based on Pre-sales

An alternative way to finance a film involves debt financing from a bank or third party. One avenue is when a producer (or sales agent) raises funding by preselling distribution rights to various territory buyers and then uses those contracts as collateral for a production loan. For example, a German distributor wanting to distribute the project in Germany might enter into a license agreement for a film to be produced. Financing through pre-sales can be a difficult process because there are many different agreements that need to be made with buyers that may have competing interests.

International sales agents are a type of distributor, although they usually do not own a single theater, home video label, or television outlet. They are essentially distributors that license films to local or territory distributors (buyers). Territory distributors acquire rights to exhibit a film within their country or license rights for several different countries (such as all Scandinavian rights). They often learn about upcoming projects from sales agents who they meet at various film and television markets held throughout the year. Sales agents and buyers typically attend the three major film markets, which are at Cannes, Berlin, and Santa Monica (AFM), as well as TV markets such as Mip and MipCom.

Pre-sales require a distributor to sign a contract to license a movie for distribution in their country even though the movie does not yet exist. By pre-buying the movie, the buyer knows that when it is completed they will not have to compete with other buyers for the rights to distribute the film in their territory. On the other hand, if the movie does not turn out well, they have already committed to buy the rights. These agreements, mostly focused on buyers in large territories that can offer a substantial license fee, such as France or the United Kingdom, are used as collateral for a production loan. Pre-sale buyers will usually require a completion bond before committing to license a movie. The bond is an insurance policy that guarantees that the film will be delivered on time and within budget—or their investment will be returned. See Completion Bonds.

For more information and pre-sale and completion guarantee templates, see Entertainment Industry Contracts 16.01–16-2 and Entertainment Industry Contracts 16A.01–16A-3.

When relying on production bank loans based on pre-sales, a producer must first assemble a package including the script, stars, director, and budget. Writing a great script can take years of effort. Once the script is ready, the producer then assembles the other elements. However, pre-sale buyers, and directors may want to approve the script, budget, and stars before making a commitment. For example, a buyer might insist that the producer hire an actor who has a following in their country to make the film more marketable there.

There are a limited number of specialized banks that will provide production financing. These banks are knowledgeable about the buyers and whether they are financially sound and likely to pay for the film upon delivery. The borrower (producer) will assign to the bank (lender) a security interest in the collateral which is all of the borrower's rights in the motion picture and any proceeds from it. The sales agent will have acquired the right to distribute the motion picture from the borrower.

Completion Guarantor

The bank and a completion guarantor enter into a completion guarantee agreement pursuant to which the completion bond company has guaranteed to the bank that the picture will be completed and delivered to the sales agent. In other words, if there are cost overruns and the production budget does not have sufficient funds to complete the picture, the completion guarantor will step in and advance those funds so the picture can be delivered. The bank assigns to the completion guarantor a security interest in the collateral subject only to the bank's rights under the loan agreement.

The completion bond company, bank, borrower, and sales agent will enter into an interparty agreement that will supersede the other agreements entered into by the parties. It will require the sales agent to approve the screenplay, principal cast, director, producer, and budget of the picture, and to remit all receipts derived from the picture to the bank to repay the production loan. The borrower, sales agent, completion guarantor, bank, and each distributor will enter into a notice of assignment. This agreement assigns all amounts payable by the distributor to the completion guarantor, subject to the rights of the bank. All revenues are remited to the bank and the completion guarantor (if they have advanced monies) until they have been repaid. For related templates, see Loan Agreement (Financing Motion Picture) and Laboratory Pledgeholder Agreement (Financing Motion Picture).

The production company, which is usually the borrower, will also have to negotiate various production agreements before the loan will be disbursed. For further discussion, see Motion Picture Production Agreements and Documents. Finally, the bank will require that certain insurance policies be purchased including liability and errors and omissions insurance. For more on errors and omissions insurance applications and clearance procedures, see Entertainment Industry Contracts P 15.01.

Domestic Tax Incentives

Another method to partially finance films relies on tax incentives to cover a portion of the production budget. In this context, tax incentives are sometimes referred to as "soft money." These rebates are usually based on the amount spent on production within the applicable state. Some states allow producers to transfer their incentive to a third party and receive cash for it to provide production financing.

For example, Georgia offers a tax credit of 20%–30% for money spent on crew. There is a 20% base tax credit and an additional 10% that can be earned by including an embedded Georgia logo on the film and a link to Explore Georgia.org/Film on the project's landing page. Production expenditures must be made in Georgia from a Georgia vendor to qualify. There is a minimum expenditure of $500,000 required. For a project to be eligible for the 20% transferable tax credit, the Georgia Department of Economic Development must certify the project. (More information may be found on the Georgia state website.)

In-Kind Incentives

Another type of incentive may be reduced prices for locations, facilities, use of police, and permit fees. New York City, for example, provides a tax credit, free police traffic control, and does not charge for permits. See New York City Mayor's Office of Media and Entertainment.

Certain companies may offer free products for use in a film in exchange for showing the product on screen. This is known as product placement. The producer is permitted to feature a company's product in the film, along with a release of any intellectual property rights. Sometimes, manufacturers may pay a fee to include their product in a film. For an in-depth discussion of product placement agreements, see Product Placement Agreements.

International Tax Incentives

In addition to domestic incentive programs, producers also consider other benefits that can arise from taking a production abroad. In Eastern Europe and South Africa, for example, the wage scale is so low that local crew members and extras can be hired for a fraction of the cost of those in the United States. Likewise, food, lodging, equipment, and construction costs can be a bargain. If a producer can hire crew members or book a hotel for 20% of what those items would cost in the U.S., then the producer is essentially receiving an 80% subsidy. But savings may be offset by increased travel and accommodations costs, which may be negligible for a moviemaker shooting in the moviemaker's own community. Additionally, some locations may not offer the equipment rentals needed for a shoot. If you shoot in New York or Los Angeles, and a camera breaks, it can be replaced in a few hours from local vendors. That is not necessarily the case if you need a replacement in a far-off locale.

Productions in Canada

Canada has been very successful in luring American productions to its country. Toronto and Vancouver have a deep reservoir of skilled and experienced crew members, so numerous productions can shoot simultaneously. A favorable exchange rate with the U.S. dollar may allow American producers to stretch their resources by buying goods and services for less.

Canada offers a variety of programs designed to support both Canadian and foreign producers. A distinction is made between Canadian content films, which receive a generous tax credit, and films without Canadian content, which are eligible for a substantial but lesser credit. Producers cannot receive benefits under both programs simultaneously, but they may combine these production incentives with those offered by Canada's provincial governments.

Many countries have co-production treaties that allow filmmakers to take advantage of incentive programs in several countries simultaneously. Canada, for example, has entered into more than 50 co-production treaties with other countries. These allow their filmmakers to combine incentives from several countries. However, each country will require certain minimum local elements to qualify. The production may have to shoot in Canada, arrange post-production in South Africa, and include cast and crew from both. Note that changing scripts and cast merely to attract co-financing does not necessarily improve a film. "Europudding" is the derogatory term for bad movies comprised of awkward stories welded together to attract multisource financing.

For information on tax incentives worldwide, see Entertainment Partners. For additional information on film commissions, see the Association of Film Commissioners International.

Public Offerings

A public offering is a process by which an issuer offers securities such as equity shares to investors on the open market. Independent filmmakers rarely attempt to raise funds from a public offering on a public market such as the New York Stock Exchange. The accounting and legal expenses amount to hundreds of thousands of dollars.

Initial public offerings (IPOs) occur when a company sells shares on listed stock exchanges for the first time. A public offering usually requires the issuing company to publish a prospectus detailing the terms and rights attached to the offered security, as well as information on the company itself and its finances. Many other regulatory requirements surround a public offering. An investment underwriter usually manages or facilitates public offerings. The Securities and Exchange Commission (SEC) must approve all registrations for public offerings of securities in the United States.

For an in-depth discussion of IPOs, see Initial Public Offering Process and Initial Public Offerings Resource Kit in the Capital Markets & Corporate Governance practice area of Practical Guidance. See also U.S. Securities and Exchange Commission – Regulation A.

Private Placements

Filmmakers try to avoid the burden and expense of SEC registration by qualifying for one or more of the exemptions to registration. These exemptions are largely restricted to private placements, which generally entail approaching people one already knows (i.e., the parties have a preexisting relationship) rather than offering an interest to the public at large. Private investors are often family or friends, or others who are willing to take a lot of risk because if the script does not turn out well, or the producer cannot attract the other elements needed to make a successful film, their investment can be completely written off.

Producers will need an investment agreement for projects funded by private investors. These offerings are often subject to state and federal security laws designed to protect investors. An equity investment can be structured in a number of different ways such as using a corporation, an LLC, or a limited partnership.

Active vs. Passive Investors

A major consideration is whether the investors are going to be active or passive. An active investor is one that is managing the business with you. If all the investors are active, such as when a writer, director, producer, and actor collaboratively make a film and finance it themselves, the deal can be structured as a joint venture or co-production. Since all the parties are involved in making the movie, there are no security issues, and you may only need a co-production agreement among the parties, and often an LLC to make and own the movie. Such a co-production or collaboration agreement would set out the various rights and obligations of the partners including what screen credits each would receive, what tasks they would handle, and how decisions would be made.

However, if any of the investors are passive, meaning they are putting money into the endeavor but have little or no other involvement in making the movie or running the business, then the security laws will apply. State and federal securities laws are designed to protect such investors by ensuring that the people managing the business do not defraud them by giving them false or misleading information, or by failing to disclose information that a reasonably prudent investor would want to know. These laws have strict requirements and it can be complex and expensive to comply with them. A single technical violation can subject general partners to both civil and criminal liability.

Exemptions for Private Placements

There are several of exemptions for private placements.

Intrastate Offerings

There is an exemption for intrastate offerings by an issuer within that state that is limited to investors all of whom reside in that state. To qualify for the intrastate offering exemption Rule 147 (17 C.F.R. § 230.147), a company must:

- Be incorporated in the state where it is offering the securities –and–
- Carry out a significant amount of its business in that state

There is no fixed limit on the size of the offering or the number of purchasers under federal law. Relying solely on this exemption can be risky, however, because if an offer is made to a single nonresident the exemption could be lost. Issuers conducting an offering pursuant to Rule 147 or Rule 147A are not required to file any information with or pay any fees to the SEC. Issuers, however, must comply with state securities laws and regulations in the state in which securities are offered or sold.

For further information, see the U.S. Securities and Exchange Commission's Intrastate Offering Exemptions: A Small Entity Compliance Guide for Issuers.

Regulation D

Under SEC Regulation D (Reg. D), there are several exemptions from federal registration. These can permit filmmakers to offer and sell their securities without having to register the securities with the SEC as required for public offerings.

While companies relying on a Reg. D exemption do not have to register their securities and usually do not have to file reports with the SEC, they must file a document known as Form D when they initially sell their securities. This document gives notice of the names and addresses of the company's owners and promoters. State laws may also apply, in which case the offeror will likely need to file a document with the appropriate state agency for every state in which an investor resides.

Blue Sky Laws

State registration can be avoided by complying with the requirements for limited offering exemptions under state law. These laws are often referred to as "Blue Sky" laws. They were enacted after the stock market crash that occurred during the Great Depression. They are designed to protect investors from being duped into buying securities that are worthless—backed by nothing more than the blue sky. See Securities and Transaction Exemptions under Blue Sky Laws in the Capital Markets & Corporate Governance practice area of Practical Guidance.

The above-mentioned federal and state exemptions may restrict offerors in several ways. Sales are typically limited to 35 nonaccredited investors, and the investors may need to have a preexisting relationship with the issuer (or investment sophistication adequate to understand the transaction), the purchasers cannot purchase for resale, and advertising or general solicitation is usually not permitted. There is generally no limit on the number of accredited investors.

A "preexisting relationship" is defined as any relationship consisting of personal or business contacts of a nature and duration such as would enable a reasonably prudent purchaser to be aware of the character, business acumen, and general business and financial circumstances of the person with whom the relationship exists.

504 Offering (17 C.F.R. § 230.504)

A 504 Offering under Regulation D exempts from registration the offer and sale of up to $10 million of securities in a 12-month period. A company is required to file a notice with the Commission on Form D within 15 days after the first sale of securities in the offering. In addition, a company must comply with state securities laws and regulations in the states in which securities are offered or sold. Because one also has to comply with state securities laws, this section is not used as often as the 506 offering below.

The following companies are not eligible to use Rule 504:

- Exchange Act reporting companies
- Investment companies
- Companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies –and–
- Companies that are disqualified under Rule 504's ''bad actor'' disqualification provisions

Under the Securities Act, some offerings are not required to be registered or qualified by state securities regulators. Even if the offering is made under one of those exemptions, the states still have authority to investigate and bring enforcement actions for fraud, impose state notice filing requirements, and collect state fees. The failure to file or pay filing fees regarding any such materials may cause state securities regulators to suspend the offer or sale of securities within their jurisdiction. Companies should contact state securities regulators in the states in which they intend to offer or sell securities for further guidance on compliance with state law requirements. You can locate your state security regulator on the North American Securities Administrators Association (NASAA) website.

506 Offerings (17 C.F.R. § 230.506)

There are two offerings under Rule 506, 506(b) and 506(c).

Rule 506(b) (17 C.F.R. § 230.506(b))

Under Rule 506(b), a company can be assured it is within the Section 4(a)(2) exemption by satisfying the following standards:

- The company cannot use general solicitation or advertising to market the securities.
- The company may sell its securities to an unlimited number of "accredited investors" and up to 35 other purchasers.
- Unlike former Rule 505, all nonaccredited investors, either alone or with a purchaser representative, must be sophisticated—that is, they must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment.
- Companies must decide what information to give to accredited investors, so long as it does not violate the anti-fraud prohibitions of the federal securities laws.
- Companies must give nonaccredited investors disclosure documents that are generally the same as those used in registered offerings.
- If a company provides information to accredited investors, it must make this information available to nonaccredited investors as well.
- The company must be available to answer questions by prospective purchasers.

Under Rule 506(b), one can raise an unlimited amount of capital. These offerings are not subject to state registration or qualification. There is no limit as to the number of accredited investors that can participate. However, only 35 nonaccredited investors can participate. For further information and related content, see Private Placements Resource Kit in the Capital Markets & Corporate Governance practice area of Practical Guidance.

Rule 506(c) (17 C.F.R. § 230.506(c))

Under Rule 506(c), a company can broadly solicit and generally advertise the offering, but still be deemed to be a private offering within Section 4(a)(2) if (1) the investors in the offering are all accredited investors and (2) the company has taken reasonable steps to verify that its investors are accredited investors. Verification could include reviewing documentation such as W-2s, tax returns, bank and brokerage statements, credit reports, and the like.

Accredited investors include (among others) the following:

- Any natural persons whose individual net worth, or joint net worth with that person's spouse, at the time of the purchase exceeds $1,000,000, excluding their primary residence
- Any natural person with an individual income in the two prior years and an estimated income in the current year in excess of $200,000 or joint income with spouse of $300,000
- Any director, executive officer, or general partner of the issuer of the securities being offered or sold –or–
- Any director, executive officer, or partner of a general partner of the issuer

Under Rule 506, each purchaser of units must be "sophisticated," as that term is defined under federal law. Note that an "accredited investor" is not the same as "sophisticated" investor. The term "accredited investor" is specifically defined by the federal securities laws, while the term "sophisticated investor" has no precise legal definition. Both terms generally refer to an investor who has a sufficiently high degree of financial knowledge and expertise such that they do not need the protections afforded by the SEC. An investor who is considered "sophisticated," might not meet the precise definition of an accredited investor.

It is up to the offeror to decide what information is given to accredited investors, provided there is no violation of the anti-fraud provisions. Nonaccredited investors must be given disclosure documents similar to those used in registered offerings. If the offeror provides information to accredited investors, the same information must be given to nonaccredited investors. The offeror must be available to answer questions by prospective purchasers.

Under Rule 506, each purchaser must represent that they are purchasing the units for their own investment only and not with plans to sell or otherwise distribute the units. The units purchased are "restricted" and may not be resold by the investor except in certain circumstances.

All security offerings, even those exempt from registration under Reg. D, are subject to the anti-fraud provisions of the federal securities laws, and any applicable state anti-fraud provisions. Consequently, the offeror will be responsible for any false or misleading statements, whether oral or written. Those who violate the law can be pursued both criminally and civilly. Moreover, an investor who has purchased a security on the basis of misleading information, or the omission of relevant information, can rescind the investment agreement and obtain a refund of their investment.

It is customary for the private placement memorandum to contain detailed information about the risks of the investment, the biographies of the principals, a budget summary, and other information a reasonably prudent investor would want to know.

Documentation

Counsel must prepare a number of different documents for a private placement to give to potential investors. These include the following:

- A private placement memorandum (PPM)
- An operating agreement of LLC (or bylaws for a corporation or partnership agreement if a partnership)
- A subscription agreement
- An investor questionnaire
- Forms to file in each state in which you are making an offer

Other documents may need to be filed with federal and state governments:

- A Certificate of Limited Partnership may need to be filed with the secretary of state to establish a partnership.
- If the transaction is subject to federal law, Form D will need to be filed electronically with the SEC within 15 days after the first sale.
- In California, a notice of the transaction and consent to service of process is filed with the Department of Corporations.

PPMs can be made under different offering rules.

For an overview of U.S. federal securities laws, see U.S. Securities Laws in the Capital Markets & Corporate Governance practice area of Practical Guidance. For related private placements content, including practice notes, templates, and checklists, see Private Placements Resource Kit in the Capital Markets & Corporate Governance practice area of Practical Guidance. To file a Form D, see U.S. Securities and Exchange Commission.

Completion Bonds

Investor funds are often held in escrow accounts and only if certain conditions are met are they released to be used to produce the film. Investors are often concerned about what happens if the producer runs out of money before production has been completed and the film delivered. In order to provide reassurance, the producer will often secure a completion bond. This is a special type of insurance that provides completion funds if a movie goes over budget. Such overages may occur, for example, when the production encounters unforeseen circumstances such as bad weather or a star getting sick. Perhaps the worst-case scenario is the death of a star before completing the role. In such a scenario, the completion bond company steps in to supply enough funds to finish the film. Or if the project cannot be completed, it will reimburse the investors for their contributions. Completion bonds are expensive, usually costing 3% or more of the net production budget. Some companies may rebate part of this fee if no claims are made. Completion bond companies usually will not bond low budget films.

Completion bond companies are selective in which projects they are willing to insure. They want their premium dollars but do not want to take unnecessary risks. Therefore, they impose many conditions before they will issue a completion bond. The bond companies have experts on staff to review budgeting and production, and they will make sure the budget is a realistic estimate of what it will cost to make the movie. The "strike price," or "production price" is the amount that the guarantor believes will be needed in order to complete and deliver the film. This includes above and below the line costs, fringes, insurance and financing costs, the completion bond guarantor's fee, and a contingency allowance.

The contingency line in the budget is usually about 10% of direct expenses to cover unanticipated costs. For example, a $20 million film might allocate up to $2 million for these unforeseen overages. The bond is usually issued right before production commences because a lot of documents and approvals need to be secured. The bond company requires signed contracts with the director and the stars firmly committing them to perform in the movie. An actor expressing interest in the film is not the same as one signing a binding contract. If the production is funded in part by a bank loan, the bank will not disburse the funds until the completion bond company issues the bond.

The bond company will also insist that the producer buys the following insurance:

- Liability and errors and omission insurance
- Insurance to cover equipment breakdowns
- Cast insurance
- Workers compensation –and–
- Negative insurance to ensure the film negative or hard drive is not defective

The bond company will review the credentials and background of all the key people making the movie, such as the department heads, director, producer, and principal cast. If your star has a history of drug use, or being unreliable, that person may not be bondable, and the bond company might refuse to insure the production. Stars may also have to submit to a medical exam.

In the event the bond company agrees to bond the film, it is given extraordinary powers. The bond company can fire the director if they go over budget. The bond company is liable for overages, so if a director is taking more time than expected, the director can be replaced.

This process of packaging a project can be intense for the producer because so many deals need to be finalized quickly. What happens if the producer signs a deal with a star and guarantees a $1,000,000 fee with a start date of July 1, and then is unable to secure a co-star, director, or other essential element of the package? The producer could lose the star, have to pay the fee, and then need to restart the process.

Pay or Play

Movie stars usually will not agree to perform in a film without the producer committing to pay them on a pay or play basis. This means they get paid even if the project does not go into production, provided they are not in default. If you are a star like George Clooney, you are offered dozens of projects every year. Even an actor who is a workaholic only has time to perform in a few movies each year because each one takes several months to shoot, with additional rehearsal and post-production time.

Thus, if you offer Margot Robbie a role in your movie, and she wants to do it, she will not firmly commit to it until you give her a start date and a pay or play guarantee that she will be paid her fee regardless of whether or not you actually commence production. This is because Margot Robbie knows once she signs a contract with you, if the next day she is offered the role of a lifetime in a movie about something she cares deeply about, she will have to turn that job down. She is therefore not going to firmly commit to be in your movie until you have secured the entire production budget, or at least commit to pay her regardless of whether you can assemble all other elements needed to go into production. Moreover, if you are an independent producer, you will likely have to make a substantial deposit in an escrow account for her to sign a contract. If she is contracting with a major studio, she might not require this, but for an independent producer, her agents may insist on a deposit. Stars may also require approval over the selection of the director, co-star, and any script changes.

For further information, see Entertainment Industry Contracts P 16A.01–16A.02.

Crowdfunding with Donations

Crowdfunding refers to the process of raising money to fund a project or business through numerous small contributors, often using an online platform or funding portal to solicit investment. Because investing in film is such a risky endeavor, being able to spread that risk among many people may substantially increase the amount of financing available for a film. Before the Tax Cuts and Jobs Act of 2017 (Pub. L. No. 115-97), crowdfunding could only be accomplished by seeking donations. Web portals such as Kickstarter and Indiegogo could help filmmakers raise such donations. While those who made a donation could not share in any profits, they might receive certain benefits, such as a screen credit on the film, a poster, t-shirts, or other "swag."

Crowdfunding Investments

With passage of the JOBS Act, promoters are now able to offer a share of the profits in a project. This will likely encourage small investors who want to participate in film or other start-up businesses, but can only afford to make a modest investment.

Funding portals are platforms that provide investors with information about investments being offered. These portals are designed to allow internet-based platforms or intermediaries to facilitate the offer and sale of securities without having to register with the SEC as brokers. Portals are required to register with the commission and become a member of a national securities association, currently the Financial Industry Regulatory Authority, Inc. (FINRA). FINRA is an independent, nongovernmental regulator for all securities firms doing business with the public in the United

States. It is authorized by Congress to protect American investors by making sure the securities industry operates fairly and honestly.

The new Regulations for Crowdfunding are to implement the requirements of the Jumpstart Our Business Startups Act (JOBS Act), enacted on April 5, 2012.

To qualify for equity crowdfunding one must meet specified requirements, including the following:

- The amount raised must not exceed $5,000,000 in a 12-month period.
- Individual investments in all crowdfunding issuers in a 12-month period are limited to the greater of $2,500 or 5% of annual income or net worth, if annual income or net worth of the investor is less than $124,000 or 10% of annual income or net worth if annual income or net worth of the investor is $124,000 or more. –and–
- The funding portal must be registered and follow the rules that govern it.

If you are an accredited investor, there are no limits on the amount you can invest. For more information, see SEC Updated Investor Bulletin, Regulation Crowdfunding for Investors.

One can only invest in a Regulation Crowdfunding offering through the online platform of a broker-dealer or a funding portal, such as a website or a mobile app. Companies may not offer Regulation Crowdfunding investments to investors directly—they must use a broker-dealer or funding portal. A list of portals can be found on the FINRA website.

Companies that offer and sell securities to the public in reliance on an exemption from registration for securities-based crowdfunding must make filings on the Electronic Data Gathering, Analysis, and Retrieval system (EDGAR), the primary system for companies and others submitting documents under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. The database provides free public access to corporate information, allowing you to research a public company's financial information and operations by reviewing the filings the company has made with the SEC.

Unfortunately, there are a lot of unethical persons attempting to raise funds. To avoid fraudsters, counsel should conduct due diligence. There are ways to check on brokers and promotors in addition to checking court records. FINRA offers a website called BrokerCheck. BrokerCheck is a free tool to research the background and experience of financial brokers, advisers, and firms. BrokerCheck gives you a snapshot of a broker's employment history, regulatory actions, investment-related licensing information, arbitrations, and complaints—including a list of brokers that are barred by FINRA.

For further information, see the related content in the Capital Markets & Corporate Governance practice area of Practical Guidance: Regulation D, Regulation A+, and Regulation Crowdfunding Requirements Chart, JOBS Act Crowdfunding Regulations, and Crowdfunding under the JOBS Act.

Protecting Investors

Counsel representing investors can take a number of steps to protect their client's interests. Thorough investigation of all the participants involved in any investment deal is important. Just as an experienced investor would research a corporation before purchasing shares of its stock, an attorney should check into the reputation and track record of any producer or distributor with whom a client contemplates doing business.¬ Background checks should involve such things as speaking to filmmakers and investors who have done business with a candidate, reviewing a candidate's previous work, and even obtaining court records to see if the candidate or their company has been sued. Simply put, research will greatly increase the odds that your business partner will be a person of integrity who brings the skills, expertise, and resources needed to succeed in the endeavor.

The importance of the track record of the film's producer or distributor cannot be understated. A prudent film investor should never back a filmmaker or production team that does not possess the proven skill needed to make a professional looking movie. While the rewards of such a venture are potentially high, the risk involved in investing in first-time filmmakers is great. You are safer backing filmmakers who have completed at least one short or a feature-length work. Filmmaking involves a tremendous learning curve. A filmmaker with many films to their credit will be measurably more professional, prepared, and understanding in dealing with you and your potential business relationship.

For further discussion, see Due Diligence for a Private Offering in the Capital Markets and Corporate Governance practice area of Practical Guidance.

Obtaining and Registering a Security Interest

A security interest gives the secured party rights in some designated collateral. In the movie and television industry, film lenders may want to secure their financial interests by obtaining a security interest in the film negative and master materials. Likewise, investors may want their filmmakers to protect themselves by having distributors grant a security interest. The collateral here is the proceeds derived from exploitation of the film. By obtaining a security interest, the filmmaker will have rights superior to those held by unsecured creditors. This can be a tremendous benefit if the distributor goes bankrupt. In such an event, the proceeds derived from the sale of the distributor's assets, including the right to distribute the investor's film, will be paid to the filmmaker first. Lenders will also want a security interest until their loan has been repaid.

It is important to have a written security agreement and to record it properly. The security interest agreement should be included in a clause within the distribution agreement. 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 U.S. Copyright Office at the Library of Congress in Washington, D.C.

For further information and security agreement templates, see Entertainment Industry Contracts P 13.01–13-9.

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Mark Litwak is a veteran entertainment attorney and founder of the Law Offices of Mark Litwak & Associates based in Los Angeles, California. His practice includes work in the areas of copyright, trademark, contract, multimedia law, intellectual property and book publishing. As a Producer's Representative, he assists filmmakers in arranging financing, marketing and distribution of their films. He also serves as an expert witness in motion picture industry cases.

Mark has been a lawyer since 1977 and worked in New York and California. He has received an AV Peer Review Rating from Martindale-Hubbell for more than a decade. This is the highest rating given a lawyer and is indicator of a lawyer's high ethical standards and professional ability, generated from evaluations of lawyers by other members of the bar and the judiciary in the United States and Canada.

Mark has also been designated a Southern California Super Lawyer 14 times by Thomson Reuters. The selection process includes independent research, peer nominations and peer evaluations. In 2004, Film Festival Today magazine named Mark as one of the "Twenty Five Most Influential People" in independent film.