Law 101 – Financing Independent Films

By Mark Litwak, Attorney at Law

Independent films can be financed in a variety of ways. In addition to a film maker using his own funds to make a movie, the most common methods are loans, investor financing, borrowing against pre-sales (a loan against distribution contracts), and distributor-supplied financing.

Loans

Loans can be secured or unsecured. A secured loan is supported or backed by security or collateral. When one takes out a car or home loan, the loan is secured by that property. If the person who borrows money fails to repay the loan, the creditor may take legal action to have the collateral sold and the proceeds applied to pay off the debt.

An unsecured loan, such as credit card debt or money given by family, has no particular property backing it. If a debtor defaults on an unsecured loan, the creditor can sue for repayment, however, the sale of his property may not be sufficient to satisfy all creditors.

A secured creditor is in a stronger position to receive repayment. In the event of a default, the secured property will be sold and all the proceeds will first be applied to repay the secured creditor's debt. Unsecured creditors will share in whatever is left, if anything.

From a legal point of view, the advantage of a loan is that the transaction can often be structured in a fairly simple and inexpensive manner. A short promissory note can be used and the transaction often is not subject to the complex security laws that govern many investments. Keep in mind that if the agreement between the parties is labeled a "loan," but gives a creditor a "piece of the backend" or some other equity in the project, the courts will likely view the transaction as an investment. And if the filmmaker has not followed securities laws, the courts could hold the filmmaker liable for violating the law.

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Equity Investments (Investor Financing)

An equity investment can be structured in a number of ways. For example, an investor could be a stockholder in a corporation, a non-managing member of a Limited Liability Company (LLC), or a limited partner in a partnership.

An investor shares in potential rewards as well as the risks of failure. If a movie is a hit, the investor is entitled to receive his investment back and share in the proceeds as well. Of course, if the movie is a flop, the investor may lose his entire investment because the producer is not obligated to repay an investor his loss.

When individuals or companies that invest in an enterprise that they do not manage, their interest is considered a security. These investors are often called silent partners, limited partners, passive investors and stockholders. They are putting money into a business that they are not running. State and federal securities laws are designed to protect such investors by ensuring that the people running the business do not defraud investors by giving them false or misleading information, or by failing to disclose information that a reasonably prudent investor would want to know.

In a limited partnership agreement, investors (limited partners) put up the money needed to produce a film, but they don't want to be financially responsible for any cost overruns or liability that might arise if, for instance, a stunt person is injured.

Because limited partnership interests are considered securities, they are subject to state and federal securities laws. These laws are complex and have strict requirements. A single technical violation can subject general partners to liability. Therefore, it is important that filmmakers retain an attorney with experience in securities work and familiarity with the entertainment industry. This is one area where filmmakers should not attempt to do it themselves.

Pre-Sale Agreements

In a pre-sale agreement, a buyer licenses or pre-buys movie distribution rights for a territory before the film has been produced. The deal works something like this: Filmmaker Henry approaches Distributor Juan to sign a contract to buy the right to distribute Henry's next film in Spanish-speaking countries outside North America.

Henry now takes this contract and similar pre-sale contracts to a bank and asks for a loan, using the distribution contracts as collateral. Henry uses this money to produce his film. When the movie is completed, he delivers it to the companies that have licensed the right to distribute it in their territory. They in turn pay their license fees to Henry's bank to retire Henry's loan. The bank receives repayment of its loan plus interest. The buyers receive the right to distribute the film in their territory. Henry can now license the film in unsold territories. From these revenues Henry makes his profit.

Because there are a lot of hoops to jump through, first-time filmmakers may find it difficult to finance their films through pre-sales. With no track record of successful films to their credit, they may not be able to persuade a distributor to pre-buy their work. But if there's a big name cast and an acclaimed scriptwriter, the distributor may be persuaded to take that risk.

Read the full article on financing films at: www.marklitwak.com/articles/general/financing.html

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