

Legal Realities

What you need to know about the legal aspects of moviemaking

THE TYPICAL FILM PRODUCTION (even a small indie film) sprouts from the initiative of one or two individuals and grows almost overnight into a multimillion dollar enterprise with 50 or more employees, where the producer is now a "CEO" with all of the attendant liabilities and responsibilities. The producer's responsibility in the legal aspects of a production are threefold: **FIRST**, the producer must make sure that the production company is in compliance with all applicable laws (whether local, state, federal or international). **SECOND**, the producer must navigate the legal waters to minimize the company's risk and avoid all possible liability that could arise from their activities (i.e. the production of the film). **FINALLY**, after having satisfied the governmental authorities and dodged any bullets of liability, the producer must also make sure that he or she has all of the legal delivery requirements that any distributor will demand before accepting the film for distribution.

The areas of law affecting a motion picture production can generally be lumped into the following basic categories: securities and lending laws, intellectual property issues, employment law and basic contracts.

The legal obligations of a production begin with raising the funds to produce a picture. Documenting the rights of the film's investors will ensure that they fully understand the terms of their investment. Whenever the production company is raising funds from passive equity investors, who invest money in the film with the hope of a financial return (as opposed to bank loan financing, for example), then the production company has to be sure to comply with federal and state securities laws. The legal documents required for completing even a simple bank loan for a film can be as extensive and complex as all of the other contracts for the film combined.

When a film is completed, it is the producer's objective to sell or license

the film to a distributor. But what is the producer actually selling? The most valuable asset that the producer sells is the bundle of rights that make up the film. These rights are intellectual property rights and consist of the rights that the producer has to exploit the screenplay and use the names and likenesses of the actors, the music contained in the film, life story rights (if any) and that unique collection of images and sound that make up the completed film. Creating and recording these rights from the commencement of production will greatly enhance and expedite the producer's ability to deliver a finished film.

There is a wide body of both federal and state employment laws that govern agreements between employers and employees regarding conditions of employment. In addition, various collective bargaining agreements (such as the Screen Actors Guild, the Writers Guild of America and the Directors Guild of America) dictate what is and is not permissible by employers.

Just as there are specialized employment contracts between the production company and its cast and crew, there are a variety of other business contracts, such as those with vendors, locations, unions and distributors, each of which contains its own peculiarities.

LESSON 1:

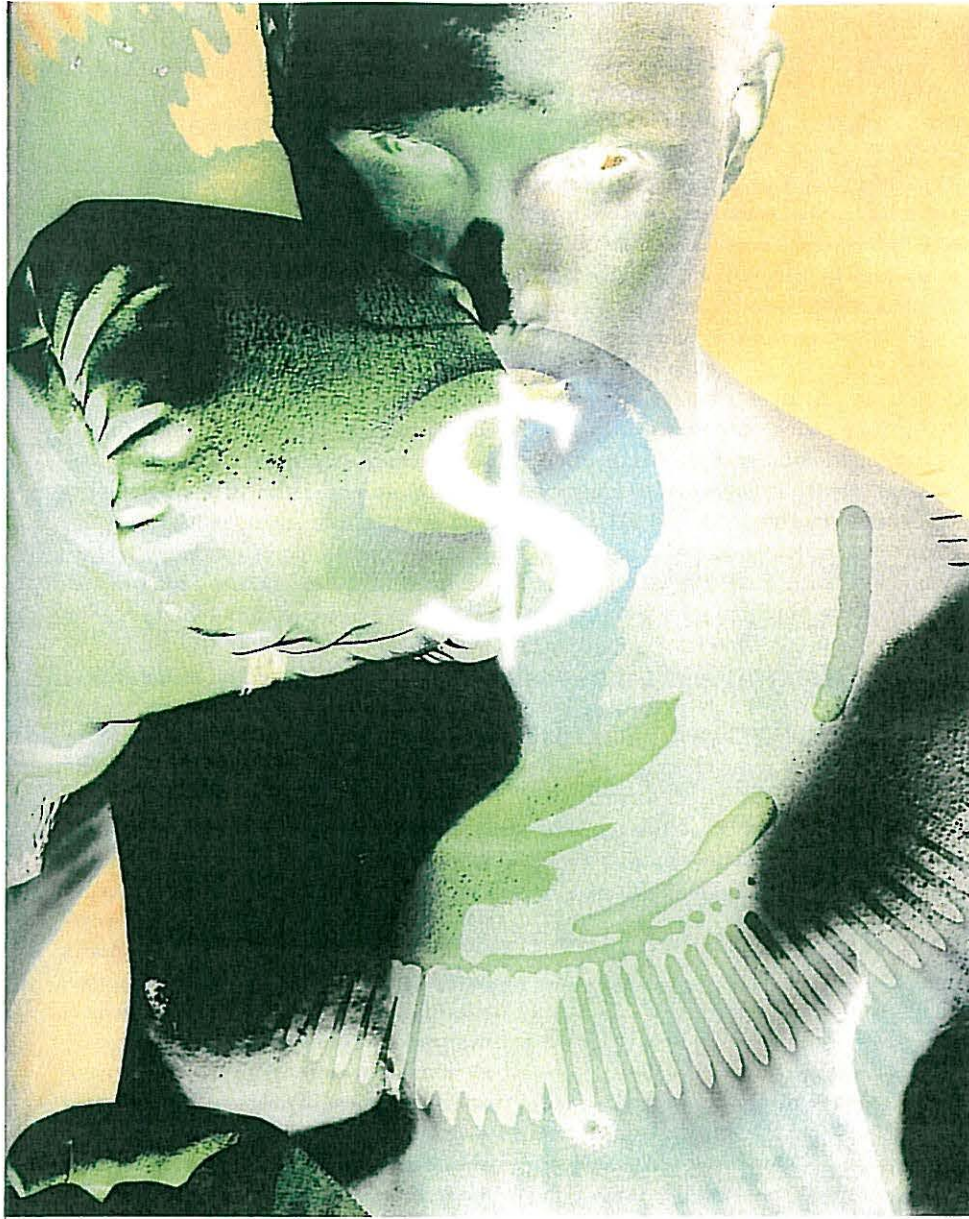
EQUITY FINANCE: WHAT ARE "SECURITIES LAWS" AND WHY DO I NEED THEM FOR MY FILM?

A SECURITIES OFFERING OCCURS when you raise money from "passive investors" who hand over their cash in exchange for the hope that you will make a movie that generates a profit. The investors are deemed "passive" rather than "active," because they have little or no say in how the film is made. Any type of investment contract where a profit is intended to be earned from the use of the "passive" investment, regardless of how it's labeled, is a "security." No matter what you call it (stocks, shares, membership interests, percentage interests, etc.), if it's a means of

people giving you money with an expectation but no guarantee of a future return, then it will likely be deemed a security and you must learn about and comply with federal and state securities laws. Failure to comply with these laws can lead to big problems.

Most independent film productions are on a scale where an exemption to the federal government's complex securities registration process must be identified in order for the company to solicit investors for the film. Fortunately, there are numerous statutory and regulatory exemptions from federal and state registration requirements. All of the various exemptions place constraints on the number and type of investors that are allowed (usually no more than 35 investors in any one state and in some circumstances that number may be even lower). More often than not there is also a strict prohibition of general solicitation and advertising. In order to make sure that the production is in compliance with the various laws, the company first has to identify which federal and state exemptions are applicable. Then the company must appropriately structure itself and the marketing of its securities. In addition, while the complex and lengthy registration process does not need to be complied with if an exemption exists, the film company must still file certain notice documents with the federal SEC and state agencies or risk the loss of that exemption.

As with any law, there are penalties for noncompliance. The government can levy fines, issue stop orders and attach a "scarlet letter" to your name in the event you ever seek to raise funds again. However, and perhaps more importantly, when it comes to securities laws, the company has its own financial incentive for complying with these laws separate and apart from the desire to avoid government sanction. Adhering to the regulations allows the production company to protect itself by eliminating the opportunity that an investor might have to recover their investment funds before a financial return is realized by the company



by “blowing the whistle” on the corporation.

The fact is, if you have passive investors and you do not comply with the securities laws, it is the equivalent of handing each investor a “get out of jail free” card. If the film makes money, they reap the rewards; if it doesn’t, they can, under certain circumstances, invoke the assistance of securities laws to force you to pay their investment back. Compliance with the law is not that difficult when you enlist qualified legal counsel, and failure to do so can be potentially devastating.

LESSON 2:

PRE-SALES COLLATERAL

FILM LOANS ARE MOST analogous to construction loans. Unlike traditional loans for the purchase of a home or automobile, there is no existing collateral for which a bank can foreclose on at the time the money is lent. Rather, in a construction loan, there is only the hope that the money the bank lends will be sufficient to build a solid and attractive

building which can generate rent after it is built to pay back the loan. Similarly, in a film loan, there is only the hope and belief that the money the bank lends will be sufficient to produce a solid and attractive motion picture, which can generate box office revenues after it is made to pay back the loan. In both cases, the bank is relying on the reputation, honor and skill of the craftsmen responsible for bringing the project to life. For a bank to have the level of trust and confidence necessary to lend money in the absence of traditional tangible credit, two things must be in place: a completion bond and territorial pre-sales of the yet-to-be made film.

The completion bond is a contractual commitment similar in form to an insurance policy (but not actually insurance) that guarantees that a film will be completed and delivered pursuant to specific requirements, on schedule, within the budget and without substantial deviations from the approved script. The completion bond provides

protection against over-budget costs and is supplied by a third party guarantor. It is a surety instrument that authorizes the guarantor to take control over the production if the terms are not met.

Territorial pre-sales are agreements obtained from various countries throughout the world for distribution of a yet-to-be-made film. The assorted pre-sale agreements (which are similar to “letters of credit”) are then brought to the bank and given as collateral. Since the pre-sale agreements are only promises to pay, and not legal tender themselves, the face value of the pre-sale agreement may be discounted. Pre-sales are accomplished by a sales agent. These sales agents are specialists at licensing various territories and assessing the legitimacy of each buyer in each territory and the strength of their commitment to pay as promised.

Ideally, enough territories will be pre-sold to cover the entire budget of the film. More often than not though, films are financed through a combination of foreign pre-sales, equity money, foreign tax credits and/or government subsidies.

LESSON 3:

WHAT'S AN “LLC” AND WHY SHOULD MY PRODUCTION COMPANY BE ONE?

THERE ARE ESSENTIALLY four basic types of production entities: Sole proprietorships, partnerships, corporations and limited liability companies. In virtually every situation, the limited liability company (particularly for productions in California) will prove to be the best possible choice for your production.

Partnerships and sole proprietorships offer certain tax benefits, but leave moviemakers vulnerable to unlimited liability in the event of any type of litigation brought against the production and thus are always strongly disfavored. Alternatively, LLCs and corporations provide liability protection to the individual moviemakers, but each has slight “pros” and “cons” that need to be evaluated for each given film.

The LLC structure is generally deemed to be the most flexible and beneficial to moviemakers. LLCs provide the full liability protection of a corporation, which is important in protecting the assets and potential future assets of the individual moviemakers, while providing passthrough partnership-like taxation which is also a benefit to moviemakers. Most importantly, LLCs generally permit different classes of stock to allow different priority royals from profits. LLCs can permit your investors to be

paid first and then the producers can share in the profit at a different point in time.

Alternatively, your particular production company might benefit from organizing itself as a corporation. There are two types of corporations: "C" Corps or "S" Corps. "C" Corps are subject to double taxation—once at the corporate level on the profits generated by the corporation and again when those profits are disbursed to the individual shareholders. This double taxation can be avoided by electing to become an "S" Corp. However, there are very strict rules on how many investors an "S" Corp can have, and who those investors can be. "S" Corps also prohibit two different classes of stock, thus making it difficult for most production companies to utilize.

Whether you select an LLC or a corporation, numerous corporate formalities must be followed in order to preserve the liability protection and prevent creditors from "piercing the corporate veil" of the assets of the individual moviemakers and their investors.

LESSON 4:

UNDERSTAND HOW TO PROTECT YOUR COPYRIGHTS

MOVIE MAKING IS A MINEFIELD of intellectual property issues. Every component, from a script to a few seconds of a song, belongs to someone, and if not treated properly has the power to become a stumbling block (or worse) to distribution. The two basic areas involving intellectual property rights are screenplay ownership and clearance issues.

As soon as your screenplay is printed or saved on your computer, copyright protection is automatically accorded to you. This is known as "common law copyright." That protection allows authors to, among other things, sue infringers who copy their work without permission. Protection is automatic without needing to do anything further. If someone steals your work, you can recover your actual damages subject to proof. But any screenwriter that rests safely in the thought that they have a common law copyright to protect them is foolish. "Statutory copyright" is a special form of copyright that is bestowed on those authors who file their work with the U.S. Copyright Office within three months after the first publication of the work or before the alleged theft of the copyrighted work occurs. To obtain a statutory copyright you need to register your work with the Copyright Office in Washington, DC by using a Form PA which can be downloaded from their Website at

www.copyright.gov. The form is easy to fill out and costs only \$30. If you register your statutory copyright and someone infringes your work, then not only can you recover actual damages (just like an author suing under common law copyright), but the U.S. government will bestow a bonanza of extra goodies as a reward for your diligence. These extra goodies include the ability to recover 1) statutory damages which range from \$30,000.00 to \$150,000.00, depending on the level of willfulness of the infringer, 2) double the actual damages and 3) attorney fees and costs.

Other methods for establishing "first in time creation" include the very popular method of registering your screenplay with the WGA's Registration System. The WGA charges only \$20 for this service and that amount is reduced to \$10 for union members. While the WGA registry does not by itself afford the statutory damages that an early filing with the Copyright Office does, the WGA registry has become recognized by courts as a valid independent means of establishing clear evidence that a screenplay was in existence first.

LESSON 5:

UNDERSTANDING HOW TO AVOID INFRINGING ON OTHER PEOPLE'S RIGHTS

CLEARANCE FOR A MOTION picture production requires a thorough evaluation of the screenplay, film footage, all contracts, set dressing, wardrobe and more. A complete list of clearance procedures should be followed prior to final cut or first exhibition of a film. Moviemakers and attorneys should always work together to continually monitor the production at all stages to make certain that the motion picture contains no material which could give rise to a claim.

Failure to follow proper clearance procedures may 1) prevent the production company from obtaining errors and omissions insurance, 2) deter a distributor from acquiring the film and/or 3) expose both the production company and the distributor to liability to third parties and 4) lead to an injunction against distribution.

A clearance report of the final shooting script is often a good first step to protect yourself. Professional clearance research companies perform a variety of tasks, such as researching all story character names and places against the commonality of the names, street addresses and business names in the general population. This will help the producer avoid possible invasion of privacy and similar type claims from people whom

the film may have unwittingly portrayed. The clearance report will also identify the proper contact from which to obtain placement clearances for any products, music cues, copyrights or trademarks that are referenced in the screenplay.

The producer should also document the origin of the work and each transaction that transferred the rights in the work up to and including the transfer to the producer, also known as "the chain of title." Did the screenwriter's engagement qualify as a bona fide work-for-hire? If not, is there an effective option or transfer of rights? Identify any potential rights-holders (particularly those who may raise a claim from earlier expired options, but whose contributions to rewrites may extend beyond the expired option). Did anyone contribute anything to the content of the script from whom a release was not obtained? Obtain "quitclaims" from any individual that may have an encumbrance to a clean chain of title.

Also note that whether the motion picture is factual or fictional, it should be certain that no names, faces or likenesses of any recognizable persons—living or deceased—or locations are used unless written releases have been obtained. The term "living persons" includes thinly disguised versions of living persons or individuals who are readily identifiable because of identity of other characters or because of the factual, historical or geographic setting. Releases from all recognizable or identifiable deceased persons in the screenplay should be obtained from the personal representative or heirs of such person. Insurance companies issuing "errors & omissions" insurance will insist on such releases unless the production company can demonstrate, to the insurance company's satisfaction, specific reasons in writing as to why such releases are unnecessary.

In addition, you need to be certain you obtain releases from all actors, extras and behind-the-scenes contributors related to film, or else distribution may never be obtained. Also note that in California and New York, a minor's contract of employment should be ratified by a court to ensure validity. If distinctive locations, buildings, businesses and/or personal real property are filmed, written releases should be secured. This is usually not necessary if non-distinctive background use is made of real property. Releases are also necessary for all props, set dressings and wardrobe items bearing distinctive logos if such items are to be featured. Remember, it is often difficult to anticipate the prominence of a

prop in a final cut; thus it is best to apply an abundance of caution in attempting to clear these items. Caution: Do not assume that items coming from prop houses or that have been used in other films have been properly cleared. Also, be especially cautious of major league sports apparel and other trademarks.

Prior to any public exhibition of the motion picture, the production's attorney should preview the film to assure that the above-listed clearance procedures, in addition to many other clearance matters, have been fully complied with on your film.

LESSON 6:

WHAT THE HECK ARE WAGE-HOUR LAWS AND WHY DO I NEED TO FOLLOW THEM?

WAGE-HOUR LAWS govern how all employees are to be paid, whether or not they are unionized. If the employee is also in a union then a second layer of union rules apply. More moviemakers are subject to litigation and wage claims than perhaps any other single dispute with employees.

This area of law may appear simple, but is more complex than it seems. Moviemakers should always speak with a legal expert on how to make proper payments to employees and avoid the nightmare of bureaucratic red tape imposed by federal and state workplace laws as well as union regulations.

Moviemakers should also familiarize themselves with child labor laws, workplace safety laws, laws governing the hiring of foreign citizens and laws governing discrimination and harassment in the workplace. You may have the mentality that you are doing little more than “putting on a show in your backyard,” but the federal and state government agencies that regulate workplace conditions see it differently and will hold you to the strict requirements of the laws that govern those employees.

LESSON 7

MAXIMIZING DISTRIBUTION VALUE.

Here are some quick tips to remember to maximize the value of your film during the negotiation process with distributors and sales agents:

Selectively screen the film. It is best to screen the film in a theater for as many distributors as possible all at the same time in order to foster competitive bidding (they will fear that their competitors will obtain the rights to the film before them). Video screeners are the least desirable way to market a film to distributors, since the quality of the video is lower and the viewing environ-

ment is less forgiving (or competitive).

Keep budget information confidential when marketing the film. No acquisition person who is contemplating picking up a completed film needs to know the budget of the film. This allows the producer to make sure that the offer being made for the rights to the film is based solely on the quality of the film, the market for it and hopefully some healthy competitive bidding.

Research the buyer. Investigate the buyer before entering into a deal with them. Make sure that the company is reputable and solvent. The best way to do that is to talk to pro-

ducers who have done business with them.

Get everything in writing. It is not uncommon for a distributor to pressure a producer into releasing the elements of a film without negotiating a contract so that the distributor can meet some upcoming deadline, such as a film market like Cannes. The producer must always take the time to deliberately and carefully negotiate the entire deal in writing without haste.

Retain an attorney to review and negotiate the contract. The producer must never sign anything without having an attorney review it. **MM**

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