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Moviefest magazine

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OF MAKING
MOVIES

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AND:
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MARGUERITE MOREAU AND
HUS MILLER IN *YOU CAN'T SAY NO*



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SWINDLER'S LIST

Seven tips for avoiding the scam in Hollywood

BY DAVID ALBERT PIERCE, ESQ.

Doyle Lonnegan: *Your boss is quite a card player, Mr. Kelly; how does he do it?*

Johnny Hooker: *He cheats.*
— *The Sting*, George Roy Hill (1973)

OVER THE PAST couple of years, my law firm has developed an unfortunate cottage industry for representing innocent producers and investors who have been scammed by shrewd thieves presenting themselves as the answer to our clients' film-making dreams.

the creative and I'll handle the business." "Look at my long list of credits. Why would you need to speak to any of the individuals from those films to attest to my abilities?" "Completion bonds, lawyers and private placement offerings are a waste of money. Let's not over-lawyer this!" "We can't disclose the other sources of financing because of a non-disclosure agreement." "I thought we were friends! You've got to be willing to trust me."

Yet cons can be spotted if you know what to look for. Any one of the statements above is a good indicator that you should think

Almost all of the scams involve one of the following lines: "Close this deal now! Match the funds." "The process for how my funds come is complicated, but it works." "You just need to focus on

twice and perform due diligence before entering that deal. You'll hedge your bets better and avoid the repeat players who promise to provide all the expertise a first-time moviemaker lacks, the ones who give a bad name to the good guys who actually deliver on such promises.

What common mistakes land investors in business with conmen—or at very least, with careless producers that place their money at risk?

MISTAKE ONE: NOT RESEARCHING THE COMPANY AND ITS INDIVIDUALS

LOOK INTO EVERY company and person you're going into business with. Here are three ways:

Check that the company is a bona fide company in good standing as either a LLC or corporation on the Secretary of State website in the state in which it claims to be organized. Check that the official name of the company is as it appears in the State records.

Research the company and individuals online. IMDbPro is essential. However, a

< **TRICKS IN EVERY TRADE: ROBERT SHAW, ROBERT REDFORD AND PAUL NEWMAN IN GEORGE ROY HILL'S 1973 THE STING**

long resume of films does not mean the individual is legitimate—in fact, some of the biggest

comen have the

longest resumes. So contact people tied to those films and inquire as to whether the named executive producer responsible for financing, and the particular line producer responsible for budgeting the film, actually conducted themselves in an above-board and honorable manner.

Do a quick “party name search” on court websites of the jurisdictions where you know the company or individual does business. This can uncover past disputes.

CASE STUDY: An indie writer/producer who raised money from friends and family hired a seasoned line producer because of his impressive IMDb resume, which included working as a line producer for a famous actress on her self-financed/self-produced independent film. Had the indie producer taken the time to reach out to that actress (or, at very least, her representatives or other key crew members), he would have discovered that the line producer had *stolen* from that actress and ruined the production. Even if that actress had refused to comment, her silence would have been somewhat illuminating.

MISTAKE TWO: NOT UNDERSTANDING THE INTERRELATIONS BETWEEN PARTIES

A PRUDENT INVESTOR knows the identity of *all* of the companies and key players connected to a film project, and doesn't just rely on the one individual with whom they may be directly dealing. A good way to ensure that everyone is familiar and comfortable with one another is via an “Interparty

Agreement.” This agreement sets forth what each party is bringing to the table, how they are involved with the project, and where they sit in relation to all other parties in the “revenue waterfall” (i.e. the order of distribution of revenues).

CASE STUDY: An individual financier provided a gap loan with the following terms: In exchange for a \$5 million loan to keep the film afloat until a primary bank loan closed, the financier would receive \$6.5 million payable when that bank loan closed. However, as part of the deal, if the bank loan was not repaid within 18 months, the financier (via a letter of credit guarantee given to the bank) would be responsible for paying back any remaining unpaid portion of the \$5 million loan, plus interest, which was not recouped from the proceeds of domestic distribution from the film.

However, the financier never did a full search on the copyright of the project and didn't use an interparty agreement, which would have revealed how the producer/borrower was truly related to other participants tied to the film. The producer/borrower also persuaded the financier that an interparty agreement was simply the financier's attorney trying to rack up a bill. “After all,” said the producer, “if the bank is comfortable with the method of repayment via domestic proceeds, you should be as well.”

It was later discovered that while the borrower *was* a producer on the project, he did not have the right or authority to assign domestic distributor proceeds to repayment of the bank loan. And since the bank lender had a letter of credit guarantee from a high-net-worth financier, the bank had no reason to engage in the due diligence which the high-net-worth financier assumed it had done. That producer, who had a long IMDb

track record, had an outstanding judgment—which was public record—for a similar fraud perpetrated against high-net-worth individuals in Arizona. (Even worse, that producer is still out there.)

MISTAKE THREE: RELYING ON SO-CALLED “FINDERS” AND MISUNDERSTANDING SECURITIES LAWS

THE MOVIES REVOLVE around relationships. Intermediaries are an essential part of the industry. Generally, when intermediary—or “finder”—deals involve matching a project with an active source of financing via a bona fide “co-production” arrangement, such finder deals are legal and the contract terms can be easily negotiated.

However, a finder who has no ownership interest in the production company itself, and is contracted to introduce passive investors to the actual owners of the production company, is acting within the definition of a “securities broker.” Unless that individual finder has a bona fide securities broker license, his actions are criminal.

Moreover, the unsuspecting producer that hires that finder can be viewed as an accomplice. There is a widespread misconception that the rules governing securities brokers and dealers in all other industries don't apply to the entertainment industry. A skilled attorney would be able to distinguish a lawful finder situation from an unlawful unlicensed broker/dealer situation, though the distinctions can often be quite subtle.

CASE STUDY: A producer hired a finder to raise money for a film. The finder ran a “boiler room solicitation” scam and told an unqualified, unsuspecting investor that

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the film was going to star celebrities who were, in fact, not attached to the film. The federal authority arrested the finder and wanted to arrest the producer—but did not, only because the producer had never signed the finder's contract. (Emails showed that the finder had jumped the gun and begun his boiler room solicitation before being contractually attached, or even informally retained, by the producer.) The producer escaped liability because of this proof of his ignorance and the federal authorities' pity.

MISTAKE FOUR: NOT PROVIDING FULL DISCLOSURE TO INVESTORS

FEDERAL AND STATE security laws protect investors. Public offerings require extensive paperwork and rule-compliance, which most independent filmmakers cannot afford to undertake. Private placement offerings (PPO) permit an easier method of compliance, but nonetheless require the producer to disclose all material information that a reasonable prudent investor would desire before rendering an investment decision. Producers that simply copy the PPO of another film, believing that that will be sufficient for their film, can run into significant problems if that prior PPO fails to disclose the unique circumstance confronting their *own* particular film.

The full disclosure rules have now also been adopted with some modification for equity-based crowdfunding—a radical change from the old clear-cut distinction between a public and private offering. Equity crowdfunding, authorized by the JOBS Act, has enabled two types of cons. First, there is the traditional con of producers promising more than they should and not disclosing all material information. The new, second type of con is the result of—in essence—internet trolls who seek to invest in a producer's film. Where these investments were once only available to friends, family and people who had a pre-existing relationship with a producer, the producer in an equity crowdfunding arrangement has no way of knowing with whom he or she is dealing. A troll could invest a small amount, wait for the film to not achieve a profit, and then bring a class action on behalf of all investors for securities violations, based on a failure to disclose all material information that a reasonable investor would want to know. After the fact, it'd be pretty easy for the troll to make a claim that something was omitted.

MISTAKE FIVE: FALLING FOR AN APPARENTLY INDECIPHERABLE, COMPLEX LOAN

FANS OF *Popeye* are familiar with Wimpy's classic con, in which he obtains free meals with a promise to “gladly pay you Tuesday for a hamburger today.” An age-old film loan scam applies this same tactic.

The representative of a private lender tells you, the producer, that they want to lend you all of the money necessary to produce your film, but you need to first contribute \$X into an escrow account that can only be controlled by the private lender. Often the escrow term includes an escrow fee that isn't refundable, even if the money is returned for reasons unrelated to the producer's failure.

“A LONG RESUME OF FILMS DOES NOT MEAN THE INDIVIDUAL IS LEGITIMATE. SOME OF THE BIGGEST CONMEN HAVE THE LONGEST RESUMES.”

In any event, the private lender tells you that this transaction needs to occur immediately; you have little time to consult lawyers or negotiate terms.

The rushed closing is always blamed on some hard-to-understand banking principal or tax deadline—so if the lender does not immediately invest the money, they will lose the money. Often they haven't even read the script or required a detailed budget breakdown vetted by their own experts. These lenders do deals that no other well-established film lender will make, but they claim to have a different business model. Also, they give you the name of five other producers who are currently being funded this same way, and if you don't sign the deal now, the fund may have to withdraw their offer to you because their money is in such high demand.

Sometimes the money received from one filmmaker is used to make good on the money the lender promises to another filmmaker—a classic Ponzi scheme—allowing these lenders to have temporary credibility while enlarging the amount of money they take in.

Another variation has the loan racking up high interest rates with a payback due sooner than the normal time period for revenue returns from distribution. If payback on a portion of the loan is not made to the lender,

even while the film is still in pre-production, then the lender need not make any further disbursements of the loan and, in fact, can call in the entire outstanding amount and take over the copyright of the producer's film before production even begins.

MISTAKE SIX: ESCHEWING A COMPLETION BOND AND NOT ASSIGNING AN EDUCATED EXECUTIVE TO MONITOR INVESTOR MONEY

COMPLETION BONDS may be costly, but there's a reason why every sophisticated investor demands them. Completion bond companies ensure that each film has a bona fide properly funded budget. They also ensure that producers and key crew members are qualified and capable to produce the

film on time and on budget.

In the event a completion bond simply cannot be obtained for the budget size or other reasons, a smart investor will insist on having a trusted key person on set for the sole purpose

of monitoring the production and protecting the investor's investment (in much the same way that a completion bond company would monitor the production).

MISTAKE SEVEN: SKIMPING ON THE SERVICES OF A COMPETENT ATTORNEY AND ACCOUNTANT

SPEND MAXIMUM time and effort to research the people hired to be line producers, production accountants and production counsel. Saving a few dollars on these key positions is a recipe for disaster—and cost overruns. Some conniving line producers will intentionally render the lines on the budget for legal counsel and production accountants so low that the production can only afford sheer novices in those positions, instead of astute watchdogs. Consider losing pricey music before going without a streetwise and well-educated lawyer and accountant.

The vast majority of people in the film industry honestly want to make quality films and live up to their contractual commitments. But no industry is immune from conmen. Legitimate producers need to be ever-vigilant to protect both their investors' money and their own work. Be diligent, alert and surround yourself with intelligent, trusted people. **MM**