OTHER PEOPLE'S MONEY:

Financing the Low Budget Independent Feature Film With Private Equity Securities Offerings

Daniel M. Satorius, Esq.[i]
Satorius Law Firm, PC

Copyright, 2007, Daniel M. Satorius
All rights reserved.

OTHER PEOPLE'S MONEY:

Financing the Low Budget Independent Feature Film With Private Equity Securities Offerings

Hundreds of low budget independent feature films are made each year. Most are financed by sources outside of the motion picture and television industry. The production companies who make these films are either unable to secure financing within the industry, unable to secure 100% of the needed financing within the industry or, choose to avoid industry financing because of the controls and other restrictions accompanying such financing.

These production companies often turn to private investors for financing - investors who are outside of the motion picture and television industries with little or no knowledge of the industry.

Private investor financing can serve many purposes. Some production companies use investor financing to develop a project – i.e. acquire rights, hire screenwriters, hire casting directors, etc. Private investor financing can also be used to finance the "gap" where the production company has secured partial funding, pre-sale or negative pick-up agreements with studios, distributors, or other industry financiers. Private investor financing can also be used to fund 100% of the production costs.

Whatever circumstances lead a production company to private investor financing, they enter the enigmatic world of securities law[ii].

STATE AND FEDERAL LAWS APPLY

Let's begin with stating the obvious: equity financing must comply with state and federal securities law, an area demanding the assistance of a knowledgeable and experienced securities lawyer. Whether the production company is selling stock in a corporation, membership interests in a limited liability company, or partnership

interests in a limited partnership, ownership interests are likely to be deemed "securities" under state and federal law. [iii] Any arrangement under which one invests money in a common enterprise with the expectation of deriving a return primarily through the efforts of others can be considered a security. Even promissory notes and investment contracts can be considered securities. [iv]

Basically, in the context of financing independent feature films, any arrangement that includes a passive investor is probably subject to securities laws. A passive investor is a person or entity who provides financing but who is not actively involved in the business of making or exploiting the film and related properties, and expects to share in the profits of the film.

Failure to comply with securities laws is illegal. **It is illegal to offer or sell securities unless a registration statement has been filed with the Security and Exchange Commission and appropriate state authorities or unless the securities or the transactions qualify for an exemption from registration. Failure to comply with securities laws can result in severe penalties, not only for the offeror but in some cases also for lawyers, accountants, and others who have control over or knowledge concerning the securities.**

What are the penalties? **Offering or selling securities in violation of the Securities Act of 1933 (the "Securities Act") is a felony punishable by up to 5 years imprisonment and a $10,000 fine[v] for each violation. It is common for criminal indictments to also include counts of violation of federal mail fraud, wire fraud and conspiracy statutes. In addition, the Commissioner of Securities is empowered to enjoin actions such as the sale of securities that violate the Securities Act[vi] and to suspend or revoke the rights of attorneys and accountants to practice before the Securities Commission. The Commissioner may also seek civil penalties up to $500,000 per violation.[vii]**

The Securities Act also permits injured parties to bring civil

actions against issuers for violations[viii] and against brokers, attorneys, accountants, and others who control the person liable under Sections 11 or 12[ix]. Most civil actions involve claims seeking rescission of the transaction and the return of the investment. But damages, penalties, and other remedies are also available to plaintiffs in such actions.

State statutes provide for similar administrative sanctions, civil and criminal penalties, injunctive remedies, and civil causes of action.

Selecting an exemption. **Registered public offerings are impractical for the single independent feature film because the transaction fees are expensive, the time commitment to prepare and register the offering is considerable and the exploitation of a film and its related properties is typically limited in duration and is not a continuing and expanding enterprise. Legal fees for registered public offerings often exceed $100,000 and underwriting fees can exceed 10% of the offering amount. Greater financial reporting requirements for public offerings also make them less suitable for the financing of a single film. Selecting the exemption(s) (the statute(s) or regulation(s) that will be relied on to exempt his/her offering from registration offering) is one of the first step in helping a production company structure its offering.**

State and federal securities laws offer a variety of options for the independent feature film offering. The following chart lists the types of offerings under federal securities laws that may be suitable for independent feature films. The offerings are categorized according to some of the issues relevant to the financing of independent feature films.

Size of Budget	Max. Number of Non-Accredited Investors	Applicable Federal Law or Regulation	Filings Required	Advertising & Gen'l Solicitation	Required Disclosure to Potential Investors
Under $1 Million	No limit	Reg D, Rule 504[x] (funds must be raised in 12 months)	Notice must be filed after 1st sale.	Permitted	None required.
		SCOR (funds must be raised in 12 months)	Form U7 must be filed with each state where offered. Form D must be filed with SEC and each state before offers are made.	Permitted	Form U7
Under $5 Million	Limited to 35 or under, plus an unltd. number of accredited investors.	Reg. D, Rule 505[xi] (funds must be raised in 12 months)	Notice must be filed after 1st sale.	Not Permitted	If sales are made to non-accredited investors & if issuer is non-report'g co. under Act, must furnish registration-like reports, financial statements & other documentation to offerees.
	No limit	§4(6)[xii] (accredited investors only)	Notice must be filed after 1st sale.	Not Permitted	None required.
		Reg. A	A form similar to a registration statemt required before 1st sale.	Permitted	Offering circular somewhat less detailed than a prospectus.
No Limit	Limited to 35 or under; plus an unltd. number of accredited investors.	Reg. D, Rule 506[xiii]	Notice must be filed after 1st sale.	Not Permitted	If sales are made to non-accredited investors & if issuer is non-report'g co. under Act, must furnish registration like reports, financial statements & other documentation to offerees.
		§4(2)[xiv] of the Act ("Private Placements") subjective std.s apply	None	Not Permitted	"Access" to the same kind of information required in a registration statement.

	No limit, but all must be state residents.	**§3(a)(11) of the Act ("Intrastate Offering"); Rule 147**	**None, but may be required under state law.**	**Permitted but only to state Residents**	**None**

Selecting the regulation(s) and/or statute(s) to apply to a particular production company's situation depends on its goals and the limitations it is willing to accept. For example, if the budget for the film is under $1 million, Rule 504 and SCOR are available for such offerings. If the budget is under $5 million, Reg. A, Reg. D, Rule 505, and §4(6) are available. If the production company believes advertising is essential to the fundraising process, then Rule 504, SCOR, Reg. A, and in certain situations §3(a)(11) are available.

Although other options are available, Rule 504 for films under $1 million, Rule 505 and/or § 4(6) for films between $1 and $5 million, and Rule 506, § 4(2), and/or §3(a)(11) for budgets over $5 million are the most likely exemptions from registration to be relied upon for independent feature film projects.

The Regulation D ("Reg. D") exemptions (Rules 504, 505, and 506) are a 'safe harbor' for those who comply with the exemptions to avoid registration. But no statute exempts the offeror from fraud claims as discussed below. The Reg. D exemptions are non-exclusive and can be utilized along with other exemptions such as §4(2).

The §4(2) or "private offering" exemption requires a subjective determination as to whether an offering qualifies as a "private placement". The relevant factors include: the degree to which the dollar size of the offering and the number of units offered is limited, the degree to which number of offerees is limited, the degree of sophistication of the offerees (i.e. whether the investors are accredited), the extent to which information is available to the offerees, the extent to which the offering is private in nature, and the extent to which purchasers are restricted from reselling their

securities[xv]. Because evaluating these factors requires subjective analysis under §4(2), whereas the factors are more objectively specified in Reg. D exemptions, it is generally advisable not to rely strictly on §4(2).

However, in limited circumstances reliance solely on §4(2) may be appropriate. For example, where there is a small number of accredited and sophisticated investors (e.g. five or less), particularly where the offeror is well known to the investors such as family members, and where the investors are given complete access to all relevant information about the offeror and the offer, in these situations it may be reasonable to save the expense of an offering memorandum in favor of abbreviated documentation.

The §4(6) exemption may be useful if financing can be raised solely from accredited investors. Accredited investors are institutions such as banks and insurance companies or natural persons whose net worth (with spouse) is greater than $1 million or whose net income exceeds $200,000 per year ($300,000 per year with spouse) for the past two years.

The §3(a)(11), the "Intrastate Offering" exempts "[a]ny security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory."[xvi] To qualify for this exemption, the offering must be strictly within a single state, including, for example, the offeror, all offerees and purchasers, and the business -- all of which must come to rest in a single state. There are no specific disclosure requirements under this exemption or the SEC's Rule 147[xvii], but, as discussed below, anti-fraud rules and the state securities laws apply.

The SCOR registration form and disclosure document uses a question and answer format known as the Small Corporate Offering

Registration Form (Uniform Form U7[xviii]) to create offering documents which are registered under state securities laws to qualify for exemption from federal registration under Rule 504, Regulation A, or Rule 147 of the Securities Act. The advantages of SCOR include: (a) the issuer may sell to an unlimited number of unaccredited investors, (b) investors can resell their shares, (c) advertising and general solicitation is permitted, (d) the prospect of a uniform registration device may allow Rule 504 offerings to be registered efficiently and inexpensively in multiple states, and (e) "minimum investments" are lower than typically available from traditional stock offerings.

In reality, the SCOR Program is of limited benefit to the independent production company. First, SCOR is only available to a corporation with an existing business. This eliminates start-up production companies. Second, SCOR is limited to $1 million. Third, the advertised sale of securities for an offering with a very low-cap, is likely to result in a low per unit price, thus increasing the likelihood that there will be large numbers of equity holders thereby increasing the paper work for the production company/offerer at the time of sale and later accountings. Given the right to advertise and the more public nature of the SCOR offerings, preparers of SCOR offerings are well advised to take greater care in the drafting of the offering memorandum that adds to the expense of document preparation. Finally, SCOR offerings generally take more time to complete, file, and qualify for than exemption offerings.

The selection of federal regulation or statute must be made in conjunction with the state securities laws (the Blue Sky Laws) of each state in which the offering is offered and/or sold.

ANTI-FRAUD.

S.E.C. Rule 10b-5[xix], other anti-fraud provisions[xx], and state "mini-10b-5" laws offer disgruntled investors causes of action for

misrepresentation or failure to disclose risks associated with the investment. Simply stated, 10b-5 says it is unlawful for anyone to make a false statement about a material fact, to omit a material fact, or mislead someone in connection of the sale of, or the offer to sell, securities.

Although some securities laws such as Rule 504 do not require the offeror to provide an offering document to the offeree, it is advisable to provide a thorough written document for several reasons. First, the offering document is a written record the terms of the offering and the representations and disclosures given to the offeree. Second, a properly drafted offering memorandum can provide a defense to claims of fraud and misrepresentation.

Not every offering demands an offering memorandum. In situations involving highly negotiated transactions with a small number of sophisticated accredited investors who have extensive access to the offeror's books and records, an offering memorandum may not be necessary and the costs of preparing it may be avoided. Nevertheless, in most situations the prudent course is to present the potential investor with a carefully written memorandum fully describing all relevant material risks and terms.

THE OFFERING MEMORANDUM

The following focuses on issues related to offering memorandums for companies producing feature film, especially independently produced films.

Rights in underlying properties.

The germ of a feature film may come from a variety of sources: original screenplays, books, articles, short stories, life stories, songs, etc. Screenplays may be owned by one or more of the principals of the production company/offeror. The production company must enter

into written agreements to acquire motion picture and television rights (and other rights) in underlying works/rights if owned by other parties. The offering memorandum should include a discussion of the production company's ownership and/or control of such rights, including the copyright status, and a discussion of the material terms of those agreements.

Disclosing risks.

Investments in the production of independent films are highly risky. Securities laws do not prohibit investors from taking such risks, but they require complete disclosure of the material risks.

Disclosure of risks was believed to be the best way to regulate securities by the three lawyers who drafted the Securities Act over a weekend 70 years ago. Along with President Franklin Roosevelt who commissioned their efforts, the drafters subscribed to Louis Brandeis' admonition about disclosure in the sale of securities: "sunshine is said to be the best of disinfectants"[xxi].

In the spirit of disclosure of material risks, the offering memorandum must be drafted to carefully spell out all material factors that contribute to increased risk. In preparing the offering memorandum, careful thought must be given to the risk factors section. The following risk factors are common in independent film offerings and deserve special mention.

The highly speculative feature film industry. **The motion picture industry is a highly speculative and competitive industry. It is impossible to predict the market appeal and profitability of any particular motion picture with any degree of certainty. The revenues of each film depend on a number of factors, such as the popularity of other films being distributed at the time, competition for exhibition time at theaters, critic's reviews, how the distributor perceives the commercial value of the film word of mouth, and the often fickle and**

unpredictable public taste. The offering memorandum should describe these risks that the production company has limited or no control over and upon which the success of the film is in large part dependent.

Competition. **The offering memorandum should include a discussion of the marketplace competition that the film will face. Many other films will compete with the offeror's film for theater and shelf space. Most such films will be better funded. These competitors include the so-called "major" studios, who have a successful history of attracting talent, obtaining properties, hiring key employees for the production of films, and distributing the completed film to choice exhibition outlets. The combination of these and other factors means a small number of films, usually from the majors, account for very large percentages of total box office receipts. Consequently, many independent films never return their investment.**

The experience of the principals**. An inexperienced filmmaker at the helm increases the investor's risk. The production company is responsibility for developing the film, securing financing, hiring cast, directors and other personnel, overseeing the production of the film, and arranging for its distribution. The effective completion of all these tasks is critical to the successful completion and distribution of the film. If the film will be the first theatrical feature-length motion picture developed and produced by the production company, this fact must be disclosed.**

Distribution**. The offering memorandum should disclose the risks involved in the distribution of the film. In particular, it should discuss whether any distribution agreements have been entered into and whether those agreements are with major or independent distributors.**

In most cases the funds raised via an offering are only sufficient to produce the film and market it to distributors. Often

funds are not raised to distribute the film because it is the intent of the production company to secure an agreement with a distributor. Until the film is distributed or an agreement is made for distribution, there will be no revenue and, consequently, no return to the investor. Therefore, the existence or lack of a distribution agreement is an important risk factor to be discussed in the memorandum.

Independent distribution may be more risky for the investor than distribution by a "major". In the motion picture industry, "independent distributor" refers to a distributor unaffiliated with the so-called "majors" such as The Walt Disney Company, Paramount Pictures, Sony Pictures Entertainment, Columbia/Tri-Star Pictures, Twentieth Century Fox, Warner Brothers, UA, Universal Pictures and their affiliates. Majors often have greater bargaining power than independent distributors, which gives them a competitive advantage when booking films into theaters and negotiating distribution agreements in other media. Majors usually devote more resources to the marketing of a film, resulting in greater prerelease exposure[xxii].

Modification to the film. **It is common in the motion picture industry for a screenplay to undergo significant revisions prior to production. In addition, after production, the film may be further revised during the editing process. These changes are made by the production company or third parties involved in the production or distribution of the film. The production company is given the discretion to make these changes, a fact which should be disclosed in the offering memorandum to alert investors that the story represented in the screenplay which is synopsized in the offering memorandum and often made available to investors may and probably will change.**

Agreements with third parties.

It may be necessary or advantageous for the production company/offeror to associate with other companies such as other production companies or distributors, to obtain financing for the

production and/or distribution of the film. These associations may take the form of co-productions, agreements for the pre-sale of distribution rights in certain territories, agreements for the distribution or broadcast of the film, or other arrangements. The offering memorandum should discuss the company's rights to make such agreements and include a discussion of the material terms of any agreements existing at the time of the offering.

Distribution of proceeds.

The offering memorandum specifies the order of distribution of the proceeds from the exploitation of the picture (and any other revenues). The production company must carefully structure the distribution of proceeds to strike the appropriate balance between the rewards to the investor and the rewards to those who make creative contributions.

Customs in the distribution of proceeds. **A common arrangement in an independent feature film offering memorandum is as follows: The first receipts are disbursed to the company's unpaid expenses (such as over-budget costs), operating costs, loans, and reserve (if one is provided) for future expenses. Second, if the distribution of proceeds provides for deferrals, the next proceeds are distributed to a level one deferral (described below). Third, the investors receive their first payment that is commonly distributed at the rate of 99 percent to the investors and one percent to the production team[xxiii] until the investors are paid back 100% of their investment. In some cases, the investors are paid something more than their investment; for example, 110% to 140% of their investment. Fourth, after the limited partners get their investment back (and in some cases a return thereon) the next funds may be applied to the level two deferral participants (if any). Finally, after level two deferrals (if any) are paid, the balance of the proceeds is divided on a fifty-fifty or similar basis between the investors and the general partner in a limited partnership or between the members and**

the manager in a limited liability company.

Deferrals. **A deferral is a delayed payment made to key parties involved in the production of the film in exchange for paying them a lesser cash payment at the time their services are rendered. To investors who are accustomed to evaluating offering memorandums for investment opportunities in fields such as real estate, medical technology, or computer technology, the concept of "deferrals" may be new. In independent film financing, the use of deferrals is common.**

Deferral agreements are made with actors, writers, the director, producers, creative personnel, equipment suppliers and other trade creditors providing goods and services to the film on terms which require these parties to be paid from revenues from the exploitation of the rights in the film. Usually such revenues come from advances from the sale or licensing of the film's distribution rights to a distributor. Thus, the deferral participant participates in the risk that the film will be sufficiently successful to pay the deferral.

A deferral is, in a sense, a future potential fixed sum of money … a "bucket of money" if you will. The production company uses this bucket of money to make favorable deals with suppliers of goods and services. These deals help the film to get made for a smaller initial budget.

Sometimes more than one deferral levels ("buckets") are created. If two deferral levels are created, the first is paid out before investors get their investment back. Therefore, participation in level one deferrals is usually limited to those parties who are essential to the sale of the film to distributors. For example, level one deferrals are often paid to actors or actress with name recognition value and who are likely to help "open" a film, that is, help to sell tickets in the first days and weeks of the film's theatrical run. The use of such actors can have considerable financial benefits to the theatrical run of the

film and to the film's performance in other markets. Actors with television or studio credits have what is called a "quote". A quote is what an actor was paid on his/her last picture. Producers of small budget independent films may not be able to afford to pay the actor's full quote, but may be able to make a deal to pay union scale or a multiple thereof. The balance of the actor's quote is paid on a deferral basis (plus in many cases, a percentage of production company's or the partnership's profits).

The justification for such arrangements is apparent. Talent who by virtue of their notoriety sell tickets (and therefore make distribution agreements with distributors feasible) deserve substantial compensation. That compensation may be beyond the means of the production company's cash budget, but the production company can offer to make up the difference out of amounts advanced by the distributor for the right to distribute the film.

All of this may be to the benefit of the investor because without marquee-value actors, there may be no distribution agreement, and without distribution, the investor's investment is worthless. Furthermore, under this arrangement investors part with less money up front for the actor's fee, although they may have to wait behind the level one actor to recoup their investment.

Deferral arrangements are a material factor affecting an investor's investment, and therefore must be disclosed in the offering memorandum. The following factors must be treated in that disclosure: (1) the priority in which the deferral 'bucket(s)' will be paid from the distribution of the entity's revenues; (2) the amount of money to be put in the deferral 'bucket(s)'; (3) the production company's discretion in committing funds from the deferral 'bucket(s)' funds; and (4) the production company's discretion to determine the value of the goods and services subject to the deferred payment.

Striking a balance. **As stated above, a balance must be struck between rewards to the investors and reward to the 'creatives' involved in the production of the film. The investors must feel they are being treated fairly or it will be difficult to sell the securities. The talent must feel that they are being treated fairly or they may not participate in the project.**

Participation in "profits." **Members of the creative team such as actors, writers, directors, and producers often receive a percentage of the production company's profits in addition to payments from the budget and deferral payments discussed above. This percentage, commonly called "profit participation" or "points". Points paid to 'creatives' are sometimes the producer's responsibility and paid from the producer's share rather than the investor's share of the profits. In other situations, the producers and the investors share those points.**

CHOICE OF ENTITY.

Separating the production company from the financing company. **The business of producing a film (hiring and firing crew and talent, operating vehicles and equipment, renting locations, entering into contracts with suppliers, and the like) can create substantial liability. Claims can be brought by injured third party for breach of contract or personal injury. To better manage the risks associated with such liabilities, a separate entity can be formed to undertake the business activities and transactions associated with the production of the film.**

A corporation is often used as the business structure for the production of the film. The assets of that corporation are usually limited to cash on hand and the expectation of payments under the agreement with the company financing the production. Creating such a corporation insulates the liabilities that can be created during production from the assets of the financing company such as the screenplay, film footage, and revenues from the distribution of the

film and derivative works. The agreement between the corporation and the financing company is a work-for-hire agreement by which the corporation acquires no copyrights in the film.

The financing company. **When choosing an entity for the financing company, the selection is generally between a limited partnership, limited liability company, or, to a lesser extent, as we shall see, a corporation. General partnerships comprised of individuals and sole proprietorships should be avoided because unlike limited partnerships, limited liability companies and corporations, they do not limit owners' exposure to liabilities. Investors find such exposure unacceptable. Note that when production companies come together to make a film, they form entities such as joint ventures, general partnerships consisting of corporations, or LLCs.**

Control is very import to a production team making a film. Filmmakers want control of creative and management decisions affecting the production and exploitation of the film. Arguably, they are the best parties to make those decisions in normal circumstances. At any rate, investors must closely scrutinize the filmmakers' creative and management skills as part of the investor's decision to invest. An investor who invests in a limited partnership cannot participate in the management of the partnership (and therefore the creative and production decisions) without losing limited liability status. Limited liability companies can be similarly structured to separate the managerial rights from the ownership rights.

Another factor to consider in the selection of the type of entity for the financing company is how much flexibility the type of entity allows in structuring the return of capital and losses to the investors. Investors generally expect most of the film's income and losses to be distributed to them before the production team participates to any significant extent. After the investors are paid back their investment and perhaps a return, the division of proceeds may switch to favor the production team. This variable manner of distributing proceeds does

not necessarily correspond to the parties' ownership interests in the financing company. This flexibility in distribution of profits and losses is useful and is relatively easy to achieve in limited partnerships and limited liability companies. It is difficult to achieve in Subchapter S-corporations where profits must be distributed prorata on a per share bases annually. Subchapter C-corporations can achieve some of that flexibility through the use of classes of shares but the resulting structure may be complex and cumbersome.

Tax considerations. **A knowledgeable tax attorney or accountant with experience in film production should be consulted to analyze the tax law issues involved in the creation of the financing and production entities. Put simply, Subchapter C-corporations are subject to double taxation, once at the corporate level and then at the shareholder level, whereas Subchapter S-corporations are taxed once at the shareholder level much like a partnership where the partners are taxed and the entity is not. Like partnerships, Subchapter S-corporation shareholders are required to pay taxes on their share of the corporation's profits regardless of whether the profits are actually distributed. Certainly the avoidance of double taxation and other tax considerations are important factors in the selection of the type of entity for the financing company.**

FREQUENTLY ASKED QUESTIONS

Filmmakers raising money for their feature films commonly ask the following questions.

"Must the offering memorandum use such negative language?"

This is a frequently expressed lament of clients who are unaccustomed to securities offerings. As creators of an artistic project, filmmakers react strongly to what they perceive as negative and disparaging descriptions of their project.

The response to this complaint is two-fold. First, for the reasons expressed elsewhere in this article, companies offering to sell securities are required by law to fully and factually describe all material aspects and risks of an offering, without misrepresentation or omission of relevant factors. This duty is imposed not only on the offeror but also on the lawyer preparing the document. The properly drafted offering memorandum serves to protect the offeror and others from disgruntled investors who seek to bring actions against the offeror for fraud or breach of contract.

Second, a thoughtful and thorough offering memorandum expressed in the customary language of securities offerings is actually a better sales tool. Sophisticated investors, typically those with disposable income to invest in projects such as feature film, are accustomed to lengthy offering documents that emphasize the extreme risk of the investment.

"Why do investors invest in independent feature films?"

At some point in the review of the offering memorandum, usually in the 'Risk Factors' section, clients will pause and in frustration ask, "Why would anyone in their right mind ever want to invest in an independent film?"

In our experience investors who buy units in an independent feature film offering are motivated by both the potential for profit and for personal reasons. The independent film investment represents a relationship with an artistic project and a group of creative people. The investment may express the investor's desire to help the filmmaker, patronize the arts, or get close to the making of a film for other personal reasons. Many potential investors with an interest in a film project have family members who are pursuing a career in film or television.

Most investors are also strongly motivated by the opportunity

to make a profit on their investment. Although risky, investments in independent features have the potential for significant profits and may therefore appeal to investors who seek to balance their portfolio with high risk and high return potential investments.

Also many investors are attracted to film because as an investment, it is not "correlated" to the stock market. That is, the box office does not go up and down with the stock market. This gives investors a counterbalance and portfolio diversification.

"How do I set the minimum and maximum amount of the offering?"

The minimum is the least amount of dollars it will take for the production company to make its film and the maximum is a larger, more ideal sum that would produce a better, perhaps more marketable film with higher production values.[xxiv]

The minimum/maximum arrangement restricts the offeror (the production company) from using any funds unless at least the minimum is raised. Thus if the minimum is not raised within the offering period, all funds must be returned to the investors. If the minimum is raised, the offeror is given the option to move directly into production or attempt to raise additional money up to the maximum. The use of the minimum/maximum arrangement protects the early investors by giving them the assurance the investors' funds will not be used and be returned to the investor if the offeror fails to raise sufficient funds to cover at least the minimum.

"How long do I have in which to sell the offering?

Realistically it may take the production company years to develop and raise financing for his/her film. What happens if the production company fails to raise the minimum before the offering period specified in the offering memorandum closes? If the offering is made on a minimum/maximum basis and the minimum is not raised,

the investors' funds must be returned at the end of the offering period.

To qualify for most exemptions under securities laws, the offering period cannot exceed 12 months. But it may be advantageous to set a shorter period. If the offering period is too long, it may be difficult for the production company to get investors to commit to the purchase of units. Investors do not want their capital sitting idly for long periods of time in an offeror's bank account or an escrow account while the offeror attempts to raise other funds to make the film. So investors tend to put off writing checks until the last minute. The longer the sales period, the longer the investors will put off buying the securities offered in the offering and the greater the opportunity for other investments to come along and draw the investors' funds away from the production company's offering. The production company must strike a balance between the benefits of a short sales period and the reality of the market that may make it difficult to raise the minimum in a short period of time.

One option is to set the sales period at a relatively short period, say 90 to 120 days, and give the production company the option to extend the offering period. This strategy may strike the right balance between creating a sense of urgency while at the same time giving the production company the flexibility to extend the offering period for the additional time needed to raise the minimum set in the offering memorandum.

"Can I use brokers and finders?" "Can I pay my friends finder's fees?"

Generally, the officers of the offeror and, if the financing company is a limited partnership - the general partner, can sell units. Broker/dealers[xxv] are permitted to sell securities in most types of offerings although the extent of their solicitation may be limited, as for example, in those types of offerings where general solicitation is

prohibited. However, in reality, most independent film offerings are not brokered.

Finders are persons or businesses who receive a fee for soliciting and directing potential investors to the offeror. Finders who are not registered broker/dealers can be used in limited circumstances but neither the offeror nor the finder should do so without the advice of counsel. Certainly finders must not undertake activities, such as general solicitation, that the offeror is prohibited from undertaking. Generally, risk is created for both the finder and the offeror when finders do more than merely introduce potential investors to the offeror. Potential liability may occur when the finder discusses the terms of the offering, negotiates the sale of the securities, is paid based on the outcome of the offering, or has acted as a finder or broker in prior transactions. Many states have regulations restricting the ability of offerors to use finders.

"Can my attorney help me sell units?"

The short answer is, "No." The sale of securities creates significant liability for lawyers and their firms. Attorneys are probably not licensed as broker/dealers and participation in the sale could violate state and federal licensing regulations. Also the attorney's participation in the securities transaction creates a potential conflict of interest between the client and the attorney.

"Can I give potential investors projections and comparables?"

The decision to make oral or written projections of the future value of an investment in an offering must be made cautiously. The statutory safe harbor for projections (so-called "forward-looking statements") is not available for offerings of a partnership or a limited liability company.[xxvi] Without a safe harbor it is difficult to predict the extent to which an offeror will be liable for his/her projections. However, the reality is that projections are common. In fact it is

difficult to discuss the proposed sale of securities in an independent film offering without making projections. Offerors may feel it is necessary to provide projections to attract investors. Those choosing to make projections should be careful to put them in writing, identify them as forward-looking statements, include meaningful cautionary statements and disclaimers, and identify the assumptions and important factors that could cause actual results to differ materially from those in the forward-looking statements. Obviously, such statements must not be made if the offeror or the person making the projections knows them to be false or misleading.

© 2007 Daniel M. Satorius

DANIEL M. SATORIUS – Satorius Law Firm. PC. **Dan's practice focuses on transactions, intellectual property, financing, and the representation of business and individuals. His clients include Academy Award, Emmy Award, and Peabody Award winning independent producers, directors, writers, and television stations in the film and television industry; Grammy award winning songwriters, recording and performing artists, producers, publishers, record companies, and studios in the music industry; and authors and publishers in the literary and electronic publishing industry. Contact Dan at IDS Center, Suite 2000, 80 South Eighth Street, Minneapolis, MN 55402. Phone: (612) 336-9332. Email: dan@satoriuslawfirm.com.**

The information contained in this article is not intended as legal advice or as an opinion on specific facts. For more information about issues raised in this article, please contact Daniel M. Satorius. The invitation to contact us is not to be construed as a solicitation for legal work, does not create an attorney /client relationship, and is not to be construed as an offer of representation in any jurisdiction in which the attorneys are not admitted to practice. Any attorney/client relationship will be confirmed in writing. You can also contact us through our Website at www.satoriuslawfirm.com.

Copyright laws and treaties protect this article. You may make a single copy of materials on this site for personal use. You may make copies for others, but not for commercial purposes. If you give a copy to anyone else, it must be in its original, unmodified form, and must include all attributions of authorship, copyright notices, republication notices and disclaimers. Except as described above, it is unlawful to copy, republish, redistribute and/or alter this article without prior written consent of the copyright owner. For reprint and redistribution requests, please email info@satoriuslawfirm.com.

ENDNOTES

[i] **Daniel Satorius' firm is Satorius Law Firm, PC in Minneapolis, Minnesota. Mr. Satorius represents clientele in the entertainment industry.**

ii. **Securities offerings for independent film projects are a special sub-category within the big world of securities law. This article focuses on some of the unique characteristics of independent feature film offering that distinguish them from the offerings of other types of ventures. As a result, some issues typically covered in discussions of securities law are not covered in this article. For example, public offerings, which for the reasons discussed in the next paragraph, are generally not used for independent film offerings. Since most independent film offering are for one film, have a limited duration, are not publicly traded and have no market, resale and the restrictions thereon are not discussed here. Because Reg. D exempted offerings (with the exception of limited allowances under Rule 504) prohibit it, general solicitation or general advertisement of the sale of securities are not discussed here in any detail.**

iii. **Private debt financing is not discussed in this article but it is a viable alternative to private equity financing. It is also possible to blend the two. In private debt financing arrangements the filmmaker does not give up to the investor any management rights, the investor can get a priority in a bankruptcy or distressed business scenario, the interest on the loan is deductible by the filmmaker, and it is possible to give the investor some participation in the upside.**

iv. **SEC v. W.J. Howey Co., 328 U.S. 293, 299-300 (1946).**

v. **The Securities Act of 1933 (the "Securities Act") §24, 15 USC §77x.**

vi. **Securities Act §20 (b), 15 USC §77t(b).**

vii. **Securities Act §20 (d), 15 U.S.C. §77t(d).**

viii. **Securities Act §§ 11, 12, and 17(a), 15 U.S.C. §77k. 77l, and 77q(a).**

ix. **Securities Act §§ 10 and 15, 15 U.S.C. §77o and 77t.**

x. **17 C.F.R. § 230.504.**

xi. **17 C.F.R. § 230.505.**

xii. **15 USC § 77d(6).**

xiii. **17 C.F.R. § 230.506.**

xiv. **15 USC § 77d(2).**

xv. **Securities and Exchange Commission v. Ralston Purina Co., 346 U.S. 119, 73 S. Ct. 981 (1953).**

xvi. **The Securities Act §3(a)(11), 15 USC §77c(a)(11).**

xvii. **17 CFR § 230.147(c).**

xviii. **Small Corporate Offering Registration (SCOR), Form U-7 Disclosure Document, North American Securities Administrators Association, (CCH) ¶5057.**

xix. **The Securities and Exchange Act of 1934 § 10(b), 15 USC § 78j(b), 17 CFR § 240.10b-5, (SEC Rule 10b-5), which states as follows:**

"Employment of Manipulative and Deceptive Devices:
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
(a) to employ any device, scheme, or artifice to defraud,
(b) to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

xx. ***See e.g.* The Securities Act §§ 11, 12, and 17(a), 15 USC §§ 77k, 77l, and 77q(a). *See also* The Securities and Exchange Act of 1934 §§ 9(e) and 18(a), 15 USC §§ 78i(e) and 78r.**

xxi. **Louis Brandeis, Other Peoples Money p. 92 (1914).**

xxii. **Most films do not recover their distribution and production costs from theatrical distribution alone and must rely on other markets such as video/DVD distribution. Many films never show a profit, even after release in other markets. Risks associated with foreign distribution include fluctuations in currency and foreign exchange control laws that delay or prevent receipt of payment in United States dollars.**

Distribution agreements grant the distributor broad latitude and discretion in the distribution and exploitation of the film. A distributor probably will not be required to distribute or otherwise exploit the film in any particular media or market. A distributor will also probably not be restricted from giving preferences to or otherwise favoring any film over any other films which the distributor may distribute including the distributor's own films. Because a distributor may have a lesser financial stake in the filmmaker's independent film than it has in films it owns and distributes, it may tend to prefer its own films in making distribution decisions. Similar risks are also present with regard to any sub-distributor utilized by a distributor. Therefore, conflicts between the filmmaker's independent film and other films distributed by a distributor may arise.

xxiii. **The tax code requires general partners to receive at least a nominal distribution.**

[25]**The production company should be advised to include in the budget appropriate amounts for marketing and administration costs, *e.g.* legal, accounting, office overhead, entering and attending film festivals, presentations to distributors, reporting to the investors, and operating the production company.**

xxv. **Where offering is offered for sale by brokers, the filmmaker/offeror must carefully negotiate the agreement with the broker/dealer, especially with respect to the issue of whether the broker is undertaking the offering on a "firm commitment underwriting" basis where the broker is underwriting the offering and must buy the unsold balance of the offering for their own account or a "best efforts" basis where the broker is not so obligated.**

xxvi. **The Securities Act § 27A(b)(2), 15 U.S.C. §77z-2(b)(2); The Securities and Exchange Act of 1934 § 21E(b)(2), 15 U.S.C. §78u-5(b)(2).**