



Nourishing the Creative Spark![®]

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Legal Issues in Film Production

A. Preparing To Produce - Formation Basics:

Key Concepts (Form Follows Funding)

Partnership/Individual/Sole Proprietorship;

"C" Corps and "S" Corps;

Limited Liability Company, Operating Agreements and Limit Partnerships;

Not For Profit Corporations

Operating Essentials (Employer ID Number, Bank Accounts, Accounting)

Key Documents

Shareholder Agreements (for corporations), LLC Operating Agreements

Writer Collaboration Agreements

Joint Copyright Owner Agreements

Co-Production/Development Agreements

Submission of Material Agreements/Waivers

Employment/Consulting Agreements

Waivers and Releases

Business and Investment Structure:

The first task of film production is to select and set up a business entity for the film. This is true whether the producer is making a short film, shooting wedding videos and commercials, or creating a larger feature film project involving hundreds of thousands of dollars, salaried employees, and a crew of independent contractors.

The goal of creating and using a business entity is to anticipate four primary areas: **control, financing, liability and tax**. Control refers to the manner in which the producer intends to manage and maintain control of the film project and involves such issues as "Who owns the film's intellectual property?" and "Who has the right to manage the creative, financial and business aspects of the film project?" Financing refers to the source of funding for the film including interactions with investors, if the financing is equity-based. Liability refers to the obligations incurred by the film production and the producer's personal liability for such obligations. Tax refers to the tax benefits (such as the Illinois Film Services Tax Credit and tax obligations incurred in the production and distribution of the film. Each of these issues should be considered as part of developing a film project.

The most common business entities are sole proprietorships, general partnerships, corporations and limited liability companies. The first two types (sole proprietorships and general partnerships) should not be used in film production because they expose the producer to individual liability for the debts of the production. This is particularly true because independent film projects normally take at least 3 years (and often 5 or more years) to reach the production phase and it may take another 2 years to obtain a meaningful distribution deal (that is, a deal where money flows back to you). Keep in mind that film production is a very high risk endeavor and individual liability will expose you to the demands of creditors who want to be paid today. Thus, it is well worth the time and expense of forming a company *and conducting all business in corporate form*.

By organizing and operating as a corporation or a limited liability company, a producer can avoid personal liability for the business's operations and can, more easily, bring investors into the project. Keep in mind that the protection offered by a corporation or LLC may disappear *if you fail to comply with all the formalities*. For example, if you fail to file annual reports with the Secretary of State your company will be dissolved, or if you mix personal and company funds, creditors may be able to reach your personal assets. So, create a separate bank account and FEIN for each entity.

To determine which entity is best for your project, you should speak with an accountant, attorney or someone familiar with the benefits and burdens of

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each type of entity. Setting up an Illinois corporation or LLC is a relatively simple process that involves filing certain forms with the Illinois Secretary of State which are available at the Secretary of State website (www.sos.state.il.us). Be aware that creating and operating as an LLC is more complicated and expensive than creating and operating as a corporation. So, if you elect to operate as an LLC you must understand what other documents and agreements (such as an "operating agreement") are required.

When beginning any business venture, a producer should consult with an accountant in order to understand and plan for tax issues. For example, Illinois has a tax credit incentive program for films shot in Illinois that expend funds for services and wages. But you must apply with the Illinois Film Office so take a look at the IFO's website (www.illinoisbiz.biz/dceo/Bureaus/Film) for complete details.

When developing a film project, many producers first create an incubator corporation or LLC (the "Development Company") that develops one or more projects until the time when each project is ready to be funded and produced. The Development Company, which is controlled by the producer, does all the development work for the film project, such as acquiring the underlying literary work or screenplay on which the film is based. When the project is ready for funding and production, it is transferred to a separate LLC (the "Production LLC"), the common practice being to create a separate LLC for each film project, thus insulating the producer's other projects from failure or liability. The Development Company often serves as the manager of the Production LLC thus creating a double level of protection for the individual producer.

The Production LLC will own or license all of the intellectual property associated with the film. This includes the rights to use the script, the rights to the actor's performances, licenses for all music, and all other items that are discussed in the section on copyright. Potential distributors will carefully examine all of the Production LLC's paperwork to make sure that the Production LLC holds all necessary intellectual property rights. Anyone working on the production should be hired by and paid by the Production LLC. The producer or the Development Company will typically be a "member" (that is, the owner) as well as the "manager" of the LLC.

Film is a collaborative process and it is common for two or more individuals to collaborate on the critical aspects of the film such as writing the screenplay, acquiring other intellectual property and retaining actors and crew. However, because producer "divorces" are also common, producers should negotiate and sign a Joint Venture, Collaboration or Joint Owner Agreement which provide who is entitled to make decisions with respect to the film project, who is responsible for certain activity, and what happens if one producer decides to leave the project. Many projects die because one of the producers has a different vision for the project and refuses to cooperate with the other producer. So remember that "good fences make good neighbors" and prepare a written agreement that sets out the expectations, responsibilities and rights of each producer.

B. Indie Film Financing

Key Concepts

Self-Funding, Family Funding

Private Investment and Compliance With Securities Laws

Film Packaging Companies and companies/individuals who "find" film financing for a fee (e.g. \$5,000 expense retainer). Check their license to act as a broker/dealer and obtain a CRD number.

Pre-production Funding Deals

Loans and the Illinois Development Finance Authority

Non-profit options: Grants, Charitable Contributions and Fiscal Sponsors

Key Documents

Securities Offering Checklist

Private Placement Memorandum and Related Documents

Promissory Note/Development Loan Agreement

Production Support Agreement

Fiscal Sponsorship Agreement

501(c) Submission and Tax Exempt Letter

Production Budget and Timeline

Film Financing Finder Agreement

Financing and Investment Issues:

Film financing is one of the most difficult and least understood challenges facing a producer and it is fraught with perils for the unwary. Many independent film producers find themselves caught in the "Producer's Paradox" namely: "You can't sign talent and develop your screenplay without financing, but you can't obtain financing without talent and a polished script." Given that most film producers do not want to use their personal assets to fund their films, the most important issue for many producers is how to finance their film project with other people's money.

The methods of financing film projects are as diverse as the film projects themselves, the most common ways being; "debt" (such as borrowing money); "equity" (such as selling membership interests); or a combination of both (such as a production support agreement). If the producer has a track record of successful film production, then additional sources such as "pre-sale" of film distribution rights or studio financing are available. And there are producers who merely package a project and assign the rights to another, better financed, production company. However, for most independent producers film financing is limited to debt and equity.

The problem with financing a project with debt is that such agreements require the payment of a *sum-certain, with interest, on or before a specific date*. A credit card is a simple form of debt and is the worst possible way of financing your film (except, perhaps, using a home-equity line of credit secured with a mortgage on your home) for the reason that the debt usually must be repaid many years before the film is commercially viable and money begins to flow back to the production company. If you have a day job, then incurring a small amount of debt (in the amount of \$5,000) may be an acceptable option to finance a short film. And there are state-sponsored programs, such as "Lights, Camera, Illinois" which can provide better terms and conditions, but generally debt financing should be used only with great care.¹

The other major source of funds, equity financing, is problematic because a securities offering memorandum (or disclosure document commonly referred to as a "Private Placement Memorandum or PPM") is required to raise money from investors outside of your family *no matter how small the amount involved*. Full disclosure is required under the securities laws and notice filings are required by the federal Securities and Exchange Commission (the "SEC") and by the laws of each state in which investors reside (known as "Blue Sky Laws"). Violations of the SEC requirements and the applicable Blue Sky Laws carry both criminal and civil penalties.

¹ The Lights, Cameras, Illinois! Program, in partnership with Illinois-based financial institutions, presents Lights, Cameras, Illinois! to encourage the film and television industry to make major motion pictures, television/cable and commercial productions in the State of Illinois by providing loans at below market rates. Questions about the program should be directed to Chuck Hagopian, Jr., 100 West Randolph Street, Suite 15-600, Chicago, IL 60601, 312-814-1793, chagopian@treasurer.state.il.us

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A business plan IS NOT a Private Placement Memorandum. A business plan and a securities offering memo serve very different functions. A business plan is a marketing document created from a selling point of view, which necessarily contains optimistic information, forward-looking statements, hopes and dreams, and possibly financial projections. A securities offering memo, on the other hand, is a full disclosure document, which must contain all the bad news, risks, and must list and comment upon all possibilities that could go wrong.

In order to safely comply with these laws, a producer should work with an attorney who is familiar with both entertainment and securities regulation. This is not a “do-it-yourself” type of project nor is it wise to “cut and paste” portions of other PPM documents that you find on the web because the producer, without help of securities counsel, has very little notion of what provisions and information are needed.

The following is a summary of some of issues that arise when preparing a private placement investment offering under this exemption:²

1. No General Solicitation. The producer may not engage in any “general solicitation.” This basically means that investors are limited to people that the producer actually knows, such as business associates, friends and family. The producer may not advertise for investors in a newspaper, or use a general mailing list or any other means of mass communication. There are specific rules regarding general solicitation, and an attorney can help to clarify exactly what a producer may and may not do when approaching potential investors.

2. Accredited investor requirements. All investors must be “accredited investors.” An “accredited investor” is a person of high net worth, or certain kinds of banks or corporations. There are exact numbers and specific requirements that a person, bank, or corporation must meet in order to be considered “accredited.” These rules are complex and change from time to time as the laws are updated. When making an initial pitch, a producer can target people or corporations who probably have high net worth. However, before finalizing the deal, the producer must coordinate with an attorney, and review the investor’s financial statements, in order to make sure the investor is indeed “accredited.”

3. Disclosure requirements. A producer should present potential investors with a “private placement memorandum” or a “PPM.” The PPM is a document that discusses the business plan, the nature and structure of the investment, and the potential risks involved. While

² These issues are provided merely as examples of SOME of the requirements to be satisfied in connection with the sale of stock or membership interests. This is not a complete list of issues and under no circumstances should a producer attempt to create a PPM or to raise equity funds without the assistance of qualified securities counsel. Note that this is costly legal work, and that producers should budget accordingly.

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securities laws do not specifically require the PPM, it is nonetheless a critical document. By communicating with investors through a PPM, a producer can significantly reduce the possibility of lawsuits or criminal charges down the road. A PPM is more than just a business plan; it is a carefully drafted legal document and should be prepared by an attorney.

4. Filings. There are certain documents that the producer must file with the state and Federal governmental authorities when issuing securities. Securities laws require these filings, and the filings act to alert the relevant governing bodies that the producer is conducting an exempt securities offering.

As you might expect, an essential part of any request for financing is for the producer to develop a credible budget and production timeline. Without both of these documents, prepared by someone with experience in film production, the producer should not undertake any serious fundraising.

So, how do you solve the Producer's Paradox? One possibility is to start with a short film and work up to a feature film project. A short is far less expensive, allows you to develop an understanding of the difficulties you will face with a feature film, allows you to develop relationships within the industry and it can become a calling-card for potential sources of funds.

c. **Copyright Basics**

Key Concepts

What is Copyright and the exclusive rights it provides?
Distinguishing Copyright from other IP rights.
Who can claim copyright? (author and work made for hire)
What works are protected? What is not protected?
Copyright Registration Procedure (www.copyright.gov)
Benefits of Copyright Registration v. WGA Depository
Copyright Infringement and Fair Use Defense
Internet Issues.
Use of Collaboration/Joint-Author Agreements
General assistance from others
Acquiring Literary Work
Use of IP rights owned by others (trademarks, art, locations)
Film Clip License Agreements
Right of Publicity/Privacy Issues

Key Documents

Copyright Assignment
Option Agreement for Literary Rights and Life Rights
Screenplay and Option Agreement
Documentary Filmmakers' Statement of Best Practices in Fair Use
(www.centerforsocialmedia.org/rock/backgrounddocs/bestpractices.pdf)
Rights And Proceeds Agreement - Certificate Of Authorship
Performer-Actor-Participant Release
Location Release
Still Photo Release
Work-Made-For-Hire Agreement
Composer Agreement
Master Use and Synch License Music Agreements

Copyright and Intellectual Property:

In order to secure meaningful distribution for a film, a producer must be able to prove that he or she owns, or has a license to use, EVERY piece of intellectual property in the film. "Intellectual property" includes many things, such as the right to use the screenplay, the right to use the music in the soundtrack, the right to use the title of the film, the right to use any brand names that appear in the film, ownership of the actors' performances and many other issues. It is critical that a producer be very conscious and organized with regard to intellectual property.

• **What is a Copyright?**

Copyright is a form of legal protection given to many kinds of creative works. In order to be protected under copyright, a work must be: 1) "original" which means that it was not substantially copied from any other source; 2) "fixed in a tangible medium of expression" which means that it exists in some reasonably permanent or stable form, such as a film or video recording; and 3) have a minimum degree of creativity. Not everything can be protected by copyright, but a surprisingly large variety of works can be.

The copyright owner has the exclusive legal right to 1) reproduce the work, 2) publicly display the work, 3) distribute copies of the work, 4) publicly perform the work, and 5) prepare "derivative works."

• **What is a "derivative work?"**

Any creative work that is based on a pre-existing copyrighted work is a "derivative work." For example, if a film is based on a novel, then the film is a "derivative work" of that novel, and the film producer will need the author's permission. A similar concept applies to every piece of copyrighted material that a film might contain, from music to acting performances, to a painting that is in the background of a shot, and even certain buildings or other architectural works that might appear in a shot.

• **How do I get permission?**

A producer should locate the current owner of the copyright. Whether the copyright owner allows the producer to use the material for free or for a fee, the producer must have written permission. An attorney can assist in drafting an appropriate document. Depending on the situation, that document might be called a "license," a "release" or a "rights agreement." Either way, the most important provisions are the "Grant of Rights," "Representations and Warranties," "Price," and "Screen Credit."

• **Grant of rights:**

There are two basic ways to transfer copyright rights: an assignment and a license. A copyright assignment refers to the transfer of all the rights to a copyright. A copyright license refers to the transfer of some of the rights to a copyright. For example, a "license" to use a piece of music might allow the producer only the rights to use the music in the film's soundtrack, while the

record label would retain the rights to use the music for CD sales, radio play, etc. An *exclusive* license means the producer is the only person who can exploit the rights granted, while a non-exclusive license means the licensor/copyright owner can give permission to several people to exploit a certain copyright. For example, a producer would want an exclusive license to adapt a novel, so that no other filmmaker can make a similar film at the same time. However, for a piece of background music, a non-exclusive license might be sufficient. Technically a non-exclusive license can be made orally or in writing, but it is almost impossible to secure meaningful distribution without WRITTEN evidence that the producer holds rights to use EVERY piece of intellectual property in the film.

- **Representations and warranties:**

This is the part of the agreement where the current copyright owner represents and warrants that he or she actually owns the copyrights and can freely transfer over the rights to the producer. A producer can check on the state of copyright ownership by getting familiar with the United States Library of Congress database at www.copyright.gov.

- **Price:**

A producer might pay an up front fee for the use of copyrighted material, or might grant a royalty in any proceeds from the film, or even a combination of both.

- **Screen credit:**

The copyright owner might ask for screen credit in exchange for the producer's use of the work. It is important to be careful about granting too many screen credit rights too early in production, especially for general areas such as "Producer" or "Executive Producer" because distributors and investors often have specific screen credit requirements. For example, an investor might require a credit as being the only "Executive Producer." If a producer has already agreed to give an executive producer credit to someone else, this could interfere with the producer's ability to close a good investment deal.

- **Other provisions:**

An agreement may deal with the right to write the screen play, the right to write any sequels or television versions, or the rights to produce live stage versions, novelizations, and derivative works based on the screenplay. In some instances, rather than actually licensing a screenplay, a producer might "option" a novel or screenplay. An "option" means that the producer has paid an author a fee to "tie up" the story, for a limited period of time so that no one else can produce it while the producer searches for finance or distribution. Eventually, the producer will either let the option expire, or will "exercise" the option by entering into an agreement to produce the screenplay into a film.

- **Is a copyright assignment or a license always necessary?**

Whether or not a producer needs to obtain copyright permission depends on the source of the film concept. For example, a producer *will* need a copyright assignment or a license if the film is based on any kind of existing work such as a novel, short story, stage play or a remake of an older movie.

On the other hand, a producer will not need a copyright assignment or a license if the film is made from his or her own original idea or a true event. For example, if you were to write a screenplay from scratch, that screenplay would belong to you. However, as a producer you will still need to license the screenplay to the LLC that holds the film. If a producer writes a film with a partner, it will be important to have a co-authorship agreement describing how the authors plan to share the rights related to the screenplay.

True events cannot be owned by anyone, and therefore do not implicate copyright issues, although an author's description of the event is protected. A producer should be careful about portrayals of real individuals, living or dead. There is a highly complicated legal interaction between the right of free speech under the First Amendment to the U. S. Constitution, and the right of individual people (and sometimes even companies) to live free from defamation and to enjoy certain rights of privacy and publicity. The individual a film portrays could potentially sue the producer for defamation or violation of privacy or publicity rights, and even a small chance of potential liability will make investors and distributors nervous. If possible, a producer should try to get written permission from the individuals portrayed in a film, especially if those individuals are not public figures.

- **Works Made for Hire:**

Anyone working directly on the production, such as actors, directors, DPs and anyone else who could create a copyrightable material, should have "work made for hire" status, if appropriate. "Work made for hire" means that an artist's work will be the original property of the production company, as if the production company had created that work itself. Actors and crew might work under union contracts, but these contracts do NOT create a "work made for hire" status. An attorney can help a producer to draft the specialized contracts that provide for this status.

- **Music:**

Obtaining all the required rights to use music in your film can be very complicated. The composer will have rights, the recording label will have rights, and there are often others with rights to be considered. There are a number of ways to obtain permission to use a piece of music. One is to directly contact the musician or the appropriate agent or record label. Certain types of rights can also be obtained through the major music clearing houses, known as "The American Society of Composers Authors and Publishers" ("ASCAP") at www.ascap.com, or "BMI" at www.bmi.com. The cost of using a piece of music can vary greatly depending on the music, the musician and the specific type of film production. Sometimes a producer will "fall in love" with a

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piece of music before beginning production, only to discover that the music license will cost more than the entire film's budget! So either don't fall in love, or check out your music costs early. One more note on music: there is a myth in the artistic community that it is legal to use under 10 seconds, or a few bars, of a song without obtaining permission. This myth is not true concerning music, or any other type of copyrighted material you may want to use without permission.

- **Trademarks:**

Trademarks are words or symbols that identify the goods or services of a business in commerce. Famous examples are Coke, McDonalds, the MGM lion. Trademarked products are often licensed for use in films but increasingly, product manufacturers will pay for the opportunity to have their products featured (otherwise known as "product placement"). As a film maker, you have broad free speech rights and will be given some flexibility in displaying trademarks in your movie. However, watch out for scenes that may disparage another company's trademark or in any way imply that the production is affiliated that other company. It is best to ask your attorney.

- **Copyright Registration:**

Once a producer finishes a film, the producer automatically has copyright protection over the completed film. However, a producer can obtain important additional benefits and protections by registering the film with the United States Copyright Office. The process of copyright registration is simple, the filing fee for basic registration is currently \$30, and the proper forms can be obtained online through the Library of Congress website: www.copyright.gov.

- **Writers Guild of America ("WGA") registration:**

A WGA registration can serve as evidence of when a screenplay was created in case there is ever a dispute over the authorship. This registration does not hurt, but should not be confused with, nor is it a substitute for, the important rights that come from copyright registration. The WGA can be found at www.wga.org and www.wgaeast.org.

While this section on copyright contains much complicated information, a good attorney can simplify this process.

D. Cast and Crew Agreements

Key Concepts

What it means to be a "SAG production"

Different types of SAG contracts

What a producer must provide to SAG

Union vs. non-union: is it all or nothing?

Deferred and "Back End" Compensation

Employee vs. independent contractor

Crew

Liability issues

Special issues with minors

Key Documents

Performer Deal Memo

Standard Terms and Conditions For Performer Deal Memo

Loan Out Company Inducement Letter

Crew Deal Memo

Independent Contractor Services Agreement

Screenplay Writer Agreement

Line Producer Agreement

Associate Producer Agreement

Director Agreement

Director of Photography Agreement

Actor Release and Waiver

Extra Release and Waiver

Minor Release and Waiver

Location Releases

Application For Errors and Omissions Insurance

SAG Low Budget Agreement Digest,

SAG Budget Agreement Digest

Working with Unions:

Unions were created to protect workers from unfair wages and poor working conditions. If a producer wants to use *any* union labor, then that producer will have to become a signatory to the appropriate union contract. This does not necessarily mean that the production must hire *only* union labor, nor does it mean that the production will need a big budget. Some unions, such as the Screen Actors Guild ("SAG") offer various contract options for small and medium budget films.³

The major unions for on-camera actors are SAG (for feature film) and the American Federation of Television and Radio Artists ("AFTRA," generally for television, radio and commercial work). The major unions for crew are IATSE (International Alliance of Theatrical Stage Employees, Moving Picture Technicians, Artists and Allied Crafts) and the Teamsters.

In this section, we will examine how a producer runs a SAG signatory production. While each union has its own specific rules, this discussion should give a good sense of how the overall process works.

SAG has a basic contract that contains all of the union rules. That contract is about the size of a novel, and a producer might never get around to reading it (that's what the attorneys do!). The producer signs a signatory agreement. This is a short document that says (essentially) "I agree to follow all the rules in the (really long) SAG basic agreement." Those rules address everything from how many hours actors can work in a row, to when lunch must be served, to how residuals are calculated, and many other aspects of employment. The rates that a producer must pay, whether the production can hire non-SAG labor, and many other questions, depend on what kind of signatory agreement the producer signs. For example, the "Ultra-Low Budget" signatory agreement applies to films of with budgets less than \$200,000 and requires a day rate of \$100 for each performer, while the "Modified Low Budget" signatory agreement applies to films with budgets of less than \$625,000 and requires a day rate of \$268. SAG has specialized agreements for shorts, and even student films.

The details of the SAG signatory agreements change from time to time, so it is important to coordinate directly with SAG and make sure the production is in compliance with the appropriate agreement. Many of the details of the SAG agreements can be found online at www.sagindie.com. SAG suggests that producers contact their local SAG office at least 4 to 6 weeks prior to beginning production. A SAG representative can be very helpful, and it's a good idea to keep in touch with SAG "early and often."

Once the production has become a "SAG signatory production," all the performers must sign a SAG form of employment agreement before the

³ Producers with questions regarding use of SAG actors should contact Kit Woods (kwoods@aftra.com) Assistant Executive Director of the Chicago office of AFTRA - SAG, (312) 573-8081 Ext. 547.

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beginning of production, which a producer can get from the local SAG office. This agreement will address basic employment questions such as pay and hours. However, this agreement does not address intellectual property issues such as copyright ownership. For this reason, it is critical that the performers sign appropriate release forms *in addition to* the SAG employment contract.

Non-SAG talent do not sign the SAG employment agreement, however SAG will usually require that a production pay non-SAG talent at the same rate as SAG talent. For this reason, it is important for the production to have a non-SAG form of employment agreement in addition to the SAG form. SAG also requires producers to carefully keep track of which performers work which days and hours. A local SAG representative can help a production set up a system for keeping track of these details.

The key to success in union relationships is to begin communication well in advance of production and keep that communication open throughout the production.

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