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Simplified Syndication for Stage and Screen: A Proposal for Modifying Securities Laws for the Financing of Theater and Film Production

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I
Background

A. Speculative Investments

Conventional wisdom regarding the success of a project in the entertainment industry is usually summed up in four words: "It's a crap shoot." While an investor should be entitled to know who is going to throw the dice and whether they will be tossed on a green felt table or a hard concrete back alley, what the shooter ate for breakfast is irrelevant. Similarly, the securities laws regulating direct investment in stage and screen productions often focus on disclosing the nourishment of the crapshooter and not on the crapshooter's skill with the dice. As a result of having to comply with irrelevant and excessive securities regulations, the promoters spend more time and money to complete their financing without providing any corresponding benefit to their investors.

In more prosaic terms, direct film and theater investments are unique. The public is the consumer of plays and movies, spending discretionary income to purchase emotion; anything from laughter, tears, vicarious thrills, to mental stimulation. The cost to the consumer, often more than just the price of admission,[1] includes the cost of transportation, parking, child care, and food. Public taste, the ultimate arbiter, is often unpredictable.

> Word-of-mouth is the great mystery factor . . . of the distribution process. No one knows exactly what it is, other than the all important ingredient in making a film a hit or a bomb. It's that serendipitous convergence of a great film, industry enthusiasm, an effective, well-handled campaign by a sympathetic distributor, favorable press attention, and a strategic release not undercut by competitive challengers or bad weather. Above all, word-of-mouth means a "buzz" about a particular film, derived from early [enthusiastic] viewers who will talk it up and encourage others to come out and spend money to see it. When you've got it, you've got a hit.[2]

Despite the uncertainties, an investor must predict, usually a year or two in advance, what combination of ingredients is likely to satisfy the public's taste. If the investor is wrong, the product invested in has little or no residual value.[3] A play that closes on opening night cannot be sold at a discount on the "used play market."

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1. The top price for a Broadway musical in 1991 reached one hundred dollars for the best seats to *Miss Saigon.* Rich, *'Miss Saigon,' From the Old School,* N.Y. Times, Apr. 12 1991, 31 at B1, col. 3.

2. D. ROSEN & P. HAMILTON, OFF-HOLLYWOOD: THE MAKING AND MARKETING OF AMERICAN SPECIALTY FILMS 323 (1986).

3. A film that fails to attract a ticket buying audience to the movie theater may still recoup some or all of its costs through subsequent markets including video cassette, pay cable television, and free television (cable and broadcast). A failed stage production has very few

At a time when the major studios are being merged into international entertainment conglomerates,[4] funding for independent film productions is severely impacted by two factors. First, investors are skittish about recession and are reluctant to take risks.[5] Second, the fallout in the independent distribution business is likely to get worse before it gets better.[6] A number of independent film production and distribution companies have fallen on hard times in the last few years. Some have been restructured and are barely hanging on, while others are out of business or in Chapter 11 Bankruptcy.[7] Bad management, underfunding, lack of hit projects,[8] and increased difficulty in persuading investors to back independent productions are just a few reasons suggested for the hard times facing film producers.[9]

B. Reasons to Invest

In good times or bad, lay investors are just as likely to pick the hits as are distributors or studio heads. As *Butch Cassidy and the Sundance Kid* screenwriter William Goldman stated, "No one person in the entire motion-picture field knows for a certainty what's going to work."[10] He summarized this truism as, "Nobody knows anything."[11]

As a result of the speculative nature of these investments, investors are motivated by more than pure economics.[12] Certainly the profit motive is a factor, but a belief in the premise and personality of a proposed

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alternative sources of revenue, although in rare instances the licensing of subsidiary rights may provide some revenue. *See generally id.*

4. Brennan, *Big Deal, Hollywood,* in DAILY VARIETY 57TH ANNIVERSARY ISSUE 14 (1990). Examples of recent or pending mergers are Sony/Columbia, Paramount Communications Corp./Capital Cities-ABC, and MCA/Matsushita. *Id.*

5. *Id.*

6. Daniels, *Making Cents,* in DAILY VARIETY 56TH ANNIVERSARY ISSUE 113 (1989).

7. Lieberman, *Backs to the Wall; Indies Running Hard to Stay in Place,* Daily Variety, Feb. 28, 1990, at F22, cols. 1, 3-4. Among the companies in trouble at this time are Atlantic Entertainment Group, De Laurentiis Entertainment Group, New Visions Entertainment Corp., New Star Entertainment Inc., Cineplex Odeon Corp., Zoetrope Productions, Vestron Inc., and Spectrafilm. *Id.* at F22, cols. 4-5; F26, col. 4; F28, cols. 3-5; F30, col. 5; F32, col. 2.

8. *Id.* at F22, col. 4.

9. McBride, *Indies,* Daily Variety, Jan. 5, 1990, at 55, col. 1.

10. W. GOLDMAN, ADVENTURES IN THE SCREEN TRADE 39 (1983).

11. *Id.* A recent example of "nobody knows anything" was Warner Brothers' decision to pass on *Home Alone* in favor of *Bonfire of the Vanities. Periscope: Conventional Wisdom Watch, Hollywood Studio Edition,* NEWSWEEK, Jan. 14, 1991, at 4. As of Feb. 20, 1991, *Home Alone* had domestic ticket sales of over $230 million while *Bonfire* had earned less than $16 million. *Film Boxoffice Report Weekend of Feb. 1-3,* Daily Variety, Feb. 5, 1991, at 4, col. 2; *Film Boxoffice Report Weekend of Feb. 15-18,* Daily Variety, Feb. 20, 1991, at 4, col. 2.

12. Rothstein, *On Broadway, Spectacles Raise the Stakes,* N.Y. Times, Jan. 8, 1989, § 2, at 1, col. 1.

film, coupled with the excitement of being involved in show business, are just as important.[13]

In this regard, theater investments are no different than film investments. As one experienced producer/investor said, "The use of the word investor is specious. You don't invest in Broadway shows as you would invest in a mutual fund. You invest in Broadway shows as you would in a crap game or a horse race."[14] Investors willing both to speculate and to support an idea or an artist have been dubbed "angels." And sometimes angels get golden wings. For example, the profits from the New York City run of *A Chorus Line*—excluding road shows and movie sales—exceeded $18,000 for each $1,000 invested.[15] Movie profits can be even more spectacular because production costs remain constant once a film is complete.

C. Typical Investment Vehicles

Typically, an individual investment in a production is made through a limited partnership. A general partner with unlimited liability manages the partnership. Those who contribute capital (the limited partners) have no right to participate in management and assume no liability beyond the potential loss of their investment.[16] Motion picture limited partnerships, and to a lesser extent theater partnerships, can be divided into two categories: single project deals and portfolio or "blind pool" partnerships.[17] The latter are exemplified by the Silver Screen Partnerships, which raised almost one billion dollars in four programs financing a slate of Disney films.[18] Typically, these big portfolio partnerships are designed to be eight- to ten-year investments, are affiliated with a major studio, and have minimized the down side risk,[19] often at the expense of the upside profit potential.[20] Limited partners invest, for the most part, in blind pools. For example, investors set up Silver Screen Partners IV to

13. M. WIESE, THE INDEPENDENT FILM & VIDEOMAKERS GUIDE 10 (1984).

14. Rothstein, *supra* note 12, § 2, at 1, col. 1. (quoting producer/investor Arthur Cantor).

15. *Id.*

16. BARRON'S LAW DICTIONARY 336 (2d ed. 1984).

17. Blind pools are nonspecified productions.

18. *Film Partnerships*, THE STANGER REGISTER, Oct. 13, 1988, at 3. Silver Screen Partners is an investment group which finances film productions. Some of the films financed by Silver Screen Partners II and Silver Screen Partners III are as follows: *Down and Out in Beverly Hills, The Great Mouse Detective, The Color of Money, Benji the Hunted, Can't Buy Me Love, Good Morning, Vietnam,* and *Tin Men.* SILVER SCREEN IV, PROSPECTUS 17-18 (Feb. 22, 1988) (brochure accompanying the prospectus) (for a copy write to limited Partnership Operations, 17 Battery Place, 17th Floor, New York, N.Y. 10004).

19. The downside risk is the loss of all or most of the invested capital.

20. Pender, *Small Investors Bet on Big Movies*, San Francisco Chron., Feb. 21, 1989, at C1, col. 3. Upside profit potential affords the investor an opportunity to share in any and all profits without any significant limitations.

finance as many as thirty-six feature films from Disney, but only four films were actually identified in the prospectus.[21]

This Note focuses primarily on the smaller type of limited partnership[22] in which investors know the name and nature of the film or play, and invest, at least in part, because they believe in the quality, commerciality, or both of that project. Because these projects tend to be one-shot deals, their life span is typically shorter than eight to ten years, and their value can be measured on an artistic rather than a purely economic scale. In other words, investors in *Les Miserables* would be more likely to judge their potential return on the basis of the script and the reputation of the producer or stars, whereas investors in Silver Screen IV would be more likely to evaluate the Walt Disney Company's reputation as a corporate entity.

II
Problem: Generic Securities Regulations

A. Traditional Standards

No matter what the form of the limited partnership, the general partner is selling securities.[23] Consequently, the securities regulations of individual states, the federal government, or both must be satisfied.[24] The problem is that these regulations are not tailored to stage and screen investments and, as a result, do not serve the investor, the syndicator, or the government.[25] This Note proposes some solutions to this problem.

The federal government and states have registration requirements for security sales.[26] The federal registration requirements are administered by the Securities and Exchange Commission (SEC), while the states' registration requirements are administered by various regulatory

21. SILVER SCREEN IV, *supra* note 18. The four films identified were *Beaches, The Good Mother, Fugitives,* and *The Little Mermaid. Id.*

22. Theatrical investments are not always made through limited partnerships, but the guidelines proposed herein may be analogized to financings made through other business entities. *See generally Proposed NASAA Guidelines for Theatrical Production Syndications,* 15 Sec. Reg. & L. Rep. (BNA) 372 (Feb. 18, 1983).

23. *See* Sobel, *Financing the Production of Theatrical Motion Pictures,* 5 ENT. L. RPTR. 3, 9 (1984). Generally, a security is an investment contract "under which one invests money in a common enterprise with the expectation of deriving a return primarily through the efforts of others." H. BLOOMENTHAL, SECURITIES LAW HANDBOOK 38 (1989).

24. Sobel, *supra* note 23, at 9.

25. 3 D. FARBER, ENTERTAINMENT INDUSTRY CONTRACTS § 131.01 [3] (1989).

26. *See* NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, PROTECTING THE INTEGRITY AND EFFICIENCY OF THE CAPITAL MARKETS (undated pamphlet) [hereinafter PROTECTING CAPITAL MARKETS]. *See generally id.,* at 4-5. *See also* H. BLOOMENTHAL, *supra* note 23, § 1.01.

bodies established to enforce "blue sky laws."[27] Both the SEC and the Securities Act of 1933[28] (the Act) were created by Congress in response to the stock market crash of 1929. The basic policy behind the Act is "full disclosure."[29] This requires the issuer of the securities to reveal completely the terms of the offering and the associated risks.[30] While it is incumbent upon the purchaser to evaluate these risks, the antifraud provisions of the Act hold the issuer liable for failure to state any material factor or to make any misleading statement.[31] Many states also require "merit review," which gives the state's security regulator the responsibility of evaluating new issues under a "fair, just, and equitable" standard.[32] This standard has generated controversy because of the vast amount of discretion lodged in the merit administrator, the inherent subjectivity of the standards, and the paternalistic nature of this regulatory technique.[33] The primary goal of registration is to "directly affect economic behavior, and not just the disclosure of information about that behavior."[34]

There are a number of exemptions from registration requirements, the common conditions for each form of exemption generally include a limitation on the total capitalization, the number of investors, or both (usually allowing a maximum of thirty-five unaccredited investors), and a prohibition against general solicitation and advertising.[35]

B. Public Offerings and Private Placements

Both film and theater productions require significant capital. An average Broadway musical costs between $5 million and $10 million to produce.[36] The average independently financed feature film, while significantly less costly than the major studios' 1990 per picture average of nearly $27 million,[37] is also a multimillion dollar proposition. An examination of the mathematics of a multimillion dollar exempt offering dem-

27. *See* PROTECTING CAPITAL MARKETS, *supra* note 26. Blue sky laws are the state registration of securities offerings. The name derives from speculative schemes "which had no more basis than a square foot of Kansas blue sky. Kansas was the first state to use its own laws to register securities." *Id.* at 4.

28. 15 U.S.C. §§ 77a-77aa (1988); PROTECTING CAPITAL MARKETS, *supra* note 26.

29. BLACK'S LAW DICTIONARY 1354 (6th ed. 1990).

30. 15 U.S.C. §§ 77a-77aa (1988).

31. Campbell, *An Open Attack on the Nonsense of Blue Sky Regulation,* 10 J. CORP. L. 553, 575-76 (1985). The antifraud statutes are codified at 15 U.S.C. § 77q (1988).

32. *See generally* H. BLOOMENTHAL, *supra* note 23.

33. Sargent, *State Disclosure Regulation and the Allocation of Regulatory Responsibilities,* CONTEMPORARY ISSUES IN SECURITY REGULATION 103, 134 (1988).

34. *Id.* at 121.

35. *See* Campbell, *supra* note 31, at 560.

36. Rothstein, *supra* note 12.

37. Eller, *Costs Deflate H'W'D's Inflated B.O.,* Daily Variety, Feb. 6, 1991, at 1, col. 4.

onstrates that, by definition, it is available only to the very wealthy. For example, a $6 million Broadway musical subscribed to by a maximum of thirty-five investors requires an average investment of approximately $171,000 each. Very few investors have that kind of money available to risk on a single production. The limits placed on promoters' general solicitation and advertising activities make it hard to reach even those few investors who do have significant risk capital.

Those investors who can afford to take big risks are not protected. Because private placements are not subject to review, the quality and accuracy of the disclosure made by such private offerings vary widely and are susceptible to abuse by a fraudulent general partner.[38]

On the other hand, public offerings, such as Silver Screen, have profited from an ability to solicit investments starting at $5,000 from a broad-based audience.[39] While such public offerings are reviewed by numerous regulators, they have suffered from a different set of problems. As noted, the nature of the big public partnerships is such that investors rarely, if ever, know which productions they are investing in. Moreover, these partnerships are structured in such a way that investors trade away the chance to make big profits in return for minimized downside risk.[40]

C. Ill-Fitting Regulations

A promoter who wishes to make a single, identifiable production available to investors in affordable amounts must comply with the public offering requirements of the SEC or the states in which the securities are offered.[41] Compliance brings its own set of problems: generic or irrelevant registration requirements that were created to test the merits of more traditional kinds of investments, such as real estate and oil and gas partnerships.[42] The more traditional investments are generally long term, rely on continuing management, and are susceptible to financial and market analysis. Consequently, the disclosure requirements focus on these items. Plays and movies, on the other hand, are short term, rely on directors, stars, and crews hired for brief periods of time, and by their very nature are unpredictable.[43] Many of these regulations are not

38. While exempt transactions need not be registered, intentional misstatements or omissions of fact constitute federal criminal violations. *See* 15 U.S.C. § 77q (1988).

39. *See* SILVER SCREEN IV, *supra* note 18, at 2.

40. *See generally id.*

41. *See* Sobel, *supra* note 23, at 9. "In fact, it is virtually certain that many if not most producers who place ads for investors in the trade papers inadvertently violate securities laws by doing so." *Id.*

42. *See, e.g., Real Estate Programs*, North Am. Sec. Admin. Ass'n. Rep. (CCH) ¶ 3601 (1991).

43. *See* Rothstein, *supra* note 12.

designed to elicit information that would be particularly useful to an investor in plays and movies. For instance, audited balance sheets of the partnership are required for an SEC registered offering.[44] Yet, most plays and movies are start-up ventures that have no financial history. A potential investor is better off reading a script than a balance sheet, because financial history is not a predictor of box office success.

Almost every state has its own discrete registration requirements. In some states, such as Colorado and Nevada, there are blanket exemptions for SEC-registered offerings and require no state review whatsoever.[45] Other jurisdictions, such as Illinois and Connecticut, review only the adequacy and accuracy of the disclosure,[46] in effect placing their faith in Supreme Court Justice Louis D. Brandeis' noted phrase: "[S]unlight is said to be the best of disinfectants; electric light the most efficient policeman."[47] Merit regulation states apply the strictest scrutiny; their "blue-sky" laws give their regulators the authority to review both the substantive merits of the offering as well as the completeness of the disclosure.[48] Some feel that these blue-sky laws are "ineffective, philosophically unsound, and unnecessarily expensive," and that they should be substantially eliminated.[49] An opposing viewpoint is held by the North American Securities Administrators Association (NASAA), which represents most state securities administrators and attempts to provide investor protection and uniform regulation of securities through the use of uniform registration forms and examinations.[50] As explained below, these forms are in large part irrelevant to a stage or screen partnership. Thus, there is a need for an alternative.

This writer was the general partner of an SEC-registered limited partnership formed to finance the production of one modest budget feature film, *The River Why*.[51] In "blue skying" the partnership in thirteen states, the author was mandated to fulfill a variety of requirements. For example, the states of Michigan and Washington required cross referencing to NASAA Real Estate Partnership Guidelines because the administrators in the two states feel that these guidelines were the most

44. Campbell, *supra* note 31, at 558.

45. *See* Sargent, *supra* note 33, at 112.

46. *Id.*

47. *Id.* at 115 (quoting L. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1914)).

48. *Id.* at 112-13.

49. Campbell, *supra* note 31, at 553.

50. PROTECTING CAPITAL MARKETS, *supra* note 26, at 2-3.

51. *The River Why*, based on David James Duncan's novel of the same name, did not receive adequate funding and was never produced.

analogous to film. The guidelines, as they appear in the *NASAA Reports*, are reproduced on the next page.

While some of the items *are* relevant to film and theater partnerships, many clearly are not. For example, items requiring information about construction, property management fees, appraisals, and mortgage loans have no bearing on the merits of a film. Moreover, the NASAA Guidelines, either alone or in combination with specific state provisions, can lead to substantial changes in the basic terms of the offering.[52] This is most apparent in relation to the profit split between the general and limited partners in a theatrical syndication. The traditional split has been fifty-fifty after the limited partners have recouped their investment, with the general partner's share subject to dilution by profit incentives offered to key players.[53] By sharp contrast, the NASAA Real Estate Guidelines provide for the promoter to receive less than twenty-five percent of the profits, which is usually paid after a preferred return to investors.[54] Thus, by applying irrelevant or non-traditional standards, a state administrator will either force promoters to comply with the standards or to withdraw their offering from that particular state.

Not only are investors *not* protected by these disclosure requirements, but they are also actually disadvantaged because the cost of compliance is inevitably passed to them. The result is increased costs per investment unit without corresponding benefits.[55]

Beyond the increased cost associated with complex compliance standards is "the risk that an issuer will inadvertently violate a state's laws."[56] Both the attorney and the accountant assisting with a public offering run substantial liability and malpractice risks, since they must provide signed opinions stating that the offering complied with appropriate regulations.[57] Some commentators have concluded that the millions

52. *See* Sargent, *supra* note 33, at 120-21.

53. *See* Sobel, *supra* note 23, at 8. Typically, the major stars, director, and writer are given a share of the profits as part of their compensation package. Traditionally, this share has come from the general partner, thus leaving the limited partners with an undiluted 50% of the profits. The advantage to the limited partners is that they know up front what their profit share will be. *Id.*

54. For example, an investor might be guaranteed a 110% return on invested capital before the general partner receives any profit. "Real Estate Guidelines Cross Reference Sheet," *Real Estate Programs*, North Am. Sec. Admin. Ass'n Rep. (CCH) ¶ 3610 (1991).

55. *See* Sargent, *supra* note 33, at 136 n.142.

56. *See* Campbell, *supra* note 31, at 562.

57. Malpractice insurance premiums can more than double the cost of protection for professionals involved in public offerings. For example, the Cal Accountants Mutual Insurance Co. recently raised the malpractice premiums for certified public accountants (CPAs) doing SEC work. Where previously there had been a 25% surcharge, there is now a $2,500 fee per engagement with an annual cap of $10,000. This means that an independent CPA whose annual premium ($500,000 coverage, $2,500 deductible) is $3,278 would have his premium rise

Real Estate Guidelines*

I. B.

Definitions

1. Acquisition expenses
2. Acquisition fee
4. Affiliate
5. Assessments
6. Asset based fee
7. Audited financial statements
8. Base amount
9. Capital contribution
10. Carried interest
11. Cash available for distribution
12. Cash flow
13. Competitive real estate commission
14. Construction fee
15. Cross reference sheet
16. Development fee
17. Financing
18. Front-End fees
19. Investment in properties
20. Major repairs and rehabilitation
21. Mandatory deferred payments
22. Net worth
23. Non-specified property programs
24. Organization and offering expenses
25. Participant
28. Program interest
29. Program management fee
30. Property management fee
32. Purchase price
33. Specified property program
34. Sponsor

II. Requirements of Sponsors

A. Experience
B. Net worth
C. Reports to administrators
D. Liability
E. Fiduciary duty
F. Termination

III. Suitability of the Participant

A. Standards
C. Maintenance of records

IV. Fees—Compensation—Expenses

B. Organization & offering expenses
C. Investment in properties
D. Program management fee
E. Promotional interest
    2. a. Interest in cash available for distribution
       b. Interest in sale or refinancing proceeds

* Reproduced from "Real Estate Guidelines Cross Reference Sheet," *Real Estate Programs*, North Am. Sec. Admin. Ass'n Rep. (CCH) ¶ 3601 (1991).
Editors note: the guidelines above appear exactly as they do in the reporter.

of dollars spent each year to comply with blue-sky laws actually retard capital formation and provide no significant investor protection.[58] This conclusion is even more appropriate for stage and screen offerings. Assuming a finite amount of investment capital is available, such capital will provide a higher return to an investor if it is put to work creating production value instead of complying with regulations that are designed to protect real estate investors.

D. The New York Model

Investors need protection. They are entitled to make informed choices, to be shielded from unscrupulous promoters, and to have access to fairly structured deals. New York is the only state that regulates theater investors,[59] utilizing the Theatrical Syndication Financing Act.[60]

The New York Legislature held hearings in the early 1960s that revealed serious abuses in the methods of raising funds and accounting for live theatrical productions.[61] Additionally, the hearings uncovered irregularities such as kickbacks and box office scalping.[62] The theatrical community concluded that these abuses had resulted in a decline of productivity and investor confidence.[63] The legislature responded with bills now encompassed in sections twenty-three and twenty-five of the Arts and Cultural Affairs Law (the N.Y. Law).[64] The N.Y. Law requires 1) that production companies provide accurate and periodic accountings; 2) that offering circulars make full disclosure; and 3) that funds be kept in special bank trust accounts, and not be commingled or expended until used for pre-production or production. It also prohibits deceptive or untrue statements in the offering circular, and kickbacks.[65]

While there are several forms of offerings and exemptions depending on the scope of the offering, the regulations regarding front money[66] and

to more than $8,000 simply by engaging two SEC clients. Telephone interview with Dan Jordan, CPA, Jordan & Decker (Mar. 3, 1990).

58. *See* Campbell, *supra* note 31, at 579.

59. N.Y. ARTS & CULT. AFF. LAW §§ 23.08, 23.23 (McKinney Supp. 1989) (citing to supplementary Practice Commentary).

60. N.Y. ARTS & CULT. AFF. LAW § 23.01-.23 (McKinney 1983).

61. N.Y. ARTS & CULT. AFF. LAW § 23.05 (McKinney Supp. 1989) (citing to supplementary Practice Commentaries).

62. *Id.*

63. *Id.*

64. *Id.*

65. N.Y. ARTS & CULT. AFF. LAW §§ 22.03, 23.97, 23.08, 23.19 (McKinney 1983).

66. Front money is used to obtain elements that make up the package to be offered to investors, such as rights to a play and the offering documents. D. FARBER, PRODUCING THEATER 116 (1981).

workshop productions[67] are minimal.[68] The content requirements for offering literature include some disclosures specifically related to theatrical syndications such as precise definitions of net profits and profit participations by actors. The N.Y. Law gives broad enforcement powers to the Attorney General, which include unique subpoena powers and the right to simultaneously pursue civil and criminal proceedings.[69] The N.Y. Law does not apply to motion picture or television productions and is limited to New York financings.[70] Offerings made to out-of-state residents must comply with applicable SEC and Blue Sky regulations.[71]

III
Solution

A variation on the N.Y. Law should be developed and applied to both federal and state securities regulations. Ironically, the Theatrical Syndications Guidelines Committee of the NASAA proposed guidelines for theatrical production syndications in 1983.[72] The guidelines, which would have adopted the N.Y. Law almost in its entirety, were never approved.[73] Despite NASAA's failure to adopt the N.Y. Law there remains substantial cultural and economic justification for creating new guidelines and broadening them to include film and video.

A. Public Policy

There are several public policies that justify special treatment for theater and film. Article I of the United States Constitution is the starting point for such justification. It states, "The Congress shall have Power . . . To promote the Progress of Science and useful Arts . . . ."[74] When Congress enacted the Copyright Act of 1909, the legislative report noted that copyrights are given in order to benefit the public and to stim-

67. Workshop productions are performed in small noncommercial settings, often without major stars, in order to develop the play to Broadway standards.

68. N.Y. ARTS & CULT. AFF. LAW § 23.07 (McKinney 1983).

69. N.Y. ARTS & CULT. AFF. LAW §§ 23.08, 23.23 (McKinney Supp. 1989) (citing to supplementary Practice Commentaries).

70. *Id.*

71. *Id.*

72. *NASAA Proposes Guidelines for Theatrical Syndications*, 15 Sec. Reg. & L. Rep. (BNA) 353 (Feb. 18, 1983).

73. Telephone interview with Lee Polson, General Counsel of NASAA (Mar. 2, 1990). Mr. Polson revealed two reasons for abandonment of the plan: 1) Theatrical syndications were not part of the market for most states, and 2) there were objections to the compensation provisions for the promoters because the amount was so much higher than for promoters of more mainstream offerings. *Id.*

74. U.S. CONST. art. I, § 8, cl. 8.

ulate writing and invention.[75] In general, both federal and state governments support the arts, but most of this support goes to the non-profit sector in the form of direct grants.[76] Favorable regulatory and tax considerations could go a long way towards supporting profit-motivated artistic endeavors.

A second argument for special treatment for theater and film involves the Securities Act of 1933.[77] The Act already allows special treatment for some industries. Railroads, educational and charitable organizations, and other industries—that the government wished to promote at the time the Act was passed—were exempted from all or part of the regulations.[78] This is in keeping with President Franklin Roosevelt's message to Congress when he proposed the legislation. Roosevelt said "The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business."[79]

Most states have established public policies favoring the arts.[80] For Example, the N.Y. Law begins with the following declaration of policy: "The maintenance and well-being of the legitimate theatre in this state is essential to the cultural, moral, and artistic well-being of the people of the state."[81] The financial incentives to a state may also have some effect. Almost every state has some form of film office designed to attract film and video production.[82] The state benefits from having such production due to increased employment, income and other tax revenues, an economic "multiplier effect,"[83] and the promotion of a "clean" industry.[84]

75. A. LATMAN, R. GORDON & J. GINSBURG, COPYRIGHT FOR THE NINETIES 14 (3d ed. 1989).

76. For example, the National Endowment for the Arts and the Corporation for Public Broadcasting.

77. 15 U.S.C. §§ 77a-77aa (1988).

78. 15 U.S.C. § 77 (1988).

79. S. REP. NO. 875, 73d Cong., 1st Sess., 77 CONG. REC. 937 (1933).

80. *See generally* THE STRATEGIC PLAN FOR INCREASING FILM PRODUCTION IN OREGON, A REPORT TO GOVERNOR NEIL GOLDSCHMIDT, at Appendix C (Sept. 1988) (to obtain a copy, write Economic Development Department, 595 Cottage St., NE Salem, Oregon 97310) [hereinafter STRATEGIC PLAN]. In addition to the states, some countries have established policies favoring the arts. For example, Canada and Australia have supported their film industry by offering significant tax advantages to investors. *See* STRATEGIC PLAN, *supra.*

81. N.Y. ARTS & CULT. AFF. LAW § 23.01 (McKinney 1983).

82. *See generally* OREGON FILM COMEBACK TASK FORCE, THE STRATEGIC PLAN FOR INCREASING FILM PRODUCTION IN OREGON, A REPORT TO GOVERNOR NEIL GOLDSCHMIDT (1988).

83. *Id.* at 49-50. Each dollar of new spending creates more than a dollar of total income. For example, a film company pays for hotel rooms for its cast. The hotel purchases labor, goods, and services with that income. The hotel employee spends his salary on labor, goods and services. The multiplier effect can range from 1.7 to 3.6 times the actual dollars spent. *Id.*

84. *Id.* Film and theater are nonpolluting, create skilled jobs, and tend to be countercyclical to an industrial economy. *Id.* at 50-51.

The economic incentive to the federal government is similar, with the added factor that film industry exports make a substantial contribution to a favorable balance of payments.[85] In 1989, the American film industry earned revenues from abroad of $503 billion. In 1990, the industry had a $3.5 billion favorable balance of payments.[86]

B. Proposal

With the cultural, artistic, and economic justifications seemingly beyond dispute, this Note proposes simplified syndication guidelines for stage and screen that have the following attributes:

> **1) A focus primarily on single or "fully-identified" multiple productions.**
>
> Blind pools should be excluded from consideration because their investors concentrate on the management team and organization rather than on the merits of a specific production. Moreover, disclosure concerning the specific budgets, personnel, and profit participations of a blind pool must be so vague as to be ineffective. Further, the very large public partnerships such as Silver Screen are more amenable to evaluation under traditional securities laws. The proposed laws should be motivated more by product and less by high finance.
>
> **2) Disclosure requirements tailored to the industry.**
>
> Guidelines that serve both theater and film productions could easily be established based on the New York model. By adding a series of definitions relating to film distribution and specifying limits on self dealing in this regard, the N.Y. Law (and these proposed guidelines) could easily encompass film production.[87] Adding film as a component might make a variation of the 1983 NASAA theatrical syndication proposal more acceptable to state administrators because the market for film partnerships is much broader based than theatrical offerings.[88]
>
> **3) Maximum selling commissions,[89] offering costs,[90] and maximum producer profit share based on the current New York guidelines.[91]**
>
> This would insure that any offering to investors was "fair" in that it would conform to film and theater industry norms. Promoters

85. Tusher, *Balance of Payments Hits $3.5 Bil; Valenti Vows to Expand Biz, Contain Piracy*, Daily Variety, Jan. 9, 1991, at 1, col. 4.

86. Balance of payments for the film industry is third highest in the United States behind agriculture and avionics. *Id.* at 41, col. 1.

87. The major distinction between a film and a theater project is in the distribution of the product. A play has ongoing running costs for theater rentals, box office, and cast and crew. In effect, the producer creates and distributes a play simultaneously. A film is produced first and distributed thereafter. Distribution is often done by an entity unrelated to the producer. The distributor handles the "running costs" and remits a royalty to the production company. *See* Rothstein, *supra* note 12.

88. *See generally* THE STANGER REGISTER, supra note 18.

89. The commission paid to a broker-dealer for finding investors.

90. The legal, accounting, and printing costs associated with an offering.

91. The profit payable to the promoter after the break even point.

should be required to disclose the names and resumes of the key creative personnel with their contractual status listed in all cases. Where no contracts exist, but letters of intent[92] or other expressions of interest have been made, the exact nature of these commitments should be listed. Disclosure of the names, experience, and levels of commitment of key players provides an offeree valuable information by which to evaluate the merits of an investment. In some instances these players are the major asset of the production.

A producer who has only suggested casting, should be required to disclose the actors' "prices" in the offering circular so that a potential investor might evaluate the figures in terms of the proposed budget. This would help to eliminate the practice of falsely promising big name stars in small time productions.[93] Additionally, the personnel section of the offering should be easily amendable so that changes in an actor's schedule necessitating a replacement could be disclosed quickly and efficiently. Similarly, the exact contractual status of the underlying literary and musical properties should be disclosed.

4) Standard definitions of gross and net profits for a uniform disclosure procedure.

This would permit an investor to evaluate two offerings side by side to determine potential rewards based on similar gross receipts. Likewise, a standard pro forma income projection[94] should be developed. While projections are not particularly helpful because of the public taste factor noted above, an investor should have the opportunity to evaluate potential returns based on the real returns of other films or plays. These figures, both good and bad, should be developed and updated annually by industry groups, such as the Independent Feature Project (IFP)[95] or The League of American Theatres and Producers.[96]

Specific attention should be given to the unique financial practices of stage and film producers. Among these practices are the use of deferments[97] by cast, crew, and equipment suppliers. While these deferments should be encouraged, a standard method of disclosing them and their possible effect on investor returns should be developed.

92. A letter of intent is a brief, usually nonbinding, writing that demonstrates the willingness of an actor, for example, to participate in a production once it has been funded.

93. Unscrupulous promoters have been known to orally promise the participation of a well-known actor in a low budget film, knowing that the actor's usual fee is much more than the budget can handle. *See, e.g.*, CHARIOT ENTERTAINMENT, PRIVATE PLACEMENT MEMORANDUM (Oct. 1, 1988) (proposed casting for two movies with combined budgets of $3 million included Jack Lemmon, Debra Winger, and James Woods). While famous actors often do participate in small films, they do it because they believe in the project and consequently will often allow their names to be used in writing.

94. An accounting based on hypothetical figures. *See* BLACK'S LAW DICTIONARY 1091 (5th. ed. 1979).

95. IFP is an organization devoted to promoting quality American independent films. MONTAGE, June 1988, at 2, col. 1.

96. The organization that represents mainstream (Broadway) producers.

97. "A deferment is a contingent but fixed sum of money payable only from gross receipts prior to the payment of net profits." P. BAUMGARTEN & D. FARBER, PRODUCING, FINANCING AND DISTRIBUTING FILM 46 (1973). For example, an actor might agree to accept 50% of his salary only after the investors reached breakeven.

Formal provisions should also be adopted disclosing the effects of going over budget and noting the possibilities for overcalls[98] or the costs (financial and artistic) and applicability of completion bonds.[99]

5) **Modified accounting requirements that protect the investor at a minimum cost.**

Therefore, audited financial statements should be required only where absolutely necessary.[100] While the N. Y. Law currently allows for a waiver from strict accounting requirements for low budget productions,[101] the dollar threshold should be raised or eliminated in order to reduce disproportionately high administrative costs.

6) **A standard set of risk factors in addition to any that are specific to a given production.**

Among these standard risks are the following: no operating history, general production and competition risks, restrictions on the transfer of units, tax risks, and limited rights of participation in the management of the partnership. Affirmative disclosure requirements should match the risk factors so that a participant can begin to identify what steps the producer has taken to counter these risks. Full audit rights should be given to each investor.

As a tradeoff for this tailored procedure and simplified standard, the New York provisions creating strong civil and criminal enforcement powers[102] should be adopted.[103] Presumably, producers would be willing to accept heightened government scrutiny in return for a chance to attract more investors through regulations created for the entertainment industry.

98. Overcalls are additional amounts of capital which a participant may be required or requested to contribute beyond his initial contribution.

99. Completion bonds are agreements by a bonding company to pay for the completion of an over-budget movie or to repay the financiers in full. *See* Sobel, *supra* note 23, at 9.

100. A reviewed financial statement based on inquiry and analysis by an accountant generally costs less than half that of an audited financial statement, but from an investor's standpoint makes no material difference. Telephone interview with Dan Jordan, CPA, Jordan & Decker (Mar. 3, 1990).

101. N.Y. ARTS & CULT. AFF. LAW §§ 23.08, 23.23 (McKinney Supp. 1989) (citing supplementary Practice Commentaries). Currently, exemptions are possible for offerings of less than $250,000, offerings made to 36 or fewer persons, or upon other grounds determined by the attorney general. *Id.*

102. *Id.* The New York Attorney General has used these enforcement powers several times. *See, e.g., In re* Abrams v. "John Anonymous" Esq., 62 N.Y.2d 183, 465 N.E.3d 1, 476 N.Y.S.2d 494 (1984).

103. It is beyond the scope of this Note, but it might be interesting to consider the effects of the Attorney General's subpoena power on the accounting practices of film distributors. Could film distributors' notorious ability to hide profits finally be scrutinized because of this kind of legislation if, for instance, an investor appealed to the Attorney General to help him discover why the return on a box office hit was so small? This might give an investor additional leverage in an Art Buchwald/*Coming to America* situation. Art Buchwald sued Paramount Pictures for his share of the net profits in the Eddie Murphy film, *Coming to America.* Despite earning over $100 million Paramount claimed that no net profits were available because the film had not broken even. A Los Angeles Superior Court Judge ruled that the contract was unconscionable and that Buchwald was entitled to a share of the profits. Buchwald v. Paramount Pictures Corp., 13 U.S.P.Q.2d (BNA) 1497 (Super. Ct. of Cal., 1990).

IV
Conclusion

Theater and film producers are hampered in their fund raising efforts by inconsistent and irrelevant securities laws. At the same time, investors are not protected adequately by the current disclosure requirements, which are costly and uninformative. Public policy in general, and New York's practice in particular, support affirmative changes in this situation. Uniform laws and guidelines specifically adapted to stage and screen should be adopted by the SEC, NASAA, and the individual states. The result could be a flourishing of the arts and a vast increase in that band of investors known as "angels".