

# Rights, Camera, Action!

## IP Rights and the Film-Making Process

Creative industries – Booklet No. 2



Rights, Camera, Action!  
IP Rights and the Film-Making Process

*Film-making*  
PROCESS



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## PREFACE

The World Intellectual Property Organization (WIPO) is pleased to present this second booklet in the Creative Industries series centering on the legal and financial complexities within the film industry, with a focus on the importance of strategically managing intellectual property (IP) rights throughout the main stages of film production.

The creative process and business models of film industries are being refined as new technologies are used to develop, produce, finance, distribute and market film productions. In fact the prevalent belief is that the business of making films has become more important than the actual film itself. Yet the coming together of notions of ‘art’, ‘culture’ and ‘enterprise’ is arguably common to cinematographic productions worldwide. The boundaries between the three have become increasingly blurred, to such an extent that the position of the filmmaker as creator and entrepreneur has strengthened.

The publication examines the various stages of the film making process – development (i.e. concept/idea, dealing with financiers); pre-production (i.e. underlying rights acquisitions, attaching key talent, dealing with agents); production (i.e. principal photography); post-production (i.e. editing, adding audio-sound, visual effects); distribution; and exhibition. The filmmaking process faces specific circumstances anchored in the economic, social and cultural status of the national audiovisual sector, underpinned by the country’s legal framework governing audiovisual works.

So as to integrate creative cultural works into development policies and safeguard an industry that is considered a cultural asset, countries should expand on their efforts to protect and promote the interests of their national film industries. Together with the issues dealing with entertainment financing, accounting, marketing and promotion, distribution, and other matters relating to the management and operation of film production companies, the core issue not to be neglected is the need for a coherent and dependable national IP rights system.



The use of new technologies has encouraged independent filmmakers, especially those from developing nations to enter and compete in regional and international market places. However, there are still considerable challenges facing these filmmakers as they try to keep abreast of the transformation of the legal and commercial film environment. These challenges are explored thoroughly in this WIPO Publication.

The booklet was commissioned by WIPO and written by Bertrand Moullier and Richard Holmes, experienced international film industry professionals. The views expressed in the booklet are those of the authors and do not necessarily reflect those of the Organization.

## INTRODUCTION

This booklet is written from the perspective of the small-size film producer and/or entrepreneur. His economic success depends on matching ideas with talent, obtaining relevant intellectual property (IP) rights and using them to attract finance from commercial film distributors – and the altogether more optimistic prospect of rapt audiences leaving the movie theatre with a heartfelt laugh, a tear in their eye or a spring in their step.

In choosing this perspective, the World Intellectual Property Organization (WIPO) is merely reflecting the dominant reality of the film industry worldwide. Most readers will have some acquaintance with Hollywood, and those who know about its remarkable business model will probably agree that – rather than representing a worldwide norm – it is an almost entirely singular phenomenon, one intimately connected to the specific industrial history of the United States (US) and not reflective of other film making traditions elsewhere in the world: at the turn of the new century, most films in most places on earth are made by driven, dynamic, cultural entrepreneurs with a strong creative vision, an appetite for stories, dreams of cinemas packed to the rafters and almost no money of their own. This booklet is primarily written to educate those who aspire to membership of this spirited community whose efforts do so much for IP-based economic growth and cultural diversity all over the world.

Our choice of adopting the producer's perspective is also largely motivated by our mandate to be as educational as possible about the intricacies of rights and the film production process, within the constraints of a short publication. Of all contributors to the making of a film, the producer stands closest to the heart of the process. Like a skilled and overworked traffic warden, he does his best to direct traffic at the crowded intersection where talent, rights, money and dreams all meet and – if all goes well – ends up leading them in the same direction. In this unique position,



the producer has to understand extremely well how IP rights may be used strategically to obtain production finance and attract the best authors, actors and other talent. His insights into the process should be the insights of anyone genuinely interested in understanding how films come to be made and the dynamic role IP rights play in their creative and economic genesis.

One of the central topics of this booklet centers on the profound changes currently affecting the value of different rights in the global film industry. Our presentation of current shifts in the film *value chain* was primarily based on an analysis of the mainstream Western film industries and the trend affecting the film markets there. A Western focus, as far as certain sections of the booklet are concerned, presents in our view two distinct advantages for readers all over the world:

- (i) It provides a useful insight into possible future value chain developments for producers in developing countries where film industry growth is strong and where cable, satellite and broadband connections are beginning to present consumers of film with more choice: what is happening in the US and Europe is also mirrored in many parts of Asia and will likely happen in most developing countries with a film industry in the near future.
- (ii) Experience shows that – over a certain level of budget – wherever in the world a producer lives and works, he will need to reach out to the international film financiers' community and will therefore need to acquaint himself with the global market for film rights, whose standards are those currently practiced predominantly in the West European and North American film-making arena.

Elsewhere, we have tried to be as general as possible, focusing almost exclusively on aspects of the film-making custom and practice which could apply widely across various regions of the world or, where appropriate, to point out differences.

As far as possible, we have tried to illustrate many of our analyses of how rights are optioned, bought, sold or licensed, by summarizing real life case-studies. These required the consent of the film producers, authors, and artists who were involved in the contractual arrangements, and we express our deep gratitude to those who gave

freely of their time (a precious commodity indeed in the life of a film producer) to help us breathe life into this publication. In some cases, we were given permission to use specific figures, culled from real contracts. In many cases we chose not to use them, in part because we wanted to spare our sources' blushes, but also because figures as they relate to the value of specific rights at specific times are mostly reflective of a particular film and are at best unreliable pointers to the average value of those rights across the board.

This publication is dedicated exclusively to rights and the interplay of rights in the making of feature-length cinema films. Our omission of other forms of audiovisual expression, such as the vast sector of programs made for television, is a choice dictated merely by our desire to convey a sense of the complexity of rights-based transactions in an audiovisual medium which engages the full range of rights, across the entire value chain. The story of how feature films come to be made is rich and intricate enough to deserve its own stand-alone publication. However, this exclusive editorial focus does not in any way suggest a lack of interest on our part in the rest of the audiovisual enterprise sector, and its own IP rights' challenges and opportunities deserve to be explored in just as much detail.

The cinema, perhaps more so than any other art form, is a collaborative phenomenon. Whilst we have described the film producer's role as pivotal, his own efforts are bound to be sterile unless he is able to engage and motivate the film's talent, especially its authors and performing artists, on terms which will secure their enthusiasm and commitment. To bring about this creative chemistry requires the intuitive skills to enthuse others. It also requires a willingness to strive for balance and fairness in negotiations over the authors' and performers' rights and their remuneration. We hope this booklet will act in its own modest way as a helpful guide for the novice producer willing to walk this ethical path.

Bertrand Moullier

With Richard Holmes

May 2007

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## CHAPTER 1

### Eye of the Needle – The Disciplines of Development

#### 1.i Digging for Gold – the search for the perfect script

In film making, “Development” refers to the time and actions necessary to move from an idea to a completed script (or screenplay) ready to be filmed and a so-called “package” consisting of elements such as expressions of interest from one or more lead actors and the commitment of a director to the project.

The script is the most essential part of the development process. There are only very few films made each year without a completed script. A film by the renowned British director Mike Leigh, *Naked*, which won its main star an award at the prestigious Cannes Film Festival in 1993, was made using an element of improvisation: actors came to work in the morning, were given time to rehearse and – whilst they followed the director’s story structure – they would largely improvise their lines on the spur of the moment. Such movies are extremely rare however, and most critics would agree that only a masterful film director such as Leigh is capable of making an illuminating film using such improvisation.

So, most movies have a detailed script. If they don’t have one, they don’t have the faintest chance of attracting money from financiers to make the film. A script can be an original story, or it can be based on a novel, a factual book, an existing script for another film, a theatre play, a magazine article, or culled from somebody’s real life story, etc. The script itself is always an original creation to which intellectual property rights are attached. However, if it is not an original story but an adaptation of an existing creation, other intellectual property rights will be involved. These other creations are generally referred to as the *underlying work* or *underlying material*.

A large part of the development process therefore, consists in the producer making sure that all the rights on all the underlying material used to produce a completed script are duly acquired or licensed as well as the rights of the writer (or writers) commissioned to write the film's script. The producer also needs to be able to produce written evidence that he is in control of all those rights. In the Anglo-American film business, the terminology for all this paperwork is *chain of title*. Why is the chain of title important? Because no bank or other source of funding in Europe or the US will put money behind a film unless they have the assurance that the production will not be forced to stop half-way through by a disgruntled author or other right holder whose work will have been used without due permission and financial compensation.

As noted in our introduction, in some other parts of the world, development may be less formally legalistic and the process may vary. For example, whereas the British or US producer often initiates the original idea, commissions a professional script writer and then proceeds to attract a director to the project, in France or Italy, it is more usual to have the director writing his/her own script and looking for a producer to raise the financing. In India, until recently, the script simply did not have the same status as it does in the US/European context: stars, and the promise of spectacular set pieces ably choreographed and directed by experienced artists, are deemed more important. Projects are most often sold to movie stars by the director literally acting out and mimicking every scene, not always with reference to a printed script.

For all the differences in the approach to script-writing, there are common characteristics and standards which are increasingly those adopted by the international independent film sector the world over. This chapter focuses primarily on these, because they are likely to be most useful to fledgling film makers in an industry that is fast becoming interconnected on a global scale.

## **1.ii Passion and Eloquence – attracting funds for development**

At first glance passion and eloquence may not seem especially relevant to films and intellectual property rights which are the topic of this booklet.

But they are! Negotiating for the licensing or acquisition of underlying rights and getting the best possible standard of work out of a commissioned script writer require



as much emphasis on human relational skills as they do on a good working knowledge of IP transactions. The authors of the works will often want to see evidence of your passion for the project and your connection with their work before considering a deal.

Development also requires money, often quite a substantial amount. Most production companies – the world over – simply do not generate enough income to sustain their own development. As a result, producers spend a lot of their time convincing third parties (banks, broadcasters, larger distribution companies, private investors, public funds) to finance the development costs of their projects. There again, passion and eloquence are a pre-requisite.

There is a multiplicity of sources for development funding in Europe and the US. Public sector loans are available on reasonably soft terms from national public funds set up especially to sustain local film development. The European Commission in Europe's capital Brussels, offers to support production companies over a group (or *slate*) of film projects, by providing up to 50 percent of the budgeted development costs. It does so through its MEDIA Program.

For the majority of producers across the world, public funding is a limited or non-existent option. Development loans from the private sector are a more likely prospect and the terms tend to revolve around comparable principles wherever you are:

- (i) Reimbursement – funds are loaned generally on the basis of the presentation of an itemized development budget, i.e. a budget in which every major item of planned expenditure is detailed. Reimbursement is most often required if the film reaches production, on the first day of the shoot, also referred to as *principal photography*;
- (ii) Premium and profit participation – the financier will normally charge a premium on the money loaned, also collectible at the start of production. Percentages vary according to the nature of the risk, the budget of the film and the term of the loan. Many lenders will additionally negotiate for a percentage of *net profit* from the exploitation of the finished film, typically 25-50 percent. In a later chapter, this booklet provides a definition of the notion of net profit;

- (iii) Turnaround – *turnaround* refers to the terms of contract under which a financier may be entitled to release a project, either at his/her own request or that of the producer. The financier will normally have negotiated a deal which ensures that a third party taking over the further development of the project would have to repay development spend to date, generally with a premium and/or interest charge, if the film were finally made;
- (iv) Security – in order to minimize his risk, the financier may take assignment of all the rights secured by the producer in the project over time and prevent his/her selling them on to a third party without consent.

### 1.iii Buying Time – how to negotiate an option

In an “option,” the producer pays money to a right holder in order to be given an exclusive period of time during which he/she may be the only person/company entitled to make arrangements to adapt the work into a potential new film. The option takes the *property* i.e. the book, screenplay, or other source material out of the market and gives the producer a competitive advantage over anyone else who may be interested in it. The object of the option can be any kind of underlying work, a book, say, or a pre-existing script. The option also gives the producer the exclusive choice of either buying up the rights to the underlying work – or not – at a later stage.

Paying money is much cheaper than having to purchase the rights in the work immediately. Consequently the option limits the producer’s initial development risk. On average, only about 30 percent of film projects developed in Hollywood made it into production. Consequently, any money channeled into development is entirely at risk, because the majority of projects simply stall and are never made into films. Millions of dollars are thus written-off worldwide each year. Considering the risk, the option allows the producer time to raise further funds and attract key talent and financiers to the project without having to spend too much at an early stage.

There is no standard duration for an option agreement. In Hollywood, these tend to be over an initial year-and-a-half, renewable thereafter for an equal period, because a lot of time is spent on developing a script – and the negotiations with the talent agents often take a long time. European option agreements tend to be shorter at



around one initial year with possible renewal for another six months or a year (or two additional six-month terms). Before granting a renewal, the right-holder may sometimes ask to see evidence that progress has been made by the producer during the preceding option period. In such cases, it is important to ensure that the option agreement does not give the right-holder as author of the underlying work the power to decide arbitrarily what constitutes progress. Defining specific, realistic targets may help avoid misunderstandings about this aspect of the negotiation.

The payment of the first option period is generally treated as an advance on what will become the rights' acquisition payment, if the producer finally chooses to exercise his option. The fee will not be refunded by the right holder if the producer chooses not to exercise the option. In the English-speaking Anglo-Saxon film industries, the fee is typically about 5-10 percent of the price of the rights' purchase and the figure is comparable elsewhere in the world where options are used. A second option payment is not treated as an advance on the value of the rights' purchase, but rather as a one-off, non-refundable and non-deductible payment.

Some option agreements include a clause to ensure that a share of net profit will be paid to the right holder in the underlying work if the film is produced, (and if it is ever successful enough to return net profits). The percentage will oscillate between 2 and 5 percent depending on whether the work is a book or a script, and – if it is a script – on whether there is a sole writer or multiple writers. In the film industry, net profit is generally defined as the profit to the producer from the commercial exploitation of the film. It is made up of whatever money is left after the bank has recovered its loan(s) and interest; after the international sales company has collected its fees and deducted its marketing costs; after the financiers have recouped their investments, and any *deferred* fees which were not paid fully to the cast, crew, director or producer during production. However, most films worldwide do not meet with sufficient success to even recover their full costs of production and pay-back deferred salaries of fees, let alone make a net profit.

Some right holders may also choose either to waive the option fees or reduce them considerably, in exchange for a commitment by the producer to secure their active participation in the production, should the project be successful in raising finance. This is an approach which all but the most experienced and established film producers will

normally seek to avoid: financiers may not look favorably on the underlying right holder taking a credit on the film for anything other than the authorship of the underlying work itself, especially if the author has little or no prior experience of working in film, or if the intention is only to base the film very loosely on the underlying work.

Nowhere are there any quoted market rates for options. Depending on the degree of fame of the right holder and the work optioned, the experience of the production company or the caliber of the star expressing an interest in the project, these can range from under US\$1,000 to US\$35,000.

In the Anglo-American film industry, some producers manage to obtain an initial commitment from the author of an underlying work without having to sign an option agreement. The producer expresses a written interest in the work and commits to look at it more closely in order to determine whether or not it could be made into a successful movie. This type of pre-option agreement runs mostly on trust and is more suitable for established producers with existing connections in the author's milieu.

One of the most important tasks for the producer before signing an option is to run a thorough check on the status of all the rights involved and obtain the legal assurances (*warranties*) from the author that there are no known obstacles to prevent his selling the rights to the producer at a later stage. An entertainment lawyer may be helpful to the independent producer at that stage. Failing this, there are specialized companies offering a tracking and checking service, and providing reports on individual copyright works.

#### **1.iv The Big Jump – purchasing underlying rights**

The ink on the option agreement is dry; now the producer faces the prospect of recruiting and commissioning a writer to write a good script and to attract the interest of film financiers for the project.

Whilst the script is going through its various *drafts*, the producer will also need to begin making estimates of what the film may cost. This budgeting evaluation exercise has its uses if the producer finally chooses to exercise the option and purchase the rights to the underlying work.



The producer has completed these stages and is now ready to exercise the option, meaning that he will make an offer to buy out the underlying rights. In many cases, the rights' acquisition price is expressed as a percentage of the estimated budget of the film to be made from the work and will be typically between 1 and 3.5 percent for smaller films. In most cases the purchase price is set at the time when the option is negotiated, because the option is expressed as a percentage of the purchase price. There are often pre-agreed "floors" and "ceilings":

Rights' purchase agreements require a good deal of detail if the producer is to avoid unresolved issues and legal problems further down the development and production process. Here are a few of the strategic points to address:

- (i) Rights acquired – with the growth of new digital media, including video-on-demand over the Internet, the range of rights is changing and expanding all the time. Therefore, many right holders in underlying material will not accept a catch-all clause covering "all rights in the universe, etc." It is important to be specific and exhaustive about the set of rights covered by the agreement in order to avoid conflicts of interpretation later on. In some cases, the producer may only want to acquire a limited set of rights or some may have already been acquired by another person or company;
- (ii) Assignment or license? – The advantage of an assignment over a license is very clear from a producer's point of view: a license only grants rights for a limited period of time whereas an assignment is most often a full-period-of-copyright term, where legally permitted. The choices available to the producer in this part of the negotiation may vary according to what his needs are (a limited license may be cheaper than an assignment), and the legal regime under which the negotiation is taking place. In the three leading common law countries, the US, UK and Ireland, the *legal presumption* is favorable to a full transfer of ownership from, say, the published author to the producer as a person or a company. The legal presumption simply means that – unless the individual contract says otherwise – the rights will be presumed to have been assigned. This is not the case in the so-called *droit d'auteur* countries (e.g. most of

Europe, French-speaking Africa and Latin America), where authorship of the work is vested in the individual and it may be more difficult to negotiate in-perpetuity assignment. French writers, for instance, use this presumption to impose license-based agreements for more limited periods of time;

- (iii) Moral rights – moral rights are rights which allow an author to protect the *integrity* of his work and to assert his *paternity* over it. Integrity refers to an author's right to protect the work as he/she made it and oppose by legal means any attempt to change it without his/her prior consent, in a manner that would make it unrecognizable or would radically alter its style, content or message. Paternity refers to the right of the author to assert that he/she is indeed the author of the work. It is vital to get absolute clarity over the application of moral rights in any rights' purchase agreement. There again, the room for maneuver will vary according to the legal regime: In *droit d'auteur* countries moral rights are assimilated to human rights and cannot be assigned to – or waived in favor of – the producer or anybody else. The US holds the reverse philosophical position: where they are asserted, moral rights may be waived. A *waiver* constitutes a written undertaking by the author not to prevent in any way the commercial exploitation of the work derived from the underlying source (book, script, theatre play, etc.) whose rights are the object of the purchase. In Europe, the UK and Ireland adopted moral rights into their Copyright Acts in 1996 and 1998, to bring themselves into line with European law. However, these two countries also permit moral rights' waivers. At this stage, producers in these three countries consider waivers essential in order to avoid creating a sense of insecurity for film financiers who may perceive a greater risk from the possibility of an author asserting his moral rights because he might make objections to the screen adaptation of it (or subsequent re-edited versions). However, it cannot be said that the uncompromising approach to moral rights in *droit d'auteur* countries has resulted in a climate of uncertainty over the exploitation of films: authors' contracts there specify in detail the context in which moral rights may be asserted and ensure that this may only happen in cases where the integrity of the work has been blatantly



breached or that the producer chose to ignore the author's assertion of his paternity through an end credit in the film. Conversely, although it is not described as an assertion of the paternity right, most authors of underlying works dealing with film producers in the US will find there are standard clauses to ensure that a screen credit is granted.

- (iv) Reserved rights – authors of underlying works will normally want to exclude some sets of rights from the purchase agreement. The most obvious one is book publishing, especially if – as is generally the case – the book on which the film is to be based is already in the book stores. Radio and stage versions of the work are also a standard exclusion. Reserved rights are not just rights which the author of the underlying work is allowed to exploit without constraints: most agreements have the author agreeing not to exploit those rights for a set period of time (holdback), to permit the full exploitation of the rights purchased by the producer without competitive threats. In general, the producer will insist on a *right of first negotiation* whereby prior to any sale of the reserved rights the author wishes to undertake, the rights have to be offered to the contracting producer first. Equally, the producer may be granted a *last refusal* right whereby the author is obliged to offer him a sale of his reserved rights on terms equal to those offered by another bidder.

### 1.v Into the Void – commissioning a script

By the time the producer has exercised his option and purchased or licensed the rights to the underlying works, the script for the project should be fully in development, or even completed and ready to shoot.

Writers of scripts are authors. The scripts they write may be seen by the film makers as a template for a director to take and turn into an audiovisual narrative, but most national intellectual property laws also recognize it as a work of authorship in its own right.

As a result, an agreement between a producer and a writer is generally both an employment contract and a rights' acquisition agreement. The producer typically hires the script writer to produce a *treatment* (a short narrative canvas for the film)

and a first draft script; the agreement may also specify any further drafts, re-writes or *polishes* that he expects for the agreed fees.

The legal status of the writer's contract varies according to prevailing copyright and related rights' legislation.

In the US, unless a script is written and spontaneously submitted by a writer (referred to as a *spec script*), the contracting producer is presumed the sole author of the work and therefore is entitled to the copyright and all rights in the script commissioned by him. Under this *work-for-hire* doctrine, the writer merely fulfils a service contract and has employee status. He owns none of the intellectual property in the work.

In the UK, the writer of any script, whether commissioned or unsolicited, is deemed the author – not of the resulting film – but of the screenplay itself. The British writer's contract is therefore both an employment contract and a rights' acquisition contract: remuneration is specified for the various stages (treatment, first draft, first draft re-writes, second draft, second draft re-writes, etc). The rights held by the writer in his screenplay are listed and assigned separately to the producer. The different rates paid constitute both remuneration for a service and a purchase of the rights in the material generated by the writer. Typically, when the rights in a feature film script are acquired for use on television, the initial remuneration for the script writer will cover only a limited number of transmissions on *free-to-air* television. Any further transmission thereafter is covered by collective bargaining between the local writers' guild and the producers' trade body, with specific *residual* payments corresponding to specific forms of exploitation after a specific number of runs, for subsequent use. The script writer's entitlement to authorship may seem weak at first glance, because his rights are almost always assigned to the producer as a matter of course. However, the power to assert his rights is useful on at least two counts:

- (i) If there are issues over late payment (or non-payment) by the producer of fees agreed upon, the writer may withhold the assignment of his rights to the producer, and let other parties to the financing of the film be aware of it, until such time as money has been received;



- (ii) Some established writers may use their authorship status to negotiate a limited license over certain rights to their work, rather than a straight assignment, and to retain or reserve certain rights.

Equally, although the US work-for-hire approach suggests no rights are retained by the script writer, influential writers can successfully negotiate to retain some sets of rights. These *separated rights* are granted only when the script is an entirely original work, not based on previous works. They are also only granted to writers who do not share a screen credit with other writers who may have been brought in by the producer to *polish* or *doctor* the script. The rights secured by these more powerful writers may include the right to publish a book derived from the script, or to produce a live theatrical performance. Another important right is that which allows the writer to buy the script back from the production company after a time (normally three or five years), if the film has not started production. Unlike the more limited *turnaround* provisions which may allow a writer to try to get the film made once the producer has given it up, this right is not limited in time: it's an outright re-purchase which allows the writer to enjoy full and ongoing ownership of what he wrote.

In Europe's *droit d'auteur* countries, the writer of the screenplay, be it an original one or a screen adaptation based on underlying material, has a presumption of authorship of the script as a distinct work. Interestingly, he is also deemed an author of the finished film, regardless of how much of the script ended up being shot by the director. As such, all transactions with the producer entail a negotiation for the full or partial assignment of those authors' rights. The writer's advance remuneration for writing the script is also legally treated as an advance due to the writer as the author of the work. The advance is against a proportion of all net receipts from the commercial exploitation of the film in all media.

In practice, the advance will represent most of the writer's remuneration, as the majority of films fail to generate sufficient net revenue and this revenue has to be shared proportionately with other creative contributors who share in the authorship of the work. In France, for example, there is separate authorship status for the script writer, the writer of the film's dialogue (the *dialoguiste* is sometimes separate from the writer of the overall script), the writer of the adaptation of an underlying work, the film's director and the composer of the film's score.

## 1.vi The Art of War – producers, writers and their agents

Like actors, directors, composers and other creative people, many script writers use a talent agent to represent them with the producer and ensure the best possible terms for their work engagement and/or assignment of rights.

Agents – also humorously described as *ten-percenters* in Hollywood, in reference to their commission – have been a growing force in the worldwide film industry. In Hollywood, film studios regularly complain that agents – as exclusive gatekeepers to the best talent – have far too much power. According to disgruntled film executives, the big agencies are making a major contribution to driving movie production costs upwards by negotiating high fees and revenue shares for the stars, directors and writers.

Agent representation is a major asset in a script writer's approach to the film industry. On the whole, writers are vulnerable because their work – whilst being described as vital to a film's success – is often treated as disposable by the producers and film financiers during the process of development. Acting out of their own sense of necessity, producers will frequently decide to replace the writer or bring in an additional one in order to get the final *shooting script* which satisfies their expectations and those of the director. The role of the agent is therefore not limited to making sure his client gets paid well, but also to doing everything in his power to ensure the writer will be kept creatively involved by the producer throughout the life of the project, from concept to filming.

This is not always easy to secure: historically, writers in mature film industries in North America and Europe have not always enjoyed the security of guaranteed payments. Over time their unions have negotiated standard clauses whereby a producer may not withhold payment on a commissioned script if he happens to be disappointed by its content. In return, producers have approached writers' contracts in such a way as to limit their risk past the first draft stage: they will sometimes insist that the contract be flexible enough to enable them not to go ahead and commission the writer for re-writes or a further draft. In this so-called "step-deal" approach, the writer can count therefore on a guaranteed "flat fee" for the initial work, regardless of the producer's intentions thereafter but the producer has the power not to exercise his contractual option to use the writer's services for further



re-writes and/or drafts. The standard deal structure will then be to negotiate a set fee payable in full to the writer if and when the film goes into production. The original flat fee (for the first draft of the script) and any further payment made to the writer for further drafts will then be treated as an advance on this production fee and deducted from the final amount payable when the film is finally shooting.

However, this deal only works well if the writer does not have to share credit with another writer who may have been brought in by the producer after the first draft stage. An established writer with a good agent can insist no second writer can be brought in to re-write his first draft or that – if one is – the initial draft has to be thrown away first.

In the section below, we analyze three case studies borrowed from real development situations. Each typifies a specific set of development issues and ways of structuring the development in response to those.

### **1.vii Development – the real stories**

#### **Scenario One – factual works as the source for a fiction film**

*The Farmer Wants a Wife* is to be the “true story” of how the life of a female journalist is affected by researching and writing a series of magazine articles about a matrimonial agent dedicated to helping lonely farmers in England’s remote rural areas to attract a wife.

This bittersweet comedy project, developed by a British film company, was based on a television documentary series itself based on a series of feature articles written by a freelance female journalist and published by a UK life-style magazine. The film makers made the journalist, a real-life character, the core of the story, pitting her urban sophistication sharply against the more innocent scene of rural England.

The film producers were initially approached by the company which had produced the documentary series. This company believed the story had a wonderful potential as a feature film and thought the film producers’ past body of work made them ideal to take on the adaptation.

The development process which followed required the film producers to assemble a complex *chain of title* on unusual underlying material:

1. factual publications (magazine articles);
2. a documentary film;
3. the real-life story of a living person.

The easiest rights to secure were those held by the documentary film company. They had approached the filmmakers and were therefore entirely disposed to transfer the rights, which eventually went to the film producers for a very small sum of money.

Before this could take place however, the film producers had to contact the publishing company behind the magazine which had commissioned and run the articles. This was needed because – although the publishers had already signed away the *re-format rights* of the article to the documentary company – it was not entirely clear whether or not these rights included a cinema film version. A conversation helped to clarify that point and clear this vital link in the chain of title, pending necessary documentation.

Finally, since the film makers had decided to make her the central character in the script, the journalist herself had to be approached for her consent in proceeding with the adaptation. Not to have taken care of this would have exposed the producers to a potentially damaging legal action because the journalist may then have been within her right to sue them for *defamatory treatment*, invasion of her privacy or libel, once the film was in production or on release in the cinemas. Like most other European countries (and most states in the US), the UK has libel, anti-defamation and protection of privacy laws. These are sometimes ambiguous and difficult to interpret, especially when public figures and famous people whose entire careers depend on being in the public eye are involved. Film makers anywhere in the world should always be aware of what these laws may entail before endeavoring to make a film based on someone's life story, even if the character's name is changed in the script and some of the events altered. The price of not doing so can be as high in some cases as an *injunction* on the exploitation of the finished film. In an injunction, the court would grant the plaintiff the right to stop the exploitation and/or circulation of the finished film. To avoid these, it is essential to seek the consent of the person



involved through a *life rights* agreement. Perhaps the most famous case of a movie involving a real life story and running into legal trouble as a result is *Citizen Kane*, Orson Welles' timeless cinema masterpiece. The film was based on the life of press magnate William Randolph Hearst and the similarities between him and the fictional character of Charles Foster Kane were sufficiently striking for Mr. Hearst to attempt to use legal means to stop the film from being released.

On *The Farmer Wants a Wife*, the journalist on whose life story the film was to be based agreed to sign an agreement which gave the film makers exclusive rights to portray, represent or impersonate her in the film. Although it is generally much simpler, the *life rights* deal works very much like any other form of rights' assignment or licensing in that the producer commits to making a payment against the assignment of the rights. In some cases, the person on whose life the film is to be based may also negotiate other, non-financial advantages. In this particular case, not only was the journalist offered a flat fee as a consultant but she was also guaranteed a screen credit if the film was produced. Furthermore, she did not assign her life rights in perpetuity and chose instead to license those to the film makers for a limited period of time. This approach ensured that she could remain in control of those rights and re-license them to another producer in the event that this project would not go into production.

### **Scenario Two – adapting a best-selling book**

The same company made a film entitled *Dead Babies*, a quirky, darkly comical mystery. The film's underlying material was the eponymous novel by the celebrated British writer Martin Amis.

A previous attempt to adapt one of his earlier books – *The Rachel Papers* – into a film had resulted in critical and commercial failure. Consequently, there was now a widespread perception in the film industry that his books were a challenge to adapt into films. As a result, the price of the license on the book's rights in no way reflected Amis' high status as a successful literary figure and the producers were able to secure it for a modest sum. This is a good generic example of how the value of the underlying rights of an established novelist will generally be based on the performance of previous screen adaptations more than the performance of the original work in the bookshops.

As is standard, the novelist's agent also negotiated a further payment to be made by the producer at the start of production, if the film were ever produced (the "production bonus") as well as a 5 percent share of the producer's net profit. However, the 5 percent was never paid out because the finished film did not make a profit. Regrettably, very few ever do.

### **Scenario Three – the original script**

In this case study, a French film director had an original idea of her own and approached a producer. The film, *Oh là là!*, (French title: *Seconde Chance*) produced in 2006, was to be based on an original screenplay inspired by the private correspondence of Madame Du Défant, an influential 18<sup>th</sup> Century female aristocrat who hosted a fashionable literary salon, which attracted some of the most eminent French philosophers of the era. The film charts Madame Du Défant's relationship with Julie l'Espinasse, a poor orphan adopted by the lady who, as she blossoms into a woman, becomes her rival, opening her own popular high society salon. The letters, being historical archive, were in the public domain and consequently, no clearance of underlying work was required.

The approach to the development required hiring the director and a co-writer at the same time, to develop the script together. Both writers assigned all commercial exploitation rights to the producer. Although each writer was contracted independently, each agreement acknowledged that the writing of the script was to be a collaborative effort between the two.

The director's contract and that of her co-writer also acknowledged that she was the designated director for the film to be made.

In *droit d'auteur* regimes, such as France, both the screenwriter and the director are deemed to be the authors of the resulting film. (Very often, and unlike in this example, the director is also the sole author of the script.) In that system, the way in which authorship translates into financial terms is that any payment the producer makes to the authors before and during production, as remuneration for writing and/or directing, is treated as an advance against a share of all commercial revenues from the film, to which they are entitled by law. Part of the sum paid in advance may also be treated as salary.



So, in the case of *Oh là là!*, the contracts signed with each of the two writers set out the precise list of rights purchased through the contract and meticulously laid out the percentage they were to receive from the separate revenue streams derived from the commercial exploitation of the film (cinema, video, foreign revenues, free TV, pay-per-view TV, etc.).

Another way in which the presumption of original authorship is expressed is in the fact that the purchase of the rights constitutes a limited license, not a full assignment. In this particular case, both writers agreed to a license period of 32 years, standard in the French industry. However, a sub-clause ensured that all rights would automatically revert to the writers after four years from the signing of the contract, should the producer be unsuccessful in making the film within that period of time. This type of clause, known as *turnaround* is common currency in the film industry.

While development is taking place, the producer is already engaged in the difficult business of testing the interest of key talent (directors, lead actors) in the concept of the film (or a draft script) and approaching potential financiers. The following chapter looks at the means of financing a feature film today and looks in some detail at the notion of the *value chain*, which any producer must understand if he is to embark successfully on the uncertain journey of trading intellectual property rights against financing for the film.

## CHAPTER 2

### Financing Films – On the Merry-go-Round of Debt, Equity and Rights

When distilling film financing to its most basic substance, a combination of some – or all – of three ingredients, is invariably present. These are: debt, equity and rights.

This section is primarily concerned with the use of intellectual property rights as they relate to the discipline of creating and financing films from original idea to the screen. However, it is important for all newcomers on the perilous journey of film production to understand the broad principles of forms of film financing which do not utilize rights and to gain insight into how these may relate to rights-based transactions. We hope this will help readers develop a strategic approach to combining sources of finance so that they may always strive to control the revenues and/or the rights to the greatest possible extent.

#### 2.i Sink or Swim – the trials of debt financing

The term *debt financing* is a general term which encompasses a complex set of different realities. In its crudest form, debt financing is distinguishable from equity or rights in that the lender is not entitled to either a share of the revenues from the exploitation of the finished film, or a share in its profit, or in any part of the intellectual property in the film. The debt financier typically provides a loan repayable before the film is completed and/or *in first position* in the exploitation revenues of the film – i.e. before any equity investor begins to recover his/her money. This type of loan is no different from a standard bank loan and the lender will be merely seeking to make money out of the interest and fees charged on the loan.

In practice, debt financing for film is often more complex. Here are three standard examples borrowed from different practices across the world:



- (i) Pre-production loans – these loans are offered to producers who have already covered their entire production budget through contracts with investors but are unable to start production because they cannot obtain the cash from those investors until after the start of *principal photography* on the film, i.e. the start of filming (typically because the legal paperwork demanded by the investors has not yet been completed). Pre-production loans are seen by financial institutions and banks as high-risk, because – at the point where he applies for the loan – the producer often has no way of guaranteeing that the film will effectively start production or whether it will be completed. Consequently, lenders often insist on taking a *charge* on some – or all – of the asset value constituted by the film’s intellectual property, as *collateral* for their risk. Collateral is anything of value that the bank may be given the right to sell in the event that the borrower is unable to reimburse the loan.
- (ii) Gap financing – some institutions in the West specialize in what is sometimes known as *gap financing*. Contrary to ordinary debt financing, or pre-production loans, the lending is against the “gap” in the budget which has yet to be covered by financiers. In today’s market, the gap covered by such lenders will typically not exceed 10 to 15 percent of the overall budget. Gap financiers will also insist that the value of the gap should have been assessed by a credible international film exporter known in the business as a *sales agent*. In this analytical exercise, the sales company will estimate the sale value they believe the film could fetch in the countries where the rights have yet to be sold – and make several pre-sales to demonstrate the film’s appeal. The lender will rarely consent to cover the gap if the sales agent’s estimates do not cover up to 150 to 200 percent of the value of the gap. For example, imagine the film’s budget is US\$4 million (a typical mean average for a low-budget independent North American or European film with no stars) and the gap the producer needs to cover is US\$600,000. The sales’ agent handling the film has yet to pre-sell or sell in much of Eastern Europe, as well as valuable territories such as Japan, Germany, Korea, Russia and Spain. Its total estimated sales figures for those territories come in at US\$920,000. Unless the gap lender disagrees with the estimate, the figure meets his

loan security requirement and he may choose to go ahead with the transaction, covering the US\$600,000.

- (iii) Laboratory debt – laboratory debt refers to the practise whereby the producer asks the laboratory responsible for processing the film stock and/or producing material such as master negatives, inter-positives, DI-intermediates (digital masters), etc, to defer their invoicing until the film is almost complete and ready to deliver to distributors. The deal may also include such facilities as the supply of negative film stock and elaborate post-production services such as editing, dubbing, color grading and computer-generated graphics (CGI). This practice is still current amongst some low-budget film makers in the West. It is however, infinitely more common elsewhere in the world: until a few years ago, the majority of low-budget Indian films part-financed themselves using this deferred payment facility. Film laboratories in India are often powerful monopolistic businesses (one single company is currently providing services for over 75 percent of all films made in the Hindi language). They are also strong cash businesses which depend on high-volume low-value work rather than the reverse. Loaning to producers in the shape of deferred services does not threaten their strong cash-flow and is one way in which they secure a competitive advantage. As a result, low-budget film-makers all over India can still expect to defer between 20 and 25 percent of the cost of the film through this form of debt.

Is there a downside to laboratory debt, from a producer's point of view? Most definitely. In India, laboratories expect re-payment in full before the film's post-production is completed. Since the laboratory is generally in possession of the film's negative and the producer must agree to a charge on it until repayment, the laboratory may easily proceed and sequester the negative until payment is forthcoming, thereby stalling any chance of the film being released. Unfortunately, this kind of undesirable outcome is still frequent and the vaults of most of India's leading studios and laboratories are overflowing with films (finished or unfinished), awaiting settlement.

These three instances of debt financing illustrate an important point about the link between debt and IP. In all three cases, the lender takes over rights in the project as collateral. In acquiescing to this, the producer accepts the risk that failure to repay on



the lender's terms may result in a shift in the control of IP assets locked into the film. Therefore, debt financing is not only very onerous for the producer (rates are invariably high because of the perceived nature of film as a high-risk enterprise), but potentially disastrous in enabling a confiscation of the rights by a third party with no interest in the film reaching an audience. It would be flippant, however, to suggest that producers should stay away from debt finance: the option may not exist, as is so often the case with the use of laboratory debt in the Indian low-budget industry. We only hope this publication will have helped some readers undertake such action with full awareness of the risks involved.

## **2.ii Cutting the Cake – the basics of equity financing**

Unlike debt financing, equity financing consists in an investment being made with an expectation of returns through an ongoing share in the revenues generated by the film or films.

A fledgling film maker needs to start with the basic understanding that equity investment falls into two broad categories: investment in an individual film and investment into a company's film activities.

The second category – equity investment in companies – is still a relatively rare occurrence in the cinema sector almost everywhere.

The authors of this booklet recently asked a number of senior corporate financiers in India to summarize the key factors that are – in their view – keeping equity investors away from film companies. These are the four main observations on which they all agreed:

- (i) A poor track record in financial performance – a wave of film and media sector IPOs (companies raising finance in the capital markets through issuing public shares) begun in 2001, attracted record numbers at the start. However, most of these companies have since had disappointing commercial results.
- (ii) A lack of stable cash earnings – the predominant company model in the film industry remains that of a cottage industry, the single producer with

a small company, only able to develop and make one film at a time and therefore unable to share his risk over a number of different films.

- (iii) A lack of integrated film companies – film revenues are split between a large number of smaller companies instead of being concentrated through fewer companies able to integrate development, production, distribution and exhibition under the same roof.
- (iv) Deficiencies in management – much of the culture of film company management is seen by equity investors as lacking in core skills and limited in its ability to turn business plans into reality.

What is striking about this Indian equity investors' survey is how remarkably convergent their analysis of the film industry's core weaknesses is with those made by similar experts about the film industries in Europe or North America. All over the world, with few exceptions, film companies are considered to be too small, too poorly managed and unable to concentrate sufficient revenues over a period of time to attract most investors.

Anyone looking for an equity investor to support their film company's business plan needs first to be aware of this universal perception because it is a considerable barrier. Film entrepreneurs will perhaps argue that the reluctance of the investment community to support them leaves the sector in a double bind: on the one hand, they need capital in order to support a move towards consolidation, become able to develop entire slates of films and control IP and revenues; on the other hand, the equity markets are waiting for bigger, more stable companies to appear before taking the risk of supporting the sector.

For the film-maker/entrepreneur hoping to raise equity to support his company's mid-term or long-term strategy, it is important to be realistic about investment prospects: the newer the film company, the lesser the chances of obtaining this type of financing. The business plan will need to be of outstanding quality, with considerable clarity on the company's objectives, the genres of films it wishes to make and a detailed strategy for distribution and revenue sharing.



In broad terms, it can be argued that the more the film industry becomes capable of attracting a critical mass of equity investment, the greater its bargaining power will become in the negotiation over rights with distributors, television broadcasters, video licensors, telecom operators and other categories of film buyers. Conversely, a chronic lack of self-financing capacity makes the independent producer less able to withhold rights to a film until after the film is made. For the majority of producers, rights are disposed of early, when the project is vulnerable to being turned down. In this way, the IP value becomes diluted between the various buyers and little of it remains with the producer, thus leaving his company without assets.

Equity investment is also present in individual films. In many cases in the independent film industry, powerful rights buyers such as broadcasters not only buy rights, such as free-to-air television, but also take an equity stake in the project.

In this instance, the buyer may make an offer for an overall price and negotiate with the producer (or distributor) over what proportion represents the rights acquired and what proportion represents the equity investment. The negotiation aims of the producer may vary according to his own perception of the likely success of the film. If he has the conviction that the film will be an overall success at home and abroad, he may want to do everything in his (limited) power to protect his share of the *up-side* – i.e. the net revenues generated from the film's exploitation – by trying to convince the buyer to assign more of his proposed contribution to the rights acquired and to reduce his equity investment. On the other hand, the rights given away by the producer may be seen by him as very strategic, in which case he may be more focused on trying to reduce the period of time (term) of the licensing deal, in order to get those valuable rights back while they still have some residual commercial value. However, if the term of license is short, the price paid by the buyer(s) may be lower and the producer may need more equity investment to close his budget.

As a basic rule of thumb, equity investors (there can be several attached to the same film) recover their investment, with a *premium*, that is a sum of money additional to the sum initially invested, and/or a *participation* in the net profits, on a *pro-rata* basis. *Pro-rata* means that for every US dollar of income earned by the film – after agreed deductions of bank loans, distribution/sales commissions and costs, etc –

the investor will receive a share proportional to the share of the film's budget represented by his investment.

In practice however, the investment recovery formula is rarely so straightforward: for reasons which are specific to the history of every deal: an investor may negotiate for an early *corridor* of income before other equity holders, until he has recovered a pre-agreed sum. Thereafter, the percentage of recovery may change again in favor of other equity partners in the film. Such preferential treatment is always negotiated and is justified by a number of factors: the investor may have been involved from the start of the project and taken a greater risk proportionately to others; he may separately have provided a *bridging loan*, meaning a loan which helps the producer cover his cash outgoings until more money comes in, at a critical point in the project's life, etc. Similar deals may be negotiated to share out net profits in the film.

### 2.iii IP Rights as the Most Strategic Source of Financing

IP Rights are by far the most valuable assets the film producer is likely to hold in his hand when approaching the financing of a film project. Film industry insiders often describe the process of raising finance as a begging bowl experience. In actual fact, the producer is far from resembling the proverbial beggar; in our chapter dedicated to development, readers were able to glimpse the range of risks the producer will have taken in order to acquire the underlying rights in all the works utilized to produce the script, book, or anything else entering into the film's concept. Additionally, the producer may have attached to the project a director and/or an actor with a strong reputation, making it more attractive to potential investors – producers should never underestimate their ability to build up their negotiating power in this way.

At this stage, the producer, wherever in the world he lives and works needs to have a firm grasp of how different sets of rights interact with each other inside a continuum of exploitation also known as the *value chain*. Without it, he will be clueless about how to approach negotiations over the licensing/assignment of rights against production finance.

What is the value chain? In most countries, there is a pre-agreed order in which a theatrical feature film will be commercialized. Traditionally, each form of exploitation



happens in sequence, with each market (the cinema, television, video, etc.) having its own exclusive *window* of time during which the film may not be exploited in a different medium. Across the world, wherever a film industry has achieved a certain level of maturity and critical mass and wherever broadcast television is developed, the traditional value chain has tended to be structured in the following way:

<b>Form of exploitation</b>	<b>“window”</b>
Theatrical (release in cinemas)	For 6 to 24 months. Now down to 2-3 months in some countries
Video & DVD (or VCD)	6 to 24 months after theatrical release
Pay television	12 to 36 months after theatrical release
Free television	12 to 46 months after theatrical release

The point of windows as a convention observed by the film industry (specified in rights licensing/acquisition contracts and sometimes imposed by law or regulation in specific countries), is to ensure that maximum value can be extracted from each sequential cycle of exploitation of the film. It seems logical that if the film is available in video stores and on free TV at the same time as it is being released in the cinemas, each of these forms of exploitation will be hurt by having to compete simultaneously with the other. Buyers of the rights for each of these uses will have paid good money for the film and will want to protect their investment by maximizing commercial returns. They do not want their revenues to be *cannibalized* by other media being exploited at the same time.

But the film industry is in a state of constant change. Technology, in particular, regularly forces the market to mutate whether the film community likes it or not. Very often, it doesn't: when television was first introduced, the film industry in the West fought a rearguard action against it. One prominent film industry figure prophesied that the newly-arrived Sony video cassette player would have the same terminal impact on the film industry as the infamous Boston strangler had had on his female victims! In today's world, the rapidly expanding range of digital media and Internet broadband is forcing the industry into what is perhaps the most radical re-evaluation in its history since synchronized sound was first introduced. The existing value chain (and the all-important windows of exploitation) is being challenged in a number of ways.

The unprecedented image and sound quality of the DVD, introduced to the market just over a decade ago, has revolutionized the video market. During the VHS days, video was predominantly a rental market. With DVD, millions of consumers worldwide have chosen to buy. This mutation has made DVD (until recently) the most profitable medium in the history of cinema.

Digital copies, unlike analog ones (VHS or Betamax) are an exact replica of the original and their quality does not decline over time. This factor is behind the commercial triumph of the DVD format in the West and VCD in many parts of the developing world. However, what profits the legitimate copy also profits the illegal one: the advent of DVD has resulted in the massive increase in video piracy. India, Egypt, Nigeria, Kenya are four examples of dynamic film industries in the developing world, where DVD and VCD piracy represent over 90 percent of the market, with legitimate distributors left to battle it out for the crumbs.

What is true of physical digital copies is also true of copies downloaded through the Internet or digital networks: a perfect copy can be made from films circulating illegally over the web. Once a film is uploaded onto the web without the consent of the right holders, there are few obstacles for people connected through broadband to download it and consume it without either renting or buying it. In countries with a high level of broadband connections, the control or rights over films on the Internet is a challenge for film makers and all participants in the film value chain.

Legitimate services of on-line cinema allowing people to rent or purchase films over the Internet and either download or stream them, have successfully emerged in the West over the past few years, especially in North America, France, the UK, Germany, Italy and Spain. In India, Tata Sky now also offers a video-on-demand service over the Internet. However, these services still represent a small proportion of the market.

As the impact of these technology-based changes is becoming more apparent, film's most traditional market, the cinema, has been going through its own profound transformation. Releasing a film in cinemas is the most costly episode in its commercial career. According to the Motion Picture Association (MPA), the organization representing the major US film studios, the average amount spent on releasing a Hollywood film in 2005 was US\$32 million. Hollywood may be different from other film industries but



the fact remains that the cinema release of even the smaller films require substantial amounts of cash. In the West, little impact can be achieved unless the distributor in a large country is prepared to spend at least US\$150,000 on a film. Furthermore, there are an increasing number of films competing for a finite number of screens.

As a result, it is more difficult for distributors to secure long *runs* (release periods) for their films because so many other films are waiting in the wings for a release date.

This lack of screen time is particularly damaging for the career of smaller, specialized films (those with no stars or special effects or spectacular action set pieces), because they are more reliant on a slow build-up of positive word-of-mouth to attract an audience and cannot hope to do so if the maximum release period available is between two to three weeks at the most: in this *hit-driven* industry, there seems to be a growing expectation that all films, large or small, should be released with the greatest possible number of prints from the very start and should attract most of their audience during the first week's release. Whilst this logic works well for the *blockbuster*, i.e. the big budget films with stars, it penalizes smaller films whose distributors do not have the resources to flood the market with prints and expect quick returns on their investment.

For anyone approaching the film production rights' maze for the first time, embarking on the journey without some grasp of these changes to the value chain would be equivalent to the round-the-world yacht racing skipper sailing without a compass. Knowing the value of each form of exploitation relative to the others in the chain makes it possible for the uninitiated producer to strategize his approach to financing through rights, to have realistic expectations of what each rights' market may yield and to determine what a realistic production budget for the film should be.

A criticism often leveled at film producers by financiers is that they tend to set their budgets according to their own (and the director's) creative wish (or whim), without asking themselves what the market may be able to offer considering the genre, storyline, actors envisaged, the current state of the marketplace for films, etc.

Owing to the fact that these changes are still unfolding, the inventory that follows makes no claim to being completely accurate or exhaustive. It is merely a pointer to what may be happening and the authors hope it will be helpful in guiding the new entrant to producing a film.

As discussed above, the cinema exhibition market is becoming increasingly difficult and expensive for all but the larger, star-driven commercial films. Even in countries such as India or China, where many modern multiplex chains are replacing the old, obsolete one-screen cinemas, the new infrastructure is mostly beneficial to a small number of blockbusters. In most countries, cost inflation for prints and advertising runs well ahead of the standard rise in the cost of living, while it is increasingly difficult for distributors to keep even a moderately-successful film in cinemas for long. The cinema is still seen in most film industries as the obligatory *launch market*, whose performance determines the success or failure of the film in the next segments of the value chain. However, the price of entry into that market increases while its flexibility decreases. For many, starting a film's career in the cinema no longer seems like the obligatory approach.

Cinema exhibition also suffers from the rapid growth of the market for film entertainment viewed at home. Factors such as the availability of high definition flat screens, multiple audiovisual channels and services through satellite or broadband fiber optics and the imminent introduction of the high-definition DVD (two competing systems are currently vying for the consumer's interest) are all contributing to making the quality of home-viewing competitive with the cinema.

The value of cinema films in traditional television broadcasting (free-to-air and pay-TV) is declining steadily in the West. Broadcasters tend to pay less for movies because they see new entrants into the value chain – such as broadband pay-per-view and video-on-demand operators – jumping the queue and adding new opportunities for consumers to see the film before it reaches the traditional television schedules.

Digital piracy destroys markets – professional or amateur: those who duplicate and distribute films as physical copies or over broadband networks take advantage of the slow, sequential exploitation pattern of the old value chain. While the film is still in the movie theatres, illegal copies are already whirring through broadband Internet peer-to-peer networks and flooding the streets in the form of illegal DVD or VCD copies. By the time the film reaches the next segment in the legitimate value chain, severe commercial losses have already been sustained.

All these factors combined are slowly driving the industry towards a compression of traditional windows.



The trend started in the US with the extraordinary explosion of the DVD “sell-through” market in the mid-1990s. Major studios became anxious to rush the films out of the cinemas early in order to satisfy consumer demand for new DVD releases and reduce the length of time necessary fully to realize the value of those rights.

Today, in a response which addresses both piracy and consumer demand, some films are beginning to go *day-and-date* – i.e. being released simultaneously in various media. In 2005-06, one pioneering film company in the US tested a formula whereby a series of low-budget films to be directed in digital format by the reputable Hollywood director Steven Soderbergh were to be made available to the public on the same date in film theatres, on the company’s pay-TV network and on DVD.

On-line cinema (films through the Internet), whether pay-per-view rental, download-to-buy or subscription, is beginning to compete with traditional DVD releasing – the most reliable prediction is that these windows will collapse into one single *home entertainment* set of rights, rationalizing this segment of the value chain.

In future, it is highly likely that a greater proportion of films will go day-and-date in several media at the same time. Alternatively, they will enter the rights’ value chain at different points, sometimes skipping the cinema altogether to be offered straight-to-home through on-line cinema services, pay-television and packaged DVDs. In the old days, it was mostly films perceived as failures which distributors would take straight to DVD, avoiding the high costs of a cinema release – in future this approach could become part of a positive strategy to release a good-quality film targeting a specific audience.

No one can accurately predict what is going to happen to the value chain and how each set of rights will be affected by the emergence of radically new business models for the commercial exploitation of films. In the Anglo-American film industry, which is still economically dominant, nervousness and uncertainty prevail, making negotiations over rights frequently unpredictable: the value of the home video/DVD is no longer increasing and may be going on a slow historic decline over the next few years. Meanwhile, on-line cinema is still largely untested, both in terms of technology and business models and has not become an obvious replacement market for DVD. And, as we discussed earlier, prices paid for films on television are

on a steady decline. The result is a climate of insecurity and second-guessing which makes buyers more nervous and less ready to commit to licensing and acquisitions on all but the most sought-after films. Distributors are also more aggressive in acquiring all available rights in order to cover their risk.

In this time of mutation, it is difficult to offer the new producer a clear recipe for action: the first thing a new entrant to the production business needs to do is to turn himself into an avid consumer of information about the film industry worldwide and how rights' markets are developing.

The developments presented and discussed above are at their most active within the Western film industries, in Europe and North America. It is undoubtedly the case that other film industries in different regions of the world often struggle with a different set of challenges. In West and East Africa, where many feature films are being made on very low budgets using digital video, the market is still predominantly video: producers either sell the film (sometimes on a non-exclusive basis) to *marketeers* or self-distribute through their own physical network. In either configuration, almost the only market outlet is in VHS and VCD physical copies. The local cinema exhibition infrastructure is still either non-existent or too limited to be able to support the financing of films. Television, meanwhile, struggles with budget shortages, with the result that producers are often expected to pay for the privilege of airing their films on a TV network. There are some pan-African satellite channels with deeper pockets, but these tend to select mostly non-African films to broadcast to middle-class African consumers with the means to install satellite dishes in their homes.

The basic map has been drawn; the time has now come to navigate the complex territory of rights' transactions.

#### **2.iv Into the Rights' Jungle – the film distribution agreement**

The distribution agreement defines the terms of business agreed between a film distributor and the producer. In the process, the producer will license or assign rights acquired by him at the development stage, against remuneration and the prospect of the film being exploited in key markets.



It is an established convention that rights are roughly divided between *primary* rights and *secondary* rights – the latter are also described as *ancillary* rights. To make matters more complicated than they already are, the definition of these two sets of rights varies country by country: in the US, primary rights tend to be defined simply as those which relate to the primary market for films, – i.e. the cinema. Secondary (i.e. ancillary) rights are all those corresponding to the four main windows which follow the cinema release, namely video/DVD, pay-TV, National Network Television and the so-called *syndication* television channels, which are local broadcasters.

In Europe, the norm is generally to include the cinema and television broadcasting in the definition of primary rights, whereas the secondary rights will range from video/DVD, to pay-TV, video on demand, down to merchandising, theatre spin-offs, book adaptations, etc. This difference in approach also reveals the historic importance of television as a film medium in the European market.

There is no such thing as a standard deal and agreement with a distributor. A producer may be dealing with an integrated company able to release the film in cinemas locally, to release on VCD/DVD, license it to local television stations, sell it to foreign buyers at markets and festivals, etc. On the other hand, he may be dealing with different distributors, each active in one or two market segments (e.g. cinema or video) and may need to license those rights separately. Whatever the format, here are some of the key points which a negotiation will be likely to throw up.

### ***1. Type and scope of rights sold or licensed***

As a matter of course, most distributors will put pressure on the producer to assign or license all available rights. In this matter, the producer may not have the choice as he may be lacking in bargaining power, either because he desperately needs the distributor to provide an advance which will help move the film from script to production, or because he has a completed film whose investors are putting pressure on the producer to see a return on their investment.

As a matter of principle however, the producer may try as much as possible to keep to himself (*reserve*) those rights which are either less important to the distributor's business and/or which the distributor has no solid expertise in exploiting but which

can make a difference to the production company's revenues over time. These include airline screening rights (now a lucrative set of rights due to the worldwide increase in air traffic) and extend to the so-called *non-theatrical* rights which include public performances of a non-commercial nature (educational institutions, conferences, etc) and which may help bring added visibility to the film in the long run.

## ***2. The key strategic rights which the film distributor will generally insist on obtaining are:***

Theatrical – meaning the rights relating to the exploitation of the film in commercial cinemas. Theatrical is still seen as the strategic launch market for most films, the success or failure of the film in the cinemas having an important knock-on effect on performance (and therefore pricing) in subsequent windows of rights' exploitation – however, as the table below illustrates, the theatrical market is almost always a loss-leader for the distributor, which creates all the more pressure for his investment to be recovered in subsequent segments of the value chain:

<b>Revenue breakdown – UK theatrical (cinema) release of a low-budget British film (1997)</b>	<b>Revenues (£)</b>
Total gross box office receipts over the cinema release period	4 000 000
Cinema exhibitor's share + VAT	(-) 2 840 000
Distributor's gross receipts	1 160 000
Recovery of distributor's prints' and advertising expenses	(-) 1 400 000
Distributor's commission (30%)	(-) 232 000
Net from the cinema exhibition of the film	(-) 472 000

Video rights (or *video-gram* rights) – refer to all rights of duplication (and exploitation thereafter) of the film on analog video cassettes and optical disks including compact disk, VCD and DVD;

Pay-television (also known as *premium cable* in the US) – refers to television offered to the public against subscription payments and requiring the use of a decoding device which protects the signal from unauthorized uses. Coming before the



explosion of the DVD in Western markets, pay TV has been a considerable force in the exploitation and financing of films over the past twenty years.

Satellite television – refers to television services available to the audience direct-to-home and requiring the installation of a satellite reception dish. These rights may sometimes replace or extend those of free-to-air television in countries where free-to-air broadcasting is limited due to geographic and/or economic factors.

Free-to-air television (or free television) – refers to television services received by the audience free of subscription charges and not normally requiring a decoding device to be viewed. These services are usually supported through income sources such as advertising, sponsorship and state aid or a specific annual tax or levy on each household with a capacity to receive those services.

Distributors' agreements will generally contain clauses ensuring that they will have the legal right to make certain changes to the film for the purpose of distribution. These may include changes to the title, cuts designed to comply with film classification/censorship requirements, dubbing and sub-titling, etc. The producer should therefore take care that all relevant *consents* have been obtained from the authors/creative contributors to the work as a misunderstanding may lay the film open to legal action by a right holder whose consent was not sought, for breach of exclusive rights or moral rights.

### ***3. Advances and minimum guarantees***

In an ideal world, mature film industries should be characterized by the capacity of local film distributors to participate fully in the financing of films by investing in them against future revenue projections. Today, Hollywood is generally seen as the most accomplished model for distributor-led financing and the overwhelming majority of high budget US films are financed through a studio distribution deal which covers anything between 40 and 100 percent of the cost of production. A Hollywood studio is essentially one large global distribution and marketing entity able to acquire a critical mass of intellectual property rights and exploit them on a worldwide scale and this model is held in high regard in other film industries (even if there is a healthy debate about its cultural impact across the world), because it ensures that

film projects are selected by companies whose job consists almost entirely in trying to understand what audiences want to see.

In the rest of the world however, film distributors are typically smaller, less well financed and far less able therefore to contribute funds to film production in the form of *advances* or *minimum guarantees*. The UK and India are two examples of highly mature film industries where distributors are fragmented and all too seldom involved in the business of financing films. In India, the so-called *hero* films, i.e. those starring the most eminent male stars, can attract distributors' advances sometimes equal to – or in excess of – the cost of production. In the latter case, this means the production may be in profit even before it starts! However, the overwhelming majority of the 1,000 films made in India each year start production without a distributor being involved in the financing. This means they start filming without a single intellectual property right sold to ensure the commercial exploitation of the film. Those that do receive distributor finance tend to come from established producers and known actors. Even then, unless a bankable hero is cast, the distributor's advance will generally be well below half the budget and the producer will always struggle to cover the gap from other sources.

The table below illustrates a typical film financing structure for a South Indian film with no star.

#### **Financing sources for a low-budget Telugu or Tamil film (India)**

Producer's own funds	15 -20%	May include deferred fees for producer and director or lead cast (fees are in the budget but are not paid up – they are to be earned back from future exploitation of the finished film).
Equity or debt	25%	Generally provided by local high net worth individuals or by larger film companies (e.g. Adlabs).
Film distributor's advance	25%	33% paid before delivery of the finished film. Balance thereafter.
Laboratory debt financing	25%	Lab + post-production facility including camera hire.
<b>TOTAL</b>	<b>95-100%</b>	



In the UK, as in most of Europe, the leading local film distributors predominantly sustain their businesses through buying distribution rights to US films, through *output deals* with the major Hollywood companies. Local films are often seen as higher risk because they tend to have smaller budgets and cast actors who may be stars on television but whose ability to attract audiences to the cinema is seen as uncertain at the best of times.

As a general rule, most independent low-budget film makers wherever in the world they live and work, will find it very difficult to attract a distributor into their financing plan before the start of production. Most successful films in this section of the worldwide film market are picked up by distributors after completion (festivals, film markets or preview screenings organized by the production or sales company) or towards the tail end of production, when a *rough cut* of the film may be presented to potential buyers. A rough cut is a version of the film in which most of the scenes are in the right order, where dialogue has been synchronized but which lacks elements of post-production finish such as optical or digital effects, music soundtrack, etc.

If you are amongst the happy few who have managed to attract a distributor to part-finance your film, an understanding of the difference between an advance and a minimum guarantee will be helpful to you at the point of signing away distribution rights.

- (i) Minimum Guarantee (MG) – under this type of deal structure, the distributor guarantees to the producer that the film will either earn a certain sum in revenues or that he will pay the producer the guaranteed projected sum, whether or not he generates enough revenue from the exploitation of the film to cover this sum. The distributor is therefore at risk. In some cases, he may agree to advance the value of the MG to help the producer make the film; alternatively, the producer may be able to *discount* the value of the MG contract with a bank, which requires a *letter of credit* as a condition. In a discounting deal, the bank agrees to cash-flow the value of the MG contract. It is discounted in that the cash advanced by the bank rarely covers 100 percent of the value of the contract.
- (ii) Advance – under this model, the distributor advances a sum of money against future revenues to the producer. The advance may be cash-flowed

in part or in full and is recoverable by the distributor out of first income from the film's commercial exploitation, sometimes with interest charged on top, before the producer can share in revenues. The advance also puts the distributor at risk because the revenue generated by the film's exploitation may not match the amount of the advance, but he will generally secure a bigger share of the revenues if the film is successful.

#### 4. *Share-out of distribution revenues*

The standard approach worldwide is for the producer to receive a share of the net income the distributor receives from sales and/or direct exploitation. This is received by the producer from the point after which the distributor has recovered his *distribution commissions* (between 20 to 35 percent is the worldwide film industry norm though percentages vary according to each set of rights exploited), *distribution expenses* and – if applicable – the value of the advance. The recovery of the advance may also be with interest and the distributor may further insist on a share of the net profit if the advance was a sizeable one.

From the exhibition of the film in the theatrical market, the distributor receives a percentage which varies across the world on average between 25 and 50 percent of the film exhibitor's gross. The balance is retained by the cinema to cover its *overhead* costs, i.e. the costs of operating the cinema. France has a specific statute which compels distributors and exhibitors to share receipts on the basis of a 50/50 split; the UK, US and India are driven by individual market negotiations as is much of the rest of the world. In the US, the proportion varies according to the perceived value of the film to the exhibitors but averages out at 50 percent. In the UK, most independent films can only hope for between 27 to 30 percent of gross theatrical receipts to be retained by the distributor.

Thereafter, the split between the producer and the distributor will vary according to each agreement. In the US, producers directly attached to a major studio typically get 50 percent of the distributor's net, after deduction of advances, print and advertising costs and studio overhead charges. In fact, since the producer has to pay out *participations*, i.e. net income percentages to key talent in the film, his actual percentage earned can be much lower than 50 percent. This is also the prevailing split of net profit in the rest of the world.



On video revenue, the deals vary enormously between countries and, within them, between the companies themselves, thus it is not possible to cover those in the appropriate level of detail within the scope of this introductory publication. New entrants to film production should begin by understanding the notion that video/DVD is an entirely different business model from the cinema release: whereas revenues generated from cinema come and go within a few months, video exploitation may go on generating revenue for over ten years. However, whilst films on cinema release generally have to compete with between 10 and 15 other films in any given week, films in the video market compete with thousands of other titles at any given time. In this context, the management of a video catalogue by the video publisher becomes the main factor in making a film visible and competitive. If possible, the producer should always take great care in choosing a video publisher with a strong track record in managing catalogues over a long period of time, in order to ensure that his film gets the marketing support and market profile it deserves.

### *5. Assignment of copyright in the film*

Very often, the film's distributor will try to negotiate a full transfer or assignment of copyright in the film. The distributor's reasoning may be that control over copyright will enable him to exploit the film fully in all markets (if he has obtained worldwide exploitation rights) without impediment and to take direct legal action in the event of the film being unlawfully copied and distributed by a third party.

### *6. Size and apportionment of distributor's expenses*

Every distributor will need to incur marketing and physical print costs in order to give the film its best chance in the marketplace. In negotiating the distribution agreement the producer will invariably try to ensure that there is a sufficient commitment to print and advertising spend on the part of the distributor (otherwise the film is more likely to fail) and that these expenses are *capped* – i.e. that the distributor may not go over the pre-agreed budget without the producer's consent (the higher the spend, the less likely it is that the producer will recover any income from net profit, so he will want to ensure that any over-spend is justified).

The producer will also endeavor to negotiate consultation rights over the shape and direction of the marketing campaign to support the release of the film.

## *7. Term of assignment or license*

As the rights' market has become more elaborate and more prolific with the introduction of pay-per-view, video-on-demand and other digital media, this aspect of the producer/distributor negotiation has become more fraught. This is because both parties see them as strategic to their long term commercial interest. There is no specific rule of thumb for the term of an assignment or a license, with distributors fighting for long terms (between 15 years to perpetuity) and producers often attempting to negotiate shorter periods.

With very few exceptions, distributors are in a strong position to impose terms and a producer's insistence on a limited number of years carries the risk of the distributor reducing his financial offer proportionately.

In some cases, terms may be variable and linked to certain performance expectations. At its most basic, this means that agreements protect the producer against the distributor making no effort to release or exploit the film in other media and ensures that rights revert to him after a period of time during which no exploitation of the rights has taken place. The agreement may also provide for a more sophisticated approach. An example may be found in French film distribution contracts: if, after an initial term of 10 years, the distributor has recovered the advance paid to the producer plus the agreed marketing costs, he may be entitled to a series of 3-year extensions. However, the producer will have the power to revoke this clause and ensure that the rights revert to him.

## *8. Producer's warranties*

At the insistence of the distributor, the agreement will invariably contain clauses stipulating that all IP rights involved in making the film have been cleared and that the distributor will face no outstanding clearance charges or liabilities for underlying material to which the producer may have failed to acquire or license the rights.

## **2.v The Rights' Jungle thickens – a strategic look at television rights**

As was pointed out at the start of this chapter, for producers new to the adventure of film-making and the complexities of IP-based transactions, an understanding of



the changes in the value chain is an essential determinant of success. Rights are not neutral and abstract: they are alive; they are strategic and their respective value is constantly shifting relative to each other.

At the start of this chapter we evoked the complexity of the changes affecting the rights' value chain. In film's primary market, the cinema, print and advertising costs have increased several-fold in the past 10 years, while the number of films seeking a theatrical release keeps increasing. As a result, the market is overcrowded, the larger films tend to take up most of the available screens and there are fewer opportunities to give specialized, non-blockbuster films a chance to find an audience. The commercial performance of most films in the cinema is not sufficient to ensure that the print and advertising costs will be recovered, let alone the cost of producing the film.

This is the reality most film distributors the world over have to face. Where markets and technology are mature, and where piracy has not reached pandemic levels, distributors try to recover losses from theatrical exhibition by pinning their hopes on the video/VCD/DVD market. However, there too, the challenge is steep: in the larger Western countries the video market is flooded with over 100 new titles released each week. High street retailers, on the other hand, have limited shelf-space and the result – a quandary not dissimilar to that of the theatrical market – is that only the few high end commercial titles are displayed, drawing the attention of consumers. Elsewhere in the world, mature film markets such as India or China are still seeing the value of the video market almost entirely destroyed by piracy.

In this adverse context, television appears to be the most solid component in the value chain. Despite being challenged by the advent of new media (pay-per-view, Internet streaming, cinema online, etc), with attendant scattering of advertising revenues and a relative decline in audience share, both pay television and free television continue to represent reliable outlets for rights' exploitation. In countries with an emergent commercial television sector, new satellite broadcasters, such as India's Sony TV, Zee TV and Sahara, increasingly compete head-on for rights to the more commercially-appealing films.

In Europe, many countries (France, Germany, Denmark, the UK and Holland are salient examples) have broadcasters who are ongoing partners of production companies and co-

producers of films. In some cases, this is the result of an enlightened policy to get involved with quality projects to showcase to a national television audience. BBC Films – the feature film division of the UK’s public broadcasting system – has over the years become a respected entity in the independent film-making community, investing money into third party projects and developing its own projects in-house. In France, all broadcasters are obligated by law to acquire licenses for French language feature films; independently, all the leading channels have film co-production subsidiaries which invest at risk in third party projects. In Denmark, broadcasters now also have certain investment and licensing obligations towards films produced by film makers in the Danish language.

In the US, the leading pay-TV channels (premium cable) have become commercially shrewd patrons of US independent films: market leaders HBO and Showtime both have their own branded divisions devoted exclusively to low-budget films.

From all the above, it would be tempting to conclude that the picture is very rosy indeed for producers hoping to attract broadcasting finance against transmission rights. In actual fact, broadcasting rights are a challenging proposition for producers because of a number of market factors.

Hollywood studios have *output deals* with the leading pay TV and/or free TV broadcasters in many countries around the world. These deals consist in a studio pledging a number of films to the broadcaster annually. Each film has a base price related to its performance in US cinemas (nearly always the film’s first market) and/or in local cinemas in the country in which the broadcaster transmits. The base price for each film may go up if the theatrical performance goes over a pre-set gross box office figure (this practice is referred to as an *escalator*). Output deals make good business sense: the studios are able to plan revenues in a safer, more accurate manner; broadcasters get exclusive supply, which makes good competitive sense. However, the knock-on effect of these deals for non-studio producers is rarely positive: on the one hand, it leaves fewer slots available for other films in a finite schedule; on the other hand, rights for films offered to a broadcaster outside an output deal, tend to be acquired for much less, if not free-of-charge.

Film distributors in the producer’s country will rarely pick up a film for a theatrical release unless they can secure television rights too. This is perfectly logical since –



as we have seen – most films lose money in the cinema and a distributor’s only hope of recouping his investment thereafter is in the next segments of the IP value chain. In countries where broadcasters are active participants in the financing of films, this presents the producer with a dilemma: on the one hand he needs a distributor in order to “launch” the film through a theatrical release and obtain revenue from other ancillary rights; on the other hand, if a broadcaster is offering to license transmission rights in advance – against a production advance – he knows that accepting this agreement will result either in a much lower offer from a local distributor or, indeed, no offer at all.

As co-financiers of feature films, broadcasters generally bring a lot of bargaining power to the negotiation with the producer – they will typically attempt to acquire all broadcast rights beyond the primary transmission rights which fit in with their core business. In some cases, the broadcaster negotiating the acquisition or license may be operating several services, including pay-TV, free TV and even pay-per-view and video-on-demand and will be justified in trying to aggregate all these rights together to sustain its operations. In other cases, the broadcaster may be active in just one segment of the broadcasting value chain but may still want to buy out the rights to the other segments because – understandably – it does not look kindly on its commercial rivals getting the same film either sooner or later. The producer will generally want to negotiate for a limited license rather than an assignment of broadcasting rights. If the broadcaster wants to include different types of transmission rights into the same quoted license price, the producer may also insist that each use be valued separately and a market rate negotiated for each, to avoid a bundling of the value of IP rights into one bulk quote. If the broadcaster insists on taking transmission rights for broadcast services it does not itself own and operate, the producer may negotiate an obligation for the broadcaster to proactively license those additional broadcasting rights to third party broadcasters and to share the revenue with the producer from the licensing of those rights. Also, the agreement may provide that – in the event that the purchasing broadcaster fails to successfully license or sell the rights on to a third party – those unsold/unlicensed rights could revert to the producer after a pre-agreed period of time. This last clause can be very strategic as it helps prevent a *warehousing* of the rights by ensuring there are incentives for the fullest value to be realized across the range of broadcasting IP rights.

In some European countries governments have intervened in rights' bargaining between producers and broadcasters, to level the playing field and ensure the opportunities for secondary rights to be fully exploited in due course. France has specific clauses in agreements between producers and broadcasters to that effect.

The broadcaster's initial license is limited to two transmissions over a period of two years – thereafter the rights revert to the producer though the broadcaster has rights of *first negotiation* if it wishes to exploit the rights further.

Broadcasters may not make an equity (or co-production) investment into the film through their acquisitions' department. These investments may only be made through a wholly-owned film production subsidiary, with separate staff, accounts and governance. This measure is designed to prevent a bundling of rights' licensing and investment under the same roof, which the French regulator believes would concentrate bargaining power and give the broadcaster the opportunity to take control of all the revenue "upside" from the film. Additionally, single investments by a broadcaster's film subsidiary may not exceed 50 percent of the production budget.

The broadcaster may only take a financial interest in one ancillary market for the film. For example, if the broadcaster takes some control over the video/DVD rights, he will not be able to have any stake in the foreign rights, or *vice versa*.

In this chapter, we hope to have provided a few useful clues as to how producers may carve a path through the film rights' jungle and get their films financed whilst also retaining a healthy degree of control – or financial interest – over exploitation. The picture we have painted is that of an ever-changing value chain in which rights' values are shifting along the fault lines left by technology breakthrough and changes in consumers' expectations.

In the next section, we look at how producers find a way through the complex maze of relationships with the key talent involved in the making of the film.

Custom and practice and economic conditions may vary from one country to the next and no two film industries are exactly alike. However, all successful films have one thing in common: actors, directors, and other artists doing their very best to



make the film work. For this prescription to succeed, the producer needs to be an inspired band leader, an exceptional listener and a fair negotiator.

## CHAPTER 3

### The Talent Maze – Rights and Engagement Terms

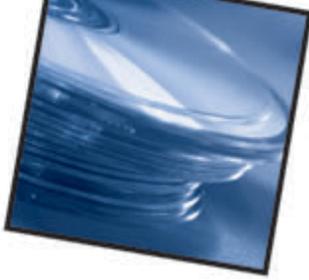
A successful feature film is a unique and singular coming together of individual talent, focused and coordinated towards the same creative vision. There are creative contributors in almost every single department of a film production unit. In a contemporary film, these range from make-up artists, costume designers, choreographers and story board draughtsmen, to special effects concept artists, art directors and directors of photography. And the list goes on.

Many of these artistic contributors require basic consent for the use of their work as part of the finished film as an independent copyrighted work. In this chapter however, we shall focus exclusively on two categories of talent whose contribution can most spectacularly make or break a film: the director and the actor. On the one hand, they are almost invariably the most prominent talent on any film set; on the other hand, the IP clearances involved in attaching them to a film are the most complex and sensitive, lending them a didactic value for the producer in his approach to all the other talent.

#### 3.i Actors Rights' – an uneven patchwork

Worldwide, the legal status of the actor varies considerably from one jurisdiction to the next. Some countries grant actors a comprehensive set of *neighboring rights*, which include the right of recording (*fixation*) of their performance in the film, reproduction rights, communication to the public right (broadcasting) and the right of “making available to the public” (pay-per-view, video on demand, etc.).

Many countries still accord virtually no rights to actors and performers, who are hired on film work purely as employees of the production, with no assignment or license



being negotiated. In some countries – the US is the most salient example – although actors are not characterized as neighboring right holders, they benefit from powerful union representation, ensuring that the pay scale for non-stars is sufficient and securing further payments linked to the exploitation of the film: US screen actors, though signed up to a production as work-for-hire employees can look forward to minimum pay and a complex scale of residual payments administered through the film studios (or other signatories to the union agreements) and rigorously policed by their union, the powerful Screen Actors Guild.

In many other countries, however, the lack of neighboring rights, combined with weak union representation has left screen actors vulnerable in contractual and economic terms. The International Federation of Actors has been campaigning actively to rectify this imbalance by introducing statutory neighboring rights in primary legislation across the world.

The European Union has adopted harmonizing legislation which makes it binding for all its member states to recognize neighboring rights for actors and performers in national law and to ensure they are enforced accordingly.

In many European jurisdictions, the law also builds in a presumption that these neighboring rights are fully transferable to the film's producer at the point where the actor signs a hire contract. This presumption may be qualified or not: for example, it may be *rebuttable*, meaning that the presumption applies unless the performer proactively specifies that he is unwilling to let his rights go. Even if it is a straight legal presumption and non-rebuttable, most European legal systems will provide that the condition for the full transfer is remuneration.

In the French intellectual property code (L 121-4), the condition for the presumption of transfer is that remuneration should be offered by contract and that any advance remuneration should be treated as a minimum guarantee against a share in exploitation revenues from the finished film. Consequently, French actors' contracts, whilst specifying remuneration against a buy-out of all neighboring rights for their entire legal term (50 years from first release), also provide for *supplementary remuneration* generally expressed as a fixed sum for each cinema admission above a certain threshold.

Moral rights are also an issue for actors worldwide, as legislations vary in the extent to which they grant those to creative contributors other than the authors of the film and the underlying works. However, even when working under a jurisdiction which does not grant him a moral right, the actor may be capable of ensuring the protection of his own image and a degree of approval of the use of it as part of the promotion for the film.

### **3.ii Hollywood Stars – their agents and inflationary effects**

For film producers living and working in the Anglo-Saxon world, the ability to attract movie stars to a project has a significantly positive impact on the valuation of the IP rights in the film by potential buyers. It is therefore an essential plank in the strategic deployment of the producer in search of financing for his project.

However, the challenge of attracting a bankable lead to a low-budget project is considerable and becoming more daunting with each passing year.

One of the reasons is that many of the stars from countries such as Britain, Canada or Australia are also pursuing Hollywood careers. Examples of Hollywood luminaries with non-US Anglo-Saxon passports have included Christopher Plummer (Canada), Anthony Hopkins (UK), Russell Crowe (Australia), Naomi Watts (Australia). Known or unknown, a growing number of actors from these countries also have agents in Los Angeles and are members of the extremely powerful Screen Actors Guild, a US union which insists on extending jurisdiction over its members even for productions where hiring is taking place outside the US.

This relative “Hollywoodization” of Anglo-Saxon actors outside the US creates substantial obstacles for lower-budget film makers aspiring to cast lead actors. On the one hand, stars willing to appear in a low-budget movie can make a huge difference to the perceived value of the project. Their commitment to the film will often be the most significant factor in helping raise finance to meet the target budget. On the other hand, popular actors who have appeared in Hollywood films have what agents call a “quote,” meaning a standard rate for the films in which they are willing to appear, based on their perceived attractiveness to the audience. The “quote” however, is rarely affordable for movies with budgets under US\$5 million.



The producer's two main assets in persuading a star to work for a price well under the quoted one are:

- (i) the arresting quality of the story and screenplay;
- (ii) current shifts in the way leading actors tend to manage their careers: there was a time when stars took few risks that may have tarnished their heroic image with the public and showcased their true "range" as actors. Today however, taking such risks is part of most leads' strategies to acquire credibility with newer, younger, discerning audiences by accepting roles that do not necessarily fit their standard screen persona. Witness Tom Cruise as the deranged sex coach in Paul Thomas Anderson's LA saga *Magnolia*, or Bruce Willis' down-on-his-luck boxer in Quentin Tarrantino's *Pulp Fiction*. Two films distinctly out of the mainstream, directed by young film makers and with budgets well below those two stars' normal market rate. In these examples, both stars reaped substantial career dividends from laudatory reviews, even if their take-home pay was nothing like their usual rate.

So, having managed to attach stars to low-budget projects, how do producers negotiate a workable package with them?

Let's look at a film which came out in 2003, won critical acclaim throughout the world and turned in a very respectable commercial performance in most countries where it was distributed.

The film is called *The Girl with the Pearl Earring*. Based on the acclaimed novel by Tracy Chevalier, it imagines a simmering tale of erotic tension, laced with class tension, behind the painting of the eponymous portrait by Vermeer of Delft, perhaps the most celebrated of the Dutch 17<sup>th</sup> Century master painters.

The film was a labor of love for British producer Andy Patterson and his writing partner Olivia Hetreed. The US\$11 million project was many years in development before cameras finally rolled. Like many ambitious independent film projects it demanded enormous vision and tenacity from all involved. However, for Patterson and his team, the result

was worth the wait: when the film finally came together, they were lucky enough to be able to attach both British star Colin Firth (*Bridget Jones, Love Actually*) and the rising new female sensation Scarlet Johansson (*Lost in Translation, Match Point*).

At the time, both actors were riding high on the successes of recently-released films. Both had agents in the US whose quoted prices were well over the affordability line for this modest budget.

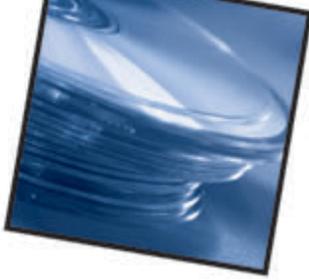
Both actors accepted the producers' offer to be remunerated for their respective parts on the basis of an advance payment worth only a fraction of their quote. However, having accepted such a substantially lower offer, the actors also had two important demands:

- (i) That the balance between their advance remuneration and their quoted price could be earned by them from the time the first revenues started to flow from the commercial exploitation of the film. In film industry parlance, this practice is called "deferrals" or "deferments".
- (ii) That after revenues had recovered the full costs of the production of the film, they would be entitled to a significant participation in profits.

This type of deal structure is now standard in transactions between producers and lead actors across the independent film community in the Anglo-Saxon world. In insisting on such terms, actors and their agents are lining up with Hollywood practice, albeit with lesser figures involved. In essence, against the commitment to take modest fees advances in order to facilitate the making of a low budget film, they will insist on becoming investors in the film.

This approach has its ambiguities:

- On the one hand, it allows small projects to – as it were – punch above their weight and guarantees a strong opening for the film in cinemas, due to the presence of popular actors in the cast list. This is a vital competitive factor for many independent films tackling more difficult subjects and whilst competing for an audience used to escapist Hollywood blockbusters.



– On the other hand, the agents now insist that the revenue “corridor” going back to the actors as part of the deferral deal, should be calculated from the first dollar of income from commercial exploitation. In the industry’s jargon, these types of arrangements are referred to as *gross deals* because the actor is meant to receive his/her share from first dollar instead of having to wait until the full costs of production have been recovered.

The difficulty for independent low budget producers is that they are dependent on international film exporters (known in the business as “sales agents”), to provide realistic forecasts of the total value of the sales of the film’s distribution right in various countries. In order for the producer to raise the production budget, he needs to be able to persuade them that accumulated sales values will exceed the cost of making the film. The lead actors’ demand for a revenue share-out based on gross income, deducts a significant amount in advance from the value of those sales, making it more difficult to match them to the film’s budget and thereby making the risk seem greater for the financiers.

The way out of this quandary is to offer the actors an intermediate deal whereby they are entitled to a “corridor” of income, not from the first gross dollar earned but from this same dollar, after the distributor has deducted the costs of film prints and marketing, and before his commission. In the business, this is often known as “adjusted gross.” Although this improves the chances of matching budget with estimated sales values, it is generally still far from optimal from the producer’s point of view.

With non-star actors, producers will tend to agree to deals made-up of advance fees (or salaries), based on published union rates, combined with residual payments calculated either as a fixed amount for each sale of the film rights in a variety of media and territories, or a royalty based on a small percentage of the value of the sale. Standard actors’ union agreements vary in Anglo-Saxon countries in that respect. There are also some differences in the share-out of net profit. In some agreements, there is no specific clause providing for a share-out of a film’s net profits in favor of the actors – the negotiation on this aspect of an actor’s remuneration is left to the negotiating power of the agents, which is itself predicated on the perceived value of their clients to the project. In practice, this means that if a standard agreement does not have clauses for profit sharing, only the leading roles tend to impose such terms on the producers because of their perceived market value.

Other union agreements ensure that every one of their members hired on a production may choose to claim a profit share: in the UK, the Actors' Equity agreement with independent producers gives the actor a choice between a profit share (2 percent of net profit to be shared out between all), or a royalty based on the value of all sales of the film rights, after sales revenues have exceeded 50 percent of the cost of producing the film.

### 3.iii In the Director's Chair – author vs technician-for-hire

The director is widely recognized as the most pivotal creative artist and technician in the making of a feature film. The mystique surrounding the work of world class directors attests to the powerful influence of a consistent personal vision behind the success of many films. Over many decades and through many memorable films, great directors have often shaped a body of work with an instantly recognizable style signature, recurrent themes and narrative devices.

Under some legal regimes, the director is presumed to have the initial authorship in the film and his contract with the producer will be structured around the transfer or licensing of all exploitation rights, against negotiated remuneration and a participation in revenue streams. The contract will also define the respective powers of the producer and the director, especially with regard to the strategic issue of who has the *final cut*.

In France, the producer hires the director under two separate and inter-linked agreements: a technician's contract to direct the film and an author's contract taking a transfer of all exploitation rights in the work and laying out the specific arrangements for revenue sharing.

In this configuration, the director's advance remuneration is typically split into two halves, with one sum allocated as a one-off fee for technical services and the other as a minimum guarantee deductible by the producer against future revenues.

The *final cut* refers to the power to decide about the final shape of the film. Under a *droit d'auteur* legal regime, it would be contrary to IP statute for the director to have this power taken away from him; he will see it as an important expression of his moral right, whereas the moral right itself cannot be waived, transferred or assigned.



In regular custom and practice however, pragmatism always prevails: it is therefore standard for French directors' contracts to provide that the final cut will effectively be a joint decision between the producer and the director. The agreement also typically provides that "*the director will have the possibility to supervise foreign versions* [of the film]". This is another example of how the exercise of the moral right is accommodated through contractual practice, as there is no mention here of the director having to authorize the said foreign versions, despite the fact that these may include cuts made to accommodate censorship requirements in foreign countries. Elsewhere, the contract even specifies that no modification may be made to the final cut of the film without the director's prior written approval, "*except however, those demanded by censorship*".

This type of director-as-author agreement is very detailed with regard to the director's further income streams as an author of the film: each market, from theatrical down to small ancillaries such as theatrical or radio spin-off programs, carries a percentage pegged either to the price paid by the public (*gross deal*), or the producer's share of net income from exploitation.

In the US, the director's status recalls that of the actor in that it is normally a work-for-hire contract involving no characterization of neighboring rights to be transferred: the director is remunerated for providing a service over the life-span of the production, which will include pre-production and tasks linked to the development period, such as script meetings, etc.

The US director's treatment as a technician rather than an author does not necessarily mean that his actual contractual terms will be any less advantageous than the director in *droit d'auteur* countries: the difference between the two regimes in this respect is that whilst the *droit d'auteur* contracts will provide an innate set of advantages (final cut, participation in film revenues) to all directors, the work-for-hire system will only grant such advantages in the context of a market-driven negotiation based on the perceived competence and box office drawing power of each director.

It is a known fact that, although moral rights do not feature in the negotiations, a few of the most famous *A list* Hollywood directors will insist on a final cut provision or – at the very least – a joint final cut. This facility is made somewhat easier by the fact

that directors operating at this level in the Hollywood hierarchy will often be involved as producers as well as directors on their projects. Even for the less powerful directors, union agreements provide for the director to initially deliver his version of the film's cut, before any final decision can be made. This *director's cut* may be exploited separately at a later stage.

Equally, while the majority of work-for-hire directors have to contend with the standard residual payments negotiated through their union, those with a sound commercial track-record will negotiate hefty shares of a film's net profits or – in some rarer cases – a percentage of revenue from before the point at which the film's cost is fully recovered (*adjusted gross* deals; c.f. section on actors, above).

In the UK, a hybrid contractual system prevails. Since it was harmonized in the mid-nineties with the dominant *droit d'auteur* continental system, the Copyright Act has provided that the principal director of a film is its author or one of its authors. Prior to this, the British film director was hired along similar lines to his US colleague, and – much like the US – copyright law established the producer or production company as the sole author of the film.

The statutory change of the British director from a technician-for-hire to an author has not led to any substantive changes to his contractual position. Most directors' contracts take an assignment of all the director's rights against advance remuneration. UK producers, like their US counterparts, also insist on a waiver of the director's moral rights. A standard waiver clause will read like this:

*"[...]... and the director hereby waives the benefits of any provision of law known as moral rights of authors or the "droit moral" or any similar law in any country of the universe and hereby agrees not to institute, support, maintain or permit any action or lawsuit on the ground that any Film and Soundtrack [...] produced and/or exploited by the company in any way constitutes an infringement of any moral rights or "droit moral" of the director or is in any way a defamation or mutilation of the Film..."*

The reasoning behind Anglo-Saxon moral rights' waivers is that leaving the work open to an author exercising his moral right would be a devastating deterrent to most film investors, all of whom want legal certainty before deciding whether or not



to take a substantial risk on a film. They argue that whilst custom and practice in the film industries in *droit d'auteur* have had decades to adapt to non-waivable moral rights and developed a number of risk-minimizing practices, the only existing recourse under existing Common Law would be blunt instruments such as an injunctive relief. The prospect of a film being stopped in its tracks over a moral right dispute is one that Anglo-Saxon film industries find difficult to adjust to, given the high risk nature of the film business and the size of the financial investments required.

### **3.iv Licensing by Numbers – collective management and talent rights**

Certain rights pertaining to the talent are normally not under the direct control of the producer. These are very specific rights whose exercise requires collective consent and licensing rather than individual transactions in order to make practical sense.

A perfect example of this type of right can be found in the music industry: it involves the use of musical tracks by radio and television broadcasters who air a large volume of recorded music across their schedules on an ongoing basis. No such broadcasting service would be remotely viable if individual clearance was required for all such usage.

In this instance, artists' rights are represented through large collecting societies which provide blanket authorization for use and negotiate umbrella rates with the broadcasters, collect bulk revenue from them and re-apportion this revenue to individual authors or performers through a complex set of calculations.

Collectively-managed rights that are specific to the audiovisual medium consist mainly in cable re-transmission rights and home video copying levies.

The cable retransmission right is exercised at the point when a non-encrypted program-carrying signal from a television broadcaster overflows across a country's borders, there to be picked up by a cable company which then re-distributes the signal into the homes of its subscribers. In this instance, individual licensing of rights would not be a manageable proposition since the broadcaster's original signal is an ongoing stream of audiovisual content and clearance is required for a considerable volume of works.

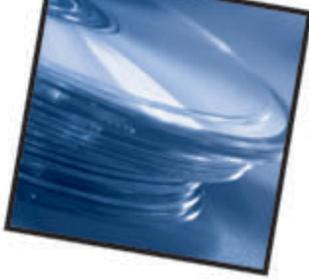
In this instance, actors and authors may have assigned the cable re-transmission rights to the producer as part of their engagement contracts. In this event, the producer may be made responsible for collecting the talent's cable royalties, accounting and remitting the amount back to them. The more usual agreement structure however, entails the author or actor either assigning this right independently to his collecting society or granting it a mandate to give consent and collect cable retransmission revenues on his behalf.

In this eventuality, the contract with the producer will specify that nothing in the contract will prejudice the actor or author's assignment or mandating of this right to his collecting society and to receiving revenues accordingly.

Some jurisdictions specify that authors and actors may only be permitted to license their cable retransmission right and collect cable revenue through a collecting society of their choice.

The other main form of collective management concerns private copying for the purpose of home viewing. This use is often mischaracterized as a "right" when it is in fact an exception to copyright. Another way of expressing this would be to say that private copying has had to be tolerated because the limits of technology did not permit consent to be given and individual payments to be collected. Under this exception, viewers at home may use recording devices such as VCRs and DVD recorders to make a copy of a film received through free television, strictly for the purpose of viewing the work again for themselves and/or the family circle. It does not grant the public the right to make further copies and release them outside the home.

Collective compensation for rights holders against home copying has been dependent on statutes developed in countries where private copying is formally recognized. In most jurisdictions, collecting societies representing the various sets of rights holders (directors, other authors, producers, actors, other performers) may collect their share of a centrally managed private copy levy entity: a set levy is collected by this entity on each blank video or recordable VCD/DVD unit sold and the revenue is re-apportioned to rights holders according to an elaborate weighing system. In some countries, levies also apply to the sale of video and digital video recording equipment.



This chapter sought to impart a sense of the basic dynamics of IP rights' clearances and attendant negotiations which shape the two most important types of producer/talent relationships. Obtaining these rights and ensuring that these relationships are balanced and fair is an essential step on the ladder of film-making success: without a fluid dialogue between producer, director and leading actor, the film is more likely to be poor. This issue goes well beyond a matter of understanding the rights and obligations of each. From a producer's perspective, yet again, it requires a willingness to subordinate everything to the overall goal of making a movie the audience will not forget. Intuitive people skills are as much a part of this equation as a firm grasp of copyright law or neighboring rights.

## CHAPTER 4

### Managing the Risk of Production

This chapter looks at the issues arising over the delivery risk in film production. At first glance, the issue and the means through which it is being addressed in the independent film industry may not appear immediately relevant to a publication chiefly concerned with the handling of IP rights in film production. In actual fact, as we shall see, they are extremely relevant.

Film making is a highly hazardous undertaking. Once filming has started the production may be vulnerable to anything from adverse weather conditions, the death of or accident to a lead actor (or the director), some of the financing failing to materialize because investor X has just filed for receivership, etc.

Most financing contracts provide for financiers to accept a measure of risk such as “acts of God” (e.g. catastrophic storms or unexpected political violence, *coups d’état*, etc.), which fall under standard insurance terms. However, films can fall apart at the production stage for reasons that have nothing to do with the standard risks covered by standard policies. The production team may be over-running budget and/or schedule, with the eventual result that the film’s completion cannot be covered out of the budget initially agreed by all investors and rights’ purchasers.

In the Hollywood system, typically, this type of delivery risk may sometimes be assumed entirely by the studio, which has complete ownership of the project and can supervise its production in minute detail, even if the film is made through an independent producer. The studio’s physical production expertise, combined with its extensive supervisory rights, means it may be able to anticipate budget overruns and impose drastic re-scheduling or agree to an extension of the budget, against a re-negotiation of certain terms governing the sharing of profits with the producer.



In India, the risk is also assumed directly by the larger production companies, while the producers of lower budget films tend to attract investors who will accept the risk as inherent to the film-making process and charge interest rates or premiums commensurate to the perceived risk. In West and East Africa, no established mechanisms exist to manage the risk: most films are in the micro-budget bracket and made using deferred services and small scale individual investments, which are a more intuitive way of making films happen, even in the absence of a risk management structure.

In the international independent film industry however, few entities have the capacity to buy out all rights against 100 percent financing, monitor the production process for an ongoing assessment of the delivery risk and cover this risk by themselves. The overwhelming majority of independent films are made according to a “patchwork financing” model in which the pre-selling of certain domestic and foreign rights, combined with local incentives, television license fees, equity investment, gap financing and other contributions, eventually meet the budget necessary to make the film to the agreed standard and with the approved cast and principal artistic and technical contributors. In this situation, no single financier is in a position to guarantee the completion of the film in the event of the production over-running. Additionally, producers will very often require bank financing in the shape of discounting of the rights’ licensing contracts in order to open up the cash-flow that will allow the production to start.

It is at this point that the *completion guarantee* generally comes in. The completion guarantee is simply a form of specialized insurance which covers banks and investors in the film against the risk of the production failing to complete. In most cases when the completion guarantee (or completion bond) company intervenes during the production process, it will either advise the producer on the ways of putting budgets and schedules back on track and avoiding disaster, or it will take over the production entirely and attempt to complete the film one way or another. There is however, a third scenario, one which happens relatively seldom because its consequences are negative for all involved: the completion guarantor takes over the production and finds he is unable to complete the film to the delivery criteria expected by the financiers. In this particular case, the guarantee will be called and the completion company will reimburse investors for the losses incurred. The completion guarantor

will charge a premium for his services, generally equivalent to between 3 and 6 percent of the production budget. In most cases however, a rebate will be offered to the production in the event that the guarantee is not called. As a result, the real cost of the completion bond to most budgets is between 1.5 and 3 percent.

In order to perform its role satisfactorily the completion bond company will need to have a number of tools at its disposal. These include:

- The power to make its own independent assessment of the producer's budget, the production schedule and all the documentation relating to the pre-production of the film. If they find these wanting, they may advise the investors who will make demands for specific changes based on the guarantor's assessment and recommendations, prior to giving the production the go-ahead.
- The power to make its own independent assessment of the personal competence (and emotional stability) of key technicians, production management personnel, artistic contributors and lead actors – again, if the completion bond company has reason to doubt the competence or reliability of any of these leading contributors, they may require changes before agreeing to a Letter of Intent signaling their intention to bond the film.
- Considerable in-house knowledge of the film production process in all its intricate technical and managerial details – all bond companies employ seasoned *line producers* or production managers with years of experience working across a whole range of productions.
- Extensive supervision powers – the guarantor often has a representative in the production office throughout the process. He has full access to call sheets, production account records, daily cost reports and any other document relevant to the day-to-day management of the production.
- Re-insurance structure – all guarantors cover their own risk through a re-insurer in order to reduce their own exposure.
- Power to take-over – this is an essential aspect of the completion guarantee contract. The completion company must be allowed to take over the production if,



according to its judgment, the film is in clear danger of failing to complete within the parameters agreed with the financiers.

From all the above, it may be tempting to conclude that the completion bond company, whilst providing an essential guarantee without which no financier and bank finance may be forthcoming, creates an atmosphere of tension and suspicion on a film set. In most cases however, the producer's experience is more complex and mitigated: completion guarantors are invariably people with considerable knowledge of the details of film production and their experience can be a boon to the producer by helping him anticipate problems and manage the production to obtain an optimal result.

Completion bonding is at its most generalized in the Anglo-Saxon film industries, where the overwhelming majority of films above the micro-budget level require a bond in order to clinch a final legal commitment from banks, distributors and other financing parties. It is undoubtedly a sign of the Indian film industry's growing maturity that one of the leading international completion bond companies now has offices in Mumbai and is doing brisk business with the local film industry.

Although it has been increasing steadily over the years as international co-productions have increased in volume, European countries where *droit d'auteur* prevails have traditionally been more reluctant to adopt completion bonding as a means of oiling the mechanism of multi-party film financing. Initially, this was because the take-over and completion powers granted to the completion guarantor were perceived as necessarily adversarial to the exercise of the authors' moral rights and, in particular, the right of the director to assert his paternity over the work by making the decision on the final shape, form and structure of the film. In practice, the *droit d'auteur* system has yet again been able to demonstrate its adaptability and flexibility by accommodating the exercise of those rights alongside the completion powers of the guarantor, and, though it is still far from being the norm in some countries, an increasing number of films are resorting to the guarantee in order to close their financing.

It is impossible for most film producers with international ambitions to embark on the adventure of co-production and foreign pre-sales without at least a passing

acquaintance with the requirements of completion bonding in the mainstream independent film industry. Without a completion bond in place, most films cannot proceed to production, and the rights' edifice painstakingly assembled by the producer over months or years, may crumble and scatter.

In the preceding chapter, we have opened up the producer's basic tool kit and analyzed the different pathways he may follow in order to take the film from idea to production. In the next chapter, we shall highlight the strategic importance of foreign rights in the making of most films and impart some essential notions about the complex art of international co-production.

## CHAPTER 5

### **Crossing Borders – The Art of Selling and Co-producing**

This chapter examines the strategic role of foreign distribution rights in the making of films. Broadly speaking, there are two different methods a producer may use to bring financing into his film through negotiating foreign rights: the first method consists in “pre-selling” the film’s rights to distributors abroad. The foreign buyer may then have a degree of approval on the completed script and the choice of the main actors, director, etc, if his contribution is substantive. However, the buyer will not have any responsibility for the production itself and will not participate in it fully, either technically or creatively.

The second method consists in the producer “co-producing” the film with production partners in one or several, other countries. In a co-production, the foreign partner will generally be responsible not only for pre-selling the film to local distributors, but also for organizing the part of the filming and/or post-production which will take place in his own country. Again, very broadly, international co-production demands fully-fledged creative and technical cooperation between producer-partners, whereas pre-sales are mostly limited to the licensing of certain rights to the foreign distributor, against an advance or minimum guarantee.

#### **5.i Weaving the Patchwork of International Pre-sales**

There are over 300 international film festivals in the world, many of the countries involved also boasting a film market. These festivals range from the most basic to the most sophisticated and international film export companies will prioritize one over the other depending on the status of their catalogue of films, the time of year, the size of their annual sales and marketing budgets. Additionally, there is an unrecorded number of international film markets.

In the main these markets and festivals provide opportunities for companies to sell the rights to finished films. In keeping with the topic of this booklet, we shall limit our analysis to the pre-sales market, i.e. sales effected before the film is completed, allowing the producer to cash-flow the whole or a part of the value of the sales (either through advances or bank discounting) in order to complete the production of the film.

Foreign pre-sales are very often an essential strategy for the producer trying to make certain kinds of films. The entire Hollywood business model today is reliant on its ability to distribute films on a worldwide basis. In many instances, the studios self-distribute through subsidiaries across the world. In other cases however, they will choose to reduce their worldwide distribution risk by laying off rights to some of their *tent pole* movies to third party distributors in some territories, against a minimum guarantee. In Europe and the US, most independent films over a budget of US\$5 million will generally need to pre-sell some foreign rights in order to close their production financing because the value they will collect from the licensing of local rights may not suffice. Most of the high-budget Chinese *crossover* films – i.e. films made for an international as well as a local audience – find considerable demand from foreign buyers at the pre-sales stage, as do a growing number of Korean films and films from Latin America's leading production countries (Mexico, Argentina, Brazil). India has a vast worldwide *diaspora* (currently estimated to be over 25 million strong) as well as rising levels of demand for Indian films from non-expatriates; although the Indian cinema pre-sales market still provides only a fraction of the production financing available in India, it is a very fast growing segment of the Indian film economy, with major companies now based in the Persian Gulf, the UK and the US as the three leading markets for non-resident-Indians, and offering substantial advances to producers against rights to those territories.

Another example of the dependency of film production on foreign rights' opportunities is the Middle East and North Africa. A geographical land mass comprising of approximately 20 separate states, most of them united by a common language; the Arab world represents a potential audience of 320 million, many of whom belong to the affluent middle classes with leisure time and money to spare.



Today, Egypt remains the leading film industry in the Arab world. However, despite a population of over 80 million, the value of rights on the Egyptian market alone cannot in general support films other than those made with very low budgets. The reasons for this market failure are typical of the challenges experienced by film industries all over the developing world: the cinema-theatre infrastructure is insufficiently developed; local television is as yet limited in its capacity to support local film production; there are no government incentives in place and video/DVD piracy is rife. For any film project with a budget over US\$1 million therefore, the producer will have little choice other than to seek pre-licensing rights outside Egypt as far as possible. Luckily, the market for good Egyptian films remains extremely buoyant all over the Arab world.

The example which follows illustrates vividly the role of international pre-sales in the making of a higher budget film and exemplifies the sometimes complex arrangements required to ensure that each buyer can secure an adequate “window” of exclusive exploitation.

The film, *Fool el seen el azeem*, was an adventure comedy-genre film produced in 2004 to critical acclaim and with excellent commercial results. The film charts the comical mishaps suffered by a hapless Egyptian chancer who runs into trouble with a gang of local hoodlums. Having fled to China, he is recruited against his will into an *haute cuisine* competition, despite never having cooked in his life. In the process of trying to save both his life and the remnants of his dignity, he finds the time to fall madly in love with a local girl.

This type of family comedy with a romantic twist can be extremely popular both in Egypt and the rest of the Arab-speaking world. This is just as well because its main producer, Mohammed Ramzy had budgeted for a US\$1.8 million film, with an additional US\$200,000 in marketing and prints costs to support the release of the film in Egyptian cinemas. By the standards of most of the world’s film industries outside the US and Europe, this was a big budget film. Most movies in the Middle East are made for half – or much less than half – of *Fool el seen el azeem*’s costs.

<b><i>Fool el seen el azeem</i>*</b>	<b>US\$</b>	<b>Budget %</b>
Net Budget	1,800,091	
Cinema prints and advertising (Egypt only)	200,000	
<b>Total Budget</b>	<b>2,000,091</b>	
Producers' advance against Egyptian cinema release rights (theatrical)	1,045,000	51%
Gulf area theatrical and DVD/video rights	400,000	19%
Theatrical and video/DVD Jordan/Lebanon/Syria	10,000	0.5%
Egyptian DVD/video rights	30,000	1.5%
Rest-of-the-world DVD/video rights	20,000	1%
<b>Total theatrical and DVD/video</b>	<b>1,505,000</b>	<b>75%</b>
Free satellite rights Arab region	150,000	7%
Pay-satellite Arab region (3 runs – 3 different satellite channels)	250,000	12%
<b>Total satellite TV rights</b>	<b>400,000</b>	<b>19%</b>
Free TV Egypt	35,000	2%
Other Arab free TV (10 channels)	35,000	2%
<b>Total free TV rights</b>	<b>70,000</b>	<b>4%</b>
<b>Grand Total Pre-financing</b>	<b>1,975,000</b>	<b>99%</b>

\*Used with permission from Mr. Mohamed Ramzy, Chairman, United Artistic Group, Egypt

The above table shows in detail how this big budget film was financed using a combination of local rights and international pre-sales. *Fool el seen el azeem* makes for an exemplary case of just how strategic foreign rights can be in the making of an independent film. In this instance, barely 55 percent of the film's budget came from Egypt, with the balance (45 percent) entirely made up of pre-sales to other territories and pan-Arab satellite TV operators. Looking more closely at the detail, other issues emerge:

- The total amount raised, US\$1.975 million, did not cover the budgeted total of US\$2.9 million. However, the latter figure included US\$200,000 in Egyptian cinema release costs (prints and advertising) of which the producers were required to cover only 10 percent upfront. The balance would be earned back by the local distributor from first position on local cinema revenues.



- A massive 52 percent of the budget came in the form of an equity investment against returns on Egyptian cinema release revenue only. The producers put up some of their own capital and assembled a portfolio of investors across the Arab region. Investors were to recover their funds in first position on Egyptian theatrical, with an additional profit share of between 5 and 30 percent.
- Egyptian video rights represented only 1 percent of the total raised by the producers. This is testimony to the acuteness of the audiovisual piracy problem in the country (as in much of the rest of the developing world), which prevents these rights from having any current strategic value.
- Egyptian free television rights were also sold off for a very small sum (1 percent of budget), again evidencing the budgetary limitations of much public television in Egypt and the rest of the Arab world.
- In contrast, cinema and video/DVDs for the Gulf region were hugely strategic, contributing 19 percent to the budget. This shows the high level of technological development in the Emirates and the Gulf as a whole, as well as the higher percentages of household income which may be devoted to filmed entertainment – furthermore, it generally takes longer for pirated copies of a non-national film to flood those markets and the video distributor is able to use the time to his advantage.
- Of equal strategic value were the satellite television rights. These are commercial pan-Arab satellite operators whose footprint typically covers the entire region. They are financed out of a mix of subscription and advertising, depending on whether they are freely available over the air or encrypted.
- The producers negotiated rights for two free-satellite windows: Melody, an Egypt-based operator obtained the first window, while Rotana in Saudi Arabia, obtained the second run. These two sales combined brought in 7 percent of the budget.
- Encrypted satellite rights required separate licensing to three different operators, combined with a joint negotiation on exclusive windows: ART, a Jordan-based pay-channel obtained the first window, with a year's holdback; Showtime was allocated second window while the third window went to ORBIT, which broadcasts out of Italy into the Arab region.

- Free television in the rest of the Arab region also represented a low strategic value, again evidencing the budgetary constraints of much of the public service channels, with pre-sales to ten different channels bringing in only 2 percent of the film's budget.
- Rights for the rest of the world's (ex-Arab territories) video/DVD exploitation sold for a disappointing 1 percent of budget. The potential market for Arab-speaking audiences outside the Arab region is considerable. However, a lethal combination of international video piracy combined with poor access by Arab-language titles to the shelf-space of high street video retailers and the under-development of alternative networks for legitimate sales and rental conspire to make these rights strikingly unstrategic at this point, despite the massive underlying demand.

The *Fool el seen el azeem* story illustrates the considerable value of international rights in a producer's strategy. It also, in some ways, highlights the limitations of this strategy, inasmuch as some sets of rights continue to be licensed for well under their potential value. Endemic audiovisual piracy has a lot to do with it, as in the case of video/DVD licensing in Egypt, the country where the film was mostly shot. Another factor is the under-funding of local public broadcasting, with budgetary priorities which may not allow them to become consistent supporters of local film production. Finally, it is important to note that not all films are suited to a foreign pre-sales strategy. The appeal of *Fool el seen el azeem* in this respect was due in part to the popularity of Egyptian screen stars across the Arab world, but also to the fact that the movie was designed to be a broad popular comedy appealing to a common denominator of taste amongst Arab audiences as a whole. The majority of films are in fact extremely difficult to pre-sell outside their country of origin because their cast may be unknown beyond their national borders, and/or the subject matter deemed too narrowly local for international buyers.

## **5.ii The World is Not Enough – the role of the sales company**

Producers capable of setting up their own international pre-sales as well as dealing with all the other demands of film development and production are few and far between. These are the senior producers with track-records, access to the best talent and a history of working with established rights' buyers in foreign countries.



For the majority however, the road to pre-sales goes through an agreement with a company specializing in exporting films in the worldwide market, or raising pre-sales for them when they are still in development or production. In the film industry, these entities are referred to as *sales agents* or sales companies. The terminology is generic and does not do justice to the range and complexity of what these companies may offer the producer. Broadly speaking, there are three types of sales agents, each type corresponding to different positions in the market and degrees of power in raising finance.

At the bottom end of the market, sales agencies are small, not capitalized and generally specialized in smaller, *auteur* films corresponding to the more up-scale, cultivated end of the international film market. These companies are often dedicated enterprises with an impressive level of commitment to specialized films and a readiness to find a market for them abroad, often against great odds. What these companies cannot do, typically, is offer the producer a minimum guarantee on the sales of the film in foreign territories: the risk is simply too great, and the capacity of the sales agents to advance any money against the value of the rights is too limited. What these companies offer is state-of-the-art handling of the film's foreign sales potential after its completion. In this instance, the producer enters into a straightforward agency agreement whereby the sales agent is given the exclusive right to commercialize the rights in the film in pre-defined foreign territories.

At the middle-end of the market, some sales agents have the capacity to offer the producer a minimum guarantee (MG) against future sales/licensing of relevant rights to foreign buyers. The MG is an amount of income from future sales that is guaranteed to the producer, whether or not the agent achieves his sales targets. It therefore involves companies with sufficient selling power and strong cash-flow, because it represents a risk. In this instance, the producer may be offered an advance against the value of the MG, which is cash-flowed before or during production (typically 10 percent). The balance is generally paid after the producer has satisfied the delivery requirement of the sales agent.

At the top-end of the market, some sales companies act a little like Hollywood studios: they may become involved financially and creatively at script development stage; they sometimes have the capacity to attract star talent and, more importantly,

they are capable in some cases of guaranteeing a significant proportion of the film's budget (if their own creative requirements have been satisfied) without yet having pre-sold a frame of the project internationally. These companies may have output deals with powerful distributors or broadcasters in a whole range of countries and may be confident that they can obtain the right value out of the marketplace to cover their risk. They also have relationships with banks or *gap* financiers who are prepared to back-up their risk based on estimated values of future sales. Evidently, on such agreements, the sales company may take a full assignment (or long license) of foreign rights and may also negotiate to be included in recovery of income from the country in which the film is being made. These entities fulfill a role more akin to that of an *executive producer* than that of a conventional sales agent. The number of films financed in this way remains relatively rare and tends to be limited to high-budget international films with stars.

International sales agents are mostly operating in the European region and North America. A large number are members of the worldwide trade association of film exporters, the Independent Film & Television Alliance (IFTA), based in Los Angeles, USA. IFTA is a mine of information on the business of international film rights' licensing and makes international distribution deal memos and agreement templates available to its members. Readers are encouraged to refer to IFTA for more detailed information about sales companies and any aspect of international rights' licensing.

### **5.iii The Producer – Sales Agent Agreement**

All international rights entrusted to a sales company are backed up by a legally-binding agreement. There are a few salient points to which both parties will be particularly required to pay attention:

- The agreement will specify the rights the agent is licensed to sell and the designated territories – this definition is all the more important as some of these rights may already have been assigned to a third party in a relevant territory against equity, co-production, etc, or may have been entirely pledged to a particular buyer in a specific territory.



- The term of licensing is also an important aspect – agency terms granted to a sales company may vary from the very short, to perpetuity (more rarely, and specifically if the sales agent has also put up most of the value of the budget as a guarantee). It is more typically a fixed initial term ranging from 1 to 25 years. Separately, the parties will also negotiate a maximum term for the rights to be licensed by the sales agent to distributors and other media buyers in the territories designated in the agreement.
- Many contracts will contain a termination clause – i.e. the right for the producer to terminate the agreement without notice if sales revenues fail to meet a pre-agreed minimum target or if the sales company goes into receivership.
- As with the distributor’s agreement, expenses required to market and promote the film at international events (festivals, film markets, etc.), will be specified within the agreement and initially *capped* at a mutually-agreed level. Should the sales agent wish to spend in excess of the cap, he will have to seek permission from the producer. This is a strategic matter for producers because those costs are deducted “off the top” from the value of rights’ licensing deals in the relevant territories. Therefore the higher the expenses, the less likely it is that the producer will receive any *overages* from those sales.
- A similar negotiation occurs over the commission charged by the sales agent for his work. Typically, commission rates vary from 7.5 percent of the value of each sale, to 25-30 percent. Commissions are higher in the case of successful pre-sales of an unfinished film because the revenue from this type of rights’ licensing may be more strategic to the producer who may be able to discount its value with a bank. The commission charges will also vary according to the perceived difficulty of specific territories. The table below shows a scale of sales agents’ commission for a recent independent low-budget British film:

<b>Territory</b>	<b>Sales agent commission %</b>
North America	15%
United Kingdom	12.5%
Rest of the World (ROW)	25%

The sales agent is a pivotal player in the complex game of international film financing. It is important for producers with ambitions to make films for an international audience to cultivate relationships with those sales agents best able and willing to support the type of films that correspond to their creative and business vision. Such relationships will pay handsome dividends over time, helping to raise the profiles of the films in world markets and developing a producer's own sense of what may be suitable for audiences outside his country.

#### **5.iv Through the Pain Barrier – international co-productions**

The second method a producer may use to bring foreign rights into the equation of financing a film is through an international co-production.

What is co-production? In its purest form, a co-production takes place when two (or more) production companies in two (or more) different countries agree to join forces to make the film together. The approach typically entails each company sharing in the artistic, technical and financial resources necessary to make the film and sharing the resulting IP rights *pro-rata* of their respective contributions.

The strategic rationale behind co-production may vary: the principal motivation may be that the story requires it: a script developed in say, Britain by a British producer is set in the days of the Indian Raj, with a mix of characters and narrative developments requiring shooting the film in both countries with a mixed cast of British and Indian actors. In this instance, a co-production structure should in theory enable the producer developing the script to find a partner able to a) access a key Indian cast, b) raise joint finance in India for the project and c) to hire elements of a local shooting crew which offers the advantage of high-level skills and competitive wages, thereby helping to reduce costs.

The rationale may also, in some cases, be either financial or technical only: in the case of a purely financial co-production, the foreign co-producer has no direct involvement in the development of the script or the management of the production. He confines himself to arranging financing from his country and – generally – very little of the film is shot in his country. Financial-only differs from a pre-sale in that a producer is involved and in some cases, may ensure the production meets the



qualifying criteria to be granted nationality status in his country. If that is the case, the co-producer may then raise public sector subsidies or other benefits available to film production locally. When a co-production is technical only, the foreign co-producer may be unable to contribute a significant amount to the financing of the picture but is working in a country where the technical labor pool and film industry services are competitive, which may induce the lead producer to locate the majority of the production there in order to keep the budget down. In this case, the co-producer plays an important part in hiring a local crew and services and organizing production locally.

Europe is the region of the world where co-production is currently practiced the most. Many of the smaller countries there have insufficiently-sized domestic markets to sustain film production over and above the low-budget category in all but the most exceptional cases. Consequently, their producers look to other potential partners in neighboring countries to help them finance more ambitious projects. The larger film production countries, such as France, Germany or the UK, approach co-production with a variety of motivations: the French state actively encourages producers to co-produce films in the French language, as part of a consistent policy to uphold the standard of French culture and the French language in Europe. German is spoken outside Germany in some Eastern European countries as well as Austria and Switzerland, which are natural partners for co-productions in that language. UK producers, on the other hand, bank on European audiences being well-accustomed to watching films in the English language in the cinema, and the worldwide popularity of some British stars.

Whatever the European states' respective strategies in relation to co-production, the producers always have the same objective: to obtain national production status for the film in each of the co-production countries, so that valuable film industry subsidies in those countries may be legitimately accessed and used to finance the film. And in most cases, the best way for the film to obtain the nationality of the co-producing state, is to go through an official *co-production treaty*.

Co-production treaties are bilateral agreements between two states: many of these link European countries. Other bilateral treaties cover co-production relationships between a European country and an extra-European country – e.g. France has

bilateral treaties with approximately 23 non-European countries including Canada and India. Although these treaties vary in their expectations and demands, they all broadly operate along the same principles:

- States want the co-production treaty to enable – over time – the use of labor and services (and the payment of related taxes) in their own country; they do not look too favorably on financial-only co-productions because these tend not to bring a broader benefit in the shape of increased economic activity.
- Treaties therefore encourage co-producing partners to ensure that a balance is struck as far as possible between their respective financial contributions.
- Treaties also require that co-producing partners strive to make their artistic and technical contribution to the film proportional to their financial contribution.
- Each bilateral co-production treaty specifies the minimum financial contribution required from each of the partners. These typically vary between 30 and 40 percent. However, when a co-producer in a third country is involved (through the interplay of other bilateral treaties, or the use of the Council of Europe Co-production Convention), this minimum percentage may be as low as 20 or 10 percent.

If these conditions are fulfilled, the production may be given the go-ahead to qualify for national status in both (or more) countries, opening the door to production incentives which may help cover a significant proportion of the budget.

The co-production agreement between the parties involved is generally a complex and detailed document. We shall limit ourselves, within the scope of this publication, to the main issues surrounding the transaction of IP rights in the film and how these are normally resolved:

**Chain of title** – the co-producers must obtain warranties from the lead producer who generated the project, that all underlying rights (books, theatrical plays, scripts, etc.) will have been cleared and that he has the necessary consents and assignments or licenses to make the film unimpeded.



**Underlying rights** – the most basic agreement will make the producer (or producers) responsible for the initial purchase of the underlying rights agree on the means to recover those costs *pro-rata* from other co-producers (either in advance or via an agreement for him to recover those costs from the budget or income from the film in first position before his colleagues). Thereafter, the rights to the underlying materials may be assigned to the *special purpose vehicle* (SPV) – i.e. the company established especially to manage the co-production, or they may be licensed to each co-producer for exploitation in his respective territory.

**Copyright** – The general approach is for the co-producers to share in the rights of the underlying material *pro-rata* to their contribution to the film. Copyright in these materials may be held by the principal producer with consent from his co-producers: this is more expedient in setting up bank financing of the distribution and sales agreements, because all banks will require a charge on the copyright as security against their loans.

As far as copyright in the film itself is concerned, the co-producers will normally share its ownership, to the effect that copyright and all related economic rights belong in perpetuity to co-producer A in country A, and ditto for co-producer B in country B. For the rest of the world, copyright will be shared, with all net profit from sales (*overages*) split between the co-production partners *pro-rata* to their financial contribution to the budget of the film.

Another possibility is that the copyright in the entire film may need to be the object of a temporary assignment to one or other co-producer who may require it in order to successfully apply for approval of tax incentive funding in his territory.

**Soundtrack** – all music used in the film must be provided to each co-producer after clearance and cue sheets supplied for use by the local distributor in the co-production country (or countries).

**Completion guarantor rights** – Although the completion company's rights are not *stricto sensu* IP rights, their full exercise amounts to a take-over of the film from the co-producers, which in turn will affect their ability to remain in charge of the exploitation rights on the finished film (if the guarantor manages to finish it).

The co-producers will include in their agreement an undertaking that the completion guarantor may take over the production and take any measure necessary thereafter, regarding completion, cost recovery and assignment of rights for security.

### Co-Production Responsibilities

Example: Ken Loach's *The Wind That Shakes The Barley*

A co-producer effectively splits responsibilities with the other co-producer and it is very useful in a co-production agreement to specify precisely what functions each co-producer will be required to carry out. The two producers entering into the co-production agreement set out their respective functions and the basis of the financial transaction between them (i.e. the percentage of the cost of production to be found by each co-producer).

An interesting example of a co-production film is Ken Loach's *The Wind That Shakes The Barley*, which won the *Palme d'Or* at the Cannes Film Festival in 2006. The film was a co-production between the UK, the Republic of Ireland, Germany, Italy and Spain. Notwithstanding the numerous countries, all five co-producers were able to co-produce the film under the terms of the European Cinematographic Convention of 1992. The budget of the film was a mid-sized budget for a European film and was contributed to by the various co-producers and other financiers as follows:

- (i) Italian co-producer – the arrangements with the Italian co-producer were on the basis of a finance only co-production which effectively meant that the Italian co-producer financed in the region of 10 percent of the budget of the film and acquired the rights to exploit the film in Italy.
- (ii) UK – the UK aspects of the financing were partly dealt with by funding from the UK Film Council which was contributing to the budget, by way of equity investment and partly by a pre-sale of UK rights to a UK distributor (Pathé Pictures).
- (iii) Ireland – the Irish Film Board also made available a financial contribution and the production was able to take advantage of the tax benefits in that country. The Irish co-producers also included a small Irish television sale in



their contribution. There was a production service arrangement between the Irish co-producer and an Irish service company to assist in this structure.

- (iv) Germany – the German co-producer was able to enter into a finance only co-production. In return for a financial contribution the German co-producer was able to acquire the theatrical rights in the film in Germany, Austria and German-speaking Switzerland. The German co-producer also introduced subsidy funding from one of its regional film funds, the North Rhine Westphalia Film Fund, in exchange for a spend in that region.
- (v) Spain – the Spanish co-producer acquired the rights in Spain and Andorra in return for a contribution to the budget as a finance-only co-producer.
- (vi) Certain territories in the world were pre-sold, in particular Belgium and its associated territories and French territories (including France's domestic territories and French-speaking North Africa). To add to the complication, certain UK individual investors contributed to the production cost and acquired the finished film as and when it was completed. A completion guarantee was supplied by Film Finances Inc and the discounting of the pre-sales was carried out by the Royal Bank of Scotland which took the usual security over the physical material of the film and the rights.

In the co-production agreement itself, as well as dealing with matters such as the budget and the various financial contributions which were being provided by the various co-producers, specific reference was made to the percentage of copyright and ownership of physical materials. The agreement further allocated the distribution rights between the various parties in accordance with the commercial arrangements as, effectively, a co-production means that distribution rights are owned on a joint basis. It is usual in a multi-party co-production for one party to be appointed as agent to enter into agreements for the rest of the world and to procure the engagement of a collection agent.

Each party permitted the other co-producers to have access to its accounts and there were strict time limits as to delivery of financial reports for adjudication purposes by the various authorities. *Overspend* and *underspend* were dealt with in detail. Overspend would normally have been dealt with by a payment from the co-producers in proportion to their respective financial contributions to the budget and underspend being returned also on a *pro rata* basis.

The co-production agreement laid out the arrangements for location, shooting at designated locations, together with editing, sound recording and post-production work, all in accordance with relevant local requirements and the Convention. The original negative of the film was kept at the chosen laboratory and the other co-producers had access to it.

The agreement also designated the identity, nationality and functions of the various parties to be engaged in the film. All principal decisions were to be made jointly by the co-producers in good faith but, in the event of a deadlock, the decision of the delegate producer prevailed. The consequences where the provision approval is refused by any of the authorities in which the co-production is to be registered were also laid out.

In this particular production, there were a number of matters which required consideration, such as:

- (i) Currency – most of the expenditure was in Euros, but there was a UK spend and it was necessary for the production to ensure that the budget included sufficient funds for the UK elements to cover any possible currency fluctuations.
- (ii) Shooting – it was decided that, in view of the subject, the shooting should all take place in Ireland - which it did in Cork.



- (iii) Essential elements – because of his reputation, Ken Loach was considered an “essential element” and covered by insurance. This effectively meant that if anything untoward should have happened to Mr Loach and he was unable to continue directing the film, it would be open to the financiers to close the production and to claim their costs to date from the insurers.
  
- (iv) Credits – specific credits were required by the UK Film Council, the Irish Film Board and the North Rhine Westphalia Film Fund. These needed to be added in specific terms to the film. Media, which advanced certain sums to the production under the Information Society Media Programme through the European Commission, also required specific credit.

This chapter has aimed to provide newcomers to the business of film production with basic directions on how to navigate the complex array of opportunities in the international film market and how to utilize their IP rights strategically in this respect. Today, by and large, these rights are still negotiated for use in a value chain that has varied little over the past 20 years. In the conclusions which follow, we explore how the advent of the Internet and digital distribution networks is in the process of redefining this old order and challenging film makers to invent new models for realizing the full value of IP rights.

## CONCLUSION

### **The Great Film Bazaar in the Sky?**

It is a little known fact that one of the most successful DVD releases of 2005 in the UK was an amateur film shot by a Southern England farmer, glorifying the sheep-herding talent of a particular breed of dog. As readers may have gathered, the film's success had nothing to do with a clever marketing campaign, smartly designed and expensively rolled out by a major video label. As a matter of fact, no one in the "real" video industry had even heard of the very existence of the modest home-made film until tales started emerging of record numbers of units shipped. So, how was this all achieved? Quite simply, though a website which enthusiastic farmers and dog lovers could visit and from which they could place their orders for a physical video copy. But wait till next year and these keen observers of working canines won't even have to bother with waiting for a padded envelope to come through the letterbox. At a click of the mouse on their computer, they'll be able to safely purchase-download a copy and keep it for as long as their over-the-net license with the rural video amateur will allow.

This story of how a very specialized video product became a bestseller at almost no marketing cost is an emblematic tale of the Internet video age. The mere fact that its bucolic author was able to bypass the traditionally expensive gateways to the market and speak straight to his constituency of special interest, suggests that – in the age of the Internet – the economic theory of the *long tail* is no longer an academic construct, but a description of current reality.

*Long tail* theory holds that as long as the cost of market access is high, the offer of an audiovisual product will tend to support primarily the "hit" products – i.e. those likely to be attractive to the largest possible number of consumers in the shortest period of time achievable. In traditional physical distribution of films, the cost of



access to market is considerable. The average cost of marketing a Hollywood movie in its primary market (the cinema) today, is US\$34.5 million (MPAA Figure, 2006) (i.e. not including negative costs, which averaged US\$65.8 million in 2006) just for the US theatrical release. Even for the low-budget independent films made throughout the world, the cost of a theatrical release is high and is rarely ever recovered entirely through the income generated at the box office. Similarly, the video/DVD market requires a bulk of pre-recorded units being shipped out to video stores at great cost, without any guarantee that the demand will meet or exceed the expense. When costs-to-market are such a tangible barrier, the relative cost of duplicating, storing and marketing even a small number of units of film titles which only appeal to a small, specialized segment of the audience, hardly makes economic sense. Thus, in the physical print infrastructure, it could be argued that a vast underlying demand for specialized fare from sections of the consumer market remains unmet.

With the advent of Internet broadband, everything begins to change: if all the distributor of the present – or near future – requires is a website with technology permitting digital downloads or video streaming straight to the consumer; storage costs virtually disappear, as do duplication costs. Marketing costs remain, but the relative cost of advertising through search engines (or negotiating hyperlinks with third parties) still compares favorably with the crippling rates of billboard advertising or the 30-second television spot. With this technology, it becomes possible for films likely to attract low levels of demand over long periods of time to make plenty of economic sense. The *long tail* has arrived.

In a broadband connected world, are we therefore going to see a new breed of producer? Will this new prototype not only be producing films but also be by-passing the distribution middlemen to license video-on-demand rights directly to web-savvy consumers? Perhaps the future will look like this. However, for producers new to this profound mutation and motivated to think strategically about the management of their IP rights, a number of issues need to be considered.

The theatrical window may be destined to co-exist quite dynamically with Internet VOD. This is due not only to the enduring appeal of the cinema as the “most immersive consumer experience” but also to radical changes in film theatre technology: the advent of the digital theatre will allow a reduction in print duplication

and handling costs and – especially through the use of direct satellite transmission of films into secure servers in the cinemas – will make the movie theater both more piracy-proof and more able to adopt flexible programming to cater for a broader range of consumer taste.

In time, it is likely that the Internet VOD window will squeeze out most of the current home entertainment windows, in particular, rental DVD, the current pay-per-view systems and encrypted pay-television. A possible outcome is that the value chain will become simpler, with theatrical, followed by video/DVD *sell-through*, (many consumers will still want to “own” films as they do books) Internet VOD, followed by free-to-air television.

With the theatrical release no longer an obligatory first window for all films, “day-and-date” releases of films simultaneously across several segments of the rights’ value chain may become more frequent. In this approach, price discrimination will replace sequential releases – e.g. agreements between distributors may be such that consumers would pay a premium to access the film on Internet VOD while the film was still in the cinemas, in order to give the cinema window a competitive edge, etc. However, the day-and-date approach may not allow as efficient an economic yield across the value chain as sequential windows have until now. The effect may nevertheless be mitigated by the fact that day-and-date is an efficient way of rolling out a new film before audiovisual pirates begin to compete.

This radical re-designing of the film rights’ value chain raises important transitional challenges: producers should ask themselves what unforeseen negative effect (even if temporary) a reduction of, say, the theatrical window, will have on the ability of traditional distributors to put money at risk into new productions. While Internet distribution is beginning to look like a potentially effective medium for reaching the consumer, the market is still in its infancy; the technology often unreliable and the income from such forms of distribution still extremely low. While threatening to compress other windows, with attendant negative impact on the value of advances for traditional rights, Internet movie-on-demand operators will not be – for a while yet – able to substitute their own investment for these declining sources of rights’ exploitation. This will leave the entire film industry in a vulnerable position.



As we come to the end of these general conclusions on future trends, we would like to leave readers with a short inventory of points they may want to consider when licensing rights to Internet operators at this unpredictable juncture in the re-shaping of the film value chain. We hope these will prove helpful to those producers willing to embark on the uncertain business of making their films available through this fast-changing and exciting technology.

The online window may need to be negotiated so that its placement does not hurt other rights' licensees and their own rights' exploitation windows. It may be advisable to locate it where traditional pay-per-view currently sits – i.e. a few months into the theatrical release window and before DVD rental and sell-through as well as all television windows (pay and free). This will ensure that the producer avoids locking himself out of possible licensing deals with licensees further down the value chain or seeing the value of those rights substantially curtailed.

The market for online rights is at a pioneering stage and changing at an extremely rapid pace. This means companies, business models and technologies currently in the market may not be there next year or the year after that. In this context, the producer may find it more rational to negotiate short licenses and resist the pressures from new VOD Internet operators who want to build up a catalogue and attempt to lock films into long licenses.

Exclusivity is sacrosanct in the old value chain. It does not need to be (as yet) in the Internet VOD link. This is because few services reach a significant market. On that basis, granting exclusivity may prevent a maximization of the exploitation of rights in this segment.

Unlike traditional satellite encrypted broadcasting, by now a proven and tested technology – the producer licensing rights to an Internet VOD service may need to exercise a degree of diligence over the technological system in place to license consumers over the ether and to guard against illegal copying and re-distribution. Licensing to unsafe technologies may lead to unwanted “leakage,” facilitating illegal copying and circulation of the film.

A very important aspect of this novel type of licensing is to define just what uses the agreement will cover, and through which types of devices: does the agreement cover download-to-buy and download-to-rent? Does it cover video streaming, etc., or are only specific uses authorized? What is the consumer's term of use (days, weeks, ownership)? Is the VOD licensor authorizing the consumer to playback on devices beyond the home PC or television set? Do these include downloads or streaming onto portable devices such as mobile phones, or players built-in to automobiles, etc.? Is the subscriber home defined as the principal residence only, or does the content play to devices in a second home?

Clarity is also essential when dealing with payments from the licensee. Hardly anyone in the Internet VOD market pays advances on the exploitation of the rights, simply because revenues are still very limited. Producers may want to familiarize themselves with the detail of the operator's pricing points to the consumer and negotiate a share of income on a royalty basis. If the operator is subscription-based rather than pay-per-view, producers will typically obtain a share of overall subscription revenue rather than a royalty on each use.

To many producers working in countries where broadband infrastructure is nascent, while traditional windows are corroded by piracy, these final observations may have seemed both abstruse and premature. However, we note that for all the glamour and novelty of broadband Internet as a vehicle for film distribution, the producer's strategic discipline in licensing his IP rights remains remarkably similar to that which he will have brought to the traditional value chain. If this publication has one common thread running throughout, it is that for the creative film entrepreneur, IP rights are not a theoretical proposition: they are the living material on which their extraordinary occupation depends, the dynamic currency that leads them gradually and painstakingly towards the fulfillment of a singular creative vision and its expression into a unique work, the result of the collaboration of many.

We only hope that this all-too-brief introduction to IP and the film making process will have exposed a little of the complex IP wiring behind the production of even the simplest and most inexpensive film. We hope also, that by not playing down the considerable challenges involved in the enterprise of film production, we will have introduced a note of realism to readers whilst also nourishing their true ambitions.



## ANNEX

### Glossary of Film Production Terms

**Above-the-Line:** line items in the film’s budget that refer to sums paid to key talent and rights holders who are often also profit participants.

**Advance:** a sum paid in cash for the rights to distribute a film in a territory and/or a particular medium.

**“A” List:** a director or star whose presence in the film will ensure that it will attract finance and/or distribution.

**Below-the-Line:** line items in the film’s budget that refer to sums paid to contributors who are engaged on a work-for-hire basis.

**Cap:** usually, a limit to sales or distribution expenses that cannot be exceeded without the producer’s permission.

**Chain of Title:** the documents and contracts that demonstrate exactly how the rights in a project are controlled by the producer.

**Charge:** a legal charge over the rights of the film that ensures contractual obligations are satisfied.

**CGI:** computer generated effects.

**Collection Agency:** an agency set up to administer the collection of revenue from the film’s exploitation and the dispersal of that revenue to the financiers of the film. The collection agent also distributes net profits.

**Common Law Rights:** in the context of filmed IP, the convention in countries such as the UK and the US that the producer is the author of the work and controls its final shape and form.

**Completion Bond or Guarantee:** specialized production insurance that guarantees the timely delivery of the film to an agreed budget.

**Co-production:** a film that combines creative, production and/or financial inputs from more than one territory.

**Co-production Treaty:** a cross-national governmental agreement that sets out how a co-production must be structured to benefit from national incentives.

**Cottage Industry:** any small, low-profit, nationally-based industry that relies on little capital and local markets to survive.

**Crossover Film:** a modestly-budgeted film with a quirky edge that manages to attract a much wider audience than originally envisaged.

**Day-and-Date:** simultaneous release of a film across multiple territories and, more recently, multiple distribution platforms.

**Debt Financing:** finance lent to the production and recoverable in first position.

**Deferrals or Deferments:** delayed payments or remuneration paid to a supplier or contributor as and when the producer receives revenue from the film.

**Delivery:** the technical delivery of the elements of the film to distributors and/or financiers in order that it can be sold and/or distributed.

**Development:** refers to the time and actions necessary to move from an idea to a completed script (or screenplay) ready to be filmed.

**Dialoguiste:** the writer of dialogue only.

**Director's Cut:** the early form of the film that is under the direct control of the director.

**Droit d'auteur:** the right of the author to assert paternity and moral rights over the works s/he creates; prevalent in countries like France, Italy etc.

**Equity:** an investment that attracts a significant share of the profits of a film but recoups back debt.

**Escalator:** bonus payments made to producer or participants if performance thresholds are exceeded or awards are won.

**Executive Producer:** usually a producer whose principal task is the financing of the film.

**Final Cut:** the right of a director, producer or financier (or a combination of all three) to approve the final shape and form of the film.

**First Negotiation and Last Refusal:** the right of a person or company to have the first opportunity to bid for rights and the last opportunity to match a third party's bid.

**First Position:** the finance that comes out first as revenue is accrued.

**Letter of Credit:** a banking instrument often issued by distributors that allows a producer to cash flow an MG via a bank.

**Long Tail:** in commercial terms a phrase coined by Chris Anderson to describe products that are in low demand or have low sales volume but which can collectively make up a market share that rivals or exceeds the relatively few current bestsellers and blockbusters.



**Gap Financing:** finance (usually debt) against unsold territories.

**Gross Deals or Adjusted Gross:** direct participation by a major financier or talent participant in first revenues.

**License:** a time-limited grant of rights.

**Life Rights:** the right to make into fiction the real-life experiences of a living person.

**Line Producer:** non-creative, work-for-hire producer responsible for seeing the production is managed properly on a day-to-day basis.

**Minimum Guarantee or MG:** finance promised against exploitation of a film in a territory and/or medium.

**Moral Rights:** the right of the author of the work (usually the director) to control the final shape and form of the work.

**Net Profits:** the profits that return to the producer of the film.

**Option:** the instrument by which a producer controls a property for a limited amount of time before making the decision to purchase the rights.

**Output Deals:** pre-negotiated deals usually between studios or major producers and local distributors and/or broadcasters ensuring certainty of distribution.

**Overage:** any sums paid to any recipient of a film's revenues after recoupment of the production cost and any sums payable to financiers.

**Overspend:** any costs incurred in the completion and delivery of a film which exceed the amount of its agreed budget including any contingency.

**Package:** consisting of factors such as expressions of interest from one or more lead actors and the attachment of a director to the project.

**Participation:** the share of net profits that is owned by a creative or financial contributor to the film.

**Polishes:** short engagements of a writer to improve sections or themes within a script shortly before financing or production.

**Pre-Production:** the preparation and organization of the film prior to principal photography.

**Primary, Secondary and Ancillary Rights:** rights windows usually defined, in order, as theatrical, video/DVD/TV and other (airlines, publishing, merchandising, etc.).

**Principal Photography:** the period during which the principal action and the principal actors are filmed.

**Prints and Advertising or P&A:** investment in the release of a film in the physical prints and the costs associated with marketing the film.

**Producer:** the person or company responsible for making the film; usually controls the rights.

**Production Bonus:** a further sum paid to a writer or rights owner on the first day of principal photography.

**Production Budget:** the cost of making and completing the film.

**Production Insurances:** standard film production insurances required to be in place by the completion bond that cover all risks associated with production such as illness, fire, theft etc.

**Property:** the script, story or other material a producer options or purchases to make a film.

**Rebutable:** rights granted by moral law to a rights holder allowing him/her to retain his moral rights.

**Re-Format Rights:** the right of a producer to convert the script to another format than originally envisaged, e.g., not film but TV.

**Reserved Rights:** those rights a writer of a spec script or owner of the rights might reserve for himself when granting an option or license, often radio or stage rights.

**Residuals:** payments to a contributor to a film from the exploitation of the film; usually imposed and controlled by union agreements.

**Rights:** the underlying rights to the content of the film.

**Rough Assembly:** the early cut of a film in post-production.

**Royalty:** the payment to a rights holder of a share of a film's exploitation in certain media.

**Sales Agent:** corporation set up to sell rights on behalf of the producer to distributors around the world.

**Sell Thru:** VHS/DVD distribution from which the purchaser owns the unit.

**Separated Rights:** similar to reserved rights but granted to a writer or rights owner in a work-for-hire context.

**Spec Script:** an un-commissioned script owned and controlled by the author until its purchase or option by a producer.

**SPV (Single Purpose Vehicle):** a UK limited company responsible for producing and delivering the film.

**Supplementary Remuneration:** similar to a royalty and used mainly in *droit d'auteur* countries to refer to a share of cinema revenue.

**Syndication:** licensing usually very successful films to local US TV broadcast networks.

**Ten-Percenter:** a slang term for talent and literary agents.

**Tent Pole:** those half-dozen pictures per year on whose success the US studios depend.

**Treatment:** a short document that outlines the shape and form of an intended feature length script.



**Turnaround:** a pre-negotiated process for the reversion of rights to the author at the expiry of the option or license.

**Underlying Work or Underlying Material:** the material or story that forms the basis of the script.

**Underspend:** any difference between the final audited cost of production of a film and the total amount of its agreed budget including any contingency.

**Window:** that period of time when a distributor or broadcaster is given an exclusive right to exploit a film.

**Work-for-Hire:** those contributors to a film whose rights are purchased with their employment contract.

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