

1-1-1988

# Strategies for the International Production and Distribution of Feature Film in the 1990s

Thomas Joseph Cryan

David W. Johnson

James S. Crane

Anthony Cammarata

---

## Recommended Citation

Thomas Joseph Cryan, David W. Johnson, James S. Crane, and Anthony Cammarata, *Strategies for the International Production and Distribution of Feature Film in the 1990s*, 8 Loy. L.A. Ent. L. Rev. 1 (1988).

Available at: <http://digitalcommons.lmu.edu/elr/vol8/iss1/1>

This Article is brought to you for free and open access by the Law Reviews at Digital Commons @ Loyola Marymount University and Loyola Law School. It has been accepted for inclusion in Loyola of Los Angeles Entertainment Law Review by an authorized administrator of Digital Commons@Loyola Marymount University and Loyola Law School. For more information, please contact [digitalcommons@lmu.edu](mailto:digitalcommons@lmu.edu).

# ARTICLE

## STRATEGIES FOR THE INTERNATIONAL PRODUCTION AND DISTRIBUTION OF FEATURE FILM IN THE 1990'S

*Thomas Joseph Cryan\**  
*David W. Johnson\*\**  
*James S. Crane\*\*\**  
*Anthony Cammarata\*\*\*\**

### I. INTRODUCTION

As the infrastructure of an international information based economy takes shape, television programming emerges as one of the first truly worldwide goods. Within the massive amounts of television shows transmitted instantaneously around the world, the single largest category of programming is feature film, comprising over 65% of all shows broadcast.<sup>1</sup> Propelled by the technological developments of the film and broadcast industry, which has created the new and dynamic markets of Video Cassette Recorders, Pay-TV, Pay-Per-View and Cable, the producers of film in the United States have experienced a vibrant growth in recent years. In 1987, for the first time United States' producers made over 500 pictures.<sup>2</sup> In the same year the film industry grossed over four billion dollars at the box office, and the number of operating screens in the United States was over 23,000.<sup>3</sup> World-wide, the sale of Video Cassette Recorders is up 25% from last year alone. Cable subscribers grow

---

\* Member of the firm, Johnson & Crane, Miami, Florida. J.D. Univ. of Miami School of Law, 1984.

\*\* Member of the firm, Johnson & Crane, Miami, Florida. J.D. Univ. of Miami School of Law, 1983.

\*\*\* Of Counsel, Johnson & Crane, Los Angeles, California. J.D. Florida State Univ. College of Law, 1982.

\*\*\*\* J.D. Candidate 1988, St. Thomas Univ. School of Law, Miami, Florida.

1. Varis, *The International Flow of Television Programs*, 34 J. COMM. 53 (1984) [hereinafter *International Flow*].

2. Valenti, President of the Motion Picture Association of America, remarks at proceedings of *The International Market in Film and Television Programs Conference*, Center for Telecommunications and Information Studies, Columbia University, (Oct. 23, 1987) [hereinafter *International Market in Film*].

3. *Id.*

on every continent, as evidenced by the already hooked-up four million households in France.<sup>4</sup> The growing components of the international market, however, are enhanced by the increasing foundation of a global television audience which today tops over one billion viewers.<sup>5</sup>

A look at tomorrow suggests that advancing technology will continue to drive down the cost of distributing the product of film to the ever-expanding marketplace. Today your television set presents a picture created by 525 scanning lines which "paints" an image on the screen, but it is acknowledged that this type of system does not provide enough information to produce a picture with the quality of 35mm film.<sup>6</sup> In the near future, however, we will have high-definition television which will paint a picture of over 1000 lines. Moreover, technology is presently giving birth to a video image of over 2000 lines, which will have a higher quality resolution than 35mm film. When this becomes available, films will no longer be distributed by the duplication of prints and then shipped to theaters across the country. Rather, films will be distributed via satellite at a fraction of the cost.<sup>7</sup>

Based upon many of these premises, the past several years have demonstrated a new courtship between Hollywood and Wall Street.<sup>8</sup> The size, stability and expansion of the marketplace, coupled with the relatively fixed cost of producing the product, have brought forth a strong component of the investment community. Historically, Wall Street has supported a great deal of limited partnership offerings, usually allowing for investment in a series of films, typically driven by tax incentives. However, with the removal of all tax benefits from the motion

---

4. See WILDMAN, *THE ECONOMICS OF TRADE AND RECORDED MEDIA PRODUCTS IN A MULTILINGUAL WORLD; IMPLICATIONS FOR A NATIONAL MEDIA POLICY*, 3 (1987).

Last year, the United States exported over 500 million dollars worth of television programs, substantially aiding the United States' quest for a balance of trade. Moreover, as the economy becomes increasingly dominated by information and communications rather than manufacturing, the United States' service industries will account for two-thirds of the gross national product and approximately 70% of employment. *U.S. Completes Its Study of Services Trade, Hoping for Another GATT Round*, 20 U.S. EXPORT WEEKLY 493 (Jan. 3, 1984); *BLS, Commerce Likely to Receive Funds to Update Service Sector Data Services*, 20 U.S. EXPORT WEEKLY 309 (Nov. 22, 1983); See generally J. PELTON, *GLOBAL TALK* 165-79 (1981); PORAT, *COMMUNICATIONS POLICY IN AN INFORMATION SOCIETY, COMMUNICATIONS FOR TOMORROW: POLICY PERCEPTIVE FOR THE 1980's* 3 (1978).

5. The influence of television in the international marketplace may be best illustrated by the 1984 Los Angeles Summer Olympic Games. Over one billion people in over 50 countries around the world viewed this event. Firestone, *International Satellite and Cable Television*, UCLA COMM. L. PROGRAM 164 (1985) [hereinafter *International Television*].

6. J. Marcom, Jr., *World Outlook is Still Fuzzy for Film Quality TV Pictures*, Wall Street J., Oct. 25, 1985, § 1, at 33, col. 1.

7. See *International Market in Film*, *supra* note 2.

8. Grove, *Is Hollywood A Good Investment?*, The Hollywood Rep., Aug. 1, 1986, at 53.

picture industry,<sup>9</sup> the trend has been with equity offerings. Now, with the relative instability of the stock market, new forms of financing are being called forth and created as Hollywood looks to replace the financial base which was lost with tax reform.<sup>10</sup>

These new forms of financing and packaging of film are more complex and sophisticated than their predecessors, often requiring the skills of an attorney. In fact, the role lawyers are playing within the film industry is growing far beyond the scope of legal advice. Perhaps more than any other industry, lawyers are increasingly looked to as packagers and deal makers, delicately balancing the corporate side of distribution, the complexity of financial arrangements, and the sensitivity of creative development.<sup>11</sup> With the movement of film forging the global marketplace, attorneys will be faced with a myriad of problems within their expanding role. They will be asked to address issues of international law governing distribution and piracy, conduct diplomatic negotiations over the sensitive issue of perceived cultural erosion via international television and comprehend international financial transactions, including currency repatriation restrictions.

As a guideline for addressing these issues, offering direction to lawyers as they proceed in successfully packaging a film product, it is first necessary to develop some understanding for the global markets of film. After describing the marketplace, this article will then examine the many impediments to the international flow of the film product, and how these hurdles might be cleared. Understanding the market and its workings, we will then address how the financial clout of the market can be used to create mechanisms for film finance, offering new financial proposals as a viable alternative to the lost tax driven models. Thus, it is now necessary to investigate the particulars of the growing global market.

---

9. Crane and Cryan, *Northward Ho! How U.S. Tax Laws Are Driving Film and TV Production North of the Border*, 195 N.Y.L.J. 5 (Sept. 12, 1986).

10. *Id.* Prior to the changes in the tax code which have boxed out all film tax incentives over the past several years, film investment packages were structured to offer the investor several types of tax advantages. The form of these older models is beyond the scope of this article. For a more detailed look at these types of investments, See Note, *Tax Law: Sense and Sensibility in Film and Sound Recording Depreciation, 1984-1986 Legislative Developments*, 6 LOY. L.A. ENT. L.J. 243 (1986); Note, *The Tax Reform Act of 1976 and Tax Incentives for Motion Picture Investment: Throwing Out the Baby With the Bath Water*, 58 SO. CAL. L. REV. 839 (1985); BAUMGARTEN & FARBER, *PRODUCING, FINANCING AND DISTRIBUTING FILM* 43 (1983).

11. Harnete, *Now Lawyers Are Hollywood Superstars*, N.Y. Times, Jan. 11, 1987, § 1, at 1, col. 1. See also Natale, *Going Hollywood: Writing Screenplays, Producing T.V. Shows, Dominating the Boardrooms—Lawyers Are Suddenly Center Stage*, 7 CAL. LAW. 39, Sept. 1987; Cohn, *The Role that Lawyers Play in the Production of Motion Pictures*, 194 N.Y.L.J. 5 (April 12, 1985).

## II. THE INTERNATIONAL MARKETPLACE

Historically, the producers of film have relied primarily upon theatrical distribution in the United States to garner the revenue necessary to make a film investment profitable. Prior to 1977, 80% of all revenue to a film producer came from United States theatrical distribution.<sup>12</sup> Recent studies show that United States theatrical revenues totaled more than four billion dollars last year. Moreover, there has been a steady rise in European and Far Eastern theatrical revenues as well, accounting for almost two billion dollars per year.<sup>13</sup> Based upon the strength of these two domestic markets, producers make films which today average over 16 million dollars each to complete.<sup>14</sup>

Traditionally, it has been accepted that a film must have a gross revenue of roughly two and one half times its cost before the picture will begin to show a profit. This is due to the additional costs, beyond negative costs, or cost of production, of making prints, placing advertisements, distribution fees, cost of collections, etc.<sup>15</sup> Therefore, prior to the 1980's, producers could look only to domestic and foreign theatrical revenue to shoulder the burden of making a film profitable, with over-the-air television picking up the remainder.

With the technological explosion of the last decade, a variety of new markets for the distribution of film have been created. Each one, however, is based upon the existence of a household with a television set.

### A. Expansion of the Television Marketplace

Since the late 1960's, the number of television receivers and the size of the global television audience has grown remarkably. At that time there were approximately 273 million television receivers with an audience of 884 million viewers.<sup>16</sup> In the years to follow, these figures grew exponentially. For example, there was a world-wide audience of 600 million for the 1968 Summer Olympic Games in Mexico City, yet the 1984 Summer Olympic Games in Los Angeles drew well over one billion viewers.<sup>17</sup> Currently, there are about 525 million television sets in use throughout the world.<sup>18</sup> Of the total number of sets, the largest single

---

12. See *International Market in Film*, *supra* note 2, at 26.

13. See SCREEN DIGEST, Oct. 1986, at 207.

14. See MOTION PICTURE ASSOCIATION OF AMERICA, U.S. ECON. REV. 2 (1986).

15. See BAUMGARTEN AND FARBER, *supra* note 10, at 43.

16. See *International Television*, *supra* note 5, at 53.

17. *Id.*

18. *International Television*, *supra* note 5, at 242. The United States represents almost 85 million of the 165 million television homes in North America, many of which have more than one television set. See NIELSON CORP., NIELSON REPORT ON TELEVISION 3 (1985).

concentration is in Europe with 222 million,<sup>19</sup> followed by North America with 165 million.<sup>20</sup> The third largest market is Asia with 66 million.<sup>21</sup> This figure is misleading, however, because mainland China, potentially the largest television market in the world, is represented to have only 27 million television sets, although the total viewing audience is estimated to be 400 million.<sup>22</sup> Coupled with the fact that the Chinese government continues to open up to Western culture in an effort to further development, the television industry can expect to grow in a worldwide fashion.<sup>23</sup>

In 1982, roughly 25 million or 32% of the then 83 million television households in the United States were subscribing to a Pay-TV service.<sup>24</sup> By 1990 that figure will grow to almost 60 million Pay-TV subscribers or 60% of the then projected 100 million television households.<sup>25</sup> While there are currently 119 million television homes in Europe, only 28 million receive television signals over a cable system.<sup>26</sup> It is reasonable for Europe to expect growth comparable to that experienced in the United States; therefore, the demand for more programming will almost certainly increase. Furthermore, the potentially explosive Asian market, with a population of 2.5 billion, has seen the beginnings of Pay-TV penetration.<sup>27</sup> In Japan, for instance, 3.3 million or ten percent of television

---

19. *International Television*, *supra* note 5, at 242.

20. *Id.*

21. *Id.*

22. Redmont, *Inside Chinese Television: A New "Great Leap Forward,"* TELEVISION QUARTERLY, Winter 1986, at 8. This represents a very attractive market for television programmers. In fact, some U.S. networks have already begun to export programs to China.

23. *Id.*

24. Community Antenna Television ("Cable"), is by far the most common method of locally distributing satellite television or Pay-TV. Customers desiring this service have their television receivers connected to a main cable that originates at a central location referred to as the "headend." From the headend, numerous signals can be simultaneously transmitted over the coaxial cable, allowing the cable operator to provide a wide choice of programming to the customer. Once the foundational split or segmentation of the television marketplace is established with Cable, the technological nature of the coaxial cable allows for a multitude of services to the consumer. Specifically, Cable exists in the forms of Basic Cable, which usually includes a package of several national satellite program suppliers for a flat rate, and one or more levels of Pay-TV which the customer may purchase for an additional monthly fee. Another form of distribution is Pay-Per-View ("PPV"), whereby the customer elects to view a special event for a specific charge. See generally Crane and Cryan, *Telecommunications Pirates—America's Newest Criminals?*, 2 ENT. SP. L.J. 167 (1985) [hereinafter *Telecommunications Pirates*]; see, FROST AND SULLIVAN, INC., *THE EUROPEAN CABLE T.V. MARKET* 196 (1983) [hereinafter *European Cable*].

25. *European Cable*, *supra* note 24, at 196.

26. *Id.*

27. *International Television*, *supra* note 5, at 242.

homes are wired for cable.<sup>28</sup>

Two clear trends have emerged as the global television market continues to grow. First, there is a one-way flow of programming from large exporting nations, mainly the United States, to the rest of the world.<sup>29</sup> Second, entertainment material, composed mostly of motion pictures, dominates this flow.<sup>30</sup> Outside of the United States, imported programming averages approximately one-third or more of total programming aired.<sup>31</sup> Within the large European market several nations are heavy importers of programming, including West Germany where 24% of all programming is imported, Finland where it climbs to 37%, Ireland at 57%, and Spain, reaching 74%.<sup>32</sup> Additionally, Asia and the Pacific are large importers of programming, with Hong Kong importing 64%, Singapore 70%, and Australia 44%.<sup>33</sup>

By far, the most pervasive new domestic influence upon the global marketplace for film has been the increasing popularity of Video Cassette Recorders ("VCR"). Today, in the United States, 45% of the almost 90 million television homes have VCRs,<sup>34</sup> with expectations as high as 90% penetration by the end of the decade. Correspondingly, all of Western Europe stands at over 30% penetration while Japan is over 60%, with continued rapid growth expected.<sup>35</sup> The dollar power, in terms of dollars to producers of this market, is exemplified by the fact that today 45% of all revenue which flows to a film producer is derived from the VCR marketplace.<sup>36</sup>

The most sophisticated form of distribution to appear in recent years has been the creation of Pay-Per-View ("PPV") programs. Distributed via a Cable system, PPV allows for an additional market segregation, creating the potential for increased revenue to a producer. By 1990, it is predicted that 40% of the 60 million cable homes will have PPV capabilities.<sup>37</sup> This year PPV revenue reached 1.1 billion dollars, with the potential for the future handicapped only by the acceptability of PPV by the public. Once PPV is established throughout the world, producers will then have another valuable market in which to distribute their

---

28. *Id.* See also *Japan: Cable Gets Moving*, TV WORLD, Feb. 1986, at 16.

29. *International Flow*, *supra* note 1, at 269.

30. *Id.*

31. *Id.* at 273.

32. *Id.* at 272.

33. *Id.* It is interesting to note that the United States imports only two percent of its television programming. *Id.*

34. See PAUL KAGEN ASSOC., VCR NEWSLETTER, 1 Feb. 27, 1987 at 1.

35. See SCREEN DIGEST, June 1987, at 129-33.

36. See VIDEO MKTG. NEWSLETTER, Aug. 10, 1986, at 3.

37. See Trachtenberg, *Here We Go Again*, FORBES, Aug. 26, 1985, at 104.

product.<sup>38</sup>

### B. Program Suppliers

The producer of a film has several options among the discrete markets in which to distribute a picture. Traditionally, distribution follows a timed release pattern into the various markets. First, a film will be released in the domestic theatrical market, followed by the foreign theatrical markets, PPV, VCRs, Pay-TV and then Over-The-Air television.<sup>39</sup> Beyond theatrical and VCRs, the next largest market for a film is a satellite television program supplier.

A satellite program supplier is a network which typically transmits shows via satellite to local distributors for a monthly fee or without cost if the network is advertiser-supported, public service, or religious in nature.<sup>40</sup> The network which places a program on the satellite pays a licensing fee to the copyright holder of the event in order to be allowed to transmit the program via satellite to local Cable distributors.<sup>41</sup>

There are three main types of satellite television program suppliers. In the United States, there are National Satellite Television Program suppliers. These networks place their programs solely on the satellite which transmits their programs nationwide to be received almost exclusively by local distributors who in turn retransmit the programs to the consumer through Cable. The best examples of American networks which operate in this fashion are the USA Network ("USA"), Cable News Network ("CNN"), Music Television ("MTV") and the Entertainment and Sports Programming Network ("ESPN"), which are usually found as part of a Cable system's basic package. In Europe, there has been a growth of Pan-European satellite networks which follow the same technology and distribution pattern as in the United States. Typical examples of this type of network are Sky Channel, Music Box, and Screen Sport.<sup>42</sup> Additionally, nations such as Brazil, Japan, Australia, and the Middle East are also beginning to transmit television programs via satellite.<sup>43</sup>

---

38. See PAY-PER-VIEW UPDATE, Nov. 1, 1985, at 1.

39. See MOTION PICTURE ASSOCIATION OF AMERICA, FILM AND VIDEO PIRACY, MANUAL OF THE MOTION PICTURE ASSOCIATION OF AMERICA 2 (1985). See generally Leibowitz, *The Sequential Distribution of Television Programming in a Dynamic Marketplace*, 34 CATH. U.L. REV. 671-96 (1985).

40. See *Telecommunications Pirates*, supra note 24, at 169.

41. *Id.*

42. Sky Channel features films and sports programs. The Music Box is modeled after MTV. Screen Sport, a clone of ESPN, transmits sports programming exclusively. Telephone interview with Charles Stanford, Vice President Legal and Business Affairs, ABC Sports (Nov. 18, 1985).

43. SATELLITE ORBIT, Mar. 1984, at 6.



The second type of supplier in the United States is a Regional Pay Network.<sup>44</sup> This category is dominated by regional sports programming networks, such as New England Sports Network, Sports Channel New York, PRISM, Sports Vision and Sports Channel New England.<sup>45</sup> To receive these networks, a subscriber pays a specific fee above the cost of basic service, often referred to as "Expanded Basic."<sup>46</sup>

The third example of a satellite program supplier is the premium channels which charge a monthly fee above basic and expanded basic fees for reception of their commercial free programs. Such networks in the United States include Home Box Office (HBO), Select-TV, The Movie Channel and Showtime.<sup>47</sup> These premium channels represent the largest market for film producers, paying the highest prices for properties. Correspondingly, in Europe, there are several growing premium channels, including Canal Plus, Channel 2, Filmnet/ATN, Premiere and Teleclub.<sup>48</sup>

### III. BARRIERS TO THE INTERNATIONAL MARKET FOR FILM

#### A. Piracy

There are several major impediments to the international distribution and free movement of film across national borders. On the theatrical level, pirated prints, which are used in the unauthorized showings and duplication of films, present a problem to producers. An example of the lost revenue to a pirated film is where underground movie distributors place pirated prints into foreign countries where the producer has yet to distribute the film, thus undercutting the producers' ability to exploit the theatrical marketplace. Furthermore, foreign theatrical distribution has a variety of problems peculiar to its business environment, such as proper accounting of viewers and proper payment of monies owed. Beyond theatrical distribution, however, the ancillary markets of VCR, cable and over-the-air television are also laced with a great deal of impediments. For example, though VCR usage is the fastest growing market for film

---

44. A Regional Pay Network supplier transmits programs in a specific geographic area.

45. CABLESPORTS, Oct. 28, 1985, at 7. See also Simon, *Regional Sports Webs Take on Growing Importance*, CABLEMARKETING, Sept. 1986, at 12 (stating that there are now 20 regional sports networks in the United States). One major impediment to a regional sports network is the prohibitive cost of programming. In an effort to minimize this expense and increase the availability of programming, 10 regional sports networks agreed to share programs. See *Regional Sports Networks Agree To Share Programs*, MULTICHANNEL NEWS, Dec. 2, 1985, at 21.

46. See CABLESPORTS, Oct. 28, 1985, at 7.

47. See CABLEVISION, Jan. 15, 1987, at 80.

48. See SCREEN DIGEST, May 1987, at 105.

distribution world-wide, it is the market most crippled by piracy. Statistics indicate that one out of every two video cassettes sold outside the United States is a pirated cassette, evidencing an enormous revenue loss to the American film industry.<sup>49</sup> This fact, coupled with the reality of signal theft, puts the dollar value loss to United States' producers at over 500 million dollars per year.<sup>50</sup>

### 1. Protection from Piracy

Television signals and the programs transmitted within these signals have, for the most part, fallen into the legal category of copyright.<sup>51</sup> In examining the flow of international television programs, international copyright protection offers the oldest and most evolved body of law by which to protect copyright holders.<sup>52</sup> Nonetheless, the unanswered questions stemming from the broadcast and transmission components of television programs, coupled with a multitude of unresolved copyright issues,<sup>53</sup> places the international television industry in legal chaos.<sup>54</sup> The magnitude of the problem is demonstrated by the fact that almost every major film and television executive has asserted that the lack of copyright protection is the greatest impediment to the growth and development of the international television industry.<sup>55</sup> International copyright is dominated by three major multilateral conventions: the Berne Convention,<sup>56</sup> the Universal Copyright Convention<sup>57</sup> and the Rome Convention.<sup>58</sup> The

---

49. *International Market in Film*, *supra* note 2.

50. *Id.*

51. See generally Cryan and Crane, *International Telecommunications Pirates: Protecting U.S. Satellite Signals from Unauthorized Reception Abroad*, 17 N.Y.U.J. INT'L L. & POL. 851 (1985) [hereinafter *International Telecommunications*]; see also Jehoram, *Satellite Television in Europe*, INT'L BUS. LAW., Oct. 1983, at 16-17.

52. *International Telecommunications*, *supra* note 51, at 851.

53. *Id.* See also Corbet, *Satellites et droit d'auteur—Study of Problems in the Field of Copyright Raised by Radio and Television Transmissions via Communications Satellites*, Unesco Wido Sat 5 (1971).

54. See Deringer, *Legal Problems of Satellite and Cable TV Within the European Economic Community*, INT'L BUS. LAW., Oct. 1983, at 21. A complete analysis of these issues is beyond the focus of this work, but may be found in *International Telecommunications*, *supra* note 51.

55. See Columbia Broadcasting System, Inc., *Trade Barriers to U.S. Motion Picture and Television, Pre-Recorded Entertainment, Publishing and Advertising Industries*, (1987), reprinted in *International Television*, *supra* note 5, at 238 [hereinafter *Trade Barriers*].

56. Berne Convention for the Protection of Literary, Artistic, and Scientific Works, *open for signature* Sept. 9, 1886, *revised* Nov. 13, 1908, *revised* Mar. 20, 1941, *revised* July 24, 1971 [hereinafter cited as *Berne Convention*].

57. Universal Copyright Convention, *opened for signature* Sept. 6, 1952, *revised* July 24, 1971, 25 U.S.T. 1341, T.I.A.S. No. 7868, 216 U.N.T.S. 134.

58. Convention for the Protection of Performers, Producers, and Broadcast Organizations, *opened for signature* Oct. 26, 1961, 496 U.N.T.S. 44.

United States is not a signatory to either the Berne or Rome Conventions. They are a party to the Universal Copyright Convention; but, since the United States has withdrawn from that organization, its effectiveness is questionable. Thus, the state of United States copyright protection is questionable at best.

In light of these legal and regulatory problems, it becomes necessary to examine the positions many governments, both in Europe and the Third World, take when sanctioning the transnational flow of television programming.

### B. Government Control of the Marketplace

With the exception of the United States, over-the-air television has been controlled by state owned television stations.<sup>59</sup> Traditionally, these state monopolies have operated from tax dollars, broadcasting commercial-free programming. They do not generate any revenue.<sup>60</sup> In Europe, an annual license fee on television sets is levied by state governments.<sup>61</sup> On the average, a European family pays a seventy-one dollar annual television license fee.<sup>62</sup> It has been presumed that in return for this fee, the household should receive advertisement-free television. However, in an effort to underwrite the cost of operating a television network, many state governments began to allow the sale of limited advertising time under a myriad of restrictions.<sup>63</sup> Estimates indicate that if there were no advertisements allowed, the annual license fee would rise to \$105 per year.<sup>64</sup>

State-run television monopolies have never competed in a dynamic marketplace and, as a result, though the programming has been educational and of strong parochial concern, it has often fallen short as an entertainment medium. Coupled with the reality that many nations have

---

59. The American television industry has been privately owned since its inception. The United States has a long tradition of a right of free access to over-the-air television signals. However, under a United Nations agreement, which the United States promoted, the government sanctioned a private monopoly in the international satellite transmission industry. This has raised many legal issues concerning the free flow of international television programs, however, a complete analysis of these issues is beyond the scope of this article. For a more detailed account, see generally Cryan, Crane and Marcil, *The Future of Sports Broadcasting: An International Question*, 10 SETON HALL LEGAL J. 213 (1982) [hereinafter *International Sports Broadcasting*].

60. Maddox, *The Theology of Satellite Television*, TELEVISION QUARTERLY, Winter 1986, at 44.

61. *Id.*

62. On the average, a European family pays a \$71 annual television license fee. Taks, *Stop Your Meddling*, T.V. WORLD, Dec.-Jan. 1985-86, at 21.

63. These restrictions on advertisement are a major impediment to the flow of international television programs.

64. *Stop Your Meddling*, *supra* note 62.

a strong desire to strictly control the informational and cultural flow to its citizens, this combination has created a less than vibrant television product.<sup>65</sup> Additionally, in 1950, the state-run over-the-air television networks in Europe formed an association called the European Broadcasting Union ("EBU").<sup>66</sup> This association, which transmits programs throughout Europe, has also added to the restrictions on the international flow of television programs.<sup>67</sup> The EBU can have a drastic effect upon a film producer's revenue flow, in that the union purchases programming for the entire block of European over-the-air stations. The power of the monopoly drives the prices for licensing down below market levels, restricting the producer's potential to generate revenue. If the EBU were to be dismantled, film producers would see a rise in revenue from the European over-the-air market for their product.<sup>68</sup>

Private satellite television, however, offers the first non-government owned free market for television programs.<sup>69</sup> Though there are many restrictions on this form of television,<sup>70</sup> it is, nevertheless, the beginning of a dynamic marketplace. As private television grows on the international front, nations have become increasingly sensitive to the implications and byproducts that the vast importation of foreign cultures will have upon its parochial customs. This has led to an array of mechanisms which have been put in place to deter program importation which must be examined in an effort to increase the free flow of film.

### C. Cultural Barriers to Production and Distribution

The inadequacies of the international copyright framework<sup>71</sup> offer

---

65. This cultural protectionism is a block to the flow of international programming.

66. See generally EUROPEAN BROADCASTING UNION, EUROPEAN BROADCASTING UNION 1985 ORGANIZATIONAL BROCHURE, (1985) [hereinafter *Organizational Brochure*].

67. The formation of the European Broadcasting Union and its restrictive effect on the flow of television programs raise several antitrust questions. See *International Sports Broadcasting*, *supra* note 59, at 247-56.

68. See *International Sports Broadcasting*, *supra* note 59, at 247-56.

69. In addition to private satellite television, some nations have begun to allow private-advertising-supported, over-the-air broadcast stations to be licensed. Denmark has allowed private stations to broadcast, and although advertising is restricted in Denmark, the private channel does generate revenues from subscribers. See *Denmark: Countdown to Commercial TV*, T.V. WORLD, Feb. 1986, at 18. France has also opened its doors to private television. See *Le Développement des Télévisions*, LETTRE DE MATINON, 2 (1985). See also *Une Télévision de la Création Vivante et du Patrimoine*, Le Monde, Feb. 15, 1986, § 1, at 1, col. 1.

70. T.V. WORLD, *supra* note 69, at 18.

71. Copyright infringement is responsible for the single greatest dollar loss to the international television industry each year. The Motion Picture Export Association of America has listed the European community, Canada and the Far East as trouble areas. Unfortunately, these countries are major markets for exported programs. See *Trade Barriers*, *supra* note 55, at 238.

by far the greatest impediment to the transborder flow of television programs. Although more elusive, cultural barriers to international programming may, in fact, be an equally restrictive component within the global television market.

Historically, the nations of the world, and Europe in particular, have tried to protect their national borders and cultural identity by restricting television programming through a myriad of regulations.<sup>72</sup> Many nations believe that domestic television is a scarce national resource, and therefore, they must regulate it in order to insure the preservation of their cultural identity. These cultural barriers most often are manifested as quantitative and qualitative restrictions on: 1) the flow of information; 2) the importation of foreign programs; 3) the limitation of advertisement and sponsorship; and 4) the restricted use of advertisements produced in foreign countries.<sup>73</sup>

The free use of sponsorship of television programs to exploit a company's goods or services is not permitted by television regulatory bodies around the world, particularly in Europe.<sup>74</sup> Thus, in distributing television film programs internationally, programmers must be concerned with the law regulating advertisements and sponsorship, including domestic and international restraints.

Today, almost every nation places some restriction on the amount of daily advertising time allowed on a particular channel. In fact, several European nations including Belgium, Denmark, Norway, and Sweden<sup>75</sup> have an absolute ban on advertisement time—for example, Austria has a maximum of twenty minutes of ads per day per channel.<sup>76</sup> Italy allows

---

72. *TV's Commercial Barriers Come Tumbling Down*, EXECUTIVE WORLD, Aug. 1984, at 12 [hereinafter *TV's Commercial Barriers*]. For example, Italy bans pet food, Britain prohibits camera shots below the waist and Belgium restricts commercials altogether. See Maddox, *The Theology of Satellite Television*, TELEVISION QUARTERLY, Winter 1986, at 42.

73. For example, Canada requires privately owned broadcast stations to have at least 60% Canadian programming during the day and at least 50% from 6:00 p.m. to midnight. Additionally, private broadcasting companies in the United Kingdom may not program more than 14% imported programs, while France places severe restrictions on foreign programs and requires a percentage of programs to have substantial national content. See *Trade Barriers*, *supra* note 55, at 249.

74. See *Sponsorship Agreements Between Sponsors and Sports Teams*, 12 INT'L MEDIA L. REP. 2 (1985) [hereinafter *Sponsorship Agreements*].

75. This may also extend to a ban on imported satellite television commercials. Specifically, Belgian cable operators are required to omit advertisements from the different foreign programs. In practice, however, this is not done. See *The Half-Law of the Ad-Jungle*, T.V. WORLD, Feb. 1986, at 30. One of the methods by which Swedish advertisers attempt to circumvent this prohibition on commercials is to purchase poster sites around British soccer fields. Camera shots of the posters are then broadcast back to Sweden as part of a weekly sports telecast. See *TV's Commercial Barriers*, *supra* note 72, at 12.

76. See COMMISSION OF THE EUROPEAN COMMUNITIES, TELEVISION WITHOUT FRON-

twenty-eight minutes,<sup>77</sup> China only ten minutes per evening,<sup>78</sup> France twenty-four minutes,<sup>79</sup> and Luxembourg sixty-eight minutes.<sup>80</sup> This is a far cry from the 180 minutes allowed in the United States.<sup>81</sup> This problem is compounded when television commercials produced outside the country are forbidden for use by domestic broadcasters, as is the case in Argentina, Chile, Canada, Australia, Italy and South Korea.<sup>82</sup> Accordingly, the importation of pre-sold or sponsored programming in such instances is illegal.<sup>83</sup>

Under the wide variety of advertisement restrictions and the practical impossibility of satisfying the rules on advertising in each state that a satellite signal enters, the danger that international broadcasters may be blocked, grows.<sup>84</sup> Existing regulations are dealt with on an ad hoc basis, and must be compared and contrasted with the laws governing advertisements and sales promotions throughout the various nations in which film may be distributed.

Embroided within the issue of cultural barriers to the free flow of television programming, lies the bedrock issue of the right to free flowing information. Although the United States has enjoyed a long history of a guaranteed right to a free flow of information, including television programming, the same has not been true for the rest of the world.<sup>85</sup> Traditionally, many nations have viewed the unbridled transmission of information to their citizens as a threat to their national sovereignty and as both the industrialized and lesser developed nations continue to build national telecommunication systems, these governments seek to protect their national interests by establishing legislative and regulatory barriers restricting the transborder flow of information.<sup>86</sup>

Areas of immediate concern, because of their market status, include

---

TIERS—GREEN PAPER ON THE ESTABLISHMENT OF THE COMMON MARKET FOR BROADCASTING, ESPECIALLY BY SATELLITE AND CABLE 305 (1984) [hereinafter *Television Without Frontiers*].

77. *Id.*

78. See *Sponsors Seek a Sporting Chance*, T.V. WORLD, Dec.-Jan. 1985-86, at 34.

79. See *Television Without Frontiers*, *supra* note 76, at 343.

80. *Id.*

81. See *TV's Commercial Barriers*, *supra* note 72, at 12.

82. See *Trade Barriers*, *supra* note 55, at 250.

83. *Id.*

84. See *Television Without Frontiers*, *supra* note 76, at 255.

85. The Supreme Court has stated that the First Amendment guarantees the right to speak and receive information. *Lamont v. Postmaster Gen.*, 381 U.S. 301, 307 (1965). Moreover, the First Amendment protects the right to communicate with citizens of foreign nations. See also Branscomb, *Global Governance of Global Networks: A Survey of Transborder Data Flow in Transition*, 36 VAND. L. REV. 997 (1983) [hereinafter *Global Networks*].

86. See *Trade Barriers*, *supra* note 55, at 253.

Europe, Canada and Japan,<sup>87</sup> where governmental restrictions are viewed as a means of maintaining an influence over the national press. In fact, former West German Chancellor Helmut Schmidt was so concerned about this problem that he said, "mass appeal [satellite delivered] programming could ultimately pose a greater peril for German society than any danger inherent in nuclear technology."<sup>88</sup>

#### D. Cable Retransmissions

Another concern of international television distributors is the unauthorized cable retransmissions of their product, which inevitably limits the distributor's ability to exploit a program throughout the global marketplace. For many years, primarily in Europe due to its geography, but also in other parts of the world, Cable operators have used large antennas to receive relatively distant over-the-air signals, which they in turn retransmit via their cable systems to their customers.<sup>89</sup> For example, a cable operator in Brussels will pick up the British Broadcasting Company ("BBC") over-the-air signal from London and retransmit it to its viewers. This immediately triggers copyright infringement because when, for example, the copyright holder sells the movie "Rocky" to the BBC for over-the-air coverage in London, a fee is based on over-the-air exposure to the London population. However, when the signal is received and retransmitted to 200,000 cable subscribers in Brussels, the copyright holder has received nothing for that retransmission.

This problem is exacerbated by the technological ability of cable operators in Brussels to receive and retransmit signals from France, Holland, Germany, Luxembourg and the United Kingdom.<sup>90</sup> Therefore, program copyright holders have looked for ways to protect their product. The United States addressed this problem by passing the Copyright Act of 1976,<sup>91</sup> outlawing such retransmissions and implementing a statutory license which compensated those copyright holders infringed

---

87. *Id.*

88. See LeDuc, *Direct Broadcast Satellites: Parallel Policy Patterns in Europe and the United States*, J. OF BROADCASTING, at 100 (Spring 1983).

89. UNITED STATES COPYRIGHT OFFICE, TO SECURE INTELLECTUAL PROPERTY RIGHTS IN WORLD COMMERCE 31 (1984) [hereinafter *Intellectual Property Rights*], reprinted in *Oversight on International Copyrights: Hearings Before the Subcomm. on Patents, Copyrights, and Trademarks of the Senate Comm. on the Judiciary*, 98th Cong., 2d Sess. 845 (1984).

90. ASSOCIATION FOR THE INTERNATIONAL COLLECTIVE MANAGEMENT OF AUDIOVISUAL WORKS, COLLECTIVE MANAGEMENT FOR FILM PRODUCERS [hereinafter *Collective Management*].

91. 17 U.S.C. §§ 101-18 (1982).

upon.<sup>92</sup> Several European nations have also granted protection for these copyrights via case law. The Belgium decision of *Coditel v. Cine Vog*,<sup>93</sup> as well as cases in Austria and Switzerland,<sup>94</sup> stipulated that simultaneous cable retransmissions of over-the-air broadcasts were protected copyrighted works under national copyright law and the Berne Convention.

Television copyright holders can protect this right by contractually licensing their product in the marketplace or by attempting to legislatively implement a compulsory license.<sup>95</sup> The avenue of compulsory license chosen by the United States has come under fire because it artificially suppresses the fees paid to copyright holders.<sup>96</sup> Therefore, a statutory compulsory license should not be adopted by the rest of the world. In fact, the Belgian government recently signed an agreement with a copyright collection agency, which may offer the wisest solution to the problem.

In light of the enormous amount of programming retransmitted by Cable operators, it was necessary to form a collection agency. Thus, the Association for the International Collective Management of Audiovisual Works ("AGICOA")<sup>97</sup> was born. AGICOA functions as a central clearinghouse for the cable transmission rights of copyrighted programs, with which Cable operators may negotiate. In 1984, the first cable retransmissions agreement was entered into between the Belgian cable operators and AGICOA.<sup>98</sup> The agreement provides that Belgian cable operators may retransmit over-the-air broadcasts emanating from

---

92. See Cryan and Crane, *Sports Promoters Irked by Copyright Exemption Seek Changes in Compensation System*, 145 N.Y.L.J. 33 (1986).

93. 2 COMMON MKT. L. REP. 362 (1980). *Coditel* centered around the film "Le Boucher" (The Butcher), for which exclusive distribution rights in Belgium were granted to Cine Vog Films. Under the terms of the agreement, the Belgium television rights could only be exercised 40 months after the first theatrical showing of the film. Within the 40 month period, an authorized over-the-air television broadcast of the film in Germany was received by a Belgian cable operator, Coditel. Without authorization, Coditel retransmitted the film to its cable subscribers. The court held this to be a violation of the copyright.

94. See *Collective Management*, *supra* note 90, at 1.

95. See Verlinde, *Some Comments on the Signing of the Cable Agreement in Belgium*, 25 EUR. BROADCASTING UNION REV. 27 (1984).

96. Recently, United States legislation has been proposed to abolish the compulsory license. A compulsory license legislatively sets a fee of a percent of a cable operator's gross revenues. In the United States, this fee is 3.75% for every distant signal retransmitted, to be paid to a collection body which in turn distributes the money proportionally to the copyright holders whose programs were retransmitted down the cable. The problem is that the statutory fee is fixed and does not reflect the supply and demand of the marketplace.

97. AGICOA was created by the International Federation of Film Producers Association; see Mafoff, *AGICOA, Motion Picture Export Association of America* (1987), reprinted in *International Television*, *supra* note 5, at 393.

98. *Id.*



Belgium, France, Germany, Luxembourg, the Netherlands and the United Kingdom, in exchange for a yearly royalty of 15% of the cable operators' gross revenues.<sup>99</sup>

This is desirable because it allows the marketplace to dictate the price of the copyright royalty. With the future application of AGICOA in sight, film producers who have their product retransmitted via cable systems in Europe can go to AGICOA as a means of protecting and exploiting their copyrights.

*E. Foreign Exchange Remittance, Restrictions on Earnings, and Discriminatory Taxation*

The problems surrounding foreign exchange remittance and international taxation pose an equally large impediment to the international flow of television programs. All multinational businesses must deal with foreign exchange remittance restrictions. However, when dealing with television programming, the problem becomes more acute since revenues may be derived from licensing or copyright royalties rather than solely from the direct sale of television programs. This problem exists, for example, in many countries throughout South America, Africa and the Middle East, which totally block the exit of currency, which would include royalty payments.<sup>100</sup> Furthermore, many nations, including Mexico and Brazil, tax the repatriation of earned surplus at such an exorbitant rate that foreign investment is discouraged.<sup>101</sup> India, another nation with a large and growing television market, taxes operating profits at 52%.<sup>102</sup> Additionally, many nations impose taxes which directly burden the broadcasting industry. Canada, for example, has a tax code provision which prevents expenditures for foreign broadcasts from being treated as a business expense for tax purposes.<sup>103</sup>

It is apparent that some states will impose discriminatory customs valuation on what enters via the state airwaves as a protectionist measure. Moreover, as technologies such as Direct Broadcast Satellites continue to develop, this issue will become more pronounced.

These monetary issues, coupled with other barriers to international television, have resulted in the development of several possible solutions

---

99. *Id.* Once the money is received by AGICOA, a complex formula is employed to allocate the monies to the copyright holder. This formula is based on the length and category of each program, the time of day of the broadcast and the broadcast source. *See Collective Management, supra* note 90.

100. *See Trade Barriers, supra* note 55, at 250.

101. *Id.*

102. *Id.*

103. *Id.*

to these problems. For example, if the demand for programming is high but the money to purchase programming is lacking, the government may relax the advertising regulations and thereby create a valuable commodity. Under these two market conditions, CBS recently culminated a programming deal which takes advantage of these positions and also avoids international monetary problems. Specifically, CBS and The People's Republic of China's national network, CCTV, reached an agreement for sixty-four hours of programming.<sup>104</sup> The Chinese will be able to select from CBS' total program inventory and in return CBS is allocated advertising time to resell. CBS will retail the time to international advertisers interested in the mainland China market. Such companies include IBM, Boeing and Kodak.<sup>105</sup> This type of barter transaction bypasses all monetary exchange and taxation problems and allows CBS to receive dollars on United States soil.

#### IV. NEW FINANCING MECHANISM FOR FILM

Aware of the financial power the expanding world market for film, tempered by the barriers which must be cleared in distributing a film throughout that market, producers have watched the rise of Hollywood's reputation in the financial community with great excitement. Slowed somewhat by the loss last year of the Investment Tax Credit ("ITC"),<sup>106</sup> the growing relationship with Wall Street continues, though some of the financial packages have been modified to meet the needs of the investment community.

##### A. Present State of Film Financing

Over the past several years, films have been financed through several

---

104. See *Better by Barter?*, T.V. WORLD, Feb. 1984 at 19. See also *Sponsors Seek a Sporting Chance*, T.V. WORLD, Dec.-Jan. 1985-86, at 34. An additional advantage to this type of transaction is the avoidance of currency exchanges with a strong United States dollar.

105. *Id.*

106. In 1962, Congress implemented the Investment Tax Credit ("ITC") in an effort to give corporations and taxpayers a break for purchasing items such as new machinery to be used in a manufacturing plant or a new car to be used for business purposes. These credits were intended to provide an economic incentive for companies to expand operations, thereby creating new jobs and generally bolstering the economy. The ITC has had several revisions and most recently it allowed film producers to claim a credit of 6.6% of the cost of producing a film. This meant a producer could expect to receive a \$6.60 tax credit on every \$100 spent on producing a film. This value increases because it is a credit, not a deduction, and as such is calculated after taxes, allowing the producer to subtract a large paper loss from their federal tax bills. It is estimated that the investment tax credit in the film and television industry has totalled over \$100 million. See Crane and Cryan, *Northward Ho! How U.S. Tax Laws Are Driving Film And TV Production North of the Border*, 195 N.Y.L.J. 5 (Sept. 12, 1986).

basic formulas. One of the more common financial models is a secured financing arrangement. In this type of situation a film's producer secures a distribution contract for the screenplay. This contract guarantees that upon completion of the film it will be distributed, theatrically, in a certain number of theatres. This guarantee insures that a minimum amount of revenue will be generated by the film. Based upon this assumption, banking institutions will lend money for the production of the screenplay if the producer will post the copyrights in the film along with the rights secured under the distribution contract as principal collateral for the loan.<sup>107</sup> Operating under this principle and based on a number of other issues, including the quality of the property, the producer's track record and the distribution company's credibility, many banking institutions will offer the service of lending production dollars at a reasonable rate of interest. In today's market, the additional distribution contracts for all ancillary markets will often be required as collateral as well, so that the bank has additional security for the loan. Another form of financing has historically been the limited partnership public offering, where an investor would purchase an interest in the partnership, which usually owned rights to a series of films.<sup>108</sup> This type of offering was usually sold not only for its return potential, but was heavily based upon its tax benefits to the investor. Now with all tax benefits eliminated, Hollywood has and must continue to change its focus.

Beyond these types of limited partnership offerings which have abounded over the past several years, Hollywood has plunged head first into the traditional Wall Street mechanisms of equity and debt financing. Due in part to the changing tax structure and in part to Wall Street's confidence, many private film companies, either in existence or just starting out, have brought forth new stock offerings to raise money for film production.<sup>109</sup> These equity offerings, which are attractive in part due to long-term stability and their potential for gain independent of tax incentives, have been successful on several occasions. Though the recent instability of the stock market has slowed the number of public offerings for

---

107. For more of a complete analysis of film secured financing, see generally Weiss and Benjamin, *Feature Film Secured Financing: A Transactional Approach for Lender's Counsel*, 5 COMM/ENT L.J. 75 (1983).

108. See E.F. HUTTON AND CO., INC., PROSPECTUS FOR SILVER SCREEN PARTNERS (Apr. 19, 1983) (150,000 Limited Partnership Units).

109. See ALLEN AND CO., INC., PROSPECTUS FOR IMAGINE FILMS ENTERTAINMENT, INC. (June 1986) (1,667,000 units, each unit consisting of one share of common stock and one warrant to purchase one-third share of common stock); see also ALLEN AND CO., INC., THE FIRST BANK OF BOSTON, MERRILL LYNCH CAPITAL MARKETS, PROSPECTUS FOR TRI-STAR PICTURES (Dec. 1986) (3,500,000 units, each unit consisting of one share of common stock and one warrant to purchase one-half share of common stock).

all types of businesses, as the market stabilizes, entertainment companies, like all forms of commercial enterprise, should continue to see a growing Wall Street involvement.

On the debt side, bond offerings have begun to surface strictly for the purpose of underwriting film production. One of the larger more recent offerings was for a subordinated sinking fund debenture attempting to raise more than 200 million dollars for New World Pictures.<sup>110</sup> Once again, in light of the recent troubles on Wall Street, the future viability of these debt offerings may be questioned, certainly for the smaller companies, if not the larger ones, when considering the market's need for perceived stability with a debt offering. When taking all of these considerations into account, Hollywood is left with the question of how to fill the financial void created by the loss of tax incentives, while faced with a presently unstable stock market.

### *B. New Print and Advertisement Offerings*

Based on the need to continue to attract investors to the film community, Hollywood has been forced to offer new incentives in order to attract dollars. One of the newest incentives to draw investors is a remake of an old theme. Throughout the years, distributors have usually taken the burden of underwriting the costs of prints and advertisement ("P & A"),<sup>111</sup> in distributing a film theatrically. If the distributor did front the expense of P & A, those monies would be returned out of first revenues. At times, a distributor would look to private investors to undertake these costs, usually offering a high fixed return to be paid out of first monies to flow from the film.

Today, however, new forms of P & A financial packages are surfacing, wherein distributors are looking to limit their financial exposure by offering profit participation for P & A investment. This type of investment offers several incentives. First, P & A financing usually allows the investor to recoup out of first revenues. Thus, if the film is a box office

---

110. See L.F. ROTHSCHILD, UNTERBERG & TOWBIN, INC., PROSPECTUS FOR NEW WORLD PICTURES, (Oct. 1986) (\$215,000,000, 12<sup>1</sup>/<sub>4</sub>% Subordinated Sinking Fund Debentures, due Sept. 15, 1998).

111. Traditionally, the costs of making the film prints and the cost of advertising the picture ("P & A") have been consumed by the distribution company. Their costs can become quite high. For example, generally one 35mm print costs approximately \$1,000 and if the film is to open in a wide release of 1,000 theaters, the cost is \$1,000,000. Add advertising costs to this figure and a sizable amount of money must be spent. If the distributor pays for P & A, this money is returned before profits are shared, and correspondingly, if the producer or an independent financier pays for P & A, this debt is satisfied prior to sharing profits. BAUMGARTEN AND FARBER, *supra* note 10, at 43.

disaster, there is still a chance that monies invested will be returned. Second, these types of packages usually cover a slate of films, and therefore the odds of success are increased by the number of releases. Moreover, the recent trend in P & A deals calls for profit participation above and beyond the fixed rate of return usually secured where monies are invested. This possibility of profit participation allows unlimited return on investment should one or more of the films attract great success.

An example of a P & A offering in the market today is SSR Film Partners I.<sup>112</sup> Though there are several P & A deals in the market, this investment offers a good example of the present Hollywood financial position, in that it is offered by a medium sized distributor who has felt the pinch of the tax loss and needs to expand its financial base. This limited partnership with the mini-major Atlantic Releasing, allows the investor a 100% return of his capital contributions plus a 12% cumulative annual preferred cash return. Additionally, the investor is given a 25% profit participation in Atlantic's slate of films for the first three years. Under this investment, once funds are spent on P & A, the revenues will be reinvested to allow for participation over a longer period of time. Investments like this are even further supplemented by the offer of corporate guarantees, which further reduce the investors' exposure. As Hollywood is forced to offer cash driven deals, such as the SSR offering, the quality and soundness to the investor can only increase. In fact there have been several new stock offers to fund new companies whose sole activity will be the placement of P & A funds with distributors in exchange for profit participation in films.<sup>113</sup>

### *C. Offshore Placement of Copyrights*

Because of the need to find new mechanisms whereby film, as an investment, can remain attractive, producers have looked to attorneys to create legal entities which are sound, yet reduce taxable exposure. One such possibility, which has been utilized by Hollywood over the past several years and should see continued activity because of mobility of film rights, has been the placement of copyrights offshore. This type of activity is often called a deferred royalty program.

Under this complex formula, the copyright holder of a film or films (i.e., a United States producer), grants a license to an off-shore-tax-free entity, usually affiliated with a financial institution. This license stipu-

---

112. SSR Film Partners I, A Limited Partnership, SSR Film, Los Angeles, CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM (Sept. 1987).

113. Sterling Entertainment Company, Chicago, Ill., CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM (Sept. 1987).

lates that the hypothetical producer will receive royalties based upon the income. Correspondingly, the tax-free entity in turn sub-licenses these film rights by entering into a distribution agreement with a United States distribution company. Therefore, when revenue is generated by the films, these monies are directed to the off-shore entity which allows the revenue to be non-United States sourced for tax purposes. This arrangement is considered a non-qualified, deferred compensation agreement. Such a plan may provide for a long-term or short-term deferral wherein the royalty payment at the end of a period of time selected by the investor may be in a lump sum or installments. Furthermore, the deferred royalty may be invested to realize either conservative or high yields. The United States producer, in such an instance, will pay income tax only on the amounts actually received which the investor has absolute control over and thus the flow of revenue may be very low for the first several years.<sup>114</sup> This provides the investor with an increased investment return which will be compounded for the period of deferral. Thus, the increase in economic return generated by the continuation of low withholding tax rates via controlled passive income, income tax deferral and tax free accumulation of investment income, add up to an attractive investment.<sup>115</sup>

Moreover, this formula allows the investor to borrow monies based upon the license agreement as collateral, often from the attracted financial institution, though it may be an independent bank.<sup>116</sup> This mechanism allows the producer to use the money immediately, while not triggering a taxable event because the loan is beyond taxable exposure, and still retain the benefits of the deferred taxes off shore.<sup>117</sup>

#### D. Possibilities in Puerto Rico

As United States producers look for new avenues to create economic incentives for film investment, one of the relatively untapped possibilities may lie in Puerto Rico. In an effort to promote economic activity in Puerto Rico, the Congress passed a special provision of the Internal Revenue Code ("the Code") which offers tax incentives to qualified entities.<sup>118</sup>

Under section 956<sup>119</sup> of the Code, eligible United States companies

---

114. PIERSON, HELDRING, AND PIERSON, DEFERRED ROYALTY PROGRAM 9 (1987).

115. *Id.* at 5.

116. *Id.* at 4.

117. *Id.*

118. I.R.C. § 936 (1976).

119. *Id.*

can become 100% tax exempt from United States income taxes by having a qualified operation in Puerto Rico. Furthermore, the Puerto Rican government complements the United States tax exemption by offering companies a 90% exemption from Puerto Rican taxes under the Puerto Rico Industrial Incentives Act<sup>120</sup> which equates to an effective tax rate of 4.5%.<sup>121</sup> The only additional tax in Puerto Rico is a 10% "Tollgate" tax on dividends paid from Puerto Rico source income. However, if the dividends are re-invested in Puerto Rico prior to being removed, the effective tax rate will be in the 0-3% range.<sup>122</sup>

Though this option is new to the film industry, and no major film production company has yet to set up operations in Puerto Rico in an effort to fall under the purview of this tax exemption, it appears that such a tax posture is possible. Within the scope of these two acts a great number of service industries are exempt from taxes. The issue becomes one of definition, questioning whether or not film production falls within the category of exempt services. Services which qualify as listed include cinematographic film processing, editing and dubbing.<sup>123</sup> Based upon the breadth of this definition a United States producer could place operations in Puerto Rico, source all revenue into Puerto Rico and avoid virtually all taxes. Such an option may be more attractive to an east coast operation due to logistics. The possibilities, however, would include any United States company. The question becomes whether "production" of film will be interpreted as a qualified service. In other words, will the coordinating of all film activities from Puerto Rico, including the physical shooting and editing at other locations qualify for tax exempt status.<sup>124</sup> If such a status was to be granted, this type of operation would be analogous to the many recording companies which produce in the Caribbean.

### *E. Foreign Financing for Production*

Due to the political and economic climate in many nations, particularly in South America, investors are prohibited or severely penalized for removing currency from their nation. Yet, at the same time these investors are highly motivated towards investing in other parts of the world.

---

120. See ECONOMIC DEVELOPMENT ADMIN. (SAN JUAN, PUERTO RICO), SERVICE INDUSTRY PROGRAM FOR PUERTO RICO, U.S.A. 1-4 (June 1983) [hereinafter *Economic Development*].

121. See ARTHUR ANDERSON AND CO., TAX AND FIN. CONSIDERATIONS FOR DISTRIBUTION CENTERS IN PUERTO RICO (1986).

122. *Id.*

123. See *Economic Development*, *supra* note 120, at 2.

124. *Id.*

Many multinational companies with subsidiaries in these blocked currency countries find themselves with a stockpile of local currency which has a continually eroding value for them.

Because a film can be made anywhere in the world, and then can be marketed anywhere else in the world, creative new options for film investment have arisen. For example, the Brazilian government offers a sliding scale of tax incentives for investment of cruzados in film production through a Brazilian owned production company. Thus, a subsidiary of a United States based multinational corporation could invest its blocked cruzados through such a vehicle and retain a substantial share of the copyrights which ultimately produce revenue in the United States. Whether the film has a specific or generic locale, it can be marketed worldwide, including United States theatrical distribution. The profits are generated in United States dollars payable to the multinational's United States corporate entity. This type of investment is desirable even if the film only breaks even financially, in that to remove blocked currency from Brazil would cost fifty cents on the dollar, wherein investment in a film in Brazil and distributed worldwide would generate a return most likely of capital plus a handsome profit participation.

Yet the investor can and should expect even more from this type of arrangement. The costs of production are markedly lower overseas, often providing two or three times the purchasing power of the production dollar in Los Angeles or New York. This lower cost has no real negative effect upon marketability of the film. In fact, such cost saving increases the production value of the property often as high as two or three times its cost, thereby enhancing the likelihood of profitability.

This model, however, is not without its own difficulties. Often the blocked currency nation has laws limiting the existence of foreign controlled film companies, as is the case with Brazil.<sup>125</sup> Furthermore, above the line costs will want to be paid in United States dollars for the same reasons that blocked the currency in the first place. Therefore, workable financial packages of this type must include some component of United States dollar financing to meet these obligations.

## V. CONCLUSION

In the next ten years the industry of film production and distribution will see enormous change. As technology's advances increasingly

---

125. See *Brazil Prohibits Foreign Control of Film Outfits*, VARIETY, Apr. 3, 1985, at 1, col. 4. See also *MFEA Hires Special Council to Study New Brazilian Legislation*, VARIETY, Apr. 16, 1985, at 1, col. 4.



impact the world wide distribution of film and television programming, the business community, which has coalesced in the development and exploitation of intellectual property, will reach new plateaus. Governments will be forced to acquiesce to the call of the market as people world-wide demand certain types of programming. Hopefully then, cultural barriers, programming regulation and currency regulations will fall to the power of a dynamic market.

As transnational accords look to protect this marketplace, new international copyright and communications regimes must be put in place or the growth of film and television will be stalled. Based upon a strong and protected market, these new forms of financing will evolve and mature, offering an increasing number of vehicles in which to tap our growing global market. In such an economic arena it seems international financing and the placement of copyrights beyond United States tax liability will become increasingly popular. Wherein, the forging of the international marketplace by the instant global distribution of a film property will lead the fight for an integrated international economy.