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EDITOR'S NOTE

THANK YOU for the overwhelmingly positive response to the last issue of the **Film & Television Law Quarterly**, the first legal journal for entertainment professionals. The readers make this legal magazine unique, so if you have not yet done so, drop the **QUARTERLY** a line with your comments, questions, and perspective. In this issue, the **QUARTERLY** takes on two critical issues: Entertainment finance, and the risks and benefits of hiring SAG financial core members.

FINANCE, for better or worse, stands at the heart of film, television, and music making. A producer's first and possibly most crucial duty is forming the correct type of entity. The number of choices of business types, from corporation to LLC to partnership or limited partnership, exploded within the past few years. In this issue, the **QUARTERLY** helps readers cut through the hype and come to an intelligent decision for their project. This is the first of a multi-part series about entertainment finance.

SAG FINANCIAL CORE creates similar confusion among film and television professionals. What is it? Why could it be the most important choice you make in hiring performers for your next production? The **QUARTERLY** goes where few other publications have gone, to explore what producers must know about this elusive issue.

ENJOY this important second issue of the **QUARTERLY**. The **QUARTERLY** arrives by email and is available on file at work, at home, or wherever you check your email, four times a year. Feel free to pass on the **QUARTERLY**, or contact us about back issues.

- Eds.

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FEATURE

Finance: Corp vs. LLC

FINANCING FILM AND TELEVISION

In response to tremendous reader interest, we begin this issue with the first of a multipart series addressing the financing of film and television productions. Entertainment finance starts with a decision about what kind of business to form, generally known as *choice of entity*. Corporations, limited liability companies (LLCs), general and limited partnerships, and joint ventures compose the most common types of business entities. In the first of our multipart series on entertainment finance, we address choosing the right entity for your production.

CHOICE OF ENTITY is the first decision a producer makes before beginning pre-production. An ever-increasing number of choices in business entity can create confusion among film and television producers about which is the best entity. Like most legal questions, no one answer

is correct in all situations. Instead, consider three things when choosing a business entity: purpose, liability, and taxation.

PURPOSE

Purpose means the role a particular business entity needs to play in your production. Consider the function of the production company. Why is a new entity being formed? Purpose usually comes down to two broad categories: *operating company* or *investment company*.

OPERATING COMPANIES are established for the purpose of long-term business. A television production company may form an operating company before beginning the development of a number of different series or documentary ideas. An operating company is intended to last beyond the production of any one particular film or series. Every major Hollywood film producer maintains at least one operating company, which is used to conduct a number of different businesses.

Not only does an operating company provide a separate business name to conduct business under, but it also provides liability and tax benefits. Both corporations and LLCs are well suited to organization as operating companies. Neither needs a specific duration, or life span, so both can last perpetually. Additionally, these entities can define the ownership and participation in an entertainment business, simplifying the relationship between multiple producers and executive producers.

Partnerships and limited partnerships should not be used as operating companies. All fifty states have laws requiring that partnerships and limited partnerships include a finite *duration*, or lifespan, generally no longer than ten or fifteen years. Partnerships also fail to provide for any liability protection, which is discussed more fully below.

INVESTMENT COMPANIES comprise the other half of entertainment business entities. A producer organizes an investment company for a single production, or sometimes for a slate of two or three productions. Investment companies serve as the means by which private investors put money into a production.

When considering an investment company, it is important to remember that state and federal securities laws place additional restrictions on what can and cannot be done when raising investment money. It is extremely important to seek legal assistance when setting up any company. Serious *civil and criminal* sanctions can be imposed for failing to completely comply with federal and state securities law.

Typically, producers use LLCs and limited partnerships for investment companies. Both limit the role of the investors, so that investors cannot interfere with financial or artistic decisions. Both also provide good tax benefits to investors. Limited partnerships were at one time the standard. However, limited partnerships require the producer to form a second

DUE DILIGENCE

Hiring SAG Financial Core

Anyone who has gone through the process of becoming a Screen Actors Guild (SAG) signatory comes to know and respect the complexity and importance of the SAG Basic Agreement. Although SAG does a good job of helping producers through the process, there are a myriad of issues where a producer must bring in his or her own knowledge to satisfactorily protect the interests of the project. One such important issue is financial core. As the name implies, this issue is at the core of union issues. In short, it deals with a SAG signatory producer's right to hire essentially a non-union performer.

THE BIRTH OF THE SCREEN ACTORS GUILD

came in 1933 when eighteen Hollywood actors risked their careers to form a guild to combat the power of the studio system. Before SAG, actors served at the will of the studios that enforced mandatory seven-year contracts. Conditions of employment included unrestricted hours, no enforced turn-around and no required meal breaks. Even the personal lives of actors were subject to the control of the studios.

Two years later, in 1935, Congress enacted the National Labor Relations Act (NLRA), giving union members the right to organize and the right to take part in collective bargaining. As part of the Act, Congress set up the National Labor Relations Board (NLRB), an agency empowered to oversee the rights of union members. The Labor Board supported the fledgling Union, which quickly gained power.

THE TAFT-HARTLEY ACT amended and weakened the previous act and gave rise to the concept of financial core. Of course, the Taft-Hartley Act governs many aspects of unions, including giving rise to the obscure phrase "being Tafted," which refers to the principle way a non-union extra can become a SAG member. But perhaps most importantly, the Taft-Hartley Act gave

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FILM FESTS

Quarterly Film Festival Listings

NETHERLANDS FILM FESTIVAL

P.O. Box 1581
NL-3500 BN, Utrecht, The Netherlands
Phone: (31) (0) 30-230-3800
Fax: (31) (0) 30-230-3801
<http://www.filmfestival.nl>

ASPEN FILMFEST

110 East Hallam Street, Suite 102
Aspen, CO 81611
Phone: (970) 925-6882
Fax: (970) 925-1967
<http://www.aspenfilm.org>

VANCOUVER INTERNATIONAL FILM FESTIVAL

1008 Homer St., #410
Vancouver, B.C., V6B 2X1, Canada
Phone: (604) 685-0260
Fax: (604) 688-8221
<http://www.viff.org>

INDEPENDENT FEATURE FILM MARKET

104 W. 29th Street, 12th floor
New York, NY 10001-5310
Phone: (212) 465-8200
Fax: (212) 465-8525
<http://www.ifp.org>

NEW YORK FILM FESTIVAL

Film Society of Lincoln Center
70 Lincoln Center Plaza
New York, NY 10023-6595
Phone: (212) 875-5638
Fax: (212) 875-5636
<http://www.filmlinc.com/nyff/nyff.htm>

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Absent these formalities, the LLC or corporation will have no legal existence.

GENERAL PARTNERSHIPS, LIMITED PARTNERSHIPS, and joint ventures are often confused by producers. The limited partnership is an investment company that is filed and approved by a state, just like corporations and LLCs. General partnerships and joint ventures usually do not require state filings, with the exception of California and a few other places in the country. General partnerships and joint ventures provide no liability protection. Due to the lack of any liability protection for the owners or the investors, general partnerships and joint ventures are strongly disfavored by most producers.

TAXATION

Finally, producers should consider the tax consequences of a business entity. While this article will provide some general guidance, you should contact a tax professional before making any tax decisions. Without the right business entity, the IRS will consider all profits and losses to be personal, and the producer will incur self-employment taxes. In considering taxation, keep in mind two concepts: corporate taxation and flow through taxation.

CORPORATE TAX can apply to more than just businesses organized as corporations. Any organization that chooses to be taxed as a corporation, or that is characterized by the IRS as a corporation, can expect to be taxed at two levels: the corporate level and the personal level. Simply put, the IRS assesses corporate taxes on profits earned by a corporate entity. Then the IRS assesses personal income taxes on that same money, if it is distributed to the officers or shareholders. While certain tax benefits may be realized through the choice of corporate tax status, most independent film and television producers will pay lower taxes by selecting flow through taxation.

FLOW THROUGH TAXATION disregards the company entity, so the IRS will assess taxes on profits only at the personal level. Corporations can elect flow through taxation when structured

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Los Angeles, CA 90069
Phone: (310) 229-5365
<http://www.winfemme.com>

TORONTO INTERNATIONAL FILM FESTIVAL

2 Carlton Street, Suite 1600
Toronto, Ontario, Canada M5B 1J3
Phone: (416) 967-7371
Fax: (416) 967-9477
<http://www.e.bell.ca/filmfest/>

BOSTON FILM FESTIVAL

P.O. Box 516
Hull, MA 02045
Phone: (781) 925-1373
Fax: (781) 925-3132
<http://www.bostonfilmfestival.org>

CINEMATexas INTERNATIONAL SHORT FILM FEST

Dept. of Radio-TV-Film
CMA 6.118
Austin, TX 78712-1091
Phone: (512) 471-6497
Fax: (512) 471-4077
<http://www.cinematexas.org>

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SAN SEBASTIAN INTERNATIONAL FILM FESTIVAL

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Phone: (349-43) 481-212
Fax: (349-43) 481-218
<http://www.sansebastianfestival.ya.com>

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P.O. Box 590125
Birmingham, AL 35259
Phone: (205) 324-0888
Fax: (205) 324-2488
<http://www.sidewalkfest.com>

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business entity, typically a corporation, to serve as the *general partner* of the company. Most experienced producers now favor LLCs, both for cost savings and structure.

LIABILITY

Liability is perhaps the single most important reason to choose the correct business entity. Properly formed and maintained, a business entity protects both its owners and investors from personal claims and lawsuits. For example, suppose a writer files a lawsuit against a producer during the production of a television series. When the production is created under a production company, the writer will have a claim solely against the LLC itself, so a producer's assets, such as a house or savings, will be untouched.

THE DBA OR FICTITIOUS BUSINESS NAME is a filing with the state. A DBA filing provides the right to use a name other than a sole proprietor's own name when doing business. It provides no liability protection. It cannot protect an owner's assets, and all contracts must still be signed under the personal name of the producer. For this reason, a DBA is not considered a business entity.

THE LLC AND THE CORPORATION both function well for liability protection. The LLC creates protection for its *managers* and *members*, sheltering each from personal liability. The Corporation protects its *officers* and *shareholders* from liability in an equal fashion. Some sophisticated producers prefer the LLC structure because it provides greater flexibility in organization, and does not require *corporate directors* who may incur some liability to a corporation.

PIERCING THE CORPORATE VEIL or PCV, is an obscure term used for the devastating process whereby a court may disregard an LLC or corporation for liability purposes. An LLC or corporation is more than just a name filing with the state. These business entities require By-Laws or Operating Agreements, minutes, meetings, resolutions, and other filings, which keep the business in good standing with the state of incorporation.

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SAMPLE CONTRACTS

The Writer Loan Out

Any writer entering into a writing agreement can choose to work for his or her own company rather than the production company. Writers can create a company that literally loans out, or hires out, the writer to the producer. Called a *loan out company*, most professional writers in the film industry opt for performing their duties through such a company.

The benefits of a loan out company to a

writer include tax savings, liability protection, and in some cases, increased copyright protection. Simply put, the loan out company is to a writer what the production company is to a producer.

From the producer's perspective, care should be taken in drafting a contract with a loan out company. The producer could unintentionally give up legal recourse against the writer.

As with any sample clause, it is important to use this material in conjunction with legal counsel experienced in entertainment law. - staff

DISCLAIMER

The Quarterly periodically issues sample agreements and other information to keep its clients and friends generally informed about issues in the legal community. Neither transmission nor receipt of this information is intended to or does create an attorney-client relationship. All information provided is of a general nature, may not reflect the most recent developments in the law, is not legal advice or a solicitation therefor, is not a substitute for legal advice pertaining to a specific situation, and should not be acted on by readers without obtaining advice from legal or other professional counsel applicable to a particular set of facts.

THE WRITER LOAN OUT CLAUSE

INDUCEMENT

By countersigning this Agreement, Writer confirms all grants made by Lender and agrees to perform the services herein provided for in accordance with the terms hereof, and Writer will look solely to Lender for any and all compensation hereunder.

Writer

By: _____

Special Note: This is but one clause from a writer's agreement, and cannot in itself create a writer's loan out agreement.

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HOLLYWOOD FILM FESTIVAL

433 N. Camden Drive, Suite 600
Beverly Hills, CA 90210
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Fax: (310) 475-0193
<http://hollywoodfestival.com/>

MILL VALLEY FILM FESTIVAL

38 Miller Ave., Suite #6
Mill Valley, CA 94941
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Fax: (415) 383-8606
<http://www.finc.org>

FLANDERS INT'L FILM FESTIVAL

Ghent, Belgium
<http://www.filmfestival.be/taalkeuze.html>

AUSTIN FILM FESTIVAL

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Toll Free: 1-800-310-FEST
Fax (512) 478-6205
<http://www.austinfilmfestival.com>

THE BLACK BEAR FILM FESTIVAL

115 Seventh Street
Milford, PA 18336
Phone: (570) 409-0909
<http://www.blackbearfilm.com>

CAIRO INTERNATIONAL FILM FESTIVAL

17 Kasr el-Nil Street, Cairo-Egypt
Phone: (202) 392-3962/392-3562
Fax: (202) 393-8979
<http://www.cairofilmfest.com>

HAMPTONS INTERNATIONAL FILM FESTIVAL

3 Newtown Mews
East Hampton, NY 11937
Phone: (631) 324-4600
Fax: (631) 324-5116
<http://www.hamptonsfest.org/>

SÃO PAULO INTL. FILM FESTIVAL

Rua Antonio Carlos, 288
CEP 01309-010-Cerqueira Cesar
São Paulo, SP, Brazil
Phone: (011) (55-11) 3141-2548
Fax: (011) (55-11) 3266-7066
<http://www.mostra.org>

Financial Core continued from page 2

union members the right **not** to join a union.

FINANCIAL CORE STATUS began back in 1949 when the Labor Board held that under Section 8(a)(3) of the NLRA, a union "...could demand no more than that an employee tender dues and fees." (*Union Starch & Refining Co., 87 N.L.R.B. 187, 1949.*) The agency ruling was subsequently enforced by a federal court. (*Union Starch & Refining Co. v. N.L.R.B., 7th Cir. 1951.*) In fact, this court case is recognized as the first instance in which financial core membership conferred, to members, immunity from internal union discipline.

A Supreme Court judge coined the phrase "financial core" in a 1963 Supreme Court case. Broadly understood, the term refers to whittling down the requirements of union membership to its financial core, at the expense of activities such as picketing, voting on strikes, participation in fundraisers, and attendance at certain meetings. Unions such as SAG, under United States labor law, can primarily only force union members to pay fees and dues, although they may encourage union members to take part in a broader range of union activities such as strikes and governing the union. (*N.L.R.B. v. General Motors Corp., U.S. 1963.*) Under the National Labor Relations Act, Section 8(a)(3), employees in a so-called "union shop," referring to a place of business where union membership is mandatory, have the right to avoid any union-imposed obligations other than the duty to pay dues and fees.

In 1969, the Supreme Court went further, creating a three-part test that is used to determine if any particular rule adopted by the union for its members is legal. (*Scofield v. NLRB, U.S. 1969.*) Under the third part of the test, unions like SAG are prohibited from charging, trying, and fining employees who resign union membership prior to crossing picket lines. (*National Labor Relations Board v. Textile Workers Union of America, Local 1029, U.S. 1972.*) The Court later affirmed that full union membership cannot be a requirement of employment. Through these cases, the Supreme Court

created the principal of financial core. The effect of financial core for film and television producers has been to create a certain group of SAG performers who are free to work both SAG and non-union productions, under certain circumstances. Producers must use caution, however, as the conditions and availability of financial core make this the most intensely contested issue between SAG and producers today.

VOLUNTARY UNIONISM, or the right to take part in select union activities, emerged from the above *Scofield* case, which strongly affirmed the right of union members to resign from full membership. Additionally, financial core status as defined in *N.L.R.B. v. General Motors Corp.* allows an employee to work during a strike if he or she chooses. The strongest proponents of financial core status, such as the National Right to Work Foundation, assert that "SAG and AFTRA members may resign and declare 'financial core status' at any time in order to escape those unions' rules against working for nonunion employers." Critics, however, challenge this blanket statement, and contend that financial core is being used as a wedge between SAG/AFTRA and the membership.

In any event, since the advent of financial core status, union leaders today are obliged to carefully consider the ramifications of proposed strikes, and to assess the will of the membership. A strike unsupported by the membership could result in wholesale resignations or conversions to financial core membership. (*N.L.R.B. v. Local 54, Hotel Employees & Restaurant Employees International Union, AFL-CIO, 3rd Cir. 1989.*) Thus, financial core membership leads inevitably to the debate over what "voluntary" union membership really means.

RIGHT TO WORK STATES AND "VOLUNTARY" MEMBERSHIP

Twenty-two states are referred to as "right to work" states, because each has laws that prohibit employers from requiring union membership as a

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appropriately, as can LLCs. The owner of an LLC can choose from four different ways to be taxed depending on the structure of the company, providing unrivaled flexibility. The IRS generally treats limited partnerships, general partnerships, and joint ventures as flow through entities.

CONSIDERING THE POSIBILITIES in choosing a business entity is the first step producers take in entertainment financing. Once a producer or filmmaker selects the appropriate entity, decisions must be made about private investor financing. We will consider this topic in the next part of our finance series. - Brandon A. Blake

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CLOSING WORDS

THANK YOU for taking a moment to review the QUARTERLY. Please pass along the QUARTERLY to someone who has a need for legal news and information on the entertainment industry, or send us an email address for a new subscription.

As the only legal journal written from the perspective of entertainment professionals, the QUARTERLY fills a unique place in the world of publishing. So tell us what you think. The QUARTERLY will publish select letters to the editor on legal and entertainment topics.

Thank you again for your support of the QUARTERLY. - eds.

Financial Core, continued from page 5

condition of employment. These laws make union membership technically "voluntary." Twenty-two states equates to nearly half of the country. So in nearly half of the country, including Florida and Texas, financial core is not an option for SAG performers. Paradoxically then, it is more difficult to hire financial core performers in right to work states.

In right to work states, the collective bargaining agreement often governs on financial core issues. The Labor Board noted in a Virginia court case that financial core status might not be available to voluntary members unless the union, itself, extends that option in the collective bargaining agreement. (*NATIONAL LABOR RELATIONS BOARD (N.L.R.B.), Smithfield Packing Company, Inc., et al., 303 NLRB No. 74, 1991.*) SAG has not overtly extended that right to members.

Courts have also upheld restrictive provisions in union agreements limiting when and how a member can declare financial core status. Some collective bargaining agreements designate just a 30-day window in which members can convert to financial core status. Ruling on just such a case, an Indiana court found that the Taft-Hartley Act provision allowing members to resign membership *at any time* does not apply when membership is **voluntary**. (*Edwards v. Indiana State Teachers Ass'n, Ind.App., 2001.*) SAG has not provided much guidance in this area.

CAUTION should be practiced until such time as the courts and the states have worked out the final principles of financial core status for SAG performers, especially in right to work states where the law is the most unsettled. State and federal law may forbid a SAG signatory producer from discriminating against a financial core performer, regardless of that producer's view of financial core membership. Financial core members will still carry appropriate identification of SAG affiliation. However, in right to work states, financial core is still far from a viable answer for non-union producers hoping to work with SAG talent. - Phyllis Jean

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Shinjuku-ku, Tokyo 162-0845,
Japan
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<http://www.tokyo-filmfest.or.jp/>

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