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Hollywood Film Financing, Past And Present

The Editor interviews ***P. John Burke,*** *Partner, Akin Gump Strauss Hauer & Feld LLP.*

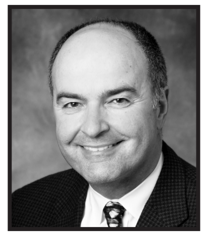
Editor: Please tell us about your professional background.

Burke: I grew up in Toronto, Canada, and I came down here to go to school. I attended USC undergrad, Southwestern School of Law and then NYU, where I obtained an LLM in taxation, graduating in 1978. I started work at Kaplan, Livingston, Goodwin, Berkowitz & Selvin (the firm was founded in 1940 by Leon Kaplan, and his clients included Ava Gardner, Gene Kelly, Warner Bros. and 20th Century Fox studios), which, at the time, was the biggest entertainment firm in the country. It was *the* job for aspiring law school graduates.

Kaplan was the first large law firm back when law firms were forever institutions, though, for a variety of reasons, they closed their doors at the end of 1980. From there, I worked as an associate for Jones Day until 1988 and then went to Rosenfeld, Meyer & Susman, LLP, which was a small Beverly Hills-based entertainment firm. In1999, Akin Gump, which was growing a new LA office with entertainment as a strategic priority, made a compelling overture, and we moved our group over to Akin. Currently, I head up the entertainment group at Akin; we've thrived and so has the firm.

Editor: We imagine that obtaining financing for new film projects can be difficult, as with any start-up. At what point do projects become most attractive to financing?

Burke: It's very difficult to get a single picture film financed unless a number of factors converge. First, you need a script that is worth making into a film, which is harder to acquire or develop than you might think. Then you need a good director or high-level actor(s) committed to the project and, most importantly, you need a major studio to commit to financing all or a portion of the budget.



P. John Burke

If you want to go the more challenging independent route, you still need the film elements as well as some distribution set up, so that when financiers assess financial risk of the project, they have some comfort that can mitigate some of the risk through pre-sales and tax rebates offered by various jurisdictions to promote local film production. For example, if it's a $20 million picture, there are very few people who will fund the entire budget, let you make the film and then go shop for distribution. Nobody sets out to make a bad film, but if it happens, you have a problem recouping your investment. Producers mitigate risk by hiring a foreign sales agent to provide estimates that the picture can get sold internationally for, let's say, $10 or $12 million. You can shoot the film in a jurisdiction that offers tax benefits and cover another $3 million. Now the investor can say, okay, it's a $20 million picture, and if I can get $13 to $15 million of it covered, at the end of the day I'll have $5 to $7 million at risk when the picture gets released. If it's successful, I'll get my money back, and I may make some money; if it's not successful, my maximum loss is $5 to $7 million, and that's a bet I'm willing to take.

Film is a very, very risky and volatile investment. It's hard to predict the performance outcome of any particular film, which is why the studios produce portfolios of films: they release 15 to 30 pictures a year knowing that something like 60 percent of those pictures are going to break even or perhaps even lose a little or a lot, but of the 40 percent that are profitable, a few will make enough money to make the entire portfolio profitable overall. But an individual investing in one picture doesn't have that portfolio diversification, so you might get really lucky with a picture that actually hits the ball out of the park, or you might be unlucky and take substantial losses.

Editor: How has investment in film productions fared in recent years, and have studios picked up more of the tab? Has investment by individuals fallen off?

Burke: The studios have always picked up most of the tab. When you consider who is responsible for funding the budgets of films on an annual basis, the studios are responsible for 85 to 90 percent, and, frankly, the other 10 or 15 percent is skewed by a couple of independent pictures like *Twilight* that make a great deal of money.

Since 2005, the studios have all taken on major co-investment partners – not individuals who are investing in one or two pictures, but investors who, depending on the studio and on the slate, have invested 25 to 50 percent of the production costs of most of the studio's films. Some of the larger equity funds participated in deals done between 2005 and 2008, when we saw the economy starting to get shaky.

Has investment by individuals fallen off? The answer is yes, and the reason is

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Please email the interviewee at jburke@akingump.com with questions about this interview.

that the business now requires larger equity bets to be made on a particular film. You used to be able to finance a film independently and have a fairly limited exposure at the end of the day, as in my example of a $20 million film where you had $15 million covered by other benefits and your exposure might be $5 million or less. Today's risk profile involves equity exposure of closer to $8 to $10 million on a $20 million film.

Editor: What changed?

Burke: The foreign presale market is not as robust as it was. Now, foreign distributors around the globe are more likely to say, "I bought too many pictures at the greenlight stage, and I didn't get my money back because the quality was not as promised, so I'm going to wait until I see the finished pictures before I buy them."

Independent producers promise that they're going to get domestic, meaning U.S., distribution, which is important because the studios spend a lot of money on marketing when they distribute pictures.

The average marketing budget for an MPAA picture in 2010 was about $40 million, and when you spend that kind of money on a picture in the U.S., the marketing effort travels a long way. You get the *Entertainment Tonight*s, the *Access Hollywood*s, the news programs – affording exposure worldwide, so the distributors in France, the UK, Germany and elsewhere don't have to spend as much on marketing. In prior years, people were much more likely to buy a picture that didn't have a U.S. distributor on board – on the expectation that U.S. distribution would be in place by the time the picture got finished and delivered. In many cases, that expectation was not met because the studios have become much less willing to pick up third-party product to distribute and, instead, focus more on their own internal development. They've concluded that they have more success with the pictures they develop internally, and if they're going to spend $40 or $50 million marketing something, they want the best possible shot at producing a hit.

That said, you also have to remember that many invest in films for reasons unrelated to making a profit. They invest because they're already very rich, and investing in film has more to do with a social or political agenda. They want to tell a story that they think needs to be told; it's personal to them, or they're being supportive of a director, actor or a producer with material they find appealing. They think the film should be made, and they want to have some fun or glamour in their lives. Maybe they make a good living manufacturing brooms and mops, but it's not a very exciting thing to talk about at a cocktail party. Investing in a picture is fun and interesting, and, for all of those reasons, people back 500-plus independent films every year.

Editor: Profit sharing on film productions is highly complicated, and in this difficult environment, many of these contracts have been challenged post-release.

Burke: It's actually not that complicated, but it has a reputation of being complicated. If you're an actor or someone participating in a film, there is an expectation in the industry that you should have some sort of profit sharing; however, frankly, if you're an unknown actor, profit sharing is going to be defined in a way that is intended to make it very unlikely for you to share in any real profits unless the film is an extraordinary hit, and industry people understand that. How professionals can be misled by that is beyond me. If you're an A-list actor in a film, your representatives will be able to negotiate a much better definition of net profits or adjusted gross profits or a better sharing of the revenue, depending on what contribution you're making to the film and how much that's worth. An A-list actor has leverage to negotiate a very good economic-sharing arrangement and will get paid quite a bit of money if the film's successful – or even if the film isn't successful. The challenges that people read about are audits of the studios. Even though an actor has negotiated as strong an economic-sharing arrangement as possible, when it comes down to the studios reporting the accounting, there are always areas of gray, and it shouldn't be a surprise that they're going to report in a way that is more beneficial to them and less beneficial to you. So it's inevitable that anybody with a major position in a film or in a film slate will ultimately audit the studio. Everybody expects it to happen, and it almost always results in additional payments to the investor.

Editor: Vertical integration of production and distribution channels is a growing trend in the entertainment sector. Do you see this trend continuing?

Burke: Yes, of course. It's actually broader than that. It's not just the existing production and distribution channels – it's all of the new distribution channels. There is a transition to digital delivery of product, with people watching on such devices as computers and tablets what used to be just in theaters and on televisions. Anyone who has a child under the age of 16 knows they don't spend much time watching TV: they take in most of their content through their computers, and, when they watch a TV show, they're certainly not watching it in real time, but off some other source – typically because they don't want to watch the advertising. At the same time, they're online chatting with their friends, and they're also accessing some browser because they might be doing research for school. You probably have a DVR; you might have Apple TV; you might be taking your Netflix through your Google TV; or you might have Slingbox®, which allows you to have the content that is recorded at your house distributed to you while you're traveling in any part of the world. It's really extraordinary what is going on, and I didn't even mention mobile.

Editor: Please tell us about your work with the American Film Institute.

Burke: The American Film Institute, where I've been the general counsel for about 20 years now, is a wonderful organization, and it was ranked last year as the number-one film school in the world. It's here in Los Angeles, and they do things a little differently than the other film schools. Rather than keeping students exclusively in classrooms, they actually focus on the craft of making a film. They teach them how to make a real film in their second year, which gives them something that they can use when they go out in the world and try to sell themselves in the film business. AFI has a terrific board – all of the studios and networks are represented and come together to support the goals and aspirations of the organization. In some ways, it's the Switzerland of the film business.