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RAISING MONEY FOR THE POPE: FILM FINANCING IN THE BRITISH VIRGIN ISLANDS

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by Jamal S. Smith
jamal.smith@thorntonsmith.com

As a contender for the Palme d'Or at the 2011 Cannes Film Festival, "Habemus Papam", which is Latin for "We Have a Pope", the Italian comedy-drama directed by Nanni Moretti and starring French actor Michel Pioccoli, still needs to raise capital to make a profitable international run. The traditional means of film financing, such as debt financing, equity financing and hedge funds have either metamorphosed into more creative structured financing models or are giving way to entirely new financing models such as small private investor funding through online media. Capitalizing a film from production to distribution is critical to a successful film and there are several innovative structures involving entities established in the British Virgin Islands ("BVI") that can be utilized.

Sale and Lease-Back Financing

A fairly recent means of film financing involves a production company entering into a sale and purchase agreement ("SPA") for the copyrights in a film with a subsidiary established in the BVI. The BVI subsidiary then uses the copyright as securitized assets in a loan agreement with a financing institution then leases it back to the production company for a percentage of the original sale. This method has become more popular with high-budget films since the legal and administrative costs of setting up such a structure may prove prohibitive for the more lower-budget film. Additionally, the 10 – 15% distribution fee on the budget of the film that normally includes territorial distribution rights where there is a collection of distribution agreements in different countries or more typically worldwide rights held by a single distribution company, plus the marketing costs before profit, makes this highly unattractive for low-budget films.

A critical consideration in a sale and lease-back financing involving a BVI company is section 175 of the BVI Business Companies Act, 2004. If the copyrights being leased back would be more than 50 percent in value of the assets of the BVI company, then the lease must be approved by the directors of the BVI company, and details of the lease must then be submitted to the shareholders for their approval. Where shareholder approval is to be obtained at a shareholders meeting, then the notice calling the meeting must be accompanied by an outline of the lease and this must be given to every shareholder, whether or not they are entitled to vote on the lease. However, if the shareholder approval is only to be obtained by written consent then all that is necessary is for an outline of the lease to be given to every shareholder, and again, this is whether or not they are entitled to vote on the lease.

There is, however, a way to get around seeking shareholder approval, especially where there will be a series of sale and lease-back transactions over a period of time involving the

Capitol Chambers
P.O. Box 3534
Road Town, Tortola VG1110
British Virgin Islands

BARRISTERS, SOLICITORS & NOTARIES PUBLIC
Founder & Principal: Jamal S. Smith

Tel. (284)494-2518
Fax. (284)494-2519
e-mail: mail@thorntonsmith.com

same companies. This would be done by establishing a trust for the benefit of the production company, where the production company is the parent company or otherwise has a direct or indirect interest in the BVI company. Once the trust is established, the directors of the BVI company may then resolve to transfer the copyrights in the film to that trust for the benefit of the production company.

Debt Financing

Production companies will normally find security-backed credit lines available with strict repayment obligations, since lenders realize the many risks involved with financing a film. Although not all debt securities sold by the issuer take priority over the lower-yield debt in film financing, the priority of the debt in this type of lending becomes critical to the production company since debt subordination can also be more costly with lenders seeking 20 – 30% interest. Therefore, while debt subordination in film financing is not uncommon it is usually seen as a last resort unless very favorable terms can be negotiated with lending institutions usually through loan syndication. The loan will often make specific provision for future receipts and provide a charge over future earnings that include theatrical film rights, DVD sales, pay-TV receipts among others. However, the typical loan agreement cannot be applied wholesale to a film since it would not capture pre-sales receipts where the production company enters into a distribution agreement that sells the right to distribute the film before completion of the production phase. Typically, a BVI company would be used to hold the foreign rights or particular windows, such as theatrical, DVD or loan provided by a senior lender.

A significant development in debt financing is through intra-group loans, where according to the publication by the Organization for Economic Cooperation and Development ("OECD"), *Measuring Globalization: OECD Economic Globalization Indicators 2010*, it becomes clear that intra-group trade amounts to a significant portion of the multinational network. Similarly, in film financing intra-group loans allow for the moving of capital from one profitable area to new product developments. However, it is prudent to ensure arms length dealings in the provision of the intra-group loan and guarantee arrangements based on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators, which although not incorporated into law in the BVI demonstrates good practice.

Where a BVI company is part of the production company's group of companies which is able to raise sufficient capital to provide a loan to the production company within its group, then it would be subject to general transfer pricing rules requiring the same interest rates, or at least a reasonable interest rate to be applied to the loan. All that is required is that the directors of the lending company adopt a resolution approving the loan, but it is advisable that within that resolution a note be made that the directors have considered transfer pricing by adopting the best interest rates unless the BVI company is a wholly-owned subsidiary and its memorandum and articles were specifically designed to provide a favorable benefit to the parent company.

An additional consideration is to ensure that the production company, as the intra-group borrower, is not conducting business in the BVI if the loan amount is over US$50,000.00 to comply with the Financing and Money Services Act, 2009 (the "FMSA"). Although the production company itself can be a BVI company, since being a BVI company does not in and of itself make a company subject to the regulation of the FMSA, the loan cannot be to a

BVI company that has operations in the BVI which may make it resident in the BVI and subject to a fine of $60,000.00 if it does not have a license under the FMSA.

Equity Financing

Accepting a higher risk by putting in equity into a business rather than taking credit is a common way of raising capital to finance films using BVI companies. A production company may offer private placements in a BVI subsidiary or use one for an initial public offering ("IPO") or as a joint venture vehicle. BVI companies have been featured on NASDAQ, the New York Stock Exchange, Singapore Stock Exchange and recently as a major player on the LSE's Alternative Investment Market ("AIM"). The memorandum and articles of association are the constitutional documents of a BVI company which can be easily tailored to meet the requirements of these various listing bodies, such as disclosure of interests in shares and shareholder practitioners. However, raising capital through IPOs is the exception rather than the norm in film financing.

The most common form of equity financing is the establishment of a joint venture company between two or more production companies, studios and distribution companies. By virtue of section 120(4) of the BVI Business Companies Act, 2004 directors of a BVI joint venture company may, unlike many other jurisdictions, act in a manner which they believe are in the best interests of the shareholders even though it may not be in the best interest of the BVI joint venture company. It is important for the memorandum and articles of association to be specifically drafted to accommodate the appointment of directors by each member separately and permit those directors to act in the interest of a member or members of the BVI joint venture company. Although there are dispute resolution mechanisms that protect minority shareholders, in a joint venture scenario it may be necessary to rely on the Insolvency Act, 2003 to resolve disputes between the shareholders of the BVI joint venture company which may involve the court appointing a liquidator on the "just and equitable" ground, a receiver or provisional liquidator, just to name a few solutions available under BVI law.

Conclusion

Although "Habemus Papam" was a lighter-touch than expected in light of the now routine attacks on the Catholic Church, the film still stirred a buzz at the 2011 Cannes Film Festival, and to keep the buzz going Moretti needed to raise capital for his film. There are many options available to help raise money for the Pope, such as sale and lease-back provisions, inter-group loans, and joint ventures all involving BVI structures. It is left to be seen how this film will continue to maintain its momentum by finding innovative funding sources.

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If you would like more information about film financing in the British Virgin Islands, contact Jamal S. Smith.

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