The Impact of the JOBS Act on Independent Film Finance

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The onset of the U.S. recession, triggered by the 2008 economic crisis, substantially reduced the capital markets for the production of independent films. In an effort to stimulate economic growth for business start-ups, Congress passed the JOBS Act in March 2012. Two provisions of the JOBS Act present the independent (“indie”) film industry the opportunity to expand its capital markets. The first provision is Section 201 (a) of the JOBS Act, which allows companies to advertise a private placement offering of securities to the general public without registering the transaction with the Securities and Exchange Commission (SEC). The second provision is title three of the JOBS Act, which creates an exemption from SEC registration for the sale of securities with an aggregate offering value of up to $1,000,000. Part I of this article examines the regulatory landscape that governed the capital markets for indie films prior to the JOBS Act; Part II explains the alternative funding strategies indie producers have employed in the face of diminished sources of capital; Part III explains the two provisions of the JOBS Act that impact the post 2008 alternative funding sources; and Part IV explores the potential impact of the JOBS Act on the indie film capital markets.

2 Mary Bruce, Obama Signs JOBS Act into Law, ABC NEWS (April 5, 2012), http://abcnews.go.com/blogs/politics/2012/04/obama-signs-jobs-act-into-law/

4 Id.
5 Id.
Part I. Indie Film Finance Prior to the JOBS Act

A. Foreign Pre-Sales

Prior to 2008, independent films were financed primarily by debt in the form of pre-sale commitments by foreign and domestic distributors. Pre-sales are the “the licensing of the distribution rights to a film in a specific sales territory to a distributor before the film is completed” based on a “film package, typically composed of a script, director and key cast.” The fee licensees pay is known as a “minimum guaranty.” The delivery of a film would trigger the release of the minimum payment guarantee from the pre-sale distributors. While the pre-sale distributors would typically not advance the cash, producers would use the minimum guarantees as collateral for a bank-financed loan. In order to mitigate the risk of the film not being completed, the bank would condition its advance on a guarantee by a completion guarantor; completion guarantors are “specialized entertainment-industry companies”, “staffed

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11 Id.
by persons with extensive production experience and by lawyers and bankers” that guarantee a film’s completion to lenders. 12

Prior to 2008, indie producers would typically present their film packages at film festivals around the world in order to pre-sell the film’s distribution rights. 13 Producers could expect to receive distribution deals at these shows that would result in a minimum guarantee of “50% or more of a film’s production budget.” 14 Domestic pre-sales, purchased by Hollywood studio backed distribution companies like Miramax, New Line and Paramount Vantage 15 would finance between 20% and 30% of an independent film. 16 Having secured cash from pre-sale commitments, an independent producer could expect government sponsored tax credits and equity investments from personal connections to fill the remainder of the budget. 17

However in 2008, the capital structure of the indie film was fundamentally altered when foreign pre-sale commitments cratered. 18 The global financial crisis sparked a credit crunch that substantially reduced the credit lines available to foreign distributors for acquisitions. 19 Foreign distributors, who long used television sales to finance their U.S. acquisitions, lost that financing tool when television advertising revenues “collapsed” in the foreign television market. 20 The credit crunch together with sharp depreciation of foreign currencies against the U.S. dollar,

12 Epstein, supra note 10; Foy, supra note 9.
13 Schuker, supra note 6.
14 Id.
15 Epstein, supra note 10.
16 Id.
17 Id.
18 Schuker, supra note 6.
20 Schuker, supra note 6.
shifting foreign tastes towards local films and foreign government financial support of local filmmakers shifted financing away from U.S. producers. The credit crunch also impacted domestic distributors. Hollywood studios, powered by Wall Street private equity and hedge funds, dropped their indie film distribution wings in the face of lower sales at the box office, reduced DVD sales and the disappearance of output deals by cable subscription channels. By 2009 only 11 indie film production houses stood standing compared to 38 in 2007; these remaining distributors substantially reduced their pre-sale budgets. Even when indie film producers were able to pre-sell their films, banks reduced their credit lines to producers limiting their commitments from 100% of minimum guarantees to 80%. The financial gap left by foreign and domestic film distributors forced indie filmmakers to fill this void left by foreign pre-sales with equity investments.

In the United States, equity can be raised in one of two capital markets: the public market or the private market. The sale of a passive profit interest in a film is a security and is regulated by the Securities Act of 1933 (“Securities Act”). The Securities Act requires the registration of securities with the Securities and Exchange Commission (“SEC”) absent a statutory exemption. SEC registration offers significant advantages for raising capital. SEC registration permits the

21 Id.
23 Id.
24 Epstein, supra note 10.
25 Davies, supra note 22.
26 Epstein, supra note 10.
27 Epstein, supra note 10.
28 Id.
30 Savare and Jaycobs, supra note 3.
issuer of securities to advertise the sale of its securities; 32 additionally, “there are no restrictions imposed on a company with respect to offerees or how many securities it may sell.”33 Registered securities on the public markets “increase name recognition and market credibility”34 and raises the sale price of shares. A public offering also creates an attractive liquid market for shareholders since the shares are re-sellable and prices are “readily ascertainable.”35

However, the SEC’s reporting and disclosure requirements make SEC registration for a small company, like an indie film producer prohibitively expensive. The legal, accounting, and publication cost to register a public securities offering with the SEC is approximately $500,000 and the ongoing reporting requirements leave a small company exposed to shareholder litigation.36 As a result, entertainment industry experts discourage public offerings for a film budget that is less than $20 million.37 With the average indie film production budget at the iconic Sundance film festival priced at $1,000,000,38 SEC registration is prohibitively expensive for indie film producers. Since 2008, in order to reach equity investors without the burden of SEC registration, indie film producers have used private placements and crowdfunding to fill the void.

B. Private Placements

In an effort to raise equity-based capital, indie film producers have taken advantage of statutory exemptions from the SEC’s registration requirements to issue securities in non-public

34 Moore, supra note 8, at 52.
35 Id.
36 Id.
37 Id. at 51.
offerings known as private placements. The three most important private placement exemptions employed by filmmakers are Regulation D Rule 504, Regulation D Rule 506, and Rule 147. While these private placement offerings do exempt small offerings from the onerous SEC registration requirements, they, unlike public offerings, impose conditions that limit the potential pool of investors.

Regulation D Rules 504 and 506 provide for exemptions to SEC registration but restrict access to the pool of eligible investors. Rule 504 permits issuers to raise up to $1,000,000 within a twelve month period. While the issuer may accept funds from an unlimited number of investors, the issuer is restricted to soliciting investment from investors with whom the upper level management has a pre-existing relationship. Rule 506, on the other hand, offers the issuer the opportunity to raise an unlimited amount of money but limits the number and type of investors through investor sophistication requirements. Under Rule 506, an unlimited number of accredited investors but up to 35 non-accredited investors are permitted to invest in a single offering.

Accredited investors are defined as “a natural person whose net worth (together with their spouse, if any) exceeds $1,000,000 (excluding the value of such person’s principal residence); a natural person who had an individual income in excess of $200,000 if single (or $300,000 if married) in each of the two most recent years, and who reasonably expects an income in excess of that amount in the current year; an entity that has over $5 million; or an entity owned solely by one or more of the foregoing.” Unlike Rule 504 which places no requirements on non-

39 JOHN W. CONES, 43 WAYS TO FINANCE YOUR FEATURE FILM 143 (1995).
40 MOORE, supra note 8 at 47.
41 MOORE, supra note 8 at 47.
42 See CONES, supra note 37, at 144.
43 Id. at 152.
44 See Moore, supra note 8 at Moore 47.
accredited investor sophistication, non-accredited investors are also required to “have such knowledge and experience in financial and business matters that the purchaser is capable of evaluating the merits and risks of the prospective investment” or the “issuer must reasonably believe prior to making any sale that the purchaser comes within that description.” There are between approximately 5 million and 7.2 million accredited investors in the United States. Unlike, publicly offered securities, Regulation D Rule 504 and Rule 506 securities are restricted and cannot be resold. Regulation D currently imposes a prohibition on advertising and solicitation that limits the pool of investors. Rule 504 and Rule 506 are both subject to Rule 502 (c), which prohibits “general solicitation and general advertising.” Such solicitation includes “any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio” and hosting “any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.” The Commission’s rulings are expansive interpreting this prohibition including even “unrestricted websites” as constituting “general solicitation and general advertising.” This means that for both Rule 504 and 506 offerings, solicitation is limited only to people the issuer already knows unless the issuer uses a broker-intermediary with its own pre-existing relationships; intermediaries charge commissions between 2.7% and 6.4% cutting into an indie

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45 See Cones, supra note 37, at 153.
46 Scott Shane, How Dodd’s Reform Plan Hurts Startup Finance, BLOOMBERGBUSINESSWEEK (March 19, 2010).
47 General Conditions to be Met, 17 C.F.R. § 230.502 (d) (2013).
48 § 230.502 (c).
49 § 230.502 (c) (1)-(2).
producer’s already tight budget.\textsuperscript{51} This prohibition also causes reluctance on the part of investors who fear that any leak of information will transform the securities from exempt to unregistered.\textsuperscript{52} Regulation D’s limitations have offered indie producers a narrow set of prior existing relationships to reach a limited pool of eligible investors.

Rule 147A is an exemption from SEC restrictions for a purely intrastate offering. Rule 147A creates no limit on the amount of money that can be raised, the number of offerees, or the number of investors; there are also no federal filing requirements.\textsuperscript{53} However, like Regulation D, this private placement also limits the size of the investor pool. The issuing entity must be a company organized in a specific state and doing business in that state.\textsuperscript{54} The offering must be conducted in that state and the investors must reside in the same state.\textsuperscript{55} All proceeds from the offering must be used in the same state.\textsuperscript{56} The securities are for the most part, illiquid; the securities may be resold only within 9 months of the initial offering and the issuer must take affirmative steps “including putting an appropriate legend” on the securities to prevent the sale of the securities across state lines.\textsuperscript{57} Rule 147A’s limitations make it only useful for indie film producers organized in a state interested in selling securities and using the proceeds from securities in one state.

\textit{C. Crowdfunding}

\textsuperscript{51} \textit{Id.} at 48.
\textsuperscript{52} \textit{Id.} at 49.
\textsuperscript{53} \textsuperscript{MOORE, \textit{supra} note 8, at 48.}
\textsuperscript{54} \textit{Id.}
\textsuperscript{55} \textit{Id.}
\textsuperscript{56} \textit{Id.}
\textsuperscript{57} \textit{MOORE, \textit{supra} note 8, at 48.}
Crowdfunding is the act of raising money through relatively small contributions from a large number of people.\textsuperscript{58} The Internet has amplified the potential for crowdfunding because it is an easily accessible communication tool for the general public.\textsuperscript{59} Since the term “crowdfunding” was first coined in relation to the internet in 2006,\textsuperscript{60} crowdfunding has become “big business”,\textsuperscript{61} in 2011, almost $1.5 billion was raised by crowdfunding portals world-wide.\textsuperscript{62}

Current crowdfunding platforms offer five different ways of raising capital: (1) the donation model; (2) the reward model; (3) the pre-purchase model; (4) the lending model and the equity based model.\textsuperscript{63}

These five different models offer investors different ways to participate in contributing capital to a project. Under the donation model, investors receive no material benefit in exchange for their payment even though the recipient may be a for profit enterprise.\textsuperscript{64} The reward-based model offers the donor a gift such as a “keychain” or “the investor’s name on the credits of a movie.”\textsuperscript{65} The pre-purchase model is the most common and generally offers investors the product the company plans to create in exchange for a donation that is below the retail value of the product.\textsuperscript{66} The lending model provides funds on a temporary basis, expecting repayment and in some cases, investors are promised interest on the funds they loan.\textsuperscript{67}

\textsuperscript{59} Id. at 4.
\textsuperscript{60} Id. at 11.
\textsuperscript{61} Id.
\textsuperscript{63} Bradford, supra note 51 at 13-15.
\textsuperscript{64} Id. at 15.
\textsuperscript{65} Id. at 16.
\textsuperscript{66} Id. at 16.
\textsuperscript{67} Id. at 20.
Equity-based crowdfunding “offers investors a share of profits or return of the business they are helping to fund.”68 A passive profit interest, such as one in a film, implicates SEC registration requirements that would prohibit advertising unregistered securities under the Securities Act;69 such advertising includes merely putting the securities for sale on a publicly accessible website.70 The dual pressures of the prohibitive expense of SEC registration and the advertising limitations on private placement offerings have snuffed out equity-based crowdfunding in the United States.71 As a result, “there are now no major, publicly accessible equity crowd-funding sites in the United States.”72 However, crowdfunding has enabled capital formation for entrepreneurs primarily through the perks based programs: rewards and pre-purchase based platforms.73

The leading sources of funding for entrepreneurs through crowdfunding are Indiegogo and Kickstarter, two rewards and pre-purchase model based platforms.74 Kickstarter offers site visitors the opportunity to donate money to projects they are interested in in exchange for a “reward.”75 Rewards are generally related to the execution of the project: “a copy of the CD, a print from the show, a limited edition comic”;76 rewards are generally priced higher than the donation from a project supporter.77 Kickstarter does not release the donated funds until the project reaches a stated campaign goal.78

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68 Id. at 24.
69 Id. at 22.
71 Bradford, supra note 51 at 4-5.
72 Id. at 25.
73 Id. at 16.
74 Id. at 16.
75 Id. at 17.
76 Id. at 17.
77 Id. at 17.
78 Id. at 19.
Indiegogo on the other hand, does not require “rewards” but highly encourages their use.\(^{79}\) Indiegogo also differs from Kickstarter by allowing projects to draw on raised funds whether or not the stated funding goal has been reached.\(^{80}\) Both Indiegogo and Kickstarter collect fees for hosting the fundraising portal. Kickstarter collects a 5% fee only if the funding goal has been reached; Indiegogo collects a 4% fee if the funding goal has not been reached and 9% if it has been reached.\(^{81}\) The success of Indiegogo and Kickstarter have made them the preferred choice for crowdfunding amongst indie film producers.

Indie film producers have experienced exceptional fundraising success using Kickstarter and Indiegogo. Indiegogo was launched in 2008 at the Sundance Film Festival originally solely for indie film projects and raised $10,000 for its first film within three months of its founding.\(^{82}\) However, Kickstarter has emerged as the dominant brand for indie film producers. Between 2012 and 2013, approximately 10% of the films at the Sundance Film Festival were Kickstarter financed, as was the 2013 Best Documentary Short Oscar winner, \textit{Inocente}.\(^{83}\) By January 2013, Kickstarter had raised $100 million for independent films.\(^{84}\) Indie films’ success using Indiegogo and Kickstarter evidence the energized globally accessible pool of capital available to filmmakers online.

\textbf{Part III: The JOBS Act}

\(^{79}\) \textit{Id.} at 17.

\(^{80}\) \textit{Id.} at 19.

\(^{81}\) \textit{Id.} at 19.


\(^{83}\) Angela Watercutter, \textit{The First Kickstarter Financed Film Takes Home Crowdsourced Gold}, \textit{WIRED} (Feb. 25, 2013, 7:05pm), http://www.wired.com/underwire/2013/02/kickstarter-first-oscar/.

\(^{84}\) \textit{Id.}
A. Relevant Provisions

In April 2012, President Barack Obama signed into law the JOBS Act.\footnote{President Obama signs the JOBS Act into law, C-SPAN (April 5, 2012), http://www.c-span.org/Events/President-Obama-Signs-the-JOBS-Act-Into-Law/10737429665/} One of the primary purposes of the JOBS Act is to facilitate capital formation for small companies, which includes indie film producers.\footnote{Bruce, supra note 2.} The JOBS Act contains two provisions that have the power to enhance the capital raising efforts used by indie producers in the wake of falling pre-sales. The first provision is Section 201 of the JOBS Act, which excludes Regulation D Rule 506 private placement offerings from the Regulation D general prohibition against advertising and solicitation.\footnote{Savare and Jaycobs, supra note 3.} The second provision is title 3 of the JOBS Act, which legalizes internet supported equity based securities offerings to the public by creating an exemption from SEC registration for the sale of crowd-funded securities.\footnote{Id.} Both changes have the power to make capital raising devices used by indie producers post 2008 global financial crisis even more effective.

B. Regulation D, Rule 506

The JOBS Act exempts Regulation D, Rule 506 from Regulation D’s prohibition against advertising and solicitation. Section 201 (a) of the JOBS Act amends, “Rule 506 [to] provide that the prohibition against general solicitation and general advertising contained in rule 502 (c) of Regulation D would not apply to offers and sales of securities made pursuant to Rule 506.”\footnote{SEC Proposed Rules, supra note 49, at 1.} While Rule 504 remains subject to the general prohibition against advertising and solicitation, Rule 506 offerings are no longer restricted to pre-existing relationships. An issuing entity is still permitted to offer securities under Regulation D Rule 506 based on the rules in place prior to the
adoption of the JOBS Act.\textsuperscript{90} In August of 2012, the SEC proposed rules that implement Section 201 of the JOBS Act.\textsuperscript{91}

The JOBS Act mandates the SEC determine rules to permit general advertising and solicitation based on criteria enumerated in section 201(a) of the JOBS Act.\textsuperscript{92} While Section 201 permits advertising to non-accredited investors, it requires that if general advertising is employed, “all purchasers of the securities [be] accredited investors.”\textsuperscript{93} This is unlike Regulation D Rule 506 prior to the JOBS Act, which permitted the purchase of securities by up to 35 non-accredited investors.\textsuperscript{94} Section 201 attaches a verification requirement to the new Rule 506 offering: the issuer must take “reasonable steps” to verify that the purchasers are accredited investors, but leaves the methods of verification in the hands of the SEC.\textsuperscript{95}

The SEC has proposed an “objective” standard to determine the status of investors in Regulation D, Rule 506 offerings that employ advertising and solicitation.\textsuperscript{96} The SEC has proposed a requirement that the “issuer take reasonable steps to verify” that the purchasers of the offered securities are accredited investors.\textsuperscript{97} Instead of a uniform verification approach that the SEC claims could become inflexible to innovation in the market, the SEC has proposed three factors will serve to inform the SEC of compliance with the “reasonable steps” standard.\textsuperscript{98} These three factors are the “nature of the purchaser”, the “amount and type of information” the issuer

\textsuperscript{90} Id. at 51.
\textsuperscript{91} Id. at 1.
\textsuperscript{93} §201 (a), 126 Stat. at 313.
\textsuperscript{94} CONES, supra note 37, at 152.
\textsuperscript{95} §201 (a), 126 Stat. at 313.
\textsuperscript{96} SEC Proposed Rules, \textit{supra} note 49 at 14.
\textsuperscript{97} Id.
\textsuperscript{98} Id. at 85.
has about the purchaser and the “nature of the offering.” No one factor is determinative; all three factors are weighed to determine whether the issuer undertook reasonable steps to verify the status of the investor.

An issuer is more likely to comply with the SEC’s proposed rules for amended Regulation D, Rule 506 when the “nature of the investor” is more likely accredited. The SEC’s definition of “accredited investor” in the proposed rules is the same as the definition in Regulation D. The SEC proposed rules that indicate that sufficient verification could range from “going to FINRA’s BrokerCheck website” or issuing a “net worth test.” The “nature of the purchaser” factor will cut in favor of the issuer if the investors fall into one of the enumerated categories of accredited investors under Regulation D, or an issuer reasonably verified an investor fell into one of these categories.

The “amount and type of information” factor is tied to the requirement that issuers take “reasonable steps to verify” that the purchasers are in fact accredited investors. The SEC has adopted a sliding scale for this factor: the “more information an issuer has indicating that a prospective purchaser is an accredited investor, the fewer steps it would have to take and vice versa.” The SEC cites “publicly available information in filing with a federal, state or regulatory body, third party information that provides reasonably reliable evidence (such as a trade publication or a W-2 form, or verification of a person’s status by a third party, provided that the issuer has a reasonable basis to rely on such third party verification” as examples of

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99 *Id.* at 14.
100 *Id.*
101 *Id.* at 14-15.
102 *Id.* at 16-17.
103 *Id.* at 17.
104 *Id.* at 17
sources that may be used to verify a purchaser’s status.\textsuperscript{105} While the SEC does not specify which one, depending on the circumstances, any one of these examples could constitute reasonable steps.\textsuperscript{106} If an issuer identifies third party information that is sufficiently reliable indicating the investor is an accredited investor, this factor would weigh against liability for the issuer.

The SEC uses a similar sliding scale in relation to the “nature of the offering” factor.\textsuperscript{107} The more publicly accessible the offering is, the higher the burden lies for the issuer to show reasonable steps to verify accredited investor status. The SEC provides an example, hypothesizing that “an issuer that solicits new investors through a website accessible to the general public or through a widely disseminated e-mail or social media solicitation would likely be obligated to take greater measures to verify accredited investor status than an issuer that solicits new investors from a database of pre-screened accredited investors created and maintained by a reasonably reliable third party, such as a broker dealer.”\textsuperscript{108} Unlike the self-certification currently permitted within Rule 506, “merely checking a box on a website would not suffice”; however, “relying on a third party curated database” can be sufficient if the third party source is credible.\textsuperscript{109} The more curated and reputable the solicitation database, the more likely the SEC will find the “steps” reasonable and the offering in compliance. Although not yet adopted, the SEC’s proposed rules provide a likely implementation of section 201 (a) of the JOBS Act.

\textit{C. Crowd-funding}

\textsuperscript{105} Id. at 18.
\textsuperscript{106} Id. at 17.
\textsuperscript{107} Id. at 19.
\textsuperscript{108} Id. at 19.
\textsuperscript{109} Id. at 19.
The JOBS Act breathes life into equity-based crowdfunding by exempting the sale of securities on the internet from SEC registration. Title 3 creates a new exemption from the general rule that securities must be registered with the SEC; the exemption is available under a set of circumstances tailored to promote capital formation for small businesses by selling securities on the internet.110 While the SEC has not issued proposed rules yet that implement title 3’s mandate, the title itself offers directives for the implementation of investor, intermediary and issuer regulations.111

The JOBS Act’s crowdfund exemption employs an aggregate offering ceiling and investment limitations. The crowdfund exemption places a ceiling on the aggregate offering amount at $1 million over a 12 month period.112 Annually, issuers may not accept from individual investors “the greater of $2,000 or 5% of an investor’s annual income or net worth for investors with an annual income or net worth of less than $100,000” and “individuals may not invest more than the lesser of $100,000 or 10% of an investor’s annual income or net worth if an investor’s net worth is equal to or more than 100,000.”113 These limitations have been put in place to safeguard non accredited investors;114 however, they also lower the threshold required to participate in the non-public offering market open the gates to a vastly expanded pool of “ordinary” investors.115

The crowdfund exemption requires that an issuer conduct its offering through an

112 Id.
113 Id.
115 Mandelbaum, supra note 109.
Intermediaries, such as websites, are required to register with the SEC as either brokers or funding portals. Brokers are any intermediary “engaged in the business of effecting transactions in securities for the account of others”; broker dealers are subject to a number of SEC regulations including “myriad fees, disclosure requirements and conduct rules that limit how intermediaries may conduct their business” exposing them to fines and other punishments for non-compliance. Funding portals are a new type of intermediary that have been created by title 3; a funding portal is an intermediary that offers or sell securities for the accounts of others solely pursuant to Title 3 of the JOBS Act. Broker dealers are subject to funding portal requirements but funding portals are not subject to broker-dealer requirements when both are acting as intermediaries for a crowd-funding transaction. Title 3 directs the SEC to protect investors by demanding rigorous reporting and disclosures from intermediaries. Funding portals must provide “disclosures related to risks and other investment education materials”, affirm acceptance of investment risk by investors, actively “take measures” to reduce fraud and ensure that all offering proceeds are provided to the issuer only when the aggregate capital raised from all investors is equal to or greater than the offering.

The JOBS Act imposes reporting and disclosure requirements on issuers. Issuers must make available to the SEC and their broker or funding portal the issuing company’s basic

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116 §302 (a), 126 Stat. at 315.
117 Id.
119 Id. at 3.
120 Id.
121 §302 (b), 126 Stat. at 316; Powers, supra note 101 at 3.
corporate information and the financial condition of the issuer.\textsuperscript{122} Information on the financial condition of the company includes all securities offerings within the preceding twelve-month period.\textsuperscript{123} If the target offerings amounted to $100,000 or less, only the income tax returns filed by the issuer and financial statements provided by the issuer are required.\textsuperscript{124} If the target offering was between $100,000 and $500,000, the SEC will require financial statements reviewed by a public accountant; target offerings of more than $500,000 are to be audited.\textsuperscript{125} Additionally, issuers must provide a description of the purpose and updated statements on the use of the funds, the target offering amount, the price or method of determining the price of the securities, a description of the ownership and capital structure, and file reports describing the results of annual business operations.\textsuperscript{126} The JOBS Act disallows specific types of promotion for crowdfunded offerings; issuers are prohibited from advertising the offering, “except for notices which direct investors to the funding portal or broker” and may not compensate any person promoting the offering without taking steps approved by the SEC.\textsuperscript{127}

The SEC missed its December 2012 deadline to issues rules implementing the provisions of title 3.\textsuperscript{128} Certain provisions of title 3 have been left entirely open to the SEC and the rules it will adopt will dictate the regulation of intermediaries, investors, and issuers. Intermediaries await rules that will regulate the requirements that will determine sufficient education of investors,\textsuperscript{129} a standard for adequate fraud protection\textsuperscript{130}, and set the number of days prior to an

\begin{footnotesize}
\begin{enumerate}
\item[122] §302 (b), 126 Stat. at 317.
\item[123] Id.
\item[124] Id.
\item[125] Id.
\item[126] §302 (b), 126 Stat. at 317-318.
\item[127] Id.
\item[128] Mandelbaum, supra note 109.
\item[129] §302 (b), 126 Stat. at 316.
\item[130] Id.
\end{enumerate}
\end{footnotesize}
offering intermediaries are required to provide disclosures.\textsuperscript{131} The JOBS Act also requires the SEC to make rules on the release of funds to an issuer based on the aggregate offering price and capital raised,\textsuperscript{132} outline the professional standards for financial statements when an offering is between $100,000 and 500,000\textsuperscript{133} and if the SEC elects, change the $500,000 amount that triggers the requirement for audited financial statements.\textsuperscript{134} The SEC must also create the rules that will permit an issuer to compensate a promoter of an offering and specify the reporting requirements an issuer must make available annually to the SEC.\textsuperscript{135} While entrepreneurs cannot take advantage of the crowdfunding provisions until the rules have been adopted, title 3’s framework alone indicates that the regulatory landscape will accommodate equity based crowdfunding.

Part III. Impact of the JOBS Act on Indie Film Finance

A. Private Placement and the introduction of General Solicitation

The JOBS Act will likely succeed in increasing the flow of capital through Regulation D, Rule 506 to small companies, including indie film producers. Regulation D is the most commonly used private placement device and Rule 506 is the most popular exemption within Regulation D.\textsuperscript{136} In 2009, 2010, and 2011 Rule 506 represented 93\% of Regulation D offerings;\textsuperscript{137} in the same time period Rule 506 accounted for 99\% of the funds raised under Regulation D. In 2009, the total amount raised by Regulation D offerings was second only to

\textsuperscript{131} Id.
\textsuperscript{132} §302 (b), 126 Stat. at 317.
\textsuperscript{133} Id.
\textsuperscript{134} Id.
\textsuperscript{135} Id.
\textsuperscript{136} See SEC Proposed Rules, supra note 49, at 46.
\textsuperscript{137} Id.
public offerings.138 Rule 506 has experienced this level of success despite the general prohibition on advertising and solicitation’s stranglehold on the number of investors to whom issuers could reach.

The elimination of the ban on advertising and solicitation in Regulation D Rule 506 offerings will expand the pool of accessible capital for private placements, reduce transaction costs, and boost investor confidence in the private market for indie films. Prior to the JOBS Act, indie filmmakers were relegated to contacting pre-existing relationships for investment in their films. Indie film producers without connections to high net worth individuals or investment institutions were forced to rent the rolodexes of commission charging broker intermediaries.139 The amendments to Rule 506, while precluding the investment of thirty-five non-accredited investors, open up access to the capital of all accredited investors.140 Niche markets power indie films;141 authorization to advertise gives indie filmmakers the license to use tools typically used such as magazine advertisements and social media142 to cast a wider net and find members of special interest groups interested in seeing a project come to life.

Indie producers can alert accredited investors interested in the indie producer’s cause to the filmmaking opportunity by using any means available including billboards, television

138 Id.
139 Id. at 48.
140 Shane, supra note 46.
commercials and websites. \footnote{SEC Proposed Rules, \textit{supra} note 49, at 6.} Regulation D Rule 506 dramatically increases the chances for an indie producer to identify high net worth entities in the limited accredited investor pool; conversely, high net worth entities will have an easier time identifying indie film opportunities to invest in.

Lifting the ban on advertising will also likely increase investor confidence. Prior to the JOBS Act, a leak of any information through any source, including a newspaper interview, could threaten the exemption from registration provided by Regulation D. \footnote{\textit{Id.} at 49.} The JOBS Act allows filmmakers to publicly advertise securities subject only to applicable anti-fraud laws. \footnote{Small Business and the SEC, (Dec. 21, 2012), http://www.sec.gov/info/smallbus/qasbsec.htm.} Investor confidence will increase in indie film investment since the JOBS Act will eliminate the risk that the securities will potentially turn into unregistered publicly offered securities. \footnote{SEC Proposed Rules, \textit{supra} note 46, at 48.} Since film investors tend to invest in a “slate” or a group of movies to mitigate risk, it is likely the indie film industry as a whole can expect increased capital flow. \footnote{Lindsay Palmer, http://www.carseywolf.ucsb.edu/mip/blog/5-things-know-about-hollywood-hedge-funds.}

While the amended rule 506 does impose accredited investor verification obligations on indie film producers, it is unlikely those obligations will hamper capital raising efforts. The adequate verification of accredited investors will require indie film producers to satisfy the SEC’s three part test. \footnote{SEC Proposed Rules, \textit{supra} note 49, at 27.} In order to fulfill the “nature of the purchaser” component, the indie producer would have to obtain information relating to an individual or entity’s net worth, annual income or verify their status on a credible website; \footnote{\textit{Id.} at 16.} this step only requires that the producer

\footnote{SEC Proposed Rules, \textit{supra} note 49, at 27.}
collect documentation or conduct an internet search. The “information about the purchaser” part of the test can be fulfilled if the indie producer checks publicly available information such as IRS forms, copies of a W-2 form, or confirming accredited status based on an account by a trusted third party such as an attorney or accountant.\textsuperscript{150}

The final test, the “nature and terms of the offering” can be managed by the indie producer based on the type of solicitation; if the indie producer more accessibly advertises its offering, such as through a website, the indie producer would have to collect third party confirmation of accredited investor status.\textsuperscript{151} However, if the indie producer advertises an offering through a pre-screened database, an indie producer “would be entitled to rely on a party that has verified a person’s status as an accredited investor.”\textsuperscript{152} The verification steps demanded by the SEC rules range between receiving readily accessible documents from investors, an internet search, asking a third party or relying on a curated database. These steps are unlikely to deter an indie producer from taking advantage of the expanded opportunity to reach accredited investors through amended Regulation D Rule 506.

\textbf{B. Equity Based Crowd-funding}

The JOBS Act’s crowdfund exemption is uniquely suitable for the changing indie film industry. Indie filmmakers’ success in raising money through donation based crowdfunding platforms shows that a vibrant capital market exists for indie films. The JOBS Act provides indie filmmakers the opportunity to reach a global audience of both accredited and non-accredited investors; this market is open to anyone with access to the internet access to even small amounts

\textsuperscript{150} Id. at 16-17.
\textsuperscript{151} Id. at 19.
\textsuperscript{152} Id. at 19-20.
of money. In 2010, the average production budget for an indie film at the Sundance film festival was $1,000,000 which means the aggregate offering ceiling for crowdfunded securities under the JOBS Act is no bar to financing.

Even for films that will cost over $1,000,000, raising an initial $1,000,000 will likely reduce the credit or investment risk of a project and spark investment by institutional investors. Not only will the JOBS Act aid in raising capital for production, it will also increase the chances that indie films will have a chance at theatrical release. The JOBS Act allows for multiple raises as long as the raises are split by 12 months; therefore, an indie filmmaker can conduct a second offering that will finance the distribution of the film. The initial raise can also act as a source of credibility to increasingly conservative distributors who can leverage the implicit promotion of a fundraising campaign for all avenues of distribution including box office, television and video on demand sales. Additionally, crowdfunded securities can be resold; this secondary market creates liquidity that boosts investor confidence through readily ascertainable values for shares.

Until the JOBS Act, indie film producers managed to successfully raise funds through rewards and pre-purchased based crowdfunding without granting equity to the donors. As a result, indie film producers may be reluctant to utilize equity-based crowdfunding. However, it is most likely that rewards and pre-purchase based crowdfunding and equity based crowdfunding

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154 §302 (a), 126 Stat. at 316.
155 See Savare and Jaycobs, supra note 3.
156 See Savare and Jaycobs, supra note 3.
157 Id.
158 Id.
159 See Savare and Jaycobs, supra note 3; see Moore, supra note 8 at 47.
will “co-exist” and serve different capital purposes. Indie filmmakers will likely continue to benefit from rewards and pre-purchase based donors; the introduction of equity based crowdfunding is unlikely to make an impact on those donors who contributed capital to projects to support art. However, films with more “commercial appeal” will likely benefit from the addition of equity based crowdfunding. It is likely that a liquid secondary market that offers readily ascertainable values to investors for film securities will draw in investors looking for profit to the indie film crowdfunded projects. Once equity based crowdfunding enters the indie film market, it is also possible that at least some of the capital contributors to indie films will start to expect a profit interest in films instead of a reward or pre-purchase gift.

The massive global scale offered by crowdfunding substantially reduces capital barriers for potentially lucrative projects; while a rewards based raise, Zach Braff’s successful May 2013 campaign raised $2,000,000 for a film project with $1.00 minimum pledges. While most indie films lose money, some films like “Napoleon Dynamite” and “Paranormal Activity” generate large profits. Paranormal Activity was made for $15,000 and grossed $193,000,000 while Napoleon Dynamite, made for $400,000 grossed $46,000,000. The low cost of investor entry coupled with the potential for high returns, will likely draw a large investor pool to commercially marketable projects.

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160 Barnard, supra note 140.
161 Id.
162 Id.
163 Savare and Jaycobs, supra note 3.
Conclusion

While the 2008 financial crisis fundamentally altered the capital structure of the indie film, the JOBS Act will fundamentally augment capital sources available to the indie film industry at the time it is most starved. Section 201 of the JOBS Act will enable indie film producers to reach accredited investors more easily through any means of communications; the costs imposed by verification requirements will likely be negligible when compared to the benefits. However, the benefits of Title 3’s equity based crowdfunding will likely outshine the benefits of Section 201. Section 201 expands the reach of indie producers to accredited investors. But Title 3’s crowdfunding exception has enlarged the indie producer’s capital market to over 2 billion internet users. The success of perks based crowdfunding indicates an energized capital market available to indie filmmakers and a secondary market will draw in investors purely interested in the potential for profit. The JOBS Act will likely not only rescue indie film from capital starvation, but also create a regulatory landscape that will facilitate a resurgence in the indie film industry.