Crowdfunding & Cryptocurrency - A New Conduit to Film Finance

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ABSTRACT

Despite the normal volatility in the film industry, it remains as robust as ever and is projected to grow to $47.9 billion dollars by 2022, slightly outpacing the U.S. economy. Prior to the latest wave of media consolidation, seven major studios controlled four-fifths of the film industry’s revenue in 2017. Superhero films and other costly genres represent a large portion of that revenue, which have dominated the marketplace. This over-indexing in the production of genre films is a result of the major studios trying to generate massive audiences by producing tent pole pictures. The combined industry box office revenue in 2018 was almost 3.3 billion, largely due to the success of genre films. However, these types of revenues do not cultivate much of an appetite in the industry for funding arthouse films. Nor does this trend of massive budgets bode well for the inevitability bursting the spending bubble or a mega picture flop.

The increased fragmentation of viewing audiences, the shrinking theatrical windows, and the exploitation of the indie film market by streaming services like Netflix, has shifted the economics of the film business. From the arthouse moviemaker to the major studio producer or film financier/venture capitalist, everyone is looking for new diversified investors to help mitigate their risk and stabilize their investments through strategic co-financing models. That is why many in the entertainment business see the emergence of crowdfunding and cryptocurrency as the answer to some of these film financing dilemmas. Through changes in equity crowdfunding legislation combined with new technological advances like blockchain, producers may be able to effectively hedge their costly investments, while generating a more expansive investor pool to fund the dearth of arthouse pictures.

These high-tech innovations, new business models and legislative advancements promise to overcome the longstanding barriers to progressive changes in the film industry like combating inefficient and unfair business practices and the exclusivity of film investments as an asset class limited to the wealthy and well-connected. There are still lots of regulatory, technological and credibility hurdles to surmount before crowdfunding with cryptocurrency becomes a viable or practical industry-wide solution for raising capital. But there’s strong evidence that the latter might be a real possibility sooner than we think. Equity crowdfunding coupled with cryptocurrency through blockchain will be the key to unlocking that future capital. So, whether cryptocurrency through blockchain helps connect unbanked communities to the global economy, supplant Byzantine bureaucracies in film financing or just guarantees fair dealing in a business transaction with potentially dubious investors, it will certainly live up to its moniker as the internet 2.0 for Hollywood. Revolutionizing film finance is now more important than ever as the Covid-19 tsunami envelopes the entertainment business and our global economy.

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INTRODUCTION

Despite the normal volatility in the film industry, it remains as robust as ever and is projected to grow to $47.9 billion dollars by 2022, slightly outpacing the U.S. economy.\(^1\) Prior to the latest wave of media consolidation, seven major studios controlled four-fifths of the film industry’s revenue in 2017.\(^2\) Superhero films and other costly genres represent a large portion of that revenue, which have dominated the marketplace.\(^3\)

This over-indexing in the production of genre films is a result of the major studios trying to generate massive audiences by producing tent pole pictures.\(^4\) The combined industry box office revenue in 2018 was almost 3.3 billion, largely due to the success of genre films.\(^5\) An example of that is “Avengers: Endgame” grossing $357.12 million opening weekend in North America.\(^6\) Additionally, the titles: “Iron Man 3,” “Captain America: Civil War,” “Batman v Superman: Dawn of Justice” and “Black Panther” each grossed between $150 to $210 million during their North American opening weekends.\(^7\)

However, these types of revenues do not cultivate much of an appetite in the industry for funding arthouse films. Nor does this trend of massive budgets bode well for the inevitability of a mega picture flop or bursting of the spending bubble. That is why many in the entertainment business see the emergence of crowdfunding and cryptocurrency as the answer to some of these

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\(^3\) Id.

\(^4\) Id.


\(^6\) Id.

\(^7\) Id.
film financing dilemmas. Through changes in equity crowdfunding legislation combined with new technological advances like blockchain, producers may be able to effectively hedge their costly investments, while generating a more expansive investor pool to fund the dearth of arthouse pictures. These high-tech and legislative advancements promise to overcome the longstanding barriers to innovation in the film business like the inefficient and unfair business practices and the exclusivity of film investments as an asset class limited to the wealthy and well-connected. Revolutionizing film finance is more important than ever as the Covid19 tsunami envelopes the entertainment business and our global economy.8

Evolving Ecosystem

As our financial markets, technology and laws continue to evolve so does our entertainment content ecosystem, and premium content is valued higher than before.9 The massive consolidation of today looks like we’re in the media arms race of the century.10 Furthermore, the streaming wars between the big media conglomerates (AT&T, Disney and Comcast) and the tech titans that descended on Hollywood (Amazon, Netflix and Apple) resulted in over $35 billion being spent, collectively, on original content for their over-the-top platforms (OTT).11 These changes deftly underscore the shift in the entertainment business from linear programming to on-demand content.12 At the heart of these seismic changes in the

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television content ecosystem is the collapsing of the pay tv business (i.e., cable operators like Comcast and Time Warner) due to cord-cutters and cord nevers.\textsuperscript{13}

While pay cable providers are hemorrhaging cash due to cord-cutters and cord nevers, the streaming services are growing stronger. Tech companies with valuations in the high billions and low trillions (Facebook, Google, Apple and Amazon) are prepared to lose money on producing content in order grow their subscription services or hardware sales.\textsuperscript{14} As the streamers build their original content slates and libraries, they are putting independent distributors and arthouse shingles out of business.\textsuperscript{15} Whether it’s due to failed business strategies, increased competition or just mismanagement, indie distribution labels and the studio arthouse shingles are going out of business.\textsuperscript{16}

Netflix and Amazon are outbidding indie distributors for films at the major markets like Toronto, while also filling a gap in the marketplace left by providing a reliable conduit for distribution.\textsuperscript{17}

At Sundance, Amazon and Netflix, which rely on subscriber growth rather than advertising or individual sales to drive profitability, waved around their checkbooks, buying more films at higher prices than the usual players, according to Variety. They stoked bidding wars for festival darlings such as Kenneth Lonergan’s \textit{Manchester by the Sea} (which Amazon purchased for a rumored $10 million) and \textit{The Birth of a Nation}, a slavery drama (which Fox Searchlight

\textsuperscript{14} Cynthia Littleton & Elaine Low, \textit{ Adapt or Die: Why 2020 Will Be All About Entertainment's New Streaming Battleground}, \textsc{Variety} (Dec 17, 2019, 6:00 AM), https://variety.com/2019/biz/features/streaming-2020-disney-plus-netflix-hbo-max-apple-tv-amazon-1203439700/.
\textsuperscript{17} Matt Donnelly, \textit{Toronto Film Market: Indie Distributors Struggle as Netflix, Amazon Look to Dominate (Again)}, \textsc{The Wrap}, https://www.thewrap.com/toronto-film-market-indie-distributors-struggle-netflix-amazon/ (last updated Sept. 7, 2017, 10:00 AM).
bought for $17.5 million, a Sundance record, even after Netflix reportedly bid $20 million).\textsuperscript{18}

Four wall film exhibitions don’t fit within the streaming business model unless the picture is an awards contender like Netflix’s Oscar winning film “Roma.”\textsuperscript{19} Roma, directed by Alfonso Cuaron, won four Critics’ Choice movie awards, three Oscars and four Baftas awards but Netflix did not adhere to the traditional ninety-day theatrical distribution window for a film.\textsuperscript{20} In order to lure cinephiles to the theaters, theatrical films traditionally run in theaters for three months but Roma only ran for three weeks before being released on Netflix.\textsuperscript{21} For Oscar consideration, films must be exhibited in theatres prior to or on the same day as an alternative distribution method.

Dismantling the nine-day window has created tension between Netflix and exhibitors.\textsuperscript{22} Netflix’s wants to acquire these films before they start production.\textsuperscript{23} That gives them control over the creative and leverage over distribution. It also enables them to program the film globally and not just to the territories that remain unsold by the filmmaker, thus enhancing their global library and distribution model.\textsuperscript{24}

While major studios need more money than ever for franchise-sized film budgets in order to grow their profit margins, indie filmmakers can no longer rely on funding from the declining number of specialty shingles and arthouse independents. Lack of consistent capital for indie

\begin{thebibliography}{9}
\bibitem{18} Nicole LaPorte, \textit{Apple, Facebook, Google, And Alibaba Take Hollywood}, FAST CO. (Apr. 18, 2016), https://www.fastcompany.com/3058507/apple-facebook-google-and-alibaba-take-hollywood.
\bibitem{21} R. Faughnder & J. Rottenberg, \textit{supra} note 19.
\bibitem{22} Id.
\bibitem{23} Pulver, \textit{supra} note 20.
\bibitem{24} Id.
\end{thebibliography}
production, increased fragmentation of audiences due to new competition for eyeballs, the shrinking theatrical windows, and the exploitation of the indie film market by streaming services like Netflix, has all shifted the economics of the film business. From the arthouse filmmaker to the major studio producer, everyone is looking for new financing partners and a means to mitigate risk.

This paper examines the viability of crowdfunding, equity crowdfunding and finally the combination of equity crowdfunding through cryptocurrency as possible solutions. These new resources may be more important than ever in the midst of the Corona pandemic. The risks attendant with big budget epics in the event of another virus outbreak will likely send those films into hibernation while the business incubates a slew of scaled-down character-driven films.

**DEBT FINANCING & FOREIGN PRESALES**

Raising capital for content through debt financing with bank loans is a common business tactic for large media companies because it’s relatively easy. Companies like Netflix, Legendary Entertainment and Lionsgate, among others, have the assets, collateral and track record that make them reliable borrowers. Netflix, with an approximate market cap of $130 billion, has a revolving credit line up to $750 million and recently raised $12.3 billion in debt to maintain its competitive edge in the flooded video-on-demand (VOD) marketplace. Chinese-backed Legendary Entertainment, purchased by Dalian Wanda Group for $3.5 billion in 2016, has a revolving credit line of $1 billion through J.P. Morgan to strengthen the company’s TV

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and film slate. Lionsgate, with an approximate market cap of $6 billion, closed an $800 million credit facility with J.P. Morgan in 2012 on the heels of its mega hits: “Hunger Games” and “Twilight.” But indie producers with midrange ($5 to $6 million) or small film budgets (under $2 million) (“average budget of $1 million per dramatic feature and $400,000 per feature documentary at Sundance”) aren’t able to easily look to these major lenders for financing. Bank financing for them entails jumping through a number of hurdles first for only partial funding.

For the indie producer to secure a production loan through a financing entity, they need to establish collateral to secure the loan (e.g., the producer’s personal assets, rights to the film property and/or rights to the film’s proceeds). That’s usually done by preselling a portion of the film’s distribution rights to one or more distributors that want the film in their foreign territory (e.g., Spain, France or the UK). In return for the rights to distribute the film, the distributor gives the producer about 20% of that rights fee accompanied by a contract guaranteeing the remaining portion when the film is delivered. But this conduit to financing is cumbersome, protracted and laden with expenses and shady intermediaries. It’s also not viable for producers without a solid track record and project that is highly marketable (i.e., packaged with “bankable”

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31 Id.


talent). Nonetheless, if a producer can overcome the latter obstacles and secure distribution deals (i.e., collateral) with credible distribution companies or well-respected sales agents with strong relationships with distributors, then they’ll likely secure a portion of their financing through a bank loan or other established financing entity. This is called “banking the money” in Hollywood parlance.\(^{34}\) But the bank loan will only equate to about eighty percent of the presale fee the distributor is guaranteed to pay to distribute the film when it’s complete.\(^{35}\)

Therefore, in addition to having to replicate this process multiple times to fully finance a budget through foreign presales as collateral for production loans, the lending institution will have an additional contingency before the release of any funding. That is the producer’s need to secure a completion bond (i.e., film completion insurance) to safeguard against the film not being completed due to unforeseen circumstances (e.g., it goes over budget).\(^{36}\) Without that completion bond guaranteeing the film’s completion and subsequent monetization through the film’s distribution in the presold territories, the bank’s collateral (i.e., the presold distribution rights) becomes useless. Furthermore, if the producer is still left with a “gap” in financing after the foreign presales, then the producer must secure bridge loans to close that gap (i.e., “gap financing”).\(^{37}\) These types of loans are more costly due to the higher risk that isn’t mitigated by collateral like presales, since it’s based on the “estimated value” of the film in the unsold territories.\(^{38}\) However, even if the producer is successful in jumping through all of these hoops, the expenses and fees can be cost prohibitive if the producer doesn’t have a significant development budget to engage in all of these business transactions. That means the producer will

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\(^{34}\) JOHN SAYLES & DIANE CARSON, JOHN SAYLES: INTERVIEWS (Diane Carson ed. 1999).

\(^{35}\) Litwak, supra note 32.

\(^{36}\) Id.


\(^{38}\) Id.
have to resort to a high interest “bridge loan” to “bridge the funding need” for that development budget as well.”

Here’s a general tally of the approximate expenses and fees associated with debt financing through bank loans: (i) 2% interest on the presale-backed loan at a floating variable interest rate such as prime or the London Inter Bank Offering Rate (LIBOR); (ii) upfront loan fee of 2% of the presale-baked loan; (iii) sharing a percentage of contingent participation with the bank in the film’s revenue; (iv) bank legal fees for preparing the loans (“two percent fee and about $75,000 in legal costs”); (v) upfront fees of 10%-12% for the gap financing loan and 3% to 5% interest rate over LIBOR on the loan; (vi) upfront fees of at least 10% of the bridge loan (if needed) and interest up to 1% per week (highest loan fees due to this being the riskiest loan); (vii) attorney fees between $35,000 and $50,000 for preparing and negotiating all of these documents and (viii) bank-required legal opinion letters from the producer’s lawyer regarding certain legal aspects of the film.  

As you can see, all of the business complexities, legal documents and disclosures to verify the producer’s business financials (business plan, tax returns, balance sheets, etc.) along with the multilayered steps to tether together funding and related expenses, severely prolongs the financing process. It also places more debt on the project and further attenuates the producer’s ability to fund pre-production, since the bank will not release the funds until right before the commencement of production. But financing alternatives do exists, such as financing through

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39 Id.
40 Moore, supra note 25.
41 Moore, supra note 37.
43 Moore, supra note 37.
crowdfunding, if the project and producer are prepared and suited for that alternative financing model.

**DONATION-BASED CROWDFUNDING**

In the event a producer doesn’t have the startup capital to finance through foreign presales, crowdfunding through donations is a practical approach to defraying those startup expenses or the full budget.\(^{44}\) Raising capital by working with a crowdfunding website can build exponential awareness for a project, which is critical to its commercial success. There are several internet-based platforms that successfully facilitate funding campaigns (Seed & Spark, Gofundme, etc.); however, Kickstarter, which launched in 2009 and raised over $4 billion in funds for 180,306 crowdfunded projects as of January 2020, is the most well-known.\(^{45}\) Indiegogo, which raised over $1 billion since its launch in 2007, is the second most successful platform.\(^{46}\)

Companies like Kickstarter help to organize, build and launch crowdfunding campaigns for up to 10% of the donations raised.\(^{47},^{48}\) In return for donations, the film donors often get perks or rewards (as described below) but they have no actual financial stake in the project.\(^{49},^{50}\) Some of these fundraising platforms are even designed with an “all or nothing” fundraising option,


\(^{50}\) Andrew A. Hecht, *Crowdfunding Right Now: Alternatives to Title III of the JOBS Act*, HECHT LAW PC (May 16, 2013), http://www.hechtbizlaw.com/TitleIIIAltternatives.pdf.
thus leaving the producer with none of the funds raised if they fail to meet their goal. An aspect like that can add credibility to a project and engender trust in the parties donating. But none of that matters if the project does not resonate with the funders. And that’s not an easy thing to do if the film is not celebrity driven or based on a popular social cause.

Celebrity-based projects have done well with donation-based crowdfunding.\textsuperscript{51} The first and most famous example is the “Veronica Mars” movie campaign on Kickstarter, which exchanged copies of the screenplay for $10.00 donations, or donors got a speaking role in the film for a $10,000 pledge.\textsuperscript{52} The campaign raised two million dollars in twelve hours (and $5.7 million in 30 days from 91,585 fans).\textsuperscript{53} Spike Lee’s project on Kickstarter: “The New Hottest” raised $1.4 million in 30 days with 91,000 backers.\textsuperscript{54} The Kickstarter funded film “The Canyons” (starring Lindsay Lohan and James Deen), raised $150,000 by offering donors writing sessions with film’s writer and script critiques from the film’s director.\textsuperscript{55} But again, it is extremely difficult to raise large sums of money like these through donations for projects not driven by a major talent or popular social cause.

On average, 1 out of every 3 crowdfunding campaigns on Kickstarter fail to reach their goal.\textsuperscript{56} Although this does not stop a filmmaker who wants to retain their creative control and spend a de minimis amount of money on launching their campaign without the need of lawyers,

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\textsuperscript{55} ALAN R. BROMBERG, LEWIS D. LOWENFELS, & MICHAEL J. SULLIVAN, BROMBERG & LOWENFELS ON SECURITIES FRAUD § 13:209 (2d ed. 2020).
\end{flushleft}
accountants or additional intermediaries. But when attempting to raise large sums of money from people or organizations that want more than a donation-based tax write off, funding in exchange for equity and profit participation (i.e., equity crowdfunding) becomes a more appealing alternative. The proposition of an ownership interest in a film greatly expands the potential funding pool, thereby allowing more access to capital for the project.

**EQUITY CROWDFUNDING**

In equity fundraising the producer offers funders partial ownership in the company that holds the film rights. This confers upon the investor an opportunity to participate in the film’s revenue in return their capital contribution to the budget. Large budget films typically cover about 25% to 60% of their costs with equity investments, while film budgets under $5 million customarily cover up to 100% of their costs with equity investments.57

But for the proper context on this approach to fundraising it is important to understand that raising capital in exchange for equity in a business enterprise is considered to be selling a “security” under section 2(a) of the Securities Act of 1933.58 That essentially means that state and federal securities laws will apply to the transaction in order to protect investors against fraud and help them make informed investment decisions. Therefore, the party (known as the “issuer”) raising the funds through equity investments needs to be prepared to follow federal and state securities guidelines. These rules are very labor intensive and costly based on the issuer needing to make all the necessary legal disclosures and provide investors with information to allow them to make an informed decision about their investment.59

Fortunately, two key barriers to crowdfunding through equity for producers (i.e., the Securities Exchange Commission (SEC) security registration requirement and prohibition on advertising and solicitations) have been eliminated for certain offerings by statutory exemptions under Regulation D (Reg D), Regulation A (Reg A+) and Regulation Crowdfunding (Reg CF), thus alleviating some the financial burden and delays in the process depending on the exemption they designate.60 61 Prior to some of these exemptions, the accounting, legal and related fees associated with the registration expenses, disclosures requirements and on-going compliance would easily amount to more than $100,000.62 63 Furthermore, the traditional exemptions that were designed to help small business owners (like film producers) under Title II Reg D64 and Title IV Reg A+65 of the Securities Act were practically prohibitive.66 It wasn’t until the Title III Reg CF was enacted, that indie producers had a viable option to crowdfunding with securities. However, even if the registration exemptions on crowdfunding under Reg D and Reg A+ are not relevant for the average indie project, they are often helpful to film financers and investors interested in larger commercial film projects who can afford the compliance expenses.

**Regulation D Offering**

Securities offerings exempted from registration are called “private placements” and are designed to be offerred to people the issuer already knows (i.e., not generally solicited or advertised publicly like in a public offering). “Reg A+” and “Reg D” exemptions are the

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62 Gold, supra, note 60.
64 Id. at §§ 230.500–08.
66 U.S. SEC. & EXCH. COMMITTEE, supra note 61.
common path to investing in films as securities offerings through a private placement offering. The vast majority of private placement offerings for film financing placements are under Reg D Rule 506(b). A Reg D offering is made privately through a formal document known as a “private placement memorandum” (PPM) and is accompanied by an investor questionnaire and the agreement governing the legal entity and parties holding equity in that entity.

The PPM is essentially a compendium of documents to advise the potential investors on the economic viability and the potential risks of the investment. It’s not always required to be used when selling securities to accredited investors. But it’s highly recommended to avoid potential liability from investor lawsuits and the antifraud provisions under federal securities laws. Under the Reg D exemption, there are two rules relevant for financing a film: Rule 504 and Rule 506(b). But the most commonly used exemption is Rule 506(b), which states that there is no limit to the monetary amount of the capital raise nor to the number of “accredited” investors. This rule also exempts the issuer from Blue Sky registration laws. But general solicitations and advertising under this rule are also prohibited and offerings to nonaccredited investors are capped at thirty-five. Under 506(c), general advertising and solicitations are permitted provided that the purchasers are all accredited investors and the issuer verifies their accredited investor status (via tax returns, statements from investor’s lawyer or accountant, etc.). The PPM in connection with Rule 506(b) can get very expensive ($15,000 to $100,000)

68 Id.
69 See PRAC. L. CORPORATION. & SEC., Section 4(a)(2) and Regulation D Private Placements
70 Litwak, supra note 32.
71 U.S. SEC. & EXCH. COMM’N, supra note 67.
72 Section 4(a)(2) and Regulation D Private Placements, supra note 69.
and sometimes up to 35% of the funds raised have gone to just the business expenses.\textsuperscript{75} Furthermore, the legal expenses and restrictions on solicitations and advertising makes these exemptions impractical for equity crowdfunding a small indie film. Also, these rules also effectively shut out retail investors like moderate and low-income Americans from the wealth-generating opportunities provided by private markets.\textsuperscript{76}

\textit{Regulation A+ Offering}

The SEC expanded its existing “Reg A” exemption (i.e., Reg A+) under Title IV of the JOBS Act) by broadening the definition of a “qualified investor” and providing for two tiers of securities offerings for both accredited and non-accredited investors: \textsuperscript{77}

- Tier 1: For securities offerings up to $20,000,000 during a twelve-month period but this tier requires registration of the securities in each state they are offered (thus slowing down the process with state review).\textsuperscript{78}
- Tier 2: For securities offerings up to $50,000,000 in a twelve-month period which preempts state Blue Sky laws (unlike Tier 1), provided the securities are sold to accredited investors.\textsuperscript{79} If the investor is nonaccredited, they are limited to investing no more than 10\% of the greater of their annual income and net worth.\textsuperscript{80}

\textsuperscript{78} PRAC. L. CORPORATION. & SEC., Regulation A Summary Chart: Tier 1 and Tier 2.
\textsuperscript{80} \textit{Id.}
Consequently, the state registration and compliance restrictions, financial reporting and preparation of offering materials amounts to a mini-public offering under this exemption and would also be too expensive for financing an indie film project. Even though Reg A+ allows general solicitation, and the securities are freely transferable (unlike Rule 506(b)), the costs for Reg A+ can amount to over $125,000 in attorney fees, 10% of the capital raise in marketing costs and additional expenses for auditors. But Reg A+ would be practical for large film slates looking for high net worth investors.

**Regulation Crowdfunding Offering**

The most practical and viable option for an indie producer under the JOBS Act exemptions would be Regulation Crowdfunding (Reg CF). It provides all of the benefits the others don’t by allowing the solicitation of accredited and non-accredited investors at affordable startup costs ($15,000 to $25,000), while allowing the deferral of the final costs ($60,000 to $150,000) until the capital is raised.

The following parameters apply for Reg CF fundraising:

1. The offering cannot be directly solicited from any individuals (must use a licensed portal or broker);

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84 U.S. Secs. & Exch. Comm’n, supra note 58.
2. Mandatory SEC filings and financial disclosures must be provided based on the amount of capital raised;
3. The funds cannot be utilized unless the target amount is reached within twelve months;
4. The offering cannot exceed $1,070,000 nor extend beyond twelve months; and
5. The amounts sold to investors cannot exceed the greater of $2,000 or (a) 5% of the investor’s annual income or net worth if annual income or net worth is less than $100,000 and (b) 10% of the investor’s annual income or net worth if annual income or net worth is greater than $100,000.

**Equity Crowdfunding Platforms**

With the arrival of these new equity crowdfunding laws there has been an emergence of equity crowdfunding platforms to provide fundraisers with the infrastructure, support, investor network and expertise needed when raising capital. Wedfunder, Localstake and Peer Realty are a few examples of the companies that appeared after the JOBS Act was enacted.\(^87\) There are a number of other companies that facilitate crowdfunding investments for producers but “AngelList” is one of the oldest and more credible.\(^88\) Registration with these services is often as simple as signing up with your Facebook login credentials. The services they offer tend to vary. Some can connect fundraisers to investors, escrow investments until the fundraising round is complete and then facilitate the transfer of equity to the company. Others are less entrenched in the transaction. They just provide a platform to advertise the capital raise, connect interested investors to the fundraisers and the transfer of equity in exchange for capital is executed off

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\(^{88}\) *Id.*
platform. These platforms earn money by charging fees for their services and/or take an equity
stake in the project as well (as described above).

Equity crowdfunding has certainly made investing in indie film properties much easier
and more accessible. However, like the rudimentary or complex business transactions before the
birth of the internet, the process is plagued by a rigid infrastructure designed by the financial
architects of the twentieth century. Each attempt at innovating on that structure offers minimal
expediency and increased complication, unless the investment opportunities are not as
substantial like in the case of Reg CF. Therefore, the process of raising capital needs to be
transitioned to an approach and perspective that leverages the advancements of the twenty first
century, if working class Americans and indie producers are going to have real access to the film
finance marketplace. Financing films through cryptocurrency has the potential to offer that
opportunity.

CRYPTOCURRENCY CROWDFUNDING

When most people hear the term cryptocurrency they tend to think of “Bitcoin.” That
virtual currency that allows its owners to freely use it in business transactions globally, while
maintaining relative anonymity. As most would attest, Bitcoin operates more efficiently (and in
some cases, more trustworthy) than a fiat currency without it being governed by any central
authority like a bank or government. The reason for its fidelity, security and expediency isn’t
its digital nature, but rather the blockchain technology undergirding Bitcoin. That technology,
in the form of cryptocurrency (crypto), can be used as the new financial instrument, tool and
business methodology to revolutionize film finance. Simply put, blockchain is the digital conduit

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89 Id.
90 Trevor Hunnicutt & Michelle Price, SEC to review decision rejecting bitcoin ETFs, REUTERS (Aug. 23, 2018),
(or superhighway) that is being used to facilitate these offerings and manage the crypto asset class.\textsuperscript{91}

When we say the words “block” and “chain” in this context, we are actually talking about digital information (the “block”) stored in a public database (the “chain”). Each computer in the blockchain network has its own copy of the blockchain, which means that there are thousands, or in the case of Bitcoin, millions of copies of the same blockchain. Although each copy of the blockchain is identical, spreading that information across a network of computers makes the information more difficult to manipulate. With blockchain, there isn’t a single, definitive account of events that can be manipulated. Instead, a hacker would need to manipulate every copy of the blockchain on the network. This is what is meant by blockchain being a "distributed" ledger. After a block has been added to the end of the blockchain, it is very difficult to go back and alter the contents of the block. That’s because each block contains its own hash, along with the hash of the block before it. Hash codes are created by a math function that turns digital information into a string of numbers and letters. If that information is edited in any way, the hash code changes as well.\textsuperscript{92}

Like with equity crowdfunding being regulated by the SEC as selling securities, the same regulations have been applied to crypto operating on blockchain technology. The government’s regulation of crypto eliminated a lot of the early instability and profiteering in the crypto market.\textsuperscript{93}

The seminal case of SEC vs The Howey Company (Howey) established the criteria for classifying securities, thereby identifying when crypto is a security. Under Howey, crypto is a security if its: (i) an investment of money, (ii) in a common enterprise (iii) with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.\textsuperscript{94} \textsuperscript{95} But due to the complex convergence of technology, finance and law in this area, let’s start by

\textsuperscript{92} Id.
\textsuperscript{93} See generally Thomas Lee Haven, Virtual or Crypto Currencies and the Securities Laws, 38 FUT. & DERIV. L. REP. 1 (2018).
\textsuperscript{95} See Haven, supra note 93.
examining how a physical asset like money can be become “tokenized” into a digital asset like cryptocurrency on blockchain.

“Tokenization” is the process of transferring an asset like a house, car or money, or a utility like a movie ticket into a digital representation of that asset (i.e., digital token). Here’s an analogy to better understand the concept: imagine the ownership title to a car (pink slip) or stock certificate being wrapped in a digital shell containing the mysterious blockchain technology so it can be traded over the internet. That’s how to think of tokenization. There are three primary digital tokens in the cryptocurrency family:

1. “Currency Tokens:” Currency tokens like Bitcoin are used to buy and sell things like actual money is used today. The currency tokens are designed by the issuer (i.e., a blockchain platform like Bitcoin) to represent money for commercial transactions between the funder (i.e., purchaser of the coin) and any party that will accept the issuer’s currency. A currency token’s value isn’t tied to an actual asset (like a security token described below would be) but its value is defined by the platform that created them.

2. “Utility Tokens:” Utility Tokens like Ethereum’s ERC20 are designed by the issuer to operate like coupons, redeemable in the future at a discounted price. For example, the utility token representing the funder’s coupon to shop on the issuer’s website at a discount for a product or service. Issuers of utility tokens will often sell them to fund their business.

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97 Hunnicutt & Price, supra note 90.
98 Annie Nova, Bitcoin takes on cash, as more places accept the cryptocurrency, CNBC (Mar. 2, 2018), https://www.cnbc.com/2018/03/02/spending-cryptocurrencies-on-everyday-purchases-is-getting-easier.html.
development costs and if the business is successful, the hope is that the token will increase in value.\textsuperscript{100}

3. “Security Tokens:” Security tokens are designed by the issuer to be equivalent to the funder’s investment. For example, the security token can represent a funder’s 50% ownership in a house the funder co-financed with 50% of its cash value going to the issuer. Security tokens are the only asset-backed tokens (like gold backing a fiat currency). Their liquidity (i.e., the expediency at which they can be bought or sold in the marketplace) compared to traditional securities also makes them very attractive assets for investing. For all of the foregoing reasons they are being heavily regulated as securities and offer a wider pool of investors for filmmakers due to their stability.\textsuperscript{101}

\textit{Token and Coin Offerings}

The process and legal framework to use security token offerings (STO’s) to raise capital is similar to traditional private placement offerings.\textsuperscript{102} Both are governed by the SEC and have the same compliance requirements under the U.S. Securities Act of 1933. While some countries created new laws to regulate crypto, the U.S. regulators held that issuers of these digital currencies needed to proscribe them to existing federal and state laws to be valid.\textsuperscript{103} Therefore, issuers raising capital through token offerings often avail themselves of the same security exemptions to registration under Reg D, Reg A+ and Reg CF.

\textsuperscript{103} Id.
However, prior to the rise in STO’s, there was the wild west of initial coin offerings (ICO’s), which market raised more than $21.5 billion in 2018 but eventually crashed due to a number of fraudulent business practices and failed business ventures. Conceptually speaking, STO’s and ICO’s are very similar on the surface, since they both entail offering crypto coins or tokens in exchange for money. However, crypto coins are not backed by real assets. Therefore, those issuers also took the position that their coins were not securities, thus not subject to government regulation. They argued that their coins weren’t being sold in exchange for an investment in a speculative business but purely for utilitarian purposes like enhanced access or benefits on the issuer’s platform to acquire goods or services. This argument often failed because the government took the perspective that the purchasers are investors (i.e., buying a security interest) if the issuer is profiting or planning to profit from that purchase of coins.

Although the emergence of ICO’s in 2017 offered the opportunity for everyday people (i.e., non-accredited investors) to invest in large scale business ventures, the change in the regulatory landscape by late 2018 has all but killed that market for most (and locked out working class venture capitalists).

After the death of the ICO market there was a shift to using SAFT’s (Simple Agreement for Future Tokens) as a safer alternative to raising capital by issuing coins. SAFT’s, which are considered a pre-ICO offering, gives the investor the opportunity to invest in the startup but they do not receive any coins in return for their investment (i.e., there is no coin issuance) until the

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106 See generally Jones & Kulerman, *supra* note 102.
107 See id.
108 Id.
coins are sold to the public. The investor only receives a commitment from the issuer entitling them to the coins when the product they have invested in launches, then the investors can presumably profit from their investment by selling their coins to the public.\textsuperscript{109} Essentially, this investment contract is designed to facilitate a pre-sale of an ICO (usually under Rule 506(b)), with coins becoming available later as registered public securities.

The intended appeal of the SAFT was to give early investors a discount prior to the coins being made available to the public. That is because it was thought that SAFT’s would not be considered securities by the SEC and could provide the issuer with capital to build their enterprise. However, the inherent problem with the SAFT approach is that the SEC deems most SAFT’s securities that are non-compliant with federal securities laws if they’re not registered prior to their issuance.\textsuperscript{110} The need to register them as securities undermines the potential cost savings for both the issuer and investor and thereby negates the entire SAFT strategy. Therefore, STO’s remain the most credible and practical approach to raising capital through the sale of private equity security tokens (also known as “equity tokens” or “stablecoins” since they are tethered to real assets).\textsuperscript{111} The customary legal costs for an STO under Reg D is under $50,000 but twice that much is required to effectively market the offering.\textsuperscript{112}

Like with equity crowdfunding platforms that facilitate private placement offerings, blockchain platforms facilitate STO’s by digitally programming the security tokens (on behalf of the issuer) with the information proscribed from the purchase terms (e.g., regional or transfer


restrictions). This reduces the reliance on attorneys and voluminous documents. Platforms like Coinbase, Prime Trust and others will provide connections to investors and licensed broker-dealers to facilitate the launch of the STO. There are already numerous examples of these partnerships in the film community. The upcoming Atari movie, which is budgeted between $40,000,000 and $50,000,000 is being financed entirely by tokenization on blockchain in a partnership between producer J.D. Seraphine and Vision Tree Media. Actor/producer Wesley Snipes is tokenizing a $25,000,000 movie fund through his partnership with the foreign company Liechtenstein Cryptoassets Exchange (LCX) so that investors can invest in his portfolio of movies. Alibana Pictures is partnering with blockchain-powered producer, Breaker to finance and distribute Chinese films.

The financial services firm Central Wealth Group of Hong Kong and Step Ventures recently announced an $100 million-dollar investment in mega Hollywood producer Ryan Kavanaugh’s security token Proxicoin, which under Reg. A provides investors access to participate in its tokenized offers in film (amongst other IP-driven content). But the connective tissue facilitating all of these transactions (e.g., tokenization and the purchase of security tokens) are smart contracts.

**SMART CONTRACTS**

Smart contracts are digitized, “self-executing” contracts, pre-programmed (i.e., coded) with all the terms and conditions needed to complete the deal that was brokered by the contracting

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The smart contract exists within the designated blockchain network and is easily trackable but irreversible after execution. Smart contracts are the bedrock of cryptocurrency transactions. They also allow for complete anonymity between the parties. The additional benefits they offer like removing the bureaucratic methods in film financing, automating legal processes and infusing fidelity into an anxiety-ridden transaction will transform how all business sectors and industries operate in years to come.

The full incorporation of smart contracts into the film business could help end copyright ownership and piracy disputes. By restricting exploitation of the owner’s rights solely to the terms pre-programmed in the smart contract, the infringement upon license, distribution and ownership rights could be eliminated, or at worst, severely curtailed. For instance, the European distribution rights for a producer’s film not being released by the smart contract unless the filmmaker’s smart contract receives a verifiable record of payment first. Alternatively, imagine an instance where all internet service providers, search engines and end users immediately and simultaneously being notified of a rights violation requiring them to discontinue use of the content. In the case of record keeping, payment calculations and profit participation in connection with film revenues, smart contracts can be used to provide for autonomous payments and transparent ledgers for investors and other profit participants on the project. This can help eliminate the antiquated reporting systems, mismanagement of

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117 *Id.*
119 *Id.*
121 *Id.*
finances and frequent delays in royalty payments, net receipts payments and license payments customary in film distribution. There are a number of companies in the entertainment business already using blockchain and smart contacts to run their businesses more effectively. London and New York-based “Big Couch,” is one of those companies using their blockchain product “FilmChain.co” to facilitate financing and payments for their projects. Swedish-based “Cinezen Blockchained Entertainment” is building a video-on-demand offering on blockchain that includes using smart contracts for functions like invoicing, financial reporting and revenue payments for its distributors. Through smart contracts Cinezen will transfer a portion of money it receives from its users directly to the content rights holders with complete transparency. But it’s the decentralized aspect of blockchain (i.e., no one party, government or company controls it) and its distributed digitized ledger (i.e., comprehensive database accessible across its network) that empowers the use of smart contracts.

Beyond the celebrities and Hollywood producers leveraging crypto in the film business, there are other lesser-known companies like Crypto Film Fund focused on the indie film market. Crypto Film Fund is combining the power of fundraising through STO’s and the enhanced administrative efficiencies through smart contracts to ignite the needed changes in the film industry. The company CEO and founder, Anne Sjoblom, said that they’re “working to provide tools for the industry that will result in better accountability, transparency, security, efficiencies, and cost-savings.” BlockFilm is another blockchain platform created to leverage the

122 See id.
125 Id.
technology advancements of blockchain for the indie filmmakers.\textsuperscript{127} \textsuperscript{128} This Canadian-based company plans to finance and market films and long-form television programs intended for audiences around the world.\textsuperscript{129} They’ve set out to “disrupt the film industry by transforming the current studio model into a more efficient and value-driven ecosystem, resulting in a new slate of unique films being produced and viewed around the world.”

**CLOSING**

Cryptocurrency through blockchain is bound to change every aspect of not only film finance but our content ecosystem. As COVID-19 ravages our economy and forces us into a new version of normalcy, the strain on our content ecosystem will lean heavily on technology in the coming years to survive.\textsuperscript{130} The increased fragmentation of viewing audiences, the shrinking theatrical windows, and the exploitation of the indie film market by streaming services like Netflix, has gutted the indie film business for filmmakers and over-leveraged the major studios. These global economic factors create a unique opportunity for the use of crypto to finance film content. But many businesses are already ahead of that curve.

A number of major banking institutions (e.g. JP Morgan and Goldman Sachs) and tech companies (e.g. Facebook, Microsoft and Amazon) have already been investing in crypto and blockchain.\textsuperscript{131} Those businesses are motivated by connecting the millions of unbanked people

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\begin{footnotes}{127} Id.
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in the world to our global economy so they can leverage that untapped capital.\(^{132}\) Furthermore, those unbanked communities are motivated by the economic power they’ll have with a reliable currency they can access freely that circumvents their destabilized economies (due to corruption, archaic technology or Byzantine bureaucracies).\(^{133}\) Clearly, both sides of that crypto equation also serve to sufficiently inspire changes in film business that will ultimately transform our global economy. In contrast to volatile global markets, counter-cyclical investments in content offer investors valuable hedge against future downturns.\(^{134}\) Although there are varying motivations and uses for this blockchain technology, the billons being invested ensures that we will not escape the economic shift on the horizon. So, the film sector should be positioning itself to unlock that capital as well.

There are still lots of regulatory, technological and credibility hurdles to surmount before crowdfunding with cryptocurrency becomes a viable or practical industry-wide solution for raising capital. However, there’s strong evidence that the latter might be a real possibility sooner than we think. Equity crowdfunding coupled with cryptocurrency (crypto) through blockchain will be the key to unlocking future capital.\(^{135}\) Thus, whether crypto through blockchain helps connect unbanked communities to the global economy, supplant Byzantine bureaucracies in bank and presales financing or just guarantees fair dealing in a business transaction with


potentially dubious investors, it will certainly live up to its moniker as the internet 2.0 for Hollywood.