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# Co-Productions: *The Future Feature*

- By Jenica Yurcic\*

*ambo*, an American movie saga, began with *First Blood*.<sup>1</sup> John Rambo, a veteran of the Vietnam War, is a lone soldier adrift in a society that has forgotten him.<sup>2</sup> A perfect specimen of a finely tuned killing machine in Vietnam, Rambo finds that life after the war is very different. He returns to a country that does not appreciate his efforts.<sup>3</sup> On one trip in search of an army buddy he discovers trouble with a small town sheriff.<sup>4</sup> Encircled by purple and white police cars, he is once again entrapped, this time, sadly enough, in his own country—or is he in Canada? While many viewers get caught up in the action, the careful observer might wonder where in the United States Rambo is that purple and white police cars patrol the streets. Indeed, he is not in the United States but in Canada, where purple and white distinguish cars of the Royal Canadian Mounted Police Force.<sup>5</sup>

*Rambo* is not the only American action film for which Canada has provided a backdrop. *X-Men*, *Contact*, *Leaving Las Vegas* and *Unforgiven* are just a few of the Hollywood movies produced in part in Canada.<sup>6</sup> Besides film, many favorite American television programs, including the *X-Files*, have been shot in Canada.<sup>7</sup> These decisions to shift production efforts to Canada illustrate the phenomenon known as runaway production.<sup>8</sup> Runaway production has become a common term used to describe the flight of film and television production to less expensive locations. The *X-Files*, a program originally shot in California but that subsequently moved to Canada in search of a lower bottom-line, provides a prime example of the runaway production phenomenon.<sup>9</sup>

Europe first experienced runaway production in the 1920s when film production fled to Hollywood to find its necessary counterpart, financing.<sup>10</sup> Money enabled major Hollywood studios to raid Europe for talent, particularly Germany where post-war angst had fueled a golden age of expressionist filmmaking.<sup>11</sup> In response to runaway production, Europe began formulating plans to compete with the Hollywood motion picture industry.<sup>12</sup> Over time, and continuing into the

1980s, the plans became more complicated and restrictive. The European Economic Community has revised its plans to include flexible co-production incentives that are beginning to resemble a competitive scheme. The new incentives are aimed at bringing filmmaking back to the European continent.<sup>13</sup> California is now undertaking measures to recapture its share of the film production market after suffering through more than a decade of significant runaway production. Measures already taken by California include reimbursements of production costs and granting filmmakers the use of government owned property at discounted prices.<sup>14</sup> However, history suggests that California's current efforts will prove ineffective.

Like Europe's unsuccessful plans to recapture film production in the 1980s, California's current initiative to regain its production business is piecemeal and focuses only on defeating the plans of foreign countries that target California's weaknesses. California should instead devise a more aggressive plan based on its strengths. Also, funding earmarked by California for use in its attempt to recapture film production must overcome allocation and eligible use restrictions imposed by the state assembly. California's current plan stands in contrast to the competitive policies such as split-rights agreements, European and Canadian co-production incentives, and the development of foreign productions sites that characterize the international market. Indeed, Canada's co-production incentives—offering tax relief to qualified producers willing to work with Canadian craftsmen—have proved highly effective for attracting production away from California.<sup>15</sup>

This Article argues that California should devise an incentive plan to attract film production projects rather than take a defensive posture to deter film flight. The objective of the incentive plan is to consolidate government funding while capitalizing on California's film marketing and distribution expertise, as well as the growing demand for digital post-production services.

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In an increasingly global film industry, this incentive plan would lower the bottom-line of international productions. The prospect of earning increased profits through international production efforts should attract more business to the California film industry. However, while such a business plan is easy to envision, its legal formation is more difficult to accomplish. A co-production agreement is the ideal instrument for California and producers hoping to make films there. Exploring the option of a co-production partnership between California and Canada demonstrates how legal provisions crafted to capitalize on California's strengths within the film industry can operate to attract production to California.

Ironically, while Canada is the greatest threat to California's film industry, it is also California's most viable production partner. Canada identifies marketing, post-production, and distribution as the weaknesses of its film industry. For this reason, Canada would eagerly participate in a plan offering the opportunity to learn from the California film industry that has mastered these skills.<sup>16</sup> At the same time, California would gladly welcome the increased demand for its costly post-production facilities and craftsmen.<sup>17</sup> The potential for success among such partnerships depends on the assumption that the California Assembly has an active and real commitment to funding and supporting the programs to which it has already allocated money. However, given the limitations imposed by the California Assembly on the use of funds for its current initiative, this assumption may prove false.

Assuming the California Assembly wants to provide the industry with aid in the form of an indirect subsidy—and without endorsing the position that the industry should be supported by a subsidy—this

objective and legal provisions, this Article first examines the phenomenon of runaway production and evaluates government initiatives taken thus far by Europe and California to deter this phenomenon. Next, the analysis focuses on the policies currently used to vie for production in the international market and on the advantages possessed by California for implementing a competitive policy of its own. Finally, this Article outlines an incentive plan and, using Canada as a potential partner, demonstrates how it could attract production to California.

### ***I. To Have and Have Not: The European Example***

The flight of production from Europe began in the 1920s with the emergence of the Hollywood studio system.<sup>18</sup> Unlike Europe, which treated filmmaking as a government-supported art form, Hollywood treated film making as a business.<sup>19</sup> Hollywood studios concentrated the filmmaking process by vertically integrating the business from finance, to production, to publicity, to distribution, and finally to exhibition.<sup>20</sup> Studios additionally developed cost-effective methods of production, extended the market for their product to include overseas audiences, and ensured the flow of films from producer to consumer by acquiring ownership of key theaters and performers.<sup>21</sup> Developments in mass advertising and communication spurred the Hollywood studio system to international success.

Hollywood studios became so effective that they easily "poached" European directors, cameramen, and marquee talent such as Marlene Dietrich and Greta Garbo from the European film industry.<sup>22</sup> Newspapers reported that star German director Ernst Lubitsch, known for such films as *Carmen*, *Madame Dubarry* and *Anna Boleyn*, received offers from Hollywood producers, including Mary Pickford.<sup>23</sup> However, while Hollywood drained Europe of its prime creative talent, it secured the loyalty of European audiences by acquiring the talent needed to make

films fit for their consumption.<sup>24</sup> Success at the European box office would become increasingly necessary for Hollywood to generate revenues proportional to the swelling film budgets.

To compete with the American film industry

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Article suggests that California should consolidate its current initiative into a single financial incentive plan. This incentive plan will attract international partners for specific production needs such as marketing and post-production. To give significance to the plan's

during the late 1970s and throughout the 1980s, European countries renewed their efforts to support film making through direct subsidies for both co-productions and media programs.<sup>25</sup> Each effort proved problematic. Through one effort, European countries offered subsidies to producers who incorporated talent (e.g., actors, directors, set-makers) from one or more European countries.<sup>26</sup> The inability of film productions to satisfy the rigid requirements necessary to receive the subsidies, however, inhibited the growth of co-productions.<sup>27</sup> Most subsidies limited a producer to a single co-production partner. Unable to find one partner to satisfy the financial, artistic and technical needs of the production, producers often settled for partners who met the necessary requirements for obtaining co-production funding rather than partners who could contribute creatively to the production.<sup>28</sup> Consequently, producers churned out “Euro-puddings,” productions arising out of co-production arrangements in which multi-source financing led to a disjointed, scattered, and incoherent work.<sup>29</sup> Furthermore, since the government awarded direct subsidies before film production began, producers had no incentive to consider how to attract an audience large enough to make a profit.<sup>30</sup> With audience acceptance as an afterthought, films became self-indulgent and, most importantly, unprofitable.<sup>31</sup>

In another effort, European countries allocated financial funding through media programs designed to support film production by providing training, exposure and start-up funds.<sup>32</sup> However, programs such as the MEDIA programme and Eurimages,<sup>33</sup> which sought to supply producers with start-up money, typically fostered weakness and dependence in the industry.<sup>34</sup> Producers became dependent on start-up funds and failed to use them to create films with the widespread appeal necessary to attract private financing for future films.<sup>35</sup> Thus, little connection existed between the priorities of film production and distribution. According to David Putnam, a film producer and industry specialist, studios produced nearly four hundred films a year in the early 1990s, many of which never reached an audience.<sup>36</sup> When a film was fortunate to receive distribution, it was only on a national basis since few European companies possessed the capabilities for international distribution.<sup>37</sup> Instead, Europe relied on American distribution and marketing.<sup>38</sup>

## II. Exodus: The California Crisis

The California exodus reached full swing in the 1990s as film and television production companies shifted their operations to foreign countries in order to lower their costs. These countries—most notably Canada—made higher rates of return available to producers through subsidy programs, tax incentives, favorable exchange rates, and lower labor costs.<sup>39</sup> Hollywood studios doubled their production efforts outside of the United States between 1981 and 1983.<sup>40</sup> Consider the following example, which illustrates the extent of the California exodus. Production within the United States had accounted for over 88 percent of made-for-television movies, a staple of the California film industry, through the late 1980s.<sup>41</sup> By contrast, in 1998 only 23 percent of made-for-television movies were shot in the United States; 57 percent were shot in Canada alone.<sup>42</sup> Guilds representing craftsmen quickly documented these statistics.

In 1999, the Directors Guild of America (DGA) and the Screen Actors Guild (SAG) released the *Monitor Report*, a report estimating revenues lost due to runaway production.<sup>43</sup> In 1998, according to the report, \$2.8 billion in direct production expenditures went abroad with Canada taking in an overwhelming 81 percent—\$2.27 billion—of the total.<sup>44</sup> In the same year, Canada garnered more than \$800 million in funding that originated in the United States for its film and television industry.<sup>45</sup> Because of Canada’s incentives, a favorable exchange rate and lower labor costs, a film shot in the United States for \$40 million could be shot in Canada for 25 percent less.<sup>46</sup> The production history of *Blues Brothers 2000*, the sequel to the popular *Blues Brothers* film that put Chicago on the map for filmmakers, illustrates this point. The sequel, set in Chicago, only shot a few location sequences in the windy city before setting up shop in Canada.<sup>47</sup>

Out of 1,075 film and television productions developed in the United States in 1998, 285 of those films went abroad for economic reasons—a 185 percent increase over the economic runaway productions documented in 1990.<sup>48</sup> Production crews in Canada produced more than four of every five productions going abroad.<sup>49</sup> The *Monitor Report* quoted statistics supplied by the Los Angeles County Economic Development Corporation showing a loss of 11,000 jobs by direct industry employees between 1997 and 1998.<sup>50</sup> The

job losses predominantly occurred in service industries such as catering, costuming and equipment rental.<sup>51</sup> The report projected the loss of an additional 11,400 jobs by the end of 1999.<sup>52</sup>

The 1999 *Monitor Report* drew the California Assembly's attention to the issue of runaway production.<sup>53</sup> In California, film and television production generates over \$28 billion annually—an amount roughly equivalent to the agriculture industry's share of the state's economy.<sup>54</sup> Hollywood alone employs over 475,000 skilled laborers generating an annual payroll of over \$12 billion.<sup>55</sup> The adverse effects of runaway production in the film and television industry, moreover, reach beyond the borders of California with similar consequences extending into the economy of the United States.

In 1998, runaway production cost the United States economy approximately \$10.3 billion.<sup>56</sup> Included in this figure were losses of: \$2.7 billion in made-for-television films; \$2.4 billion in films with budgets over \$25 million; \$2.3 billion in films with budgets under \$25 million; and \$800 million in revenues generated from tax and other spending accompanying film production such as meals and lodging.<sup>57</sup>

The findings of the *Monitor Report* spurred the United States Department of Commerce to conduct its own study of runaway production entitled, *The Migration of U.S. Film and Television Production*.<sup>58</sup> The Department of Commerce report includes suggestions for various programs offering aid to the industry with explanations of how each program would operate.<sup>59</sup> However, the only conclusion reached from this report is that the suggestions need further consideration.<sup>60</sup>

### III. Vertigo: The California Initiative

Despite the loss in national revenues caused by runaway production, the United States remains one of the few leading industrial countries whose government does not directly subsidize its film and television industry.<sup>61</sup> The underlying public policy approach utilized by the government treats film and television production as it does other industries, a form of economic activity in a market economy.<sup>62</sup> In the past, state or federal legislatures have responded to industry lulls by safeguarding loans. This attracts investors by making film production less risky.<sup>63</sup> In 1999, the California Assembly, after hearing a report prepared

by the Film and Television Action Committee, considered a series of indirect subsidies to the industry. The Assembly bills offered suggested a variety of options to keep production in California.

As a result of the deliberations, the California Assembly instituted the following indirect subsidies beginning with the Film California First (FCF) program.<sup>64</sup> The California Film Commission, a subset of the Trade and Commerce Agency's Office of Economic Development, will administer \$15 million annually for a three-year period for the program.<sup>65</sup> FCF funding reimburses producers for customary production charges such as: the services of state and federal employees (including the California Highway Patrol, State Park Rangers and California State Universities), film permits, public property use fees, local public employees, costs for fire and non-police public safety, and the use of public equipment owned by a public agency.<sup>66</sup> Each public agency participating in the program may not receive more than \$10,000 annually.<sup>67</sup> No single production may obtain more than \$300,000 in reimbursements.<sup>68</sup> The FCF administrators may also limit the per day film costs that the state will reimburse.<sup>69</sup>

The California Assembly also established the State Theatrical Art Resources Partnership (STAR) within the CFC to coordinate use of government property.<sup>70</sup> STAR identifies surplus state properties and makes them available for film and television production at a low cost.<sup>71</sup> However, production companies are responsible for all related expenses, including maintenance or electrical costs.<sup>72</sup>

California has formally recognized the film and television industries' annual contributions of more than \$ 27.5 million to the state's economy.<sup>73</sup> It is now California's official public policy to eliminate bureaucratic roadblocks that may bloat a film's budget. The amendments expedite the process for obtaining film permits for temporary, non-recurring location shooting from the state's film commission.<sup>74</sup>

Although not yet enacted into the California Code, the California Assembly has also proposed instituting a film "incubator" program with \$3 million in funding.<sup>75</sup> The program would provide independent film producers with more timely, cost-effective access to film and television technologies.<sup>76</sup> Finally, after repeated requests by the California Assembly, the United States Congress authorized \$1.8 million to be administered by the California Development Department to provide a retraining program for unemployed

workers of the film and television industry.<sup>77</sup>

California has proposed additional safeguards to keep Hollywood the film capital of the world. Several bills have been proposed in the last two years though none have been enacted. One bill would give a ten percent tax credit on labor costs paid for film and television productions of any size as long as they are produced entirely in California.<sup>78</sup> A second bill would

new productions.<sup>82</sup>

The remainder of California's initiative plans, much like the ineffective plans that failed in Europe, is divided and restrictive. The initiatives foster dependence on the state government rather than free market competition. Similar to the programs abandoned by Europe, the retraining program provides a mere temporary cushion for the unemployed. Further-

more, producers deciding to remain in California will likely do so only if the reimbursement or the access to high technology is subsidized. Thus, the subsidies will likely fail to encourage producers to establish ties within the California industry. The lesson learned from similar European programs is that subsidies will only give temporarily support to productions rather than perma-

nently attracting and retaining them.

## IV. Modern Times: Competitive Policies in the Current Market

While California remains preoccupied with keeping production within its borders, competitive policies are developing in the industry to facilitate international production. Policies used to access opportunities in international production include (1) split-rights agreements, (2) government sponsored incentives, and (3) the evaluation of new international production sites. Co-production agreements between international partners have been consistently used to facilitate each of these developments.

### A. Split-Rights Agreements

Originally, foreign distributors obtained from Hollywood studios a territorial right to reproduce and distribute a film through an international pre-sale agreement.<sup>83</sup> Hollywood's major studios, however, have increasingly demanded exclusive worldwide rights to films they license.<sup>84</sup> As Hollywood studios retained the worldwide rights to a film, overseas distributors obtained only temporary licenses to distribute a film rather than the more lucrative permanent right to exhibit it.<sup>85</sup> In response, foreign distributors began participating in what are known as "split-rights agreements."<sup>86</sup> In this type of contract, rather than overpaying a studio for a limited license to distribute a film, foreign distributors receive the control rights over the

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require the Trade and Commerce Agency's Office of Economic Development to support film production in California by issuing limited guarantees of loans made by lenders with an in-state presence.<sup>79</sup> A third bill, which has become law, asks the President of the United States to acknowledge problems caused by relocation of the United States film industry abroad, evaluate the current state and federal tax incentives provided to the film industry, and promote trade related legislation favorable to United States production.<sup>80</sup>

These well-intentioned initiatives will not deter production flight. The conditions accompanying reimbursement by FCF will limit its use. By restricting subsidies to \$10,000 annually by any one agency, the program limits a producer's ability to receive reimbursements for the most popularly used agencies such as the California Highway Patrol.<sup>81</sup> By restricting reimbursement to costs incurred by a limited number of government agencies, the program ensures that no single production will come close to using the \$300,000 maximum reimbursements permitted. The program also reserves the right to further limit reimbursement by giving administrators open-ended authority to place a maximum on the daily costs that the state will reimburse. These limitations suggest the California Assembly is not as committed to aiding the industry as their rhetoric implies. The conditions restricting funding make it nearly impossible for the FCF to lower the costs of film production in California substantially enough to retain production or attract

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use and distribution of the film's funding in exchange for an equity investment in the film.<sup>87</sup> For instance, Shochiku, a Tokyo-based distributor, recently executed a split-rights agreement by investing in future films made by Robert DeNiro's Tribeca Films in exchange for the right to distribute in Japan.<sup>88</sup>

The flexible structure of the split-rights agreements provides investors with a variety of means to utilize their control rights. For instance, German equity investors interested in United States production studios often demand either the option to purchase on a first look basis or the obligation to purchase on an output basis.<sup>89</sup> With both equity investors and distributors from each territory negotiating for control rights, pre-sale agreements have become increasingly complex.<sup>90</sup> *Kama Sutra*, the epic directed by Mira Nair, illustrates this complexity.<sup>91</sup> It received funding from eight sources, including a German bank, a London-based production company, an Italian distributor, and a French sales agent.<sup>92</sup> Every major talent agency now has representatives who specialize in compiling and synthesizing international financing and control rights, involving multiple partners and/or territories.<sup>93</sup>

### B. Government Sponsored Incentives

Europe and Canada have long facilitated international agreements through government incentives.<sup>94</sup> In the 1980s, however, both began abandoning the types of subsidy schemes California is currently adopting in favor of co-production agreements. A co-production is a joint venture in which two or more production companies or countries join together to create and complete a production.<sup>95</sup> The government of one or more of the entities offers financial incentives to attract production partners seeking to reduce their production costs.<sup>96</sup> The partners then pool capital and labor in order to minimize an investor's risk and gain the amount of funding necessary for access to the international market.<sup>97</sup>

In an effort to broaden support for co-productions the European Convention on Cinematographic Co-Production has granted funding for projects with diversified financial and creative control structures rather than single partner co-productions.<sup>98</sup> These changes have created a marked increase in the number of co-productions developed each year.<sup>99</sup> For example, although

the budgets for all French films declined throughout the 1980s, the percentage of films co-produced with French majority participation gradually increased to half of all European co-productions by the mid-1990s.<sup>100</sup> Moreover, the European Producer's Club has lobbied the European Union for uniform, border-free co-production rules. The Producer's Club aims to remove Europe's existing internal borders that distinguish the co-production requirements of each European country from the other.<sup>101</sup> A common definition of what constitutes a European co-production will aid in the development of a single border.<sup>102</sup>

Another more recent example is Canada, which already has the type of co-production treaties that Europe is now trying to fashion. Canadian film production has long enjoyed the financial support of the Canadian government.<sup>103</sup> Like television and the performing arts, the Canadian government uses film to define and reinforce its national identity.<sup>104</sup> Canada initially fostered the internationalization of the Canadian film industry by offering a 100 percent tax shelter for investment in film production.<sup>105</sup> As tax shelters declined, co-production incentives emerged. Today, co-production incentives make Canada a haven for runaway production.<sup>106</sup>

Canada's Income Tax Amendment Act of 1997 incorporated incentives for the film and television industries.<sup>107</sup> Part I, Division E, 125.5 of the Income Tax Act sets forth the Film or Video Production Services Tax Credit (PSTC), jointly administered by the Department of Canadian Heritage and the Canadian Audio-Visual Certification Office (CAVCO) and Revenues Canada.<sup>108</sup> The PSTC gives an 11 percent tax credit towards "qualified Canadian labor expenditures" incurred by an "eligible corporation" for services provided in Canada by Canadian residents or taxable Canadian corporations for an "accredited production."<sup>109</sup>

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To become an eligible corporation, service providers must be Canadian residents or taxable businesses. The corporation works with the copyright owner of the



production, which need not be Canadian.<sup>110</sup> The copyright owner receives an Accreditation Certificate from CAVCO.<sup>111</sup> The Canadian service provider then uses the certificate to claim the relative portion of the PSTC in computing its annual income.<sup>112</sup> The Canadian service provider's claim reduces its annual taxable income thereby allowing the service provider to reimburse the production's copyright owner whose bottom-line decreases by the same amount.<sup>113</sup>

A production is accredited or becomes eligible to receive aid if it contains substantial "Canadian content."<sup>114</sup> The tax credit further supports the Canadian industry by ensuring the employment of Canadians in key positions for a stipulated portion of the principal photography.<sup>115</sup> A film acquires Canadian content by employing a certain number of Canadians at various levels of involvement during the film's production. As a matter of illustration, the use of a Canadian director or producer is worth more "Canadian content" than the use of a Canadian technician.<sup>116</sup> Also, a majority of the days of principal photography must occur in Canada. Once a production meets the requirements, there is no maximum on the amount of the credit that it can receive.

## C. New International Production Sites

New production sites such as those in Mexico have sprung up worldwide, creating competition for Canada's well-established incentive system. At the request of the Motion Picture Association, 20th Century Fox (Fox) has urged representatives of the Mexican government to adopt a system of financial incentives similar to those of Canada.<sup>117</sup> Fox, which has a production facility in Baja, Mexico, where it filmed *Titanic*, prepared a report of specific suggestions entitled "Financing Incentives for Filmed Entertainment in Mexico." It never formally released the report but some of its suggestions and statistics reached the public through industry reporters.<sup>118</sup> The Fox Report incorporates the data on runaway production compiled by the SAG and the DGA to encourage Mexico to compete with Canada in the runaway film production market.<sup>119</sup>

According to the Fox Report, the best way to attract foreign producers is to adopt the financial incentive system like that used by Canada.<sup>120</sup> Rather than focusing on directly subsidizing local industry, these models successfully tap into the global market of producers seeking to lower production costs. In addition to financial incentives, these models offer lower

labor and production costs, union cooperation and consistent national policies.<sup>121</sup> The Fox Report suggested that such measures would stimulate the Mexican economy by promoting employment for technicians, payroll, production and lab services, local spending at hotels and for goods and services, tourism, and the growth of local film and television industry and related businesses.<sup>122</sup>

The Fox Report urges Mexico to establish a broad Canadian-style refundable tax credit system based on total production spending.<sup>123</sup> The Report recommends allowing foreign producers to hire temporary workers without paying employment taxes, adopting direct subsidies payable as cash rebates for a portion of wages and for taxes on Mexican labor, and giving relief from customs duties and excess bureaucratic procedures for the transportation of equipment such as film trucks and supplies at the border.<sup>124</sup> To ease production burdens, the Report encourages Mexico to make work permits and visas for foreign crews easy to obtain. It also helps Mexican production companies and studios by allowing them to organize under "maquila" agreements that waive the asset tax.<sup>125</sup> The report encourages expanding the authority of national and regional film commissions to expedite permits and film licenses and assist nonresident film producers. Finally, it suggests exempting dividend payments made by Mexican production companies and studios to their nonresident parent companies from tax withholding requirements.<sup>126</sup>

California's production guilds and craftsmen have criticized Fox and other Hollywood multinational media conglomerates for exporting American jobs and for cutting costs by taking advantage of cheap labor.<sup>127</sup> In response, Fox representatives stress that runaway production is a product of economic reality—the profitability of film production has declined sharply over the last ten years thereby driving producers, studios and independents, to seek the lowest production costs.<sup>128</sup> Fox representatives, while claiming that they have no alternatives, encouraged the California Assembly to provide one through a statewide tax credit scheme.<sup>129</sup>

Production is leaving Hollywood for the same reasons it left Europe in the 1920s—better financing. Capital knows no nationality.<sup>130</sup> As a result of globalization, capital flight occurs seamlessly when material rates of return differ at boundaries. In the film industry the search for bottom-line advantages dictates the production location. Lower bottom-lines increase



profitability and draw in investors. Therefore, instead of an initiative that fights production flight, California should design a plan to compete for international productions.

### **V. A Simple Plan: A Revised Approach for California**

As current competitive policies demonstrate, in order to attract international production and to save its own, California must begin to offer incentives to producers. Unlike Mexico, California need not imitate Canada's incentives. California has unique attributes that it can use to devise its own incentive plan. The next bill to reach the California Assembly should propose an incentive that (1) has a unified objective; (2) consolidates funding and implementation procedures; and (3) draws on California's position at the forefront of marketing and digital post-production technology.<sup>131</sup>

#### **A. A Single Objective**

The California incentive should have three priorities: (1) to involve producers working with budgets under \$25 million, (2) to utilize California's post-production expertise and (3) to lower the producer's bottom-line. First, given the results of the *Monitor Report* released in 1998, the incentive should target producers with budgets of less than \$25 million. The *Monitor Report* released stated that of the \$10.3 billion total production lost \$2.7 billion consisted of made-for-television films and \$2.3 billion of films with budgets under \$25 million.<sup>132</sup> Thus, productions with budgets below \$25 million accounted for nearly half of the production losses. The subsidy would have a greater impact if it targeted these smaller budget productions and makes both California producers and foreign producers eligible. In this way, the incentive will operate to retain California producers as well as attract foreign ones.

Second, California's marketing and post-production expertise is central to luring in more production to the state. Hollywood offers post-production and marketing facilities unmatched in any other film center in the world.<sup>133</sup> Producers worldwide recognize this expertise and its importance to a production's success. Marketing and post-production are arguably the most instrumental factors contributing to a film's success. Most producers prefer California's marketing and post-production expertise but com-

plain that it is too expensive.

Third, the incentive must effectively lower a producer's bottom-line. This can be accomplished with up-front financial support. The process by which a producer secures financing is fundamental to understanding why California can construct such a broad incentive. During the pre-production phase a producer generates up-front funding from a variety of sources including banks, investors, government incentive programs and production companies.<sup>134</sup> These sources finance production through production loans. As the prime source for repayment of the loan, they look to advances payable by licensees for grants of territorial distribution rights in the picture and/or recouping box office receipts.<sup>135</sup> The producer needs to secure funding during pre-production to accommodate spending fluctuations during production and to ensure the production's completion.<sup>136</sup> In exchange for the pre-production funding support, the producer will bring his project to California. This leaves California free to use the incentive to target the phase most favorable to it—post-production.

#### **B. Consolidation of Funding and Implementation**

The current California initiative provides a confusing set of separate funding and implementation procedures for several different programs. Instead, the proposed incentive should attract producers to one organization offering consistent funding and procedures for obtaining that funding. The bill should stipulate that both funding and implementation reside with the well-established California Film Commission (CFC).<sup>137</sup> The CFC promotes the film industry as a liaison, providing communication between and to producers and various government agencies.<sup>138</sup>

Section 15335.22 of the California Code authorizes the CFC to develop a Cooperative Motion Picture Marketing Plan.<sup>139</sup> The purpose of the plan is to support the marketing efforts of local film commissions which act as liaisons between the government and local producers.<sup>140</sup> The section stipulates that the CFC use funding allocated annually to workshops, trade shows, seminars and promotional mailings.<sup>141</sup>

The California Assembly could amend the Cooperative Motion Picture Marketing Plan to include the government incentive proposed here. Local commissions could market the incentive to producers just as they have previously marketed location sites for

filming. Furthermore, the incentive's funding would add to similar responsibilities that already fall under the CFC's authority. Therefore, including the incentive plan under the CFC's authority will alleviate any concerns over a separate agency rendered useless due to a decreased need for the incentive program.

## C. Digital Post-Production Technology

California can design an incentive program based on any production phase. Both the needs of producers and of the economic interests of the state should determine which production phase should be the lure. As previously mentioned, producers are eager to gain access to the expertise of Hollywood industry experts in marketing and new digital post-production technologies. Conveniently, California needs to focus on employment expansion opportunities emerging in post-production. Although post-production employment will not help retain production jobs, such as set and lighting design that have been either eliminated by new technology or lost to runaway production, it will help to replace them. If California is unwilling to do so, Canada could devise its own post-production incentives, leaving California with still fewer opportunities to bring productions back home.

Post-production employment opportunities result from developments in digital technology. Despite current unemployment due to runaway production, a report by the University of California Los Angeles Management School forecasts that employment in the California-based industry will double by 2015 to 364,000, with a likely increase to 437,000 workers by 2020.<sup>142</sup> However, new technology has changed the type and number of workers employed by the studios. Producers need fewer catering companies, costume shops, and equipment rentals. Instead of these traditional services, new jobs will likely emerge in digital media given the expansion of digital post-production. Market forces demand technology that reduces the days of principal photography and eliminates the need for extras on the set.

Digital technology, which includes special effects, sound and editing, has had the greatest impact on the post-production phase of filmmaking.<sup>143</sup> Studio restructuring and the rise of independent post-

production companies are evidence of the expansion of digital post-production. Recently, Hollywood studios have funneled foreign investments into preparation for the widespread digital revolution in computers, the Internet and television.<sup>144</sup> As early as 1992, Eastman Kodak Company opened a Hollywood studio specializing in transferring 35-millimeter film onto computers without losing resolution or color.<sup>145</sup> Disney's re-release of *Snow White* became the first film digitized by the studio. At the same time, Sony established Imageworks, its own digital studio, to handle effects for Tri-Star and Columbia.<sup>146</sup> Sony is moving to a fully digital platform by converting its extensive analog post-production infrastructure to digital.<sup>147</sup> On its Culver City lot, Sony Pictures Entertainment is expanding its film-editing infrastructure by nearly 25 percent with the construction of 39 film-cutting suites at an estimated cost of \$1 million to \$2 million.<sup>148</sup> While Warner Digital and Sony Pictures Entertainment have made in-house accommodations, Disney, 20th Century Fox and DreamWorks SKG have acquired control of outside post-production companies.<sup>149</sup>

California's post-production facilities are in high demand, but only by those who can afford them. For instance, Sony's audio post-production has become so popular that non-Sony productions repeatedly request use of their post-production services.<sup>150</sup> Non-Sony films that completed their entire post-production phase on the Sony lot include Warner Brothers' release of *Wild Wild West* in 1999 and *Castaway* in 2000.<sup>151</sup> The increased demand for visual effects and editing has led to an increase in the number and size of companies offering digital post-production services.<sup>152</sup>

Additionally, the need for post-production technicians led former employees of Quantel to set up a talent agency, International Creative Alliance Incorporated, aimed both at digital designers and related post-production professionals.<sup>153</sup> Expansion in digital post-

**CALIFORNIA'S** post-production facilities are in high demand, but only by those who can afford them. The increased demand for visual effects and editing has led to an increase in the number and size of companies offering digital post-production services.

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production offers an opportunity for the re-employment of those California craftsmen who have lost their jobs to Canadian workers. For several reasons, post-production services will likely develop and remain in Hollywood. First, having made major investments in updating post-production facilities throughout Hollywood, the studios will not want to leave.<sup>154</sup> Second, Hollywood is the recognized leader in technological innovation in the film and television industries.<sup>155</sup> Third, digital post-production equipment is not likely to become widely available due to its high cost. For example, Quantel manufactures digital editing and visual-effects systems with prices ranging from \$30,000 to \$1 million. This price does not include the thousands of dollars a year it costs to maintain and upgrade the systems.<sup>156</sup> At this price, Quantel does not aim to mass-market the equipment but sells to select post-production houses and television networks.

In sum, California has the tools with which to build a scheme to compete internationally. The *Monitor Report* has already determined which productions to target. The CFC as it currently exists is already capable of distributing funds, implementing procedures, and making full use of marketing and digital post-production expertise. Unfortunately, the current California initiative fails to take advantage of these tools. Moreover, it ignores opportunities to engage in any of the competitive policies in the international market that rely on partnering to achieve the most efficient financing and production packages available. The current initiative should be replaced with an incentive plan that incorporates California's strengths and government support to attract these production packages.

### **VI. Sense and Sensibility: Legal Formulation and Concerns**

Assuming the California Assembly is indeed willing to aid the industry with at least as much funding as it professed through the FCF, the next step is the legal formulation of the incentive. An explanation

of the legal provisions of the incentive follows. In addition, this section highlights some of the complexities of co-production agreements and the tax ramifications accompanying them.

#### **A. Legal Formation of the Government Incentive**

The basic structure of the incentive must address the State of California's contribution, what the State will receive, and finally, what controls and approvals the State can exercise. First, the State should contribute the financing through the CFC. To ensure a receptive California Assembly, the incentive must use minimal public funds to provide leverage to the industry without an undue risk of loss of

those funds. The incentive could take the form of loan guarantees, interest-free loans, or tax credits for post-production costs. Through loan guarantees the State could

help fund producers before the start of production without assuming the risk of making substantial upfront cash payments.

Second, the State must receive a commitment to spend a large percentage of its post-production budget in California from the producer applying for funding to develop a co-production. The producer must also commit to shoot a percentage of the production in California and/or to repay a percentage of the State's contribution out of the production's future revenues. The first requirement secures the State's main return in exchange for its incentive. In addition, it lures foreign producers by capitalizing on their eagerness to take advantage of Hollywood's recognized marketing and post-production expertise. The second requirement allows the State to adjust its receipts to the desired proportion of its expenditures on a case-by-case basis. It also allows the State to alter the incentive based on whether or not the producer is from California. For example, like the Canadian plan, California may require a producer to shoot a percentage of production in California. California producers previously relocating to Canada for production would instead have an incentive to remain because the

lower post-production costs would more than offset the lower relocation costs. By contrast, the State may require a foreign producer to shoot a smaller percentage of production in California, but in addition, may stipulate that the State may recoup a higher percentage of the award from the film's revenues. Recoupment from revenues is less reliable because it depends on the film's success—which the State cannot predetermine.

Overall, the cost to the California Assembly of retaining or attracting the production is the value of the incentive awarded less the percentage of the budget spent in California and any reimbursement received from revenues. The State cannot expect full reimbursement of the award. However, in the instance that a film does not recoup sufficient profits enabling it to fully reimburse the State, the State would at least receive use of post-production and production facilities and craftsmen, up to the point of full reimbursement. Thus, in the worst-case, the co-production plan accomplishes the same ends as California's current initiative does.

Finally, receipt of an award may depend on certain qualifications determined by the State. The State must adopt a mechanism to approve the post-production facilities. Potential craftsmen must be union members established in California in order to guarantee the quality of the production and to guarantee California craftsmen higher standards of employment. Each local CFC already has records of these post-production facilities and craftsmen listing their contact information and price range. Also, the State would determine the creditworthiness of the producer by considering the likelihood of the film's completion. Of course, the standards and conditions for receipt of the award would not be as strict as those imposed by banks. However, the stipulated use of a preferred California banker would help access the producer's credit and to promote the use of California's banking system. The State would make application for the award less stringent by allowing leniency in the following areas that the California Legislature would develop in more detail.<sup>157</sup> In the case of an interest-free loan, how quickly, for example, must the producer repay the loan? In the case of a loan guarantee, what percentage of the production's overall lending need will the State guarantee? In the case of a tax credit, what portions of the post-production expenses will the State refund? Lastly, what percentage of the overall budget or of production and post-production must occur in

California for the producer to be eligible for to receive the incentive? The answers to each of these questions may fluctuate depending on the package the State offers to the particular producer.

## B. Legal Issues Surrounding Co-Production Agreements

Co-production agreements between the producer-applicant and the post-production staff need to address the following contractual issues: (1) the allocation of creative and financial controls; (2) the nature of the control mechanisms and the veto rights of each partner; (3) the representations and warranties by the producers to the distributors; (4) the monetary obligations of the distributors including the amount and timing of payments; (5) the scope of the rights of the distributors regarding the exploitation of the film by each of the distributors; (6) the process for the calculation and accounting of receipts; and (7) the order and priority for distributions of profits and the forum in which disputes will be settled.<sup>158</sup>

Developments in U.S. tax law facilitate co-production agreements with foreign partners.<sup>159</sup> Co-production partners should avoid forming legal partnerships which can create tax difficulties potentially canceling the benefits of co-production.<sup>160</sup> Under section 6(1) of the Uniform Partnership Act an association of two or more persons to carry on as co-owners of a business for profit forms a partnership.<sup>161</sup> Co-production partners should avoid establishing partnerships because they can create a taxable presence for each co-producer in both countries.<sup>162</sup>

Instead, co-producers should operate under 26 U.S.C. § 482 (Allocation of Income and Deductions Among Taxpayers).<sup>163</sup> This section gives the Secretary of Treasury discretion to decide when and how to allocate gross income between any two or more businesses owned or controlled by the same interests.<sup>164</sup> The businesses need not be organized in the United States.<sup>165</sup> The section's prevents the avoidance of taxes or a distortion of income by shifting profits from one business to another.<sup>166</sup>

Treasury Regulation 1.482-7, promulgated by the Internal Revenue Service, explains the tax treatment of cost-sharing arrangements between related parties for intangible assets, including films.<sup>167</sup> The arrangement, embodied in a written document, must satisfy numerous requirements in order to qualify as a qualified cost-sharing arrangement. First, it must include two or more participants. Second, it must pro-

vide a method to calculate and allocate each participant's share of the costs. This means allocating the cost of a film between the parties based on the anticipated net income to each partner from the film's profits. Third, it needs to adjust for each participant's share of the costs in the event that these projections turn out to be incorrect by 20 percent or more. Finally, the document must list the forgoing information including a description of the scope of the development to be undertaken and the participants' interest in the intangibles developed, the duration of the arrangement and the conditions under which the arrangement can be modified or terminated.<sup>168</sup> Having met these requirements, a qualified cost-sharing arrangement will not qualify as a partnership for United States tax purposes and foreign participants will not be treated as engaged in "a United States trade or business."<sup>169</sup>

Co-production agreements will generally meet the substantive requirements of a qualified cost-sharing arrangement.<sup>170</sup> Thus, to facilitate the use of this incentive, the CFC needs to advise participating producers to structure their co-production agreements to satisfy those requirements. In sum, having considered these specific provisions, a producer may participate in co-production agreements with relatively few impediments.

### **VII. The Odd Couple: Canada as Partner**

With the California incentive program in place, Canada would emerge as an ideal partner. Unlike the United States, the Canadian government is concerned with the artistic content of the films to which it provides funding. California's incentive plan would permit some percentage of principal photography to take place in Canada with Canadian employees in exchange for increased recouping of the film's revenues. However, unlike the Canadian plan, the California incentive would concentrate on luring the producers back to the United States for marketing and post-production. Canadian film producers prefer to use California's marketing and post-production expertise. The Atlantic Film Festival in Halifax underlined the lack of expertise, effort and funding that characterize the marketing of Canadian films.<sup>171</sup> At the festival, Paul Gratton, Senior Program Executive at CityTV in Toronto spoke on a panel about how to effectively market films.<sup>172</sup> He suggested that since most Canadian distributors are

ineffective, filmmakers should try to market their films by themselves.<sup>173</sup> While Canadian distributors have a poor record of marketing Canadian films, a filmmaker can hardly be expected to single-handedly market a film to compete with a Hollywood studio. Instead, these filmmakers could take advantage of the California incentive and thereby bring production back to California for marketing and post-production -- often the most expensive phases of filmmaking.

The Canadian government has formally recognized its lack of marketing and post-production skill. The Cultural Industries Branch of the Department of Canadian Heritage released a report on Canadian film policies that highlighted marketing as a major weakness.<sup>174</sup> The report stated that on average, Canadian films capture a mere 2 to 3 percent of the box office. More than 85 percent of the ticket revenue goes to non-Canadian business. The report asserted that since Canadian films contain quality content, the failure to properly market the films is likely responsible for the poor results.<sup>175</sup> The average budget for a Canadian film is \$1.5 million in contrast to the hefty average budget of \$76 million in the United States.<sup>176</sup> Canadian marketing expenses average less than six percent of production costs.<sup>177</sup> By contrast, marketing expenses in the United States often exceed 40 percent of production costs and often account for the economic profitability of films and television shows regardless of their artistic or cultural merit.<sup>178</sup>

In addition to a review of Canadian film policies, the report listed goals the accomplishment of which largely depends on better marketing of Canadian films.<sup>179</sup> By 2004, the Department of Canadian Heritage aims to increase Canadian films' share of screen time from two to ten percent a year, along with its share of box office revenues. The department also seeks to increase marketing expenditures. Given the report's acknowledgment that inadequate marketing was almost entirely responsible for low screen time and box office statistics, these goals collapse into one—the aim is better marketing.

The remaining goals focus on increasing funding available for Canadian productions by cutting funding for foreign productions and by generating new federal funding. First, to transfer funding from foreign—especially Hollywood—production to domestic production the report suggested reducing the tax credit for foreign producers.<sup>180</sup> However, this might be economically detrimental—the Canadian film industry has undoubtedly benefited from the steady flow of

international production, especially from California. In order to attract this production the industry has shared government funding with foreign filmmakers. Tax credits for production services brought approximately \$32.8 million in Canadian taxpayer subsidies directly into the hands of foreign producers shooting in Canada.<sup>181</sup> In 1998 alone, foreign producers generated about \$332 million in total film and television production activity across Canada.<sup>182</sup> As previously described, under the tax credit program, Hollywood studios secured a tax refund for 11 percent of labor costs, or up to 5.5 percent of a production's budget.<sup>183</sup>

Second, to obtain increased federal funding, the report suggests the infusion of \$50 million and the consolidation of \$53 million of the existing funds in the two government agencies, Telefilm Canada and the Canadian Television Fund. The report notes that these funds will be distributed on the basis of success at the box office. It repeatedly mentions that success admittedly depends on adequate marketing. Taken together, the decline in Canadian incentives used to attract Hollywood productions and the need for adequate marketing of Canadian films support the revised approach—Californian incentives in the post-production stage.

Canada could accomplish more by partnering with California. Rather than trying to compete with the expertise of multinational marketing and post-production companies in the United States, Canada should try to perfect its marketing skills.<sup>184</sup> Telefilm Canada is the government agency responsible for administering funds for distribution and marketing.<sup>185</sup> One of its goals is to improve the marketability and competitiveness of Canadian films.<sup>186</sup> On its own, Telefilm Canada could not compete with foreign companies that invest significant capital in marketing and promoting their products. In response to the need for marketing expertise, the government has proposed linking Telefilm Canada with other national film agencies such as the National Film Board and the Canadian Broadcasting Corporation.<sup>187</sup> However, these national agencies differ greatly in their objectives, priorities and needs.<sup>188</sup> It would be easy for Canada to offset its lack of marketing and post-production skill by partnering with California.

**CANADA** could accomplish more by partnering with California. It would be easy for Canada to offset its lack of marketing and post-production skill by partnering with California.

## VIII. Conclusion

The current California initiative is similar to that initially taken by Europe in response to the success of the Hollywood studio system. It is piecemeal, limited and unfocused. Meanwhile, producers are taking advantage of the competitive policies offered by the international market to attract production such as split-rights agreements, co-production incentives and the development of new foreign production sites. Assuming that the California Assembly's initiative is a genuine commitment to aiding the industry; a competitive incentive plan should be devised to better utilize the funding it has allocated.

The plan should represent a single objective—consolidate funding and utilize the CFC. It should attract production by targeting producers working with budgets under \$25 million and offer them loan guarantees, interest-free loans, or tax credits. In exchange for this incentive, California would secure the use of its post-production facilities and the employment of its technicians. This plan would generate more revenue and create permanent working relationships between producers and California's post-production sector. The initiative offered by California would attract partners like Canada hoping to gain access to California's marketing and post-production expertise. The arrangement would promote the purposes of both the Californian and Canadian plans while lowering the bottom-line for producers on both sides of the border. Thus, with the proposed incentive plan in place the rivalry—currently turning into animosity—could instead become a mutually beneficial partnership.

## ENDNOTES

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<sup>1</sup> Mark Crawley, *Movieprop.com's Rambo Movie Pages*, at <http://www.movieprop.com/tvandmovie/rambo> (last visited Nov. 18, 2002). See also *RAMBO: FIRST BLOOD* (Carolco Pictures, Inc. 1982).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> The Internet Movie Database, *Powersearch Results*, at <http://www.us.imdb.com/List?endings=on&&locations=Canada> (last visited Nov. 17, 2002) (The site is a list of films whose origin is the United States but which were shot on location in Canada).

<sup>7</sup> *Id.*

<sup>8</sup> See generally The California Film Commission, *Film California First Program*, available at [http://www.filmcafirst.ca.gov/state/cfc/cfc\\_homepage.jsp](http://www.filmcafirst.ca.gov/state/cfc/cfc_homepage.jsp) (last viewed Nov. 11, 2002).

<sup>9</sup> Internet Movie Database, *supra* note 6. By moving productions to Canada, filmmakers lowered their "bottom-line," i.e., the cost of making the film, by taking advantage of Canadian tax credits and the lower salaries of Canadian production employees.

<sup>10</sup> Ruth Vasey, *The World-Wide Speed of Cinema*, in *THE OXFORD HISTORY OF WORLD CINEMA* 43 (Geoffrey Nowell-Smith ed., 1996).

<sup>11</sup> Robyn Karney, *CHRONICLE OF THE CINEMA* (1995).

<sup>12</sup> Vasey, *supra* note 10, at 53.

<sup>13</sup> Gianni Profita, *Eurimages, Media II and the European Convention on Cinematographic Co-productions: Reducing the Gap Between Europe and the United States*, 8 ENT. L.

REV. 217 (1997).

<sup>14</sup> David Robb, *Davis Opens Warchest: Governor's Budget Includes \$50 Million to "Stem Loss of Jobs,"* THE HOLLYWOOD REPORTER, May 16, 2000.

<sup>15</sup> Canada Customs and Revenue Agency, at <http://www.ccra-adrc.gc.ca/taxcredit/ftc/ftcsume.html>. (last visited Nov. 17, 2002). (The site gives information on Canadian tax credits).

<sup>16</sup> Department of Heritage, Cultural Industries Branch, *A Review of the Canadian Feature Film Industry*, at <http://www.pch.gc.ca/progs/ac-ca/pol/cinema-film/pubs/eparts.htm> (last visited Feb. 13, 2002).

<sup>17</sup> See generally Nick Madigan, *Canuk Helmers Defending Turf*, DAILY VARIETY, July 12, 1999, at 1.

<sup>18</sup> Vasey, *supra* note 10, at 43.

<sup>19</sup> Martin Dale, *THE MOVIE GAME* 116-118 (Continuum Int'l. Pub. Group Inc. 1997).

<sup>20</sup> Vasey, *supra* note 10, at 43.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 61.

<sup>23</sup> *Id.* Hollywood later lured Lubitsch's favorite star, Pola Negri, away from Europe and into its studios. *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> DALE, *supra* note 19, at 185.

<sup>26</sup> *Id.* at 186-88.

<sup>27</sup> See generally Arthur Anderson, *EUROPEAN FILM PRODUCTION GUIDE* (Routledge 1996).

<sup>28</sup> See generally *id.*

<sup>29</sup> See generally *id.*

<sup>30</sup> Vasey, *supra* note 10, at 55.

<sup>31</sup> Martha Kinder, *REFIGURING SPAIN: CINEMA/ MEDIA/ REPRESENTATION* 222 (Duke University Press 1997).

<sup>32</sup> DALE, *supra* note 19, at 208-22.



<sup>33</sup> *Id.* The MEDIA programme was designed by the Commission of the European Communities. Eurimages was established by the European Audio-visual Commission. *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 221.

<sup>36</sup> David Putnam, MOVIES AND MONEY 262-63 (Alfred Knopf 1998). David Putnam has been called the “conscience of Hollywood.” He is a British film producer who many believed saved the British-commercial film industry. He is responsible for such films as MIDNIGHT EXPRESS (1978) and CHARIOTS OF FIRE (1981). In the early 1980s, he was head of production at Columbia Pictures before returning to Britain as a producer and campaigner for the revitalization of Britain as a center of European film production.” See <http://www.britmovie.co.uk/bio/p/004.html> (last viewed Nov. 18, 2002).

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> Miles Mogulescu, *Tax Incentives for Motion Picture Investment: Throwing the Baby in with the Bath Water*, 58 S. CAL. L. REV. 839, 839 (1985). The effect of the exchange rate is significant; the American dollar is currently worth \$1.43 in Canadian currency.

<sup>40</sup> See generally *id.* at 846-847.

<sup>41</sup> ENCYCLOPEDIA OF GLOBAL INDUSTRIES 306 (Scott Heil ed., 2d ed. 1999).

<sup>42</sup> *Id.*

<sup>43</sup> Madigan, *supra* note 17, at 1.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* (noting that more than half the total production going abroad went to Canada).

<sup>46</sup> *Id.*

<sup>47</sup> BBC News Entertainment, *Hollywood’s Moving Movies*, [http://news.bbc.co.uk/hi/english/entertainment/newsid\\_434000/434462.stm](http://news.bbc.co.uk/hi/english/entertainment/newsid_434000/434462.stm) (last visited Feb. 5, 2002). See also BLUES BROTHERS 2000 (Universal Pictures 1998)

(sequel to the popular BLUES BROTHERS (Universal Pictures 1980)).

<sup>48</sup> Madigan, *supra* note 17, at 1. The report distinguishes between economic and creative runaway productions. The latter go abroad because the story line calls for a particular location. Of the 285 that fled, 100 were films made for theatrical release and 185 were films made-for-television.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> Nick Madigan, *State Hears Flight Fight*, DAILY VARIETY, May 26, 1999, available at [http://www.ftacusa.org/html/2\\_vrty052699.html](http://www.ftacusa.org/html/2_vrty052699.html).

<sup>54</sup> *Id.*

<sup>55</sup> Davis Signs off on Film Subsidies, THE HOLLYWOOD REPORTER, July 5, 2000, at 54.

<sup>56</sup> David Robb, *California Funds Runaway Production Flight*, THE HOLLYWOOD REPORTER, June 26, 2000, at 37 (Industry estimate).

<sup>57</sup> Donald Biederman, LAW AND BUSINESS OF THE ENTERTAINMENT INDUSTRY, 608 (3d ed. 1996). It appears that producers utilizing foreign subsidies are largely independent of the studios. Why should California take legislative action to protect independents? One-fourth to one-third of the major studio’s films is produced by independents. 1993 Independent Producer’s Special Issue, THE HOLLYWOOD REPORTER, Feb. 18, 1993, at 7. Moreover, research has shown that independently acquired productions have a higher rate of success than do in-house studio productions. Most technicians and producers unemployed by studios are employed as independents. Studios use one set of technicians, directors, and producers for one production and alter the cast and crew for the next. The remainder of the \$10.3 billion not accounted for in the text includes non-film/television based productions such as music and musicals.

<sup>58</sup> U.S. Department of Commerce Issues Report on Impact of “Runaway” Film Production, 22 NO. 11 ENT. L. REP. 13,

I, April 2001.

<sup>59</sup> See *The Migration of U.S. Film and Television Production: Impact of "Runaways" on Workers and Small Businesses in the U.S. Film Industry*, available at <http://www.ita.doc.gov/media/commercenews/filmmigration12001.htm> (last visited Mar. 22, 2001).

<sup>60</sup> *Id.*

<sup>61</sup> Nigel Sinclair, *U.S./ Foreign Film Funding; Co-productions*, 7 NO. 12 ENT. L. REP. 3, 1 March 1991. See also Harold L. Vogel, *ENTERTAINMENT INDUSTRY ECONOMICS: A GUIDE FOR FINANCIAL ANALYSIS* 93 (4<sup>th</sup> ed. 1998). Although the film and television industry is a significant economic entity, it is an extremely high-risk venture. Most foreign countries, like Canada, remain willing to make substantial investments in the film and television industry despite the high risk of economic failure. They regard film and television as a vital national interest, much like defense, which the state is empowered to support financially. In fact, the state is responsible for preserving film and television as tools for expressing and controlling social cohesion. Because the United States regards film and television as an industry rather than a vital national interest, it is unwilling to support them to the extent that foreign countries are. This paper takes no position as to whether subsidies offered by Canada represent unfair competition as opposed to protection of cultural identity.

<sup>62</sup> Thomas Guback, *Government Financial Support to the Film Industry in the United States*, CURRENT RESEARCH IN FILM: AUDIENCES, ECONOMIES, AND LAW 133 (1991).

<sup>63</sup> *Id.*

<sup>64</sup> CAL. GOV'T CODE §§15363.70-.75 (Deering 2001).

<sup>65</sup> §15363.71.

<sup>66</sup> *Id.*

<sup>67</sup> §15363.73.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> CAL. PUB. RES. CODE §14999 (Deering 1999).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> CAL. PUB. RES. CODE §30610.9 (Deering 1999).

<sup>74</sup> *Id.*

<sup>75</sup> Robb, *supra* note 14.

<sup>76</sup> *Id.*

<sup>77</sup> David Robb, *California Funding Film, TV Retraining*, THE HOLLYWOOD REPORTER, Oct. 28, 1999, at 1.

<sup>78</sup> A.B. 358, 1999-2000 Reg. Sess. (Cal. 1999).

<sup>79</sup> A.B. 2180, 1999-2000 Reg. Sess. (Cal. 2000).

<sup>80</sup> A.J.R. 23, 1999-2000 Reg. Sess. (Cal. 1999).

<sup>81</sup> Cal. Pub. Res. Code § 15363 (Deering 1999) (repealed 1993).

<sup>82</sup> The California Assembly's reluctance to designate substantial funding to film and television production most likely reflects the United States' policy that film and television are business industries rather than national interests. The film and television industries must compete for state funding with other industries that represent national interest such as defense and agriculture.

<sup>83</sup> Dana Harris, *Agents of Change: No Green Light? No Problem. Talent Reps are Finding Cash All Over the World*, THE HOLLYWOOD REPORTER, Nov. 18, 1997, at 1.

<sup>84</sup> *Id.*

<sup>85</sup> Robert Marich, *Pre-sale: Tougher, More Complex*, THE HOLLYWOOD REPORTER, Nov. 17, 1994, at 1.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> Schuyler M. Moore, *The German Title Wave: German Investment on Hollywood Movie Production*, 22 NO. 2 ENT. L. REP. 4, (2000). An option to purchase on a first look basis requires the seller to permit one distributor to have the opportunity to buy the film before any other distributor is given the opportunity. *Id.*

- <sup>90</sup> *Id.*
- <sup>91</sup> See Internet Movie Database, *Kama Sutra Main Details* at <http://www.us.imdb.com/Title?0116743> (last visited Nov. 17, 2002). See also *KAMA SUTRA* (Marabai Films, 1996).
- <sup>92</sup> *Id.*
- <sup>93</sup> See Marich, *supra* note 85.
- <sup>94</sup> See generally Jason E. Squire, *THE MOVIE BUSINESS BOOK* 433-36 (2d ed. 1983).
- <sup>95</sup> *Nat'l Geographic Soc'y v. Int'l Media Assocs.*, Civil Action No. 89-1200, 1992 U.S. Dist. LEXIS 12954, at \*27-28 (D.D.C. 1992). In addition to co-productions between countries, there are similar agreements also referred to as co-production agreements in which the distributor joins together with the producer to receive profits from the film's distribution.
- <sup>96</sup> *Id.*
- <sup>97</sup> *Id.*
- <sup>98</sup> Profita, *supra* note 13.
- <sup>99</sup> Putnam, *supra* note 36.
- <sup>100</sup> *Id.*
- <sup>101</sup> Profita, *supra* note 13.
- <sup>102</sup> *Id.*
- <sup>103</sup> Canada Customs and Revenue Agency, *supra* note 15.
- <sup>104</sup> See *id.*
- <sup>105</sup> Profita, *supra* note 13.
- <sup>106</sup> *Id.*
- <sup>107</sup> Income Tax Act, R.S.C., ch. 148, §125.4 (1997) (Can.).
- <sup>108</sup> *Id.*; see also Canada Customs and Revenue Agency, *supra* note 15. "Revenue Canada" is now known as Canada Customs and Revenue Agency, or "CCRA."
- <sup>109</sup> Income Tax Act, R.S.C., ch. 148, §125.4 (1997) (Can.).
- <sup>110</sup> *Id.*
- <sup>111</sup> *Id.*
- <sup>112</sup> *Id.*
- <sup>113</sup> *Id.*
- <sup>114</sup> See Income Tax Regulations, C.R.C. ch. 945, Proposed Addition Reg. 1106(3) (1997) (Canada).
- <sup>115</sup> *Id.*
- <sup>116</sup> *Id.*
- <sup>117</sup> David Robb, *Incentives in Mexico Sought*, *THE HOLLYWOOD REPORTER*, Mar. 24, 2000.
- <sup>118</sup> *Id.*
- <sup>119</sup> *Id.*
- <sup>120</sup> *Id.* (rejecting the methods used by Spain, Australia, and Ireland. The Spanish model fails because it is protectionist, aimed only at encouraging local productions. As a result, the local film industry remains fragmented, disorganized and commercially unsuccessful. Twenty-five percent of all Spanish films never gain distribution and therefore are never seen. The Australian model fails because it does not attract foreign production on a government subsidy. The Irish model fails because it supports only the local industry and its unions remain difficult to work with. As a result, Ireland's production levels are lower than ever.).
- <sup>121</sup> *THE HOLLYWOOD REPORTER*, July 24, 1999 (reporting that production at Fox's facilities in Baja came to a halt last summer due to union unrest. When a turf war among rival unions led to a week-long blockade of the lot in June, a Mexican court stepped in and ordered the facility opened.).
- <sup>122</sup> Robb, *supra* note 117.
- <sup>123</sup> *Id.*
- <sup>124</sup> *Id.*
- <sup>125</sup> *Id.* (defining "maquila agreements" as trade agreements by which United States companies have set up factories inside the Mexican border to take advantage

of lower labor costs).

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> Robert Reichy, *THE WORK OF NATIONS* (Vintage Books 1992).

<sup>131</sup> Central to an understanding of the incentive is general knowledge about the three major phases of production. During the pre-production phase, the producer makes all necessary preparations for production such as securing a cast, crew, script, budget, locations for principal photography, post-production facilities, and necessary licensing. The phase following pre-production is production, during which principal photography and the filming of all scripted material is accomplished. Later, in the post-production phase, the work is edited, special effects and finished audio and a master negative produced. Finally, the marketing and advertisement plans are implemented. Since much of the same editing equipment used in post-production is also needed to create marketing plans, the same post-production facility and craftsmen are often used. Ralph S. Singleton, *FILM BUDGETING*, 436-45 (1996).

<sup>132</sup> Madigan, *supra* note 17, at 1.

<sup>133</sup> Vasey, *supra* note 10, at 55.

<sup>134</sup> Paul Baumgarten, *PRODUCING, FINANCING AND DISTRIBUTING FILM*, 124-25 (Limelight Editions 1992).

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> CAL. GOV'T. CODE §15335.20 (West 2002) (establishes the CFC).

<sup>138</sup> Kevin Garrett Monroe, *How Foreign Film Commissions Can Lower Production Costs*, 15 ENT. L. AND FIN. 2, 1 (1999).

<sup>139</sup> CAL. GOV'T. CODE §15335.22 (West 2002) (authorizes the CFC to develop and oversee the implementation of the Plan, which is to increase the marketing

efforts of the commission and offer state resources to the local film commissions and local government liaisons to the film industry for the purpose of marketing their locales to the motion picture industry).

<sup>140</sup> CAL. GOV'T. CODE §15335.22 (West 2002) (for purposes of this section, resources offered to local film commissions and local government liaisons to the motion picture industry shall include all of the following: grants for partial or full funding of the cost to develop or participate in workshops, trade shows, seminars, or meetings that assist local governments to promote and market the use of their locales by the motion picture industry; and appropriate promotional and informational materials for the purpose of advertising to the motion picture industry).

<sup>141</sup> *Id.*

<sup>142</sup> Jeffery Daniels, *Study: Showbiz Growth Should Double by 2015*, THE HOLLYWOOD REPORTER, Sept. 17, 1998, at 1.

<sup>143</sup> Richard Setlowe, *Hi-Tech Changes Sweep Expo '92: Deck Digital Systems Lead Charge*, DAILY VARIETY, June 19, 1992, at 1.

<sup>144</sup> Diane Mermigas, *Elite Few Will Lead Digital Revolution: Report Takes Stock of Next 10 Years*, ELEC. MEDIA, May 3, 1999, at 4. (Reports estimate that before 2003, the film and television studios of major production companies such as Disney, Time-Warner and Viacom will generate an estimated \$27 billion in revenues, 5 percent of which will be revenue from digital television).

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

<sup>147</sup> Larry Armstrong, *Wow! Who Taught Those Dinosaurs to Talk?* BUS. WK., June 21, 1993, at 44.

<sup>148</sup> *Tech Talk*, THE HOLLYWOOD REPORTER, July 15, 1999, at 1.

<sup>149</sup> Carl DiOrio, *Sony Splices in Editing Posts: Adds 39 Suites in Bid to Bring More Outside Postprod*, THE HOLLYWOOD REPORTER.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> Carl DiOrio, *Demand for Effects Calls Many to Post*, THE HOLLYWOOD REPORTER, Dec. 26, 2000, at 1.

<sup>153</sup> *Id.*

<sup>154</sup> DiOrio, *Sony Splices*, *supra* note 149.

<sup>155</sup> Internet Movie Database, *supra* note 6.

<sup>156</sup> Marla Mazer, *Quantal's Special Effect*, L.A. TIMES, Feb. 26, 1998, at 6.

<sup>157</sup> Monroe, *supra* note 138, at 5.

<sup>158</sup> Schuyler M. Moore, *How Foreign Co-producers Obtain Rights in U.S. Films*, 12 NO. 3 ENT. L. & FIN. 3, 3 (1996).

<sup>159</sup> Schuyler M. Moore & Matthew C. Thompson, *Tax Issues for Film Producers, Distributors*, 12 NO. 11 ENT. L. & FIN. 3 (1996).

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* See also Uniform Partnership Act §6(1).

<sup>162</sup> Schuyler M. Moore & Matthew C. Thompson, *Tax Issues for Film Producers, Distributors*, 12 NO. 11 ENT. L. & FIN. 3 (1996).

<sup>163</sup> Schuyler M. Moore & Sheri Jeffrey, *Taxation of International Co-productions*, 11 NO. 9 ENT. L. REP. 3 (1990).

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> Moore & Jeffrey, *supra* note 163. See generally *Charles Town, Inc., v. C.I.R.*, 372 F.2d 415 (4<sup>th</sup> Cir. 1967).

<sup>167</sup> Treas. Reg. §1.482-7 (2000); Moore & Jeffrey, *supra* note 163. See generally *Charles Town, Inc., v. C.I.R.*, 372 F.2d 415 (4<sup>th</sup> Cir. 1967).

<sup>168</sup> Treas. Reg. §1.482-7 (2000); Moore & Jeffrey, *supra* note 163. See generally *Charles Town, Inc.*, 372 F.2d 415.

<sup>169</sup> Treas. Reg. § 1.482-7 (2000); Moore & Jeffrey, *supra* note 163. See generally *Charles Town, Inc.*, 372 F.2d 415.

<sup>170</sup> Moore & Jeffrey, *supra* note 163. See generally

*Charles Town, Inc.*, 372 F.2d 415.

<sup>171</sup> *Hollywood North . . . or Not?*, at [http://www.infoculture.cbc.ca/archives/filmtv/filtv\\_09271999\\_tvmarketing.html](http://www.infoculture.cbc.ca/archives/filmtv/filtv_09271999_tvmarketing.html) (last visited August 23, 1999).

<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> *A Review of Canadian Feature Film Policy: Summary of Submissions*, June 1998, available at <http://www.pch.gc.ca/progs/ac-ca/pol/cinema-films/pubs/summary.pdf> (last accessed Nov. 17, 2002).

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> *Canada Eyeing Hollywood Tax Cut*, THE HOLLYWOOD REPORTER, Dec 24, 1998, available at 1998 WL 25009389.

<sup>181</sup> *Id.*

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *Connecting to the Canadian Experience: Diversity, Creativity and Choice, Linking Production, Distribution and Marketing*, at <http://www.pch.gc.ca/mindep/misc/experience.html> (last visited Feb. 13, 2002).

<sup>185</sup> *Telefilm Canada Business Plan*, at <http://www.telefilm.gc.ca/en/org/plan/obj.htm> (last visited Feb. 13, 2002).

<sup>186</sup> *Id.*

<sup>187</sup> *Connecting to the Canadian Experience*, *supra* note 184.

<sup>188</sup> Telefilm Canada is the country's national film association. The National Film Board is a resource for archival footage and documentaries, while the Canadian

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Broadcasting Corporation concentrates on television and radio programs. Uniform programs to enhance marketing in film will take years to organize, not to mention accomplish. *Id.*