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# Production Incentive Issues Arising from COVID-19

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# Shutdown, Interim & Restart Costs



- As a result of the pandemic, production companies have incurred extraordinary expenses associated with the shut down of productions, including:
  - Shut down costs;
  - Interim holding costs, including state rentals and storage and payroll costs to hold cast and crew;
  - Restart costs, including new COVID-19 health protocols
- States have issued very limited guidance regarding whether such costs qualify for production incentives
- Informal responses to our questionnaires will be discussed *infra*
- In the absence of formal guidance, rules of statutory construction must be applied

# Georgia



- Per O.C.G.A. § 48-7-40.26(b)(8), production expenditures are defined as “preproduction, production, and postproduction expenditures *incurred in this state* that are *directly used* in a qualified production activity . . . and other direct costs of producing the project *in accordance with generally accepted entertainment industry practices.*” (emphasis added)
- Pursuant to the DOR regulations, “[i]n determining whether an expenditure is directly used in a qualified production activity, the Department of Revenue will consider the *proximity* of the expenditure to the activity as well as the *causal relationship* between the expenditure and the activity.” Ga. Comp. R. & Regs. 560-7-8-.45(6)(b).
- These terms may be a reference to the tort law doctrines of *cause in fact* and *proximate causation*
- Cause in fact applies a “but for” test
- Proximate cause applies a foreseeability of event test
- Accordingly, qualification of expenditures may depend on factors such as: i) could the production be completed but for the expense, ii) are the expenses incurred in accordance with generally accepted industry practices, iii) are the expenses reasonably foreseeable, iv) how close in time are the expenses related to a qualified phase of production?
- The problem is nobody knows what is “generally accepted practice” for COVID-19

# Informal Georgia Guidance



- Shut down and *non-payroll* interim holding cost, and restart costs should qualify
- *Payroll* holding costs do not qualify (I disagree with this informal guidance)
- The DOR has previously issued policy guidance on season interim expenditures for episodic series (Policy Bulletin IT 2016-01)
- Pursuant to such guidance, interim season expenditures are qualified expenditures that may be claimed in the tax year of the next season, if the production returns to Georgia; otherwise the expenditures may not be claimed; the guidance does not exclude payroll costs
- The DOR has historically treated “hold days” (on a day out of days schedule) as qualified expenditures on audits
- Interim cast holding costs during COVID-19 shutdown should arguably be treated like otherwise-qualified hold days
- Whether cast is physically present during the hold may be a factor

# New Mexico



- New Mexico law defines “direct production expenditures” as:
  - directly attributable to the production in New Mexico;
  - are subject to taxation by the state of New Mexico;
  - exclude direct production expenditures for which another taxpayer claims the expense;
  - do not exceed the usual and customary cost of the goods or services acquired when purchased by unrelated parties (NM Stat. § 7(b)(1))
- The term also includes “other direct costs of producing a film in accordance with *generally accepted entertainment industry practice.*” NM Stat. § 7-2F-2(o)(2).
- Per informal guidance from the NM DOR:
  - Hold costs for stages and equipment qualify
  - Payroll hold costs do not qualify “since they are not being paid while filming in NM”
  - Shut down and start up costs qualify
  - Incremental new start up costs for COVID-19 health reasons qualify

# Virginia



- Virginia defines qualified expenditures as “amounts spent in the Commonwealth by a production company in connection with the production of a motion picture filmed in the Commonwealth” and “are directly attributable to the production of a project” Va. Code § 58.1-439.12:03(a)(1); Ruling of Commissioner, P.D. 10-281 (December 21, 2010)
- Per informal VA Film Office guidance:
  - Hold costs for stages and equipment qualify
  - Payroll hold costs for cast and crew do not qualify
  - Shut down and start up costs qualify
  - Incremental new start up costs for COVID-19 health reasons qualify

# Incremental COVID-19 Restart Protocol Expenses



- As a result of state and local production-restart protocols, as well as guild agreements and other industry standards being adopted, productions will have to incur new categories of expenses
- These new expenses may include things like:
  - For productions adopting a “pod” quarantine approach, costs for separate accommodation, feeding and entertainment of different production units being held in quarantine;
  - Costs for medical testing and having additional medical personnel on set, including potential new HIPAA record-keeping compliance costs;
  - Costs for PPE;
  - Costs for duplicate equipment for different production units;
  - Increased security costs;
  - Need for increased space for social distancing

# Incremental COVID-19 Restart Protocol Expenses



- Because these expense are new, it will be difficult to determine what is a generally accepted industry practice until industry standards start to coalesce, which may take years
- It will also be difficult to determine which expenses are directly and proximately related to the production
- For example, if a production adopts safety standards in excess of those deemed mandatory by state and local health authorities, will those expense be deemed “direct” under a “but for” standard?
- If there is a breakout of an infection and extraordinary costs are incurred filming around that, are such expenses reasonably foreseeable and proximately related? What if they are subject to insurance reimbursement?
- Prior to the crisis, entertainment expenses for cast and crew (e.g., wrap parties) were not always qualified expenses. If a quarantine approach is established, will entertainment expenses now be necessary? At what level?



# Applicability of *Force Majeure*, Impossibility & Frustration of Purpose



- The shutdown of production due to the pandemic may cause productions to violate time limitations in tax incentive statutes
- Additionally, there may be changes in film tax credit programs in the interim between when a production was certified and when the production may be completed, raising the question of when should certification or level of credits be grandfathered
- Further, it may become financially infeasible to finish certain productions, meaning that commercial distribution and state promotional requirements can't be fulfilled
- In such cases, statutory or contractual *force majeure*, impossibility and frustration of purpose provisions may come into play

# Applicability of *Force Majeure*, Impossibility & Frustration of Purpose



- *Force majeure* (superior force) provisions in contracts typically suspend or excuse performance by one or both parties due to extraordinary circumstances that are beyond the controls of the parties
- Such provisions may be contractual or statutory (e.g., in Georgia)
- Unforeseen circumstances may include acts of God, acts of governments, labor disputes, severe weather occurrences and other natural disasters, etc.
- There are two main issues to determine enforceability: i) is the event specifically identified in the contractual or statutory language, or if not, did the parties reasonably foresee the event?; ii) did the event make performance impossible?

# Applicability of *Force Majeure*, Impossibility & Frustration of Purpose



- Courts tend to *strictly construe* these provisions so if specific events or conditions are used, courts will limit applicability to the events listed
- If the language used is general (“act of God”), then reasonable foreseeability becomes the test
- Accordingly, when a contract was entered into become important (*e.g.*, a contract entered into after the start of state or local mandatory restrictions or quarantines might be construed differently than one entered into beforehand)
- Even if a force majeure provision covers COVID-19, performance is only excused if the event makes performance impossible, meaning extraordinarily and unreasonable difficulty; mere financial hardship or difficulty will likely not excuse performance
- Prompt notification is usually required under the contract

# Georgia Provisions



- In Georgia, force majeure is both a contractual and statutory defense
- Pursuant to O.C.G.A. § 13-4-21, “If performance of the terms of a contract becomes impossible as a result of an act of God, such impossibility shall excuse nonperformance, except where, by proper prudence, such impossibility might have been avoided by the promisor”
- O.C.G.A. § 1-3-3 defines “act of God” to mean “an accident produced by physical causes which are irresistible or inevitable, *such as* lightning, storms, perils of the sea, earthquakes, inundations, sudden death, or illness. This expression excludes all idea of human agency.”
- Georgia courts have held that the financial crisis of 2008 involved human agency and was therefore not an act of God; Unclear if government-ordered quarantines or safety and health concerns resulting from COVID-19 involve human agency

# Impossibility of Performance, Frustration of Purpose



- Even in the absence of contractual or statutory *force majeure* provisions, some courts excuse performance under common law doctrines when it would be impossible, or even in some limited instances, commercially impractical, to perform a duty
- Usually, extreme hardship is required versus mere difficulty
- The “frustration of purpose” doctrine discharges a party’s duty to render performance when the party’s purpose is substantially frustrated by the occurrence of an event whose non-occurrence was a fundamental assumption underlining the contract. *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 901 A.2d 106, 113 (Del. 2006).
- Arguably, the purpose of entering into a film incentive MOA or performance agreement is to produce a film and promote the state; if that purpose becomes frustrated by an epidemic, performance is arguably excused
- State legislatures are likely to amend state act of God or *force majeure* provisions so as to address the COVID-19 crisis

# Example



- The Virginia film incentive MOU has the following provision: “Any failure by the company to perform its obligations hereunder . . . shall be excused if occasioned by an event beyond its direct control (e.g., the unavailability of qualified Virginia crew, a hurricane, an injury to a lead actor). . .”
- This is relatively broad language that arguably does not even contain a reasonable foreseeability requirement
- It does not appear to exclude acts of human agency based on the examples listed
- This kind of provision would very likely apply to COVID-19 events

# Questions and Resources



- For more information, please contact Peter Stathopoulos at [peter.stathopoulos@btcpa.net](mailto:peter.stathopoulos@btcpa.net).
- Visit Bennett Thrasher's COVID-19 Resource Center at <https://www.btcpa.net/services/coronavirus/>.