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Client Alert: Did Relativity Media Run a \$100M “Romance Scam” on a Film Investor?

RKA Film Financing has sued a group of film executives and financiers claiming that they schemed with much-hyped film distributor Relativity Media to pull off a \$100 million-plus fraud.

Putting movie industry context aside, RKA’s fraud allegation, in key respects, looks like a classic “Romance Scam”, in which the scammer:

- ** posts great-looking photos
- ** claims he or she is trapped and
- ** begs cash to escape and join the “mark” (the victim of the scam).

Is this alleged fraud a new twist on an old scam?

The Complaint

In its complaint, RKA Film Financing alleges that the defendants promoted a massive financial fraud to prop up beleaguered Relativity Media.¹ RKA believed it was making *low-risk* loans to be used solely for release prints and advertising buys (“P&A Costs”) of studio-level motion pictures. But, RKA claims, Relativity instead used the loans for working capital. In July 2015, Relativity filed for bankruptcy, leaving RKA almost totally underwater on a slate of films.

P&A vs. Working Capital Loans

Some film investors favor P&A loans over working capital loans. Why? Loans for P&A Costs are typically made on a “LIFO” basis: loan advances are “Last In”, but are repaid “First Out” from specific revenues of the released picture. By contrast, working capital loans are typically repaid out of a company’s general revenues pursuant to a very different formula.

Use of Loan Advances

Per the complaint, each of RKA Film Financing's P&A loan advances should have been routed to a separate, special purpose entity ("Film SPE") set up by Relativity for each of the films, and used by such Film SPE solely for the P&A Costs of the film owned by that SPE. For example, RKA's P&A loan advance for the film *Solace* should have been routed to RML Solace Films, LLC for that film's P&A Costs. Same for other films for which RKA advanced P&A Costs, such as *November Man*, *Best of Me*, *Beyond the Lights*, *Woman in Black 2*, *Black or White*, *Lazarus Effect*, *Solace*, *Masterminds*, *Before I Wake*, and *Disappointments Room*.

But some films in the slate were barely released domestically, others not at all, and per the complaint, Relativity used the P&A loans, instead, for working capital. Then, as Relativity headed toward bankruptcy, its senior lender, One West Bank (under the then-stewardship of Steve Mnuchin, the new Treasury Secretary) swept Relativity's bank accounts, seizing RKA loan advances and applying them to One West debt.

But why did RKA Film Financing give loan proceeds to Relativity in the first place? Why didn't RKA advance the loans directly to the SPEs?

Claimed Problem #1: Film Vendor Discounts were Restricted

RKA alleges that it wanted to disburse P&A loans straight to specific Film SPEs, but that:

[Relativity Chairman Ryan] Kavanaugh told RKA that it could and should not send funds directly to the Film SPEs because Relativity's contracts with its vendors were only with Relativity, which received benefits and discounts from those vendors by virtue of its purchasing power.

But was it true that Relativity's vendors would only have honored volume discounts if paid directly by Relativity, not by affiliates? And if true, couldn't there have been a workaround?

Claimed Problem #2: Separate Bank Accounts would be Burdensome

Per the complaint, defendants also told investor RKA that:

it would be too logistically and legally cumbersome to set up individual bank accounts for each Film SPE, and that the funds would instead be earmarked in a Relativity account for P&A on each film.

But, again, was it true that managing a separate bank account for each Film SPE would have been unduly burdensome? And wasn't a workaround possible?

The Classic Romance Scam

With that background, let's return to the elements of a classic Romance Scam. In a Romance Scam, the scammer:

1. posts great-looking pictures
2. claims he or she is trapped and
3. begs cash to escape and join the mark.

The scammer often starts by posting the great-looking pictures to an online dating site. Once online affections are kindled, the scammer then claims a costly obstacle to meeting in person, such as a transcontinental flight or an onerous exit visa. And when the unwitting mark offers to directly pay the cost of the obstacle, the scammer says, "No, you can't do it yourself, the only way is to give me the cash, and I'll do it . . . *Believe me.*" Then, when the cash arrives, the scammer disappears.

Comparison to Defendants' Alleged Fraud

How does the classic Romance Scam compare with the fraud alleged by RKA Film Financing?

1. The relationship between RKA and the defendants was built around great-looking pictures; in this case, great-looking *motion* pictures, starring the likes of Pierce Brosnan, Michelle Monaghan, Kevin Costner, Olivia Wilde, Colin Farrell, Kristen Wiig, Zach Galifianakis, Kate Bosworth, Gugu Mbatha-Raw and Kate Beckinsdale. Handsome and beautiful people . . .
2. Relativity lacked necessary funds to release the films. Absent P&A loans, the films were trapped.
3. Relativity begged cash for release of the pictures, with a promise that RKA would be rewarded. But *the only way* to do this was for RKA to disburse the cash straight to Relativity. There was no other way. *Believe me . . .*

What This Means for You

When lending or investing, be alert for things that don't ring true. If your would-be counterparty tells you something that doesn't make sense, pursue it. If your counterparty says "This is the only way business can be done in my industry", but that structure increases your risk, make your counterparty find a workaround. If, out-of-the-gate, your counterparty keeps saying "*Believe me*", don't!