

Part II

Background and evidence

3 Background to the inquiry

Contents

	<i>Page</i>
Reasons for the reference	63
Previous reports	63
The OFT's experimental scheme	64
The Films (Exclusivity Agreements) Order 1989	65
Trade Disputes Committee and Appeals Tribunal	65
The 1984 Government White Paper on Film Policy	66
The Downing Street seminar	66
British Film Commission	66
Department of National Heritage	66
Pan-European audio-visual support schemes	67
GATT Uruguay Round: audio-visual services	68
Article 85 exemption applications	68
The 1994 EC Green Paper	68
Consultations with EC Commission and Centre National de la Cinématographie	69

Reasons for the reference

3.1. On 29 September 1993 the DGFT referred to the MMC the matter of the existence or possible existence of a monopoly situation in relation to the supply of films for exhibition in cinemas in the UK. He explained in a press release that his enquiries into the industry had initially been prompted by complaints from independent cinemas about their difficulties in obtaining popular films from the major distributors, despite changes put into place following an earlier MMC investigation. The DGFT said that most major companies were vertically integrated and followed practices which could lead to the exclusion of independent producers, distributors and exhibitors from the market. He was aware of the changes that had taken place since the 1983 MMC report, such as the emergence of multiplex cinemas, but considered that competition remained restricted to such an extent that it was appropriate for the MMC to undertake a fresh investigation and decide whether any aspects of the industry continued to operate against the public interest. A reference was accordingly made to the MMC on 29 September 1993; the terms of reference are set out in Appendix 1.1.

Previous reports

3.2. The supply of films has been investigated on two previous occasions. In September 1964 the supply in Great Britain of films to exhibitors for exhibition in cinemas was referred to the Monopolies Commission (the Commission) under the provisions of the Monopolies and Restrictive Practices (Inquiry and Control) Act 1948. The Commission's report *Films: A Report on the Supply of Films for Exhibition in Cinemas* (the 1966 report) was published in October 1966. In December 1980 the supply of films to exhibitors for exhibition in cinemas in Great Britain was referred to the MMC under the provisions of the Act. The MMC's report *Films: A Report on the Supply of Films for Exhibition in Cinemas* (the 1983 report) was published in May 1983.

The 1966 report

3.3. The 1966 report found that the introduction of a larger measure of competition into film exhibition would be advantageous both to the industry and the public. Competition was found to be deficient partly because of the various practices that were customary in the industry, but mainly because of the structure of the industry which resulted from the dominant position of the two main exhibition circuits. The Commission concluded that to give the industry a new and competitive structure would mean breaking up the circuits, but that would be a drastic step the results of which would be uncertain. Instead the Commission recommended a series of less drastic remedies which were intended to eliminate practices which restricted competition. Although each remedy individually could not be expected to have far-reaching consequences, the Commission believed that, provided they were all carried out, their combined effect should be to permit the development of greater and more effective competition. A summary of the conclusions and recommendations of the 1966 report, and the action taken in response to them, is at Appendix 3.1.

The 1983 report

3.4. The 1983 report found that scale monopoly situations existed in favour of two distributors and the two major exhibition circuits. The systems of alignments and barring were found to give rise to complex monopoly situations which operated and might be expected to operate against the public interest. Divestment was considered in the case of alignments. But taking into account the then market circumstances (the decline in cinema audiences, the continuing need to close cinemas and the fact that some cinemas were making losses) the MMC concluded that such a remedy was not practicable and could not be recommended. The MMC recommended that the barring system cease to operate and be replaced by arrangements under which exclusivity would be negotiated for each film hire agreement on a case-by-case basis.

3.5. Delays in the release of popular films to exhibitors other than the two major exhibition circuits were found to be a consequence of the market power which the circuits possessed as scale monopolists. This was reinforced by the system of alignments. It was recommended that popular films should not be exhibited for more than four weeks unless they had been made available to all other competing cinemas which sought to show them.

3.6. The MMC recommended changes to the procedures and membership of the Trade Disputes Committee (TDC) and the Appeals Tribunal, both of which had been established after the 1966 report. It was recommended that the TDC be empowered to deal with disputes relating to the extent of competition between individual cinemas and with disputes or complaints in connection with film hire agreements in certain circumstances. The arrangements for awarding allocations of product to independent exhibitors should continue and the TDC should give reasons for its decisions.

3.7. The MMC recommended that the undertakings which the major exhibition circuits gave, as a result of the 1966 report, to extend further the practice of giving trial runs to certain films whose appeal to the public was in doubt, and giving limited or partial circuit bookings to films of limited or minority appeal, should be allowed to lapse. Concern was expressed at the possibility of further concentration in the industry in Great Britain.

3.8. A summary of the conclusions and recommendations of the 1983 report is at Appendix 3.2.

The OFT's experimental scheme

3.9. In December 1983 the DTI announced that undertakings on barring and on the release of popular films, on the lines recommended by the MMC (see paragraphs 3.4 and 3.5), would be sought in respect of two or more major cities only, initially for a trial period of six months, to assess their effectiveness in practice. In February 1984 the DGFT was invited to consult with the relevant parties with a view to obtaining such undertakings. Glasgow and Manchester were chosen as the trial cities (where new distribution policies were implemented), with Liverpool and Birmingham acting as the control cities (where existing distribution arrangements continued).

3.10. The OFT sought undertakings from distributors that, in the two experimental cities, they would only negotiate exclusivity arrangements with exhibitors on a case-by-case basis; that all subsequent-run cinemas would be able to exhibit any film four weeks after its opening at a first-run cinema; and that quarterly questionnaires covering both the trial and control areas would be returned to the OFT.

3.11. The experiment ran between May 1985 and May 1986 and included all cinemas within a 14-mile radius of each of the four city centres. In reporting on the experiment, the OFT noted that the MMC's recommendations were highly controversial within the industry, and that the experiment had been difficult to mount because of both this and the need for undertakings from the large number of participants concerned. A large amount of information had to be collected and analysed by the OFT in order to identify any changes of behaviour as a result of the experiment. As had been anticipated from the difficulty of the negotiations prior to the experiment, the less than full-hearted co-operation from some of the larger distributors and exhibitors resulted in information which was in some ways no more than adequate. Information from smaller distributors and exhibitors was patchy, delayed and incomplete and, at the outset, many of them had been ignorant of the preceding negotiations.

3.12. In addition, the experiment took place against a background of coincidental factors, notably the unexpected upturn in cinema audiences generally and the increasing use of widespread release of particular films backed by television promotions, which complicated assessment of its results. The OFT felt it necessary to supplement its examination of the detailed information received with case studies of particular films, as well as seeking general comments from the participants.

3.13. The OFT acknowledged that its conclusions from the experiment were not decisive but recommended that action should be taken against the practice of barring and to ensure the earlier release of popular films by means of an Order under the Act.

The Films (Exclusivity Agreements) Order 1989

3.14. In late 1987 the DTI initiated a consultation period on a draft Order which would (a) effectively prohibit the practice of barring, and (b) impose a limit of four weeks on the length of time for which first-run cinemas could exhibit a popular film without it being made available to competing cinemas on normal commercial terms. The consultation revealed widespread support for (a) but strong opposition to (b), which was not proceeded with.

3.15. Following a further period of consultation with the industry, an order prohibiting the practice of barring came into effect in April 1989 (Appendix 3.3). The 1989 Order made it unlawful for an exhibitor or a distributor to make or carry out an agreement relating to the supply of any film for exhibition at a cinema in Great Britain if the agreement contained or provided for terms about exclusivity relating to more than one film (but excluding agreements relating to not more than three films in respect of their exhibition at the cinema in question as a single programme). Effectively, therefore, distributors and exhibitors were required to negotiate exclusivity on a film-by-film basis.

Trade Disputes Committee and Appeals Tribunal

3.16. Developments in the industry between 1983 and 1989 led the DTI and the OFT to agree that the remit envisaged for the TDC (see paragraph 3.6) had disappeared. The recommendations relating to the TDC were considered to be no longer relevant, particularly as the question of allocation of product was addressed by the 1989 Order. We understand that, while the TDC has not formally been wound up and the CEA elects members to sit if required, it has not been active in recent years.

The 1984 Government White Paper on Film Policy

3.17. The White Paper entitled *Film Policy* issued in July 1984 spoke of considerable optimism in the British film production sector, noting strong indications of a rekindling of interest in making commercial British films, and growing market opportunities abroad. A very different picture was painted in respect of the exhibition sector, which was characterized by declines in admissions, box office takings and the number of cinema screens. While other countries had shown a long-term decline in admissions, nowhere had it been so steep or so apparently continuous and irreversible as in the UK.

3.18. The White Paper described as outmoded aspects of the existing regulatory framework. Considerable attention was focused on the Eady Levy, which was raised on the price of cinema admissions. The principal reason for the introduction of the levy in 1957 was to divert money from film exhibition to support domestic film production. The White Paper stated the Government's belief that statutory recycling mechanisms, such as the levy, were not an efficient means of encouraging an economic activity that should essentially be oriented towards the market. It noted that the levy was no longer fulfilling its original purpose with much of the payout going to distributors rather than to producers. Moreover, the levy was an unreasonable burden on the exhibition sector.

3.19. The White Paper stated the Government's intention to remove the levy as part of a shift in its approach to the film industry away from statutory intervention and towards the creation of a business environment that would encourage innovation and reward success. The Eady Levy was terminated in 1985.

The Downing Street seminar

3.20. In June 1990 British film producers were invited to discuss the industry's problems and opportunities at a seminar hosted by the then Prime Minister. It was agreed at the seminar that, *inter alia*: the Government would provide £5 million over the next three years to help British producers seeking to enter European co-productions; a working party, chaired by the DTI, would be set up to examine the structure of the industry and how to attract greater private sector finance to UK film production; the industry should explore whether changes were needed to the tax regime for film production and report to Treasury Ministers; the Government would continue discussions in Europe on how best to support the film production industry, notably through the MEDIA programme; and the Government would study proposals from the industry, including the idea of a Film Commission, to improve the promotion of British films in the UK and overseas.

3.21. The working party examining the structure and financing of the industry was unable to agree its report and is now defunct. The industry working group's proposals on changes to the tax regime were submitted to Treasury Ministers in 1991 and partially implemented in the Finance Act 1992.

British Film Commission

3.22. The British Film Commission (BFC) was launched in May 1991, following the Downing Street Seminar, and became fully operational in 1992. Its purposes are: to promote the UK as a location for the production of, *inter alia*, feature films; provide a comprehensive information service to producers; and to facilitate filming in the UK.

Department of National Heritage

3.23. In 1992 the Department of National Heritage (DNH) took over the film industry responsibilities of the DTI. Its stated objectives in relation to film are: to help reverse the decline in British film production since 1985; to promote the UK as a location for producing feature films; to expand the opportunities for access to high-quality films from Britain and elsewhere; and to foster international co-operation in production, distribution and exhibition of films.

3.24. The DNH provides funding of approximately £17 million a year to the BFI, the national body charged with responsibility for encouraging the understanding and development of moving-image culture in all its forms. The BFI's concerns range across all aspects of film, television and video including production, distribution, archiving, education and publishing. The DNH also provides a £2 million annual grant to British Screen Finance Limited (British Screen), a private sector company whose current shareholders are Rank, MGM Cinemas, Channel Four Television Corporation (Channel 4) and Granada Television Limited. British Screen operates three film support schemes under which funding is provided, respectively, to low to medium budget feature films, short films and script development. Its remit requires it to support projects which it believes might not otherwise proceed to production, including a high proportion of projects which explore British themes, cultural values or current concerns and which involve new talent. British Screen typically provides about 20 per cent of a film's production budget. As a general rule the loan is available as an equity investment which is recouped by British Screen from world-wide receipts at least *pari passu* with other co-financiers. Between 1986 and November 1992 it committed funds of £31.7 million, including support of £29.5 million for 75 feature films.

3.25. The European Co-Production Fund (ECPF) was set up in 1991, following the Downing Street Seminar, with Government funding of £5 million over three years (see paragraph 3.20). The fund, which is administered by British Screen, exists to promote collaboration between producers in the UK and other EC member states, by providing funds to enable them to invest in feature films and film development work.

Pan-European audio-visual support schemes

3.26. The UK is a member of, and contributes financially to, three major pan-European audio-visual support schemes: MEDIA, Audio-Visual EUREKA and Eurimages.

MEDIA

3.27. MEDIA is an EC programme, the purpose of which is to stimulate the economic development of the European audio-visual industry sector and to help create the right environment for small and medium-sized businesses to collaborate and develop. Its aims are to: stimulate and increase the European audio-visual sector; increase European production and distribution companies' share of world markets; encourage a business-like approach to the industry; and develop the use of new technologies. MEDIA was provided with a 200 million ECU (approximately £140 million) fund for its first five years of operation, of which the UK provides approximately £28 million.

Audio-Visual EUREKA

3.28. Audio-Visual EUREKA, an initiative involving 33 European countries, the EC Commission and the Council of Europe, is aimed at strengthening the European audio-visual industry by encouraging: the emergence of a more transparent and dynamic audio-visual market on a European scale; a favourable framework for financing the production and co-production of original European works; the launching of actions and concrete co-operation projects; the widest possible distribution of European programmes; the development and widest possible diffusion of production from countries having a limited geographical or linguistic coverage; all aspects of audio-visual production; and the promotion of European technologies. Audio-Visual EUREKA does not support projects by means of financial backing.

Eurimages

3.29. Eurimages is a Council of Europe fund which supports programmes in three categories: co-production of feature length fiction films; co-production of creative documentaries; and support for distribution or broadcasting of works, including dubbing, subtitling and manufacturing of release prints. In 1993 its budget amounted to approximately 122 million French francs (£14.6 million at an exchange rate of 8.34 French francs to £1). The UK's contribution is approximately £5.5 million over three years.

GATT Uruguay Round: audio-visual services

3.30. In December 1993, as part of the broader conclusion of the GATT Uruguay Round, agreement was reached on the General Agreement on Trade in Services (GATS). GATS provides a framework of general rules covering trade in all services, requiring, for example, that regulations and agreements affecting trade in services should be transparent. GATS also lays down rules for the scheduling of commitments by signatories on market access and on national treatment-the equal treatment of domestic and foreign companies-made during the Round. Sectors not covered in a signatory's schedule of commitments remain subject to the general provisions of GATS. Article XIX requires members to enter into successive rounds of negotiations, beginning not later than five years from the date of entry into force of GATS and periodically thereafter, with a view to achieving a progressively higher level of liberalization.

3.31. During the negotiation process, the EC sought to achieve some form of individual treatment of the audio-visual services sector by, for example, including an annex in the GATS package which, in effect, would have removed the audio-visual sector from the liberalizing elements of the agreement. The USA for its part sought to conclude a package with the EC that would have gone beyond the services element of the negotiations. In particular, it wished any deal with the EC to address the question of access for US film producers to copyright levies raised in some EC member states on the sale of blank audio and video tapes.

3.32. In the event neither of these aims was achieved. The EC has committed itself to no particular liberalization measures, its GATS obligations being solely to secure transparency and share information with other parties to the agreement on any new measures taken by the EC or its member states. Through exemptions from the most favoured nation clause, eg for Eurimages, most aspects of the existing audio-visual policy have been secured.

Article 85 exemption applications

3.33. In 1982 the EC Commission received from UIP BV, on behalf of MCA Inc, Metro Goldwyn Mayer Film Co and Paramount, an application for negative clearance or alternatively an exemption from the provisions of Article 85(1) of the Treaty of Rome in respect of joint-venture agreements and related agreements concerning the distribution of feature films.

3.34. The agreements as notified contained several provisions which prevented the granting of an exemption. Following discussions with the EC Commission, the notifying parties presented a number of amendments to the agreements in order to meet its objections. In July 1989 the EC Commission granted an exemption, declaring the provisions of Article 85(1) of the Treaty of Rome inapplicable for the period 27 July 1988 to 26 July 1993 to the basic agreement and to the accompanying agreements between the parent companies or subsidiaries of them and the joint venture company, subject to certain obligations.

3.35. In October 1993 the EC Commission invited third parties to submit observations they might have on UIP BV's request, submitted in June 1993, for renewal of the exemption. A decision on the request is not expected before 1995.

3.36. In January 1993 the EC Commission received from Paramount Communications BV (Paramount BV), MCA International BV (MCA BV) and UCI BV an application for negative clearance or alternatively an exemption from the provisions of Article 85(1) of the Treaty of Rome in respect of a joint-venture agreement concerning the acquisition, development, operation and management of a chain of cinemas in various countries through UCI BV and its direct or indirect subsidiaries. No decision on the application is expected before 1995.

The 1994 EC Green Paper

3.37. In April 1994 the EC Commission issued a Green Paper which examined options for strengthening the EC's audio-visual sector. The paper, entitled *Strategy Options to Strengthen the European Programme Industry in the Context of the Audiovisual Policy of the European Union*, emphasized the cultural importance of films and the need to develop a strong, forward-looking industry able to compete in world

markets, to help European culture to flourish and to create jobs. The paper posed a number of questions about how these objectives were to be achieved. The EC Commission has embarked on a series of consultations on the options advanced in the Green Paper, with a view to presenting proposals for action by the EC authorities.

Consultations with EC Commission and Centre National de la Cinématographie

3.38. During the course of the inquiry, MMC members and staff met with officials of the EC Commission in Brussels and the French Centre National de la Cinématographie (CNC) in Paris. Discussions with the EC Commission focused on the Article 85 exemption applications (see paragraphs 3.33 to 3.36), state aids in the film industry, European audio-visual support schemes and the cultural importance of the film industry. Discussions with the CNC focused on the experience of the French film industry in competing against US films, financial support to the industry and European support schemes.