

# 6 Views of third parties

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6.1. In this chapter we summarize the views of the interested parties who gave evidence to us, other than the leading exhibitors (see Chapter 7) and the distributors in the complex monopoly group (see Chapters 8 and 9). We did not receive any representations from individual consumers or from the National Consumers Council or the Consumers' Association.

## Exhibition interests

### Cinema Exhibitors' Association

6.2. The CEA represents approximately 90 per cent of UK cinema operators, including all the leading exhibitors. It gave written evidence and attended a hearing. Its written submission was the result of a major consultation exercise among its members. The CEA told us that whilst all its members agreed with the views expressed, its comments did not represent all the views of all members.<sup>1</sup>

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<sup>1</sup> Odeon, however, told us that its views were not necessarily the same as the CEA's.

### ***Print availability***

6.3. The CEA stated that the availability of first-run prints had improved since the last MMC inquiry. This was acknowledged by all exhibitors. Although some felt that, as new screens opened, their access to first-run prints had decreased, others, who in the past had been only occasionally offered first-run prints, were now nearly always offered them.

6.4. From time to time all exhibitors found that they were unable to book the film that they wanted at the time they wanted it. Most independent exhibitors and the smaller circuits were generally able to book the films that they wanted. Sometimes, however, they did not obtain the number of prints that they wished. The smaller circuits also were not permitted to move the prints around their circuits as they wished at all times.

### ***Minimum exhibition periods***

6.5. The major difficulty for most exhibitors was the minimum exhibition periods demanded by distributors. These had increased over the years and were now rarely less than two weeks; they were often more if an exhibitor wished to show a film in the opening weeks. Recent examples of films with minimum playing times exceeding two weeks included *Jurassic Park*, *The Fugitive* and *Aladdin*. The CEA said that a long minimum exhibition period caused problems, especially where a cinema had fewer than four screens. The problems were exacerbated as the number of screens on a site decreased. A minimum exhibition requirement on one film might preclude a smaller cinema from showing another, more popular film during that period. If a film performed below expectations, it was often difficult for the exhibitor to secure the distributor's agreement to it being taken off early.

6.6. There was also a growing trend among distributors to demand a long minimum exhibition period for films which had been on release for some time. This caused particular difficulties for exhibitors in smaller towns and suburbs where a film might already have been exhibited in a nearby cinema. The problem could be more acute where a cinema had a single screen with a large seating capacity.

6.7. The CEA was undecided whether the length of run which could be demanded by a distributor should be dealt with by an Order or an agreed code of practice.

### ***Restrictions on screen use***

6.8. The *Standard Conditions* (see Appendix 4.3) laid down that, with the permission of the distributor, another film might be shown 'over and/or under' the main feature. Permission to do so was, according to the CEA, not given sufficiently often, though more frequently than in the past. Most distributors demanded that only their film be shown during the normal exhibition day. This caused particular problems for cinemas with fewer than four screens and those which were situated in small towns or suburbs. Often these cinemas were open only in the evenings, except during school holidays. The insistence that no other film be shown over or under the main booking often deprived a neighbourhood of family entertainment during school holidays. It could also prevent an exhibitor from showing films of wider appeal in the evening.

6.9. Some distributors gave permission for another film to be shown over or under their own film, but imposed arbitrary screening times which were totally unsuitable for the local situation, thereby making the offer unacceptable. For example, a distributor might allow another film to be shown after 8.30 pm. While this might be suitable in urban areas, it was not appropriate in rural areas. The CEA thought the conditions should be more flexible.

6.10. Distributors sometimes gave permission for a film which had played in a cinema for an exclusive run to continue to play in an over or under situation or on a limited number of days. At the same time, they would not make this concession available to nearby second-run cinemas (ie cinemas which did not get films on release date) which had not yet shown the film. This increased the problems for those cinemas.

6.11. The CEA argued that the demand for exclusive use of a screen for one film was abused by distributors. It prevented exhibitors from utilizing screen time to the benefit of the public and could put the viability of cinemas in jeopardy.

### ***SFD Standard Conditions***

6.12. The CEA stated that the *Standard Conditions* did not take account of the last report of the MMC, did not reflect current trading conditions and used archaic language. The *Standard Conditions* were, in their present form, particularly burdensome to smaller exhibitors.

6.13. It was wrong that exhibitors had to abide by *Standard Conditions* which were biased totally in favour of the distributors, in that exhibitors required the distributors' permission before making changes to the operation of their businesses. It was, for example, unreasonable that exhibitors could not change their ticket prices without first receiving the permission of the distributors. Distributors had refused permission for some exhibitors to reduce their admission prices on Monday evenings when attendances were low. This applied particularly where two cinemas were in competition: the distributor would refuse permission for one to reduce prices in order to undercut the other. The *Standard Conditions* also gave distributors unreasonable rights to intervene in the exhibitors' box office operations.

6.14. The SFD had agreed with the CEA that the *Standard Conditions* should be reviewed and the first part of this exercise, to bring the document to a usable state, had been completed in June 1992. Rather than proceeding to the second, substantive stage of the review, however, the SFD had stated that it would consider further amendments that the CEA put to it in writing. The CEA considered that this was not in the spirit of what had been agreed and would, on past experience, be an exercise in futility.

6.15. The CEA favoured some form of evenly-balanced standard terms and conditions in order to protect, in particular, smaller exhibitors and distributors who did not have the commercial strength to refuse unreasonable demands. The CEA believed the best way to achieve this was by regular meetings with the SFD to review the *Standard Conditions* in the light of changing circumstances and any new legislation. It identified specific elements of the *Standard Conditions* which it thought were particularly in need of revision.

### ***Exchanges of information***

6.16. The CEA also believed that members of the SFD often shared commercially sensitive information, for example on break figures or house nuts and on creditworthiness, about the membership of the CEA. It observed that since the announcement of the MMC inquiry, different break figures were being agreed by different distributors for the same cinema, but commented that this had happened only rarely in the past.

### ***Alignment: possible remedy***

6.17. Commenting on our first possible remedy on alignment (see paragraph 7.16), the CEA questioned how the first part of the remedy would operate and how it would be policed. If the offer of a film were to be based only on a cinema's merits, the difficulties independent exhibitors already experienced in obtaining prints on a specific date were likely to be exacerbated. A distributor would simply be able to say that a cinema did not merit the film at that date. If cinemas under the same company's control were to be ignored when negotiating a play date, which was always linked with the amount of film rental, it was likely that rentals would increase. The CEA said that in the case of *Jurassic Park*, where the rental terms originally demanded had been high, major exhibitors had been able to exert pressure on the distributor because of the potential number of screens they offered. This had benefited all exhibitors. If the suggested remedy had been operative when the negotiations had taken place the rental terms would have been higher.

6.18. On the second part of the remedy, the CEA said that distributors were always trying to increase the rental paid by exhibitors and, as making returns to the OFT would increase their costs, they would use this as an excuse to seek higher rental. Asking for information only from MGM Cinemas and Odeon appeared to be

discriminatory. Alignment of product, especially when films moved over from arthouse to mainstream cinemas, probably had a greater effect within the arthouse market on the potential income of a film than it did within the mainstream cinemas.

## **Independent exhibitors**

6.19. Evidence received from the 22 independent exhibitors listed in Appendix 6.1 is summarized below. Six of these exhibitors (Apollo Leisure UK Ltd (Apollo), Cosmo Leisure Group, Full Circle Film and Theatre Company, Hippodrome (Wrexham) Ltd (Hippodrome), North West Leisure (Manchester) Ltd (North West Leisure) and Richmond Filmhouse) attended hearings as well as providing written submissions. We also carried out a survey of independent exhibitors, the results of which are summarized in Appendix 4.4.

### ***Availability of prints***

6.20. Fifteen exhibitors complained about non-availability of prints. Most said that they were unable to obtain films on release or within a reasonable period after release. Some blamed the distributors' preference for allocating films to multiplex cinemas.

6.21. North West Leisure said that a two-screen cinema it had owned at the time of the previous MMC inquiry had been forced to close as a result of a multiplex cinema opening nearby. Certain distributors had stopped supplying the cinema with films on release and those that had been shown after a run at the multiplex had collapsed at the box office.

6.22. Hippodrome told us that it had also experienced difficulty in obtaining new releases after two multiplex cinemas opened in a town more than ten miles away. This prevented Hippodrome from competing fairly. If it were squeezed out of business, there would be no local cinema.

6.23. Richmond Filmhouse said that it had had difficulty in obtaining films after a second Odeon cinema had opened in the same town. It was unable to obtain prints on release and in some cases, eg *Much Ado About Nothing*, had been unable to obtain the film at all. It believed that Odeon had persuaded Entertainment, the distributor of the film, to play it at the Odeon, despite a prior agreement that the film would be played at the Richmond Filmhouse. It believed this was because Odeon would be showing the film in many other cinemas throughout the country and Entertainment did not wish to upset their relationship. Richmond Filmhouse said that difficulties in accessing films were a deterrent to independent operators building new multi-screen cinemas. Potential backers would be concerned that, if a new independent cinema was successful, one of the large exhibitors would build a cinema in the same area and block the independent's access to films.

6.24. One exhibitor said that, as a result of the unfair treatment of independent exhibitors by distributors, no capital was available to enable small exhibitors to add more screens to their cinemas. No independent exhibitor or group of independent exhibitors would be willing to invest in building a multiplex cinema when there was every possibility that it would be denied the product to operate.

6.25. Another exhibitor, which had cinemas in the Midlands, North Wales and the North of England, said that, in cases where films were limited to 120 to 150 prints, it was often unable to obtain a sufficient number to cover its circuit. It might typically be offered between one and four prints. The number varied for each film and was often reduced between initial negotiations and play date.

6.26. Another exhibitor believed that some distributors identified particular key towns and refused to supply cinemas in other towns in the same area with first releases. The exhibitor subsequently wrote to say that, since giving its initial evidence to the MMC, its relationship with distributors had improved.

6.27. Queens Film Theatre in Belfast said that distributors were happy to give films to the leading exhibitors under any circumstances, but adopted a different approach when supplying independent cinemas.

The circuit exhibitors, particularly MGM Cinemas, had a stranglehold on some of the small distributors, to the detriment of independent cinemas.

### ***Conditional booking***

6.28. Two exhibitors complained about conditional booking (see also paragraphs 4.180 to 4.182). Hippodrome told us of two instances where it considered that conditional booking had been practised. In one case, after the exhibitor had refused to take a particular film, the distributor had refused to supply it with three other films. Another distributor had agreed to supply the exhibitor with the two films it wanted on condition that it took two less successful films. Empire Cinema said that, in order to obtain films it wanted, it had to take less popular films.

### ***Minimum exhibition periods***

6.29. Nine exhibitors complained of the distributors' tendency to stipulate minimum exhibition periods for films, which meant that they must either wait for some time to show a popular film or play it for a long period with poor attendance. One exhibitor felt that interest in most films waned after two weeks and the public and exhibitors would be better served if a film was moved to another cinema after that period rather than making an exhibitor show it for longer. If this were the case, the second cinema would show the film only two weeks after release. When multiplex cinemas had to take a film for a long period they were able to move it from a large to a smaller screen. However, in these circumstances the print would be earning progressively less and would still be withheld from another venue where it would be the main (or only) feature. The exhibitor thought that distributors might be imposing minimum exhibition periods in order to block the showing of competing films.

### ***Restrictions on screen use***

6.30. Five exhibitors complained about distributors' inflexibility over the use of screens to show films under or over the main film. One exhibitor said that, during a school holiday, a distributor had refused to allow it to show a 'U' certificate film in the same auditorium as a '15' certificate film (which was not due to start until 5.00 pm), unless the former finished by 2.00 pm. This meant that the screen was closed for three hours in the afternoon at a time when a potential audience was looking for entertainment.

6.31. Another exhibitor said that a distributor had allowed it to show an adult film as the last performance each day when its children's film was playing in the afternoon. However, the distributor had stipulated that the showing of the adult film could not start before 8.30 pm. This did not allow the exhibitor to adapt to local habits or transport times. Neither would it cater for local licensing conditions which, in some towns, restricted the hours a cinema could show films. The exhibitor said that, in other cases, distributors of adult films would not let it put on a children's film in the afternoon when the main film was newly released.

### ***Calculation of rental payments***

6.32. Seven exhibitors complained about the high rental charges for prints. Most of these also complained about the increasing tendency on the part of distributors to impose special terms for popular films. Some said that distributors had refused to increase the break figures applying to their cinemas for several years despite increases in admission charges. One exhibitor said that, to be effective and fair to exhibitors, rental terms should be updated in line with factors such as inflation and increases in admission charges.

6.33. Another exhibitor said that, increasingly over recent years, the 50 per cent ceiling on the rental payable to distributors for a film had been withdrawn, and terms of 75 per cent (or, in a few instances, 90 per cent) of net take in excess of the break figure had been applied, with no maximum. Initially distributors justified this on the basis of increased promotional activity on major films. In practice most major films, and consequently a high proportion of the business, bore premium terms. It had been the practice that the break

figures specific to individual screens were increased in line with inflation. In recent years the increases had been less than the rate of inflation.

### ***Availability of British films***

6.34. Richmond Filmhouse said that the choice of films in the cinema was not as wide as it could be. It attributed this to the fact that the large exhibitors were also distributors of US product. Independent multi-screen exhibitors would be more likely to exhibit a wider range of films than the multiplex owners, most of which had their own distribution set-up or other vested interests. The development of networks of independent cinemas would, therefore, encourage distributors to take more risks, and invest more money, in distributing British films. In the view of Mainline Pictures all British films sufficiently commercial enough to play around the UK had done so. The new wave of British films, eg *Raining Stones* and *Naked*, would also be played around the UK, but for how long and in how many screens depended on market forces.

### **Mr Geoffrey Henshaw**

6.35. Mr Henshaw, North West Leisure (and Chairman of the Independent Exhibitors' Committee of the CEA), gave written evidence as an individual exhibitor and attended a hearing. Giving his views on the general situation, Mr Henshaw told us that distributors always ensured that multiplex cinemas and the major circuits were the first to obtain copies of new releases. Multiplex cinemas were often given two prints of a new film, presumably so that it could be shown at different times on different screens. Remaining copies were then given to independent exhibitors. The allocation of prints to the independent exhibitors appeared to be done on a random basis; no priority was given to cinemas in areas where there was no multiplex or circuit cinema. Some were allowed films only when other cinemas had finished with them. By the time this happened, the films had lost their initial appeal and would not attract large audiences. As multiplex operators and the major circuits extended their exhibition periods, prints for independent exhibitors were put back even further.

6.36. Distributors benefited from extended exhibition periods at multiplex cinemas and this led them to demand similar arrangements from independent exhibitors. Independents, particularly those with single screens, often found that this was not viable, especially when the film had already played extensively in other cinemas. Certain distributors had little sympathy if a film failed to attract customers and usually insisted on the film completing its contract. In the case of the more popular films, in addition to insisting on an extended run, certain distributors imposed special terms which could result in an exhibitor paying the distributor up to 75 per cent of box office takings. If an exhibitor refused the terms it would not get the film.

6.37. Mr Henshaw believed that the consideration given by distributors to the multiplex operators resulted from vertical integration. Distributors gave priority to their own in-house interests without any concern for the traditional British-owned cinemas which had supported them for many years. Mr Henshaw proposed that legislation be introduced which would force distributors to offer films at the same time to all cinemas which were in competition with each other, thus enabling them to compete on a fair and equitable basis.

6.38. We invited Mr Henshaw to comment on our first possible remedy on alignment (see paragraph 7.16). After consulting with six exhibitors, whom he said represented a small cross-section of interested parties in North-West England, he told us that they had no firm views as to the merits or otherwise of the alignment system. The present system did not appear to have any influence on the availability of prints for independent exhibitors. Mr Henshaw supported the idea that distributors should submit information to the OFT on prints supplied to MGM Cinemas and Odeon and proposed that this information be extended to include the supply of prints to independent cinemas.

## **Distribution interests**

### **Society of Film Distributors Limited**

6.39. The SFD has the following members: Buena Vista, Columbia, Entertainment, First Independent, Fox, Gala Film Distributors Limited, Guild, Mayfair, RFD, UIP and Warner Distributors. In written evidence, the SFD told us that it aimed to provide a forum for its members' discussions and to represent them on matters of common interest. One of the services it offered was to negotiate with the CEA the *Standard Conditions* (see Appendix 4.3). The SFD thought that the use of these conditions suited both distributors and exhibitors as it meant that little time or effort generally needed to be spent in establishing the formalities of the legal relationships between them. The use of the *Standard Conditions* was entirely a question of convenience and a matter for the free choice of SFD members, who could vary the conditions as they wished, or decline to use them at all. The SFD had not issued any further guidance to its members on any of these conditions. Other than to the extent that they used the *Standard Conditions*, the SFD did not play any part in its members' operations and thus was not involved in decisions on the release of films or negotiations between distributors and exhibitors. With regard to the old SFD Recommendations to its members referred to in the MMC's 1983 report (paragraphs 5.5 to 5.8 of that report), the SFD told us that these had all been rescinded or allowed to lapse. None of them had been acted on by the SFD since the publication of that report.

6.40. The SFD said that the film industry was unlike any other and that it was more competitive than ever before. Each film was unique; its production costs and most of its marketing costs were committed long before it was offered to the public and, accordingly, before the producer or distributor knew how successful it might be. Many films did not attract sufficient consumer interest to enable the marketing costs to be recovered; others recovered sufficient to enable distributors to recoup the marketing costs but not the producer's investment. Although the success of a film did not depend on its cost, most successful films involved substantial investment.

6.41. Similarly, investment in cinemas played a crucial role in attracting audiences. The SFD drew our attention to the high level of investment in exhibition which had been made in the last eight years, not only by the larger companies. More new cinemas had been built in the UK than in any other EC country. This had contributed to the doubling of cinema audiences over this period. In response to increasing consumer demand, distributors had increased the number of prints which were available to exhibitors.

### ***Refusal to supply***

6.42. Commenting on our possible remedy on refusal to supply (see paragraph 7.46), the SFD said that it would be undesirable to introduce any form of legislation intended to fetter the judgment of a distributor as to how best to exploit a film. A distributor must reasonably be allowed to determine how many prints to purchase and how to employ them within the strategy determined for the film—whether that were a gradual release with an initially low number of prints or a blanket release using a large number of prints—in order to take maximum advantage of the publicity expenditure. The SFD questioned whether it would be practicable to seek to impose a positive obligation on a distributor to provide prints to any exhibitor which demanded them. To do so would impose extra costs on a distributor and require it to market its product through more outlets than it would otherwise choose, and in a way it did not approve, without giving any compensating advantages in terms of receipts. Indeed, the spread of an audience between two competing cinemas would, in the absence of new or special financial arrangements, almost certainly operate to reduce a distributor's total receipts. The more commercially appealing films would occupy more screens but produce less net revenue. The less commercially attractive films would be squeezed out and lose much-needed revenue; such films would become less and less attractive to distributors considering acquiring rights to distribute in the UK. The public would ultimately have less choice.

## ***Restrictions on screen use***

6.43. Commenting on our possible remedy on restrictions on screen use (see paragraph 7.69), the SFD said that, because rentals were directly related to box office takings, distributors needed to know in advance the extent to which a film would be exhibited in a cinema during the licence period. There was no reason to believe that most cinema exhibitors considered the restrictions unreasonable.

6.44. If the restrictions were thought to have adverse effects, those effects could be overcome only by imposing restrictions on the distributors which would give the exhibitors complete or limited discretion to show other films during the licence period. Such restrictions would mean that a distributor would, at best, have no more than a limited assurance as to the number of performances its film would receive. This would result in prints being less efficiently used. It would also be likely to result in a reduction in box office receipts for the film in question and, in most cases, to a disproportionate reduction in the distributor's share. If a distributor felt that the overall net return would not justify tying up a print, it might decide not to grant the licence and the exhibitor and consumers would suffer.

## ***Rental terms***

6.45. Commenting on the possibility that contracts based on box office receipts might be prohibited (see paragraph 7.146), the SFD said that the sharing of box office receipts was the industry norm throughout the developed world. Both the break figures and the nut formulae (see paragraph 4.136) recognized the need of the exhibitor to meet its overheads week by week. This helped some exhibitors to make a sufficient return to stay in business and so contributed to their survival. The alternatives of fixed or guaranteed fees would necessitate weekly negotiation of the fee for each film for each cinema. Exhibitors would face increased uncertainty and greater risk. The SFD did not think this alternative would increase the number of screens or the number of films, or lower admission costs. In its view, it would be more likely to lead to cinema closures, exhibitors' reluctance to risk certain films or certain levels of fees, and increased pressure on the less obviously commercial films competing for screen-time. In the SFD's view, any of these consequences would be contrary to the public interest.

## ***SFD's response to the CEA's comments on the Standard Conditions***

6.46. Commenting on the CEA's criticism of the *Standard Conditions* (see paragraphs 6.12 to 6.15), the SFD rejected the suggestion that the current *Standard Conditions* did not take account of the last MMC report. Specific changes had been made and agreed with the CEA. The criticism that the conditions did not reflect current trading conditions was felt to be too vague to comment on. The reference to archaic language did not address any substantive issue. The SFD's view was that, since the *Standard Conditions* were intended to be incorporated in whole or in part in legally enforceable contracts, they had to be skilfully drafted. The CEA's suggestion that the conditions were particularly burdensome to smaller exhibitors was not understood, but the SFD would be pleased to consider any specific criticisms on this aspect. The CEA's comment that it was unreasonable that exhibitors could not change their ticket prices without first receiving the permission of the distributor was unrealistic. Such a requirement was fundamental to the overall arrangements between distributors and exhibitors.

6.47. The SFD had asked the CEA to put its proposals in writing but the CEA had failed to do so. The SFD said that it was, and had always been, open to well-considered suggestions to improve its *Standard Conditions*.

## ***Small distributors***

6.48. We received written evidence from five small distributors, two of which (Artificial Eye and Mayfair) announced the merger of their distribution interests during the course of our inquiry. Artificial Eye also attended a hearing. The names of those who gave comments are shown in Appendix 6.1.

### ***Lack of exhibition outlets***

6.49. Three distributors, Colstar International Limited (Colstar), Artificial Eye and Metro Tartan Ltd (Metro Tartan), said that they had experienced difficulties in finding exhibitors in the commercial market to show independently-produced films. Colstar said that investors were unlikely to support an independent film if its exhibition outlets were not guaranteed. It also said that another result of the way in which major exhibitors dominated the market was the disappearance of the short film. This reduced opportunities for new film-makers and meant that financial backing for such films was not available. Metro Tartan said that, although multiplex cinemas had increased audience levels, they had not improved audience choice as the same distributors were supplying mostly US product. Artificial Eye said that, although some of the multiplex cinemas devoted one night a week to arthouse films, these showings happened long after a film had been released, and because they were only for one night, had no chance to build an audience. The films which it had distributed fairly widely to multiplex cinemas, eg *Cyrano de Bergerac* and *Short Cuts*, had not been as successful in those cinemas as they had been in city-centre arthouse cinemas. The audiences in the two venues were quite different.

### ***British films***

6.50. Artificial Eye said that the claim by British producers that their films' potential was not realized because of lack of available screens was wishful thinking. There was not really a substantial market for many of these films.

### ***Video market***

6.51. Oasis Film Distribution Ltd and Artificial Eye commented on the growth of the video market. They said that many films were being released into cinemas in a small way simply as a public relations exercise for the video release.

## **Production interests**

### **Producers Alliance for Cinema and Television**

6.52. PACT represents primarily independent television and film producers in the UK. It operates a range of business services, which include running industrial relations agreements with the trade unions involved in feature film production. PACT gave written evidence and attended a hearing.

### ***Bias against independently-produced UK and European films***

6.53. PACT said that there was a bias in favour of the distribution and exhibition of US films in the UK. Consequently, it was more difficult for independently-produced UK and European films to gain access to British cinema screens. US-produced independent films, having been distributed by the major US studios in North America, would have already achieved substantial market exposure. This put them on an equal footing with films handled by the vertically integrated US studios distributing into the UK market. UK and European independent films lacked this market exposure and usually received a narrow release, ie a small number of prints, and, therefore, restricted marketing and advertising budgets.

6.54. Films from the Hollywood studios, or from US independent production companies but with backing from the studios, were preferred by exhibitors because they had already been extensively market tested in the USA, enjoyed greater advertising support and consequently represented a much reduced risk. UK exhibitors sustained a self-fulfilling prophecy that a non-US film, not handled by a vertically integrated company, would be less attractive to audiences. They were, therefore, less willing to book such films. Denied an effective theatrical release, such films had reduced potential in the increasingly crucial video and

television markets. In the case of UK independent films, the near certainty of reduced revenues in their home market made it increasingly difficult to obtain a return on investment. This in turn militated against new investment in UK independent film production. Many UK film-makers now worked for the major US studios because that was the only way they could be sure to get sufficient playing time for their films.

6.55. PACT stated that, unlike in the USA, distributors contributed very little finance to the making of films in the UK. Although the Hollywood studios had distribution organizations in the UK, it was not possible to obtain finance directly from these organizations for the financing of production: instead it was necessary to approach their parent companies in North America.

### ***Reduction in choice***

6.56. The bias in favour of US films resulted in a reduction in the choice of films available for viewing. In 1991 there were 267 films released to British cinemas. This was a little over two-thirds of the number released in France and other major European countries and a little over half the number released in the USA. Released with fewer prints, independently-produced films were often unavailable outside London. Despite the publicly supported RFT network, non-metropolitan audiences were often denied access to many of these films. A narrow release also meant that there was frequently a considerable delay between the time a film was first released, when it attracted most media attention, and when it became available to regional cinemas. The delay reduced a film's revenue potential, which typically declined rapidly between three and four weeks after release date.

6.57. PACT acknowledged that the growth of multiplex cinemas had increased the choice of films but said that they were largely filled with US films. Most of them had been built by American companies, and the majority were now controlled by subsidiaries of the Hollywood studios, in order to improve access to the market for their own films and to extend the life of successful films. The benefit for British films was much more marginal.

### ***Concentration of film exhibition in the UK***

6.58. PACT said that there were fewer cinema screens per capita in the UK than in any other major market. The UK was under-screened and there were significant barriers to entry which effectively prevented the natural level of growth in the number of screens. These resulted particularly from uncertainty as to whether films would be supplied by the few distributors who controlled most of the available product.

6.59. UK exhibitors charged relatively high prices for cinema tickets, yet retained an unusually large proportion of the box office. In most countries an exhibitor's share of the total ticket price did not exceed 60 per cent. In the UK it was almost 70 per cent. For vertically integrated companies involved in both distribution and exhibition, a high exhibitor share was simply a matter of internal transfer pricing. For independent companies, however, it meant a much smaller return. This ultimately reduced investors' ability to recoup their investment in independently-produced films.

6.60. PACT stated that the restraints exercised by distributors over exhibitors, coupled with a lack of screens, served to reduce further UK and European independent producers' access to the market and the choice of films available to the public. The level of concentration in exhibition, coupled with a comparable level of concentration at the distribution level, and the close links between distribution and exhibition, discouraged new entrants into exhibition. Competition between films and, therefore, producers was reduced. This particularly affected opportunities for UK and independent producers.

## ***PACT report on the supply of independent British films in the UK***

6.61. In June 1994 PACT gave us a report on factors influencing the production, distribution and exhibition of independent British films in the UK market. This report was based on an independent study, carried out by consultants on PACT's behalf, to discover whether there was any evidence that independent exhibitors, producers and distributors in the UK faced unfair restraints as a result of the dominant market position of the US majors. In particular, the consultants were asked to collect evidence that either supported or contradicted the following hypotheses:

- (a) that restraint exercised by the US majors was preventing access by local product to distribution in the UK;
- (b) that the integration of major distributors/exhibitors resulted in local or independent films being restricted in respect of access to screens, duration of theatrical runs and availability of 'slow-burn' release patterns;
- (c) that independent exhibitors were being denied access to prints of mainstream films; and
- (d) that successful independent, and especially British, films had been taken off screens to make way for less successful product of the integrated distributors/exhibitors.

6.62. Questionnaires were sent to independent producers, distributors and exhibitors and respondents were interviewed. The consultants then analysed the budgets, marketing expenditures, release patterns and performance of the top British, European and independent US films released in the UK and USA over the last three years. Other factors that might influence the production, distribution and exhibition of British films were also considered.

6.63. PACT said that the study tested three theories which had been advanced to account for the comparative failure of British films:

- (a) the lack of competitiveness of the films;
- (b) the restriction of the market due to the dominance of a small number of large (and mostly US) operators; and
- (c) a capacity problem in the UK retail sector, especially in cinema exhibition and pay television, which created special difficulties for the low-budget, specialist and cross-over films which were the main element of British film output.

## ***Conclusions of the report***

6.64. PACT concluded that all three explanations were correct, to different degrees. It was also likely that all three factors interacted: US domination undermined the competitiveness of British films, while inadequate capacity prevented differentiation between the two at retail level.

6.65. All three explanations drew attention to the strong but unequal partnership between the British film industry and Hollywood. Most British producers chose to collaborate with Hollywood and saw the location of production and the source of financing of films as matters of little general importance. Hollywood-financed productions had a large equity component, ensuring that most of the risks as well as the benefits of exploitation were taken by the production entity, ie the Hollywood studio. While individual British films thus produced might be outstandingly successful, they could contribute little beyond short-term employment opportunities to the British production sector.

6.66. A few British producers chose to compete with Hollywood. They saw the production location and source of finance as matters of major importance. This was the option favoured by the EC Commission's recent Green Paper on programme production (see paragraph 3.37). European-financed, big-budget productions tended to be funded by a mixture of equity and distribution pre-sales, with an added element of

public subsidies and incentives. Much of the risk was thus removed from the production entity, which nevertheless was able to keep a significant share of profits. All else being equal, this approach was most likely to contribute to the success of the European production sector. From the British point of view, however, it offered limited possibilities because of the absence of significant UK corporations engaged in film production and distribution, and of a regulatory environment supportive of British films.

6.67. Some British producers valued creative integrity above commercial considerations and had low budgets and small audiences. Their productions, in the UK as elsewhere in Europe, were usually funded by local broadcasters supplemented by co-production agreements and distribution pre-sales, with little or no equity being retained by the producer. Risk was thus minimized, but so was the producer's share of profits. It was hard, on the basis of these characteristics, for this approach to lift British film production above the level of a cottage industry.

### ***Economic characteristics of film production and distribution***

6.68. PACT said that film production and distribution had a high risk profile. They required substantial capital in the long term, and production was best entered into as a function of distribution. A degree of imposed order, via alignments, fixed bookings and trading agreements at retail level, was necessary for the market to work at all. Dismantling that structure or introducing politically-inspired regulatory requirements, such as product quotas, would not necessarily serve the interests of either the industry or the consumer.

### ***Public policy***

6.69. There were three, interrelated options for public policy: to concentrate on improving the competitiveness of British films; to limit the barriers to entry erected, wittingly or otherwise, by the major operators; and to encourage greater opportunity in the retail market, especially in cinema exhibition and pay television.

6.70. Striking the correct balance between the three lines of policy was important for two additional reasons: there was significant interdependence between Hollywood and the UK film community; and the economics of multiplex investment, which was crucial to the development of the market as a whole, was finely balanced. However, PACT did not believe this fine balance would be upset by some degree of intervention, providing that legislation took care not to interfere with market forces beyond what was required to establish a level playing field. According to PACT this did not currently exist. The correct public policy was the one which encouraged the greatest success of British films while fostering continued growth and diversity in the market as a whole.

### **Production companies**

6.71. Although we invited comments from 14 production companies, only one, Adventure Pictures, gave evidence. It said that a film it had produced, *Orlando*, had done exceptionally well in London, where there was an established network of independently-owned cinemas and screens owned by the major chains which specialized in this type of film, but elsewhere it had been dependent on arthouse cinemas. Outside London there were hardly any screens with a reputation for showing quality independent/British films and which had the ability to allow an extended run for a box office success. Adventure Pictures said that quite often *Orlando* had played to full houses for a week or two at provincial arthouse cinemas and then been taken off in order to make way for the next pre-booked film.

### **Mr David Puttnam**

6.72. Mr Puttnam, a film producer since 1968, was invited, with Lord Attenborough, to a hearing. Lord Attenborough was unable to attend. Mr Puttnam supplemented the discussion at the hearing with written evidence.

6.73. Mr Puttnam told us that he had initially produced low-budget British films, largely with the help of the then British Film Fund, financed through the Eady Levy. These films, made for the UK market, were financially successful but not particularly ambitious. In 1977 Mr Puttnam had produced *Midnight Express* for Columbia Pictures and this had launched his career as a producer on a larger scale. The films he had made since then had been aimed at world-wide audiences and were financed and distributed accordingly.

### ***The audio-visual industry***

6.74. Mr Puttnam said that the December 1993 EC White Paper on growth, employment and competitiveness had identified the audio-visual sector as one of the three areas in which Europe could hope to create significant additional employment before the end of the century. It was, therefore, important that the UK was involved in this industry. Whereas the other two areas which had been identified, biotechnology and energy, had comparatively high levels of government support, the audio-visual sector had a very low level.

6.75. The feature film industry had an importance disproportionate to its actual level of economic activity within the world-wide audio-visual industry. Feature films acted as the principal sales vehicles for other types of programming, eg television.

### ***The UK film industry***

6.76. The UK produced culturally distinguished films, most of which were seen on television. These tended to be produced at a modest cost with, consequently, fairly low levels of expectation. Despite their high cultural quality, British films of this type could not consistently compete in the world-wide market and were unlikely to be sustained without some permanent form of support.

6.77. Although, in theory, it might be possible for British films to penetrate the world-wide market, this could not be achieved with only a few films a year. A permanent product flow was necessary to establish British films and their stars and to increase the acceptability of the films in other markets. Mr Puttnam said that it was economically possible to have a national industry which was independent of, and complementary to, the national culture. For example, the UK had been a prolific and successful maker of large-scale action adventure films like the *Indiana Jones*, *Star Wars* and *Superman* productions. While such films did not reflect any aspect of British life, they created significant employment, developed technical and craft skills and attracted additional investment capital into the country.

6.78. Mr Puttnam believed that every year one or two British films, which could have been commercially successful in the UK, failed because of poor distribution resulting from lack of confidence in the films themselves. *The Crying Game* and *Hear My Song* were prime examples. The ease and popularity of television viewing had hampered the competitive presentation of films to their natural audience. The return on investment received by feature film producers had little or no connection with the size of television audiences and this had adversely influenced the development of the film industry in the UK. British film-makers had developed little or no direct relationship with their audience. Their principal concerns tended to be centred on the response of reviewers and those who commissioned programmes.

6.79. The abolition of the Eady Levy had had a catastrophic effect on UK film production. Funding had, to a very great extent, been taken over by Channel 4 and, to a lesser degree, the BBC and was thus coming from product-driven rather than market-driven sources. There was an important role for television in the funding of feature films, but in the UK the influence and the decision-making process were being operated by a medium which had traditionally worked in a unique and extremely rarified market-place. Mr Puttnam said that there was, in reality, very little real competition between the BBC and Channel 4 in pursuing film drama product.

6.80. Although multiplex cinemas had been built to give audiences a wider choice of films, recent history had indicated that the new audiences did not specifically want different types of films, merely more convenience in seeing them. Another cause of decline in production was the UK tax regime. Although the problem was more apparent than real, agents advised US stars that if they worked in the UK their tax

liability could be doubled. This created an unnecessary barrier and, as US directors and stars generated a great number of jobs whilst filming, the UK economy was being deprived of both employment and income.

6.81. In the UK as elsewhere in Europe, films were produced regardless of the size of the potential audience. In the USA producers sought the largest audience possible for their work and accordingly undertook sophisticated research. The Hollywood studios identified their audience and invested in marketing based on this research. If the UK distributor of *The Crying Game* had spent more and been more confident with respect to the potential audience, the film could have been far more successful. Research was an invaluable tool and no other highly-capitalized industry addressing a large consumer base would act without maximizing its use.

### ***BSkyB***

6.82. Mr Puttnam thought that BSkyB, if properly encouraged, had the opportunity to become another important pillar in the rebuilding of the British film and television industry. It was an organization which was entirely reliant on developing and maintaining its subscriber base and so would nurture a knowledgeable ongoing relationship with its subscription audience.

### ***Revenues***

6.83. Mr Puttnam said that when he first entered the industry, the vast majority of revenue from a film came from the cinema box office. As television and then videos had been developed the figures had changed. Cinema box office returns now accounted for only 35 per cent of the average revenue achieved by the average film. He estimated that by the year 2010 the figure could be as low as 5 per cent, with the ancillary markets accounting for the remaining 95 per cent.

### ***The French film industry***

6.84. In France the cultural issue was regarded as very important and cultural industries, particularly film, were a political, even an 'electoral' issue. Although the French support system was well developed and open to change, it had not achieved all of its aims. Over the last ten years, the level of French audiences achieved by films produced in other countries had barely changed. Conversely, the level of audiences achieved by French language films had steadily dropped from 90 million to 20 million (half of which in 1993 resulted from only three films). The European industry in general was over-fragmented: too many films were probably being produced and there were too many distributors.

### ***The future***

6.85. In order to maintain a healthy film production industry in the UK it was necessary to have some form of permanent support. Mr Puttnam lived in hope of seeing positive proposals in the DNH's forthcoming policy paper. The problem was the size of the industry and the nature of the opportunity in the UK, partially because of its shared language with the USA. One method of funding he would like to see would be an internal mechanism, agreed within the industry, whereby, at each point of the distribution chain, a certain amount of revenue was recycled back into the industry as working capital. At the moment there was no European distributor who could distribute outside its own country, so distribution through a single distributor had to be carried out by a US company. The present practice was inefficient and time-consuming. One of the recommendations made by the EC Commission's Think Tank on Audio-Visual Policy had been the creation of a 'soft loan' facility which would assist the creation of some fully competitive pan-European distributors.

6.86. Mr Puttnam stressed the importance of training. Unless adequate training was provided, the UK industry would lose the skill base necessary to continue to make high-cost, high-value feature films and would, as a result, be unable to take advantage of the growth the audio-visual industry offered to the UK economy.

## *Practices of the US majors*

6.87. We asked Mr Puttnam for his views on the leading US distribution companies. He said that he had found their UK distribution arms to be efficient and professional and prepared to distribute any independently-produced films that had serious revenue-earning potential. He made the following comments about the practices we had identified.

### *Reserving screen space*

6.88. Reservation of screen space by distributors ensured a regular product supply. An exhibitor was influenced in its choice of whether to play a particular film, or to hold over an existing film, by the films that a particular distributor had lined up to offer in the future. Continuity of supply was very important and the US majors, rather than independents, were in a position to guarantee this.

### *Alignment*

6.89. Alignment was a matter of convenience and did not have a particularly detrimental effect on the industry. Mr Puttnam said that present trends indicated that it was unlikely to exist at all in a few years' time.

### *Exclusivity*

6.90. The practice of exclusivity was rapidly decreasing. Exclusive West End runs had now virtually been dropped because of the high cost of launch advertising. Mr Puttnam emphasized the importance of the cost of prints, advertising and distribution in the decision-making process. Changes in the distribution of films were increasingly driven by ever more sophisticated and cost-effective marketing techniques.

### *Refusal to supply*

6.91. Mr Puttnam was a minority shareholder in the Richmond Filmhouse and said that he had first-hand experience of refusal to supply. He attributed this to the protectionist instincts of powerful exhibitors requesting exclusivity, sometimes even in very marginal situations. Mr Puttnam believed this practice to be very shortsighted, and not in the best interests of the industry overall.

## **Others**

### **British Film Institute**

6.92. The BFI's aims include encouraging the development of the art of film in the UK and promoting its use as a record of contemporary life. The BFI's concerns range across all aspects of film, television and video, including production, distribution and exhibition, both by active participation and by funding and supporting others. About half its funding comes from the DNH. The rest is raised by subscriptions, provision of services, sponsorship and donations. The BFI gave written evidence and attended a hearing.

### ***Current state of the British film industry***

6.93. The BFI said that the main feature of the British film industry in the last ten years had been the growth in the market. Audience figures at cinemas had increased and new markets had arisen in the form of video rental and sale and satellite television channels. British cinema film production, in contrast, had slumped and there had been a reduction in the number of US and other foreign companies funding the production of films in the UK.

6.94. The decline in British film production was not due to a deficiency of UK talent. Moreover, the British television production sector was second only to the USA in terms of volume and value of output. This did not, however, provide a strong base for feature film production. The Eady Levy on box office revenues (see paragraphs 3.18 and 3.19) and tax incentives for film production were elements of the structure of assistance to British film production which had been removed in the mid-1980s. Since then, the UK distribution and exhibition markets had been increasingly dominated by US-produced films and there were fewer opportunities for UK films in the international market.

### ***Vertical integration***

6.95. The BFI said that access to cinematic distribution for independent producers was limited. Of the 51 films produced in the UK in 1992, only 40 had received any form of distribution, and of those a significant number had only limited runs in a small number of cinemas. The BFI cited *Riff Raff*, *The Crying Game* and *Enchanted April* as examples of good British films which had not received appropriate distribution in the UK. Films from other European countries were now rarely distributed in the UK, in contrast to the situation a few years ago.

6.96. The major distribution companies operating in the UK, through their vertically integrated structure, were able to offset losses from box office failures with profits from successful films and receipts from secondary markets. UK film producers were generally not integrated with distributors or exhibitors and distribution of their films was uncertain. Often UK production companies were in existence for the production of only one film. In such a system, risk could not be spread and the companies were dependent on a 100 per cent success rate. The absence of vertical integration led to a lack of control over the marketing of the film, the spread of its distribution and the duration of its exhibition. These aspects were controlled by distributors and exhibitors whose interests might not coincide with those of the independent producer. The lack of control over distribution made the raising of production finance more difficult.

6.97. It was generally accepted within the industry that, in order to achieve the correct balance between successful and unsuccessful films, a 'critical mass' of films needed to be produced. The BFI told us that it had been estimated that the critical mass for the British film industry was 80 films a year, with a total budget of approximately £400 million. This was required to build up market share, support a viable infrastructure and establish a track record capable of attracting commercial investment and artistic success.

### ***Control of the UK market***

6.98. The BFI said that much of the revenue from the exhibition market was repatriated overseas by the dominant players and, as a result, new British production was starved of capital from that potential source. In terms of shares of box office receipts, the UK was dominated by the US film industry to a far greater extent than other large Western European countries.

6.99. While cinema receipts had risen, their relative importance had declined with the introduction of video and satellite television markets. These had become the most important commercial markets, though success in the cinema was still vital as it generated demand in the other markets.

6.100. There were five major distribution companies which, together, dominated the exhibition market. Of the 50 highest-earning films in the period 1988 to 1990, 40 were produced in the USA. Of the 236 films released in UK cinemas in 1991, 56 per cent were produced in the USA, or with US finance, and these accounted for some 93 per cent of box office revenues. The video market exhibited parallel features.

## ***European film industries***

6.101. The BFI told us that European national film industries obtained assistance from their governments (as well as from the EC through the MEDIA 95 programme). These national schemes were intended to enable their film industries to compete in Europe, penetrate the US market and attract US production activity to Europe. The motivation in intervening to correct market distortions was usually cultural. The UK film industry did not obtain such benefits as it did not have such schemes. Without significant state subsidies, it was unable to compete on level terms with industries receiving governmental assistance.

## ***Restriction of choice and diversity***

6.102. Despite the growth in cinema audiences and the new markets opening up for feature films, the public had not enjoyed a greater variety of films. Nor had they been given access to the full range of films produced. Fewer films were being shown on more screens.

6.103. The exhibition of British films was being marginalized. They tended mainly to be shown at smaller independent cinemas and BFI RFTs. The bigger multiple-screen cinemas showed almost exclusively US films. The BFI said that conversations with audiences around the country indicated a widely-held view that there was insufficient variety in the films being exhibited and, in particular, that too few British films were shown.

## ***Cinema admission charges***

6.104. The BFI said that the UK was one of the most expensive places in the world to see cinema films and that London prices were alleged to be the most expensive in the world.

## ***Expression of British culture***

6.105. The BFI said that film was the most significant medium for expressing the cultural identity of a nation. The UK's ability to do so had been undermined and films relying on and exploring British culture were few and far between.

6.106. The BFI said that there was something fundamentally wrong with a country which had its most important cultural form dominated to such an extent that less than 10 per cent of the audience share went to indigenous material; where new talent had to go abroad to work; where the barriers to entry faced by independent producers were so enormous that they were practically insurmountable; where the financial returns on successful creativity were almost always expropriated out of the country and lost from the investment cycle; and where audiences could not express their preferences because their choice was restricted. The BFI found this situation, in public interest terms, unacceptable.

## ***The need for structural change***

6.107. In 1983 the MMC had concluded that scale monopolies existed in favour of the two major exhibition chains and two of their aligned distributors. The system of alignments was found to give rise to a complex monopoly situation. The BFI said that the MMC had concluded that the monopoly situation operated against the public interest but had not proposed any radical remedies. The very limited steps which had been taken had made little impact.

6.108. The BFI said that a great deal had changed in the industry since 1983. It believed nevertheless that one or more monopoly situations, within the meaning of the Act, continued to exist. Changes to the British film market were necessary because of the need for greater choice and diversity, the economic benefits which would result, and the expression of British culture in the film medium.

## **Channel 4**

6.109. Channel 4 gave written evidence and attended a hearing. It said that the channel had been set up in 1981 to cater for tastes and interests not catered for on ITV. Since the 1990 Broadcasting Act it had been a statutory corporation operating under licence from the Independent Television Commission. Channel 4 now sold its own advertising and was dependent on its own efforts to raise revenue. Its remit remained the same.

### ***Channel 4 and films***

6.110. Channel 4 said that investment in original British films had always been a central part of its drama programming. It made the films available for theatrical release before broadcasting them on television. Between 1982 and 1992, 6.2 per cent of Channel 4's total programme budget had been spent on original feature films. In total £91 million had been invested in 264 different works.

6.111. Channel 4 supported films in various ways. Sometimes its interest was by way of a pre-purchase of the UK and other television rights, but more frequently it was a major investor. For many films the channel financed the development and script-writing process; others it financed fully, for example *Raining Stones*. However, most films had to seek a range of financiers such as British Screen, the European Co-production Fund and other more commercial sources. Channel 4 said that its policy had been very successful, not because the investments had produced real financial returns (in ten years only a handful of films had actually made a profit for the channel) but because it had gained access to original drama. A theatrical release prior to the television showing gave a film significant advance publicity and might lead to a larger television audience.

### ***Film Four International***

6.112. Channel 4 sold the films in which it had rights through its sales agency, Film Four International, which was part of Channel 4 International Ltd. The channel also undertook other commercial activities, including the sale of programmes, publishing and video distribution, through Channel 4 International Ltd. Film Four International negotiated arm's length deals with outside distribution companies, in which Channel 4 did not have an interest. The channel did not own any cinemas.

### ***Channel 4's concerns***

6.113. Channel 4 was concerned mainly with the access which British film producers had to a proper distribution system and a range of exhibitors. It said that, although cinema attendances in the UK had nearly doubled since 1984, over almost the same period the expenditure on films produced in the UK had halved. There were a number of reasons for this decline. In the mid-1980s the abolition of tax incentives for film production and the abandonment of the Eady Levy, coupled with an increasingly strong pound, had led to progressively fewer large-scale films being made in the UK.

6.114. In the past, Channel 4 had had difficulties in obtaining distribution in the UK for the films which it helped fund. An example of this was *Riff-Raff*, which was fully funded by Channel 4 and nominated as European Film of the Year, but had been seen in cinemas by more people in France than in the UK. However, the situation had now appeared to have improved. Channel 4's most recent releases, *Raining Stones* and *Naked*, had had widespread exhibition, both geographically and in terms of numbers of different exhibitors. Channel 4's view was, therefore, that despite the vertical integration of the US majors and their domination of all stages of the film chain, there was no longer a widespread problem about exhibition for UK independently-produced films. It said that 'barring' still persisted in some limited forms. For example, *Howards End* had effectively been prevented from being shown in any West End cinema other than the Curzon Mayfair.

6.115. US films still dominated the UK market to an extraordinary extent. US film production appeared to have stabilized at around 500 films a year, about 60 per cent of which had theatrical releases. Much of the lack of success of UK films was often attributed to their low marketing budgets. Film expenditure in the

USA had increased dramatically recently, even though numbers of productions had stabilized. Although much of this extra expenditure went into increased production budgets, a substantial part had gone on increased marketing budgets. The average US film advertising budget was 32 per cent of total costs. No similar data were available for Europe, but Channel 4's marketing budget on average would currently be £50,000 on a total budget of £1.5 million.

6.116. In Channel 4's view, there were no simple explanations for the success of US films in the UK. It recently had the experience of relatively disappointing box office returns for *Raining Stones* and *Naked*, despite the widespread exhibition referred to in paragraph 6.114 and enhanced marketing budgets (at around £300,000). The two films would again be seen by more people in France than in the UK. The combination of high marketing spend, big production budgets and strong presence in all sectors of the industry helped to support the US film industry's dominant position in the UK. The problem did not seem to stem from abuse of their market power but nonetheless the extent of their power exacerbated the difficulties.

6.117. Cinema was a crucial part of the audio-visual culture. For those films which were shown theatrically the release was an important marketing tool. 27 per cent of global revenue for a US film would be raised through the cinema box office, compared with 49 per cent from home video, but the latter was heavily dependent on the former. This reflected Channel 4's experience that theatrical release helped the size of television audiences. Cinema's relationship with television channels and home video meant that, if anything, its role would be even more vital in the future. Other countries had introduced measures to control the market, coupled with subsidies and/or tax concessions for domestic production. Channel 4 would not support any sort of quota system in the UK (such as operated in Spain) but thought it perverse that the British tax system worked against film production and that the funds available from the National Lottery for film would be channelled through the Arts Council rather than into commercial film investment through an organization like British Screen.

## **Mr Michael Henry**

6.118. We received written submissions from Mr Henry of Nicholson Graham & Jones, solicitors. He stressed that the submissions were made in his personal capacity and not on behalf of his firm, and did not necessarily reflect the views of his firm.

### ***Distributor commissions***

6.119. Mr Henry told us that the Motion Picture Association of America, Inc (MPAA) corporations (ie members of the MPAA) distributed their films in the UK via subsidiary companies. The MPAA corporations directly fixed the commission levels retained by their distribution subsidiaries at levels which were substantially less than the subsidiaries would have retained if they operated on an arm's length basis. They were also substantially less than the terms the UK subsidiaries offered when distributing films of third parties.

6.120. The UK subsidiaries retained a comparatively small percentage of the income they received from distributing the films of their parent companies. By contrast, the terms and conditions offered to independent producers allowed the subsidiaries to retain a commission of between 30 and 50 per cent of receipts (depending on the media exploited) and permitted them to deduct and recover all advertising, publicity and physical distribution expenses. These conditions put independent producers (in the USA, the UK and elsewhere in the EC) at a competitive disadvantage. Mr Henry argued that such activities contravened the provisions of Article 85 of the Treaty of Rome and also raised certain taxation issues-notably that of transfer pricing.

### ***Collusion among distributors in fixing prices and trading conditions***

6.121. Mr Henry also argued that the MPAA corporations indirectly affected the prices at which films were made available to exhibitors. UIP's dominant position enabled terms it negotiated on behalf of one of its three shareholders to be applied for the benefit of the other two. Three of the MPAA corporations therefore shared market-pricing information in the UK.

6.122. By virtue of their common membership of the MPAA, the other MPAA corporations also had access to sensitive pricing information in the UK. This enabled them directly or indirectly to fix purchase and selling prices in the UK market. One MPAA corporation-MGM-Cannon-was able directly to fix purchase and selling prices at both the distribution and the exhibition level.

6.123. Mr Henry alleged that all other trading conditions in the distribution and exhibition sectors in the UK were either directly or indirectly fixed by the MPAA corporations as a result of UIP's dominant position; information sharing between UIP shareholders; information sharing between MPAA members; and the imposition on the exhibition sector of the *Standard Conditions*.

### ***Remittance of royalties***

6.124. Mr Henry argued that the MPAA corporations made use of the UK/US double taxation treaty to remit the majority of their UK income to the USA, thereby avoiding the payment of UK corporation tax or the deduction of withholding taxes. The income extracted was used to fund film production in the USA.

6.125. UK tax legislation was, he said, more widely drawn than the requirements of the UK/US double taxation treaty necessitated. Under the treaty, the exemption removing the obligation to deduct withholding tax on royalties for films was not available for any company which had a permanent establishment in the UK. Since the UK subsidiaries acted as the agents of the MPAA corporations, the MPAA corporations should be treated as having a permanent place of business in the UK. This would disentitle them from the benefits of the exemption. Such disentanglement would result either in the MPAA corporations paying corporation tax or rearranging their affairs so as to carry on film production activity in the UK.

6.126. The remittance of royalty income to the USA was, according to Mr Henry, a concerted practice carried out by the MPAA corporations which had as its object or effect the prevention of competition in the UK in the financing and production of films. If the amounts of royalties remitted to the MPAA corporations by way of licence fees were greater than those which would be payable on an arm's length basis, a transfer pricing issue would arise, and UK corporation tax would be payable on the excess.

### ***Location of control***

6.127. Mr Henry said that the sole or main priority of the UK subsidiaries of the MPAA corporations was to administer the business affairs of their parents in as profitable a manner as possible. They carried out very little business activity in their own name and appeared to be no more than the agents of the MPAA corporations.

6.128. The location of decision-making authority in the USA had a number of effects. Creative decisions were generally made in relation to US criteria and decisions to acquire or produce films in the UK were based on the criteria of the US market-place. The location in the USA of control of the UK subsidiaries was, he argued, a concerted practice carried out by the MPAA corporations which had as its object or effect the prevention of competition in the production of films in the UK.

### ***Acquisition of rights to distribute independent films***

6.129. Mr Henry stated that the films exploited by the UK subsidiaries might broadly be divided into two categories, namely:

- (a) films produced by the MPAA corporations; and
- (b) films acquired by the MPAA corporations for distribution.

6.130. Mr Henry alleged that a concerted practice existed between the MPAA corporations in relation to the acquisition of films from US independent producers. Where they acquired US distribution rights from an independent producer, the practice had evolved for the MPAA corporations to require such

producers to sell distribution rights in the UK. The acquisition of UK distribution rights in the context of the acquisition of rights in a film for the US market had no connection, either by its nature or according to commercial usage, with the sale of distribution rights in the USA. This practice eliminated the possibility of independent UK distributors acquiring the greater part of US independently-produced cinema films, and further restricted or distorted competition in the UK distribution sector.

### ***Withdrawal of financing from British film production***

6.131. Mr Henry asserted that the withdrawal of finance from British film production in order to favour US film production affected trade between the UK and the USA and constituted an abuse by the MPAA corporations and their UK subsidiaries of their dominant position. It was, therefore, a matter which affected the public interest. In previous years the two dominant cinema chains-Rank and Thorn EMI-could be relied on to provide finance for British film production. Thorn EMI was now part of MGM-Cannon, an MPAA corporation.

6.132. A number of industry sources would confirm that there had been no shortage over the last ten years of British and European film projects with strong commercial potential. The majority of these projects had been unable to secure investment support from Odeon and MGM Cinemas. Whilst the Rank organization continued (through its ownership of Odeon cinemas) to make substantial profits from the UK, it committed almost all its production financing activity to US projects.

6.133. The use by Rank of its dominant position in the exhibition and supply of films in cinemas to promote the production of US films to the detriment of UK films resulted in a restriction or distortion of competition in the UK market. The use by Rank of its profits derived from the patronage of its cinemas by UK cinema-goers in order to finance the production of non-UK cinema films was a matter which affected the public interest.

### ***BSkyB***

6.134. Mr Henry said that the acquisition by Fox Inc/News International of the two main pay-television cinema film channels in the UK had given the merged BSkyB channels exclusive access to films produced or acquired by Fox. BSkyB also had access to material acquired by the Fox Group's US television interests. In addition to having guaranteed access to Fox product, it had access to the output of other MPAA corporations. Because the UK film production sector was largely dependent on UK broadcasters for providing finance, the BSkyB-Fox-MPAA links had a direct effect on the UK market for films, and on their production and financing.

6.135. The interrelationship between the production sector and the television industries was complex. A number of factors merited examination. First, there was no competition in the UK market in the provision of cable or satellite movie channels. The price paid by BSkyB to acquire films was currently lower than the prices paid by Sky when it was in competition with BSB. Secondly, the vertical integration of BSkyB with Fox distorted competition for cinema films between the MPAA corporations in the pay-television area. Thirdly, the absence of external sources of finance in the UK film production sector had resulted in the sector relying on television companies as a source of finance. Prices paid by UK television channels for British films were reportedly lower than those paid by French or German television companies for their national cinema films.

### ***UIP's exemption under Article 85***

6.136. Mr Henry sent us a copy of his submission to the EC Commission objecting to the extension of the exemption granted to UIP BV from the provisions of Article 85 of the Treaty of Rome. He argued that a number of significant commercial and technical developments had changed the market for the supply and distribution of films since the original notification of the UIP BV arrangements in 1982 and since the exemption was granted in 1989. Arguments justifying exemption for cinema exhibitors and distributors needed to be re-evaluated.

6.137. Mr Henry said that the UIP Group was in a dominant position in the UK and that its activities restricted, distorted and/or eliminated competition in the production, distribution and financing of films in the UK and the EC.

6.138. According to Recital 18 of the 1989 decision, UIP BV was required to distribute any films designated by the UIP corporations (the shareholders of UIP BV) for distribution outside North America. This restricted UIP BV's activities by requiring it to guarantee distribution access for US films to cinema screens and consequently to deny European films access to European screens.

6.139. Mr Henry submitted that, while the UIP corporations retained autonomy over their own product marketing, this did not guarantee free competition between them. Indeed Recital 39 acknowledged that by joining forces in the EC, UIP BV's parent companies had ceased distributing films independently from and in competition with each other. It was likely that they would eliminate competition by harmonizing the release dates of their films. Each of the partners could be individually appraised of the other partners' intentions for release dates. This afforded them the opportunity to share the market in terms of the type of films distributed and the timing of distribution and marketing strategies. This was likely to result in a distortion or restriction of competition. The increased efficiency in the distribution of films produced or acquired by the UIP Group enabled these entities to 'crowd out' cinema screens in the UK.

6.140. To describe the EC subsidiaries of the UIP corporations as local distributors was, in Mr Henry's view, misleading. While they might operate locally in the EC, control was exercised in the USA. UIP BV was obliged to consult with the UIP corporations on the distribution plan for each film before its release. The corporations reserved control over the number of prints and amount of advertising expenditure and they were also responsible for making payments for prints and advertising costs. It was generally acknowledged in the industry that there was a correlation between advertising expenditure and box office revenues. By retaining control of the amount spent on advertising, the UIP corporations were able to distort competition in the UK and the EC.

6.141. Recital 19 gave UIP the right to make or acquire non-English language films. By contrast there were no such express provisions in relation to English language films since, presumably, this would compete with the product of the UIP corporations. Thus the UIP corporations retained control over the production and financing of English language cinema films. This restricted or distorted competition in the production and financing of English language films in the EC and, in particular, in the UK. Such distortion resulted in the exclusion or denial of finance for English language films and had resulted in the substantial diminution in the production of English language films in the UK. The fact that all decisions relating to production, financing and distribution were taken in the USA could only be damaging to UK production and to the marketing of such films.

6.142. Mr Henry argued that the undertakings given by the UIP Group to the EC Commission did not create benefit for the EC and had permitted UIP UK to increase its market share and further distort competition.

6.143. As regards production and distribution, Recital 27 recorded that UIP undertook to make itself available, based upon its commercial judgment, to produce, finance, acquire distribution rights to or distribute feature films of third parties in the EC. Each UIP corporation also undertook to be available individually, based upon its commercial judgment, to produce, finance or acquire distribution rights to local products in the EC which were offered to UIP. It was reasonable to expect that this undertaking would have resulted in a significant number of EC films financed and produced and distributed by UIP in the EC. This would have created sufficient countervailing benefits to outweigh the anti-competitive effects previously noted by the EC Commission. The fact that no such countervailing benefits had resulted meant that the EC Commission could no longer continue the exemption on the grounds specified in Article 85(3). Far from UIP's efficiency having stimulated production in the EC, there had been a marked diminution in film production in the EC financed by the UIP Group.

6.144. Mr Henry said that exhibitors suffered detriment through the concentration of product in the hands of one distributor. This resulted in the elimination of competition between the UIP corporations. If they were truly independent, they might compete on the terms on which they offered films to exhibitors in order to spoil or compete with their competitors' release patterns. Consumers did not appear to benefit from the cost

savings achieved by the UIP Group. The savings had not been passed on to exhibitors, who had not been able to lower cinema admission prices. Furthermore, there was no evidence that the range of choice of cinema films had been widened.

6.145. The UIP arrangements imposed restrictions in relation to the marketing of films which restricted competition. In view of the scale of the operations of the UIP corporations, no concession was required to these entities for them to achieve economy of scale. Moreover, the UIP arrangements contained numerous restrictions which were not indispensable to the attainment of their objectives. It appeared that the economic benefits received by the UIP Group had permitted its members to increase their market share in the EC, and in particular the UK, to the current dominant level.

### **Department of National Heritage**

6.146. The DNH gave written evidence and attended a hearing. It said that although there had been a general rise in cinema audiences in the UK over the last decade, British films had made a very limited impact on cinema-going. As the Department responsible for cultural interests, the DNH had, as one of its medium-term objectives, to expand opportunities for access to high-quality films from the UK and elsewhere. Another of the DNH's objectives was to increase the production of British films. It believed investment in British films might be inhibited by the difficulty they had in achieving UK-wide cinema release. The DNH had had consultations with the industry during a round of meetings held by the Secretary of State for National Heritage.

### ***Lack of British films***

6.147. The DNH told us that, since its creation in April 1992, it had received 92 letters from the public and a petition of 2,500 signatures. These representations sought support for increased production of British films, implying that consumers wished to see more British films than were currently available.