

UK Film Council submission to the European Commission in relation to the Proposed Italian scheme to support the digitisation of cinemas

Reference: **C25/09**

Executive summary

The UK Film Council maintains:

- **Public financial support for digitisation serves to realise the general public interest of making it possible for communities' that might otherwise lose their cinemas, or have no cinemas in the first place, to enjoy better access to a wider range of films.**
- **The high cost of introducing digital projection to cinemas is not the problem *per se*. The problem is that the economic benefits of digitisation are tending to be enjoyed by distributors, while the costs of digitisation are borne by the exhibitors.**
- **Public support, by lowering the cost to businesses, makes more cinemas viable and permits greater flexibility than the market on its own – notably using the Virtual Print Fee mechanism – is able to achieve.**
- **We do not wish to second-guess the Italian authorities about the costs of digitisation or the appropriate public mechanism to assist digitisation. We view positively the linking to public support of programming conditions. We think that cinemas may progressively be more capable of offering more diverse programming and that this would be helped by benchmarking and monitoring what individual cinemas show.**
- **Improved programme diversity, however, is not the only objective: in return for the support, cinemas might also improve their educational and audience development work, as well as improve access to the cinema, notably for members with the public with physical disabilities.**
- **The UK Film Council may, as we work through the various public consultations being carried out by the European Commission addressing other aspects of digital cinema specifically and film policy in general, develop further the views set out here.**

1. The UK Film Council is the Government-backed lead agency for film in the United Kingdom ensuring that the economic, cultural and educational aspects of film are effectively represented at home and abroad.
2. In 2004, the UK Film Council and the Arts Council England created the Digital Screen Network, a £12 million investment to equip 240 screens in 210 cinemas across the UK with digital projection technology to give UK audiences much greater choice of British, European and world cinema.
3. We have been working alongside other national film agencies across Europe to develop approaches to the public funding to assist the digitising of cinemas with a view to improving the public's access to a wide range of films. The UK Film Council is a signatory to the European Film Agency Directors' statement of 21 September 2009 (annexed).
4. In relation to its investigation of Italy's proposed digital cinema tax credits, the Commission has asked nine questions. The UK Film Council in its submission, to give its answers to those nine questions, wishes to refer to the public version of the letter sent by the Commission to the Italian government, dated 22 July 2009.
5. The part of the letter relating to the digital cinema tax credits begins at section 4.2.5 (paragraphs 71 *et seq.*) on p.12
6. The Commission attributes the "extremely" slow pace of digital conversion of cinemas across the European Union (EU) to the high cost of digital projection equipment. The UK Film Council does not consider that the high cost *per se* is the main problem. The two previous big changes in cinema exhibition – with the introduction of sound and the emergence of the multiplex model – were relatively more expensive to implement than digital projection and these changes took place relatively quickly. The same is true of the major technological development around sound that took place beginning in the 1980s. The cost of the first two changes was borne by the largest vertically – integrated film companies, the Hollywood studios and the national monopolies in Europe (e.g. Gaumont, Lusomundo, Medusa, Nordisk, Pathé, UFA and UGC). The introduction of Dolby and Sony DX sound systems was borne by the exhibitors. The problem represented by the digital conversion of cinemas is that the main economic benefit is enjoyed by the distributors whose costs are reduced, but the main economic cost is borne by the exhibitors. And today, distribution and exhibition are more separated than they were in previous eras. Therefore we consider "the slow pace" to be a function of the difficulty to come up with a model which exhibitors consider equitable. Also

contributing to the delay is the time it has taken to come up with a stable technological approach, something that in any case may not be possible given the speed of technological change and the drop in prices; both factors serve to discourage exhibitors to convert to digital.

7. But perhaps the over-riding obstacle to digitisation is the challenge for the distribution sector to maintain the business model that developed after cinema began to compete with television and, subsequently with home video: this business model involved reducing the risks associated with film releases by seeking to realise the revenue potential of a film as quickly as possible by saturating [too emotive?] the market with prints. A film will typically play in cinemas for two weeks and, following a short pause, will become available in other windows on other platforms. This model was an efficient way of using 35mm prints and of exploiting the scarcity of cinema screens. It also created the best platform for the exploitation of “blockbuster” films on the other platforms. Digital exhibition reduces both sources of scarcity – prints and screens – and it took the major distributors some time to come up with a model that enabled them to successfully exploit the “blockbusters”, or “tentpole films”, which were the source of their competitive advantage and of their relationship with the most important networks of multiplexes on which this strategy relied. As long as this model has three elements: very tight management of the availability of digital copies, very expensive projection equipment and the “virtual print fee” (VPF) system to pay for the equipment. The VPF system incentivises the exhibitor to screen a film as often as possible during its first week of release.
8. The economic benefits for distributors of digital conversion only materialise when the distribution of 35mm prints is no longer necessary. So long as distributors are confronted with some screens that want digital copies and others that want 35 mm copies, they are faced with incremental costs rather than with savings.
9. These are factors that informed the UK Film Council’s decision to move ahead in 2004 and fund the installation of the Digital Screen Network. It was important for us as to encourage distributors to commit to making specialised films available digitally (in order to show them simultaneously on more screens) and to encourage exhibitors to explore how better to reach audiences with a more diverse range of films.
10. It is not for the UK Film Council to second-guess the Italian authorities regarding the costs and the mechanisms of digital conversion in Italy; we

would hope that the proposed arrangements are the outcome of dialogue between government and industry. In Italy, to a greater extent than in many EU member states, the state is an active participant in film production, distribution and exhibition, not just through Cinecittà and the Ministero dei Beni Culturali: these two control Istituto Luce which has a major catalogue of films and a network of “cultural cinemas.” Also very prominent are the film production and distribution arms of the public service broadcaster, RAI. Many Italian municipalities are active in film exhibition, for example, through organisations like ARCI. We would point out, however, that the fact that a ceiling on the amount of the tax credit is set at €50,000 per screen and that it cannot exceed 50% of the cost of digitising the screen, does not mean that the average cost of digitising a screen is €100,000; it means that the maximum cost permitted would be €100,000. Still less does the fact that the tax credit is for 30% of the amount invested mean that the cost of digitising is €166,667.

11. If the UK’s experience with its tax relief for production is anything to go by, the extent to which the tax incentives are used is not a function of the taxable profits of the initiative itself; sale and leaseback meant that film-makers were able to avail themselves of other (more profitable) enterprises’ tax liabilities. We would assume, in the same way that the proposed tax credit for Italian exhibitors will be used as a tax shelter by tax payers outside of the sector even though the tax credit is explicitly only available to the exhibitors themselves: we would envisage the emergence of intermediaries to ensure that the tax credit is used.
12. We would further point out that we believe in many cases, especially for cinemas in smaller municipalities and devoted to specialised film, there will be other sources of support available in addition to the tax credit. So we do not accept that the extrapolations in paragraph 78 are necessarily the way that the scheme will play out.
13. The argument for providing state aid to support digital conversion is to accelerate the process – in order that the network externalities and the scope economies can be achieved – and to ensure that as many cinemas as possible can be kept open and that as many communities are served as possible. The UK Film Council, along with every other national film agency in Europe, is committed to promoting cultural diversity and – as we demonstrated with the Digital Screen Network – this means as many people as possible having access in the cinema to as wide range of films as possible.

But the value of communities having cinemas is not limited to the cultural diversity benefits, as recognised by the Commission when it approved the Finnish scheme to support digital cinema.

14. At the public meeting in Rome on 21 October, Professor Mario La Torre made a very valuable contribution to the debate when he described the tensions between the two public policy objectives – increasing the range of films being shown and ensuring that as many communities as possible were serviced by cinemas – notably with regard to the cost-benefit analysis. Professor La Torre asked how the value, of an increased range of films and of a community having access to a cinema, could be played off against one another. Professor La Torre also drew attention to the fact that the way a public authority calculated the cost and benefit would be different from the way that an exhibitor would. In the view of the UK Film Council, the Italian scheme correctly recognises that, in the case of economically-deprived communities, the main benefit to that community is of having a cinema, and we would not want to see this benefit being jeopardised by the imposition of programming obligations which would make the cinema less viable. However, we agree with Professor La Torre that the way forward is for programming obligations to be progressively increased in order to incentivise the exhibitor to stimulate demand on the part of the audience for a greater diversity of programming. So, for example, the Italian authorities could monitor the programming of cinemas, establish benchmarks and ensure, over time, that the levels of diversity are increased. As we comment below, the UK Film Council believes that the quality of diversity is not only a function of programming but also the provision of services devoted to education, audience development and improving the enjoyment of and access to the cinema of people with disabilities, of the young and the elderly, of the unemployed, of minorities etc.
15. The Commission's other concern is that the availability of the tax credit will discourage the emergence of commercial models and will lead to the cost of systems being kept artificially high. The UK Film Council does not believe that either is necessarily the case. We would expect that the availability of a tax credit will accelerate the development and take-up of commercial models by reducing the risks for the financiers and the costs of exhibitors. In other words, the availability of a scheme to absorb upto 50% of the cost of digitising will make the "virtual print fee" (VPF) model more supple and more accessible to more exhibitors (and distributors). There will still be some cinemas, notably because of their programming (for example showing social action documentaries or archive films) for which the VPF model – which relates to

new films that will be shown many times on each screen – is totally inappropriate; here we would expect the tax credit to be used with other (e.g. municipal) funding to make digitisation (and, indeed, the cinema itself) viable.

16. Regarding the impact of the tax credit on the level of prices for systems, the UK Film Council itself has expressed this concern, as has the UK Cinema Exhibitors' Association. But we think that other forms of regulation – for example, encouraging competition between suppliers and preventing collusive behaviour – can prevent “price maintenance.” At the same time, the tax credit functions like a lower price, pushing out the demand curve.
17. The UK Film Council does not know, but presumably the Italian Authorities do, how many of their country's 1,816 cinemas will be able to convert to digital under a variety of cost assumptions. The Italian authorities are also presumably pursuing parallel paths in relation to non-commercial venues such as film societies, multi-use cultural centres, schools, libraries etc. The commercial cinemas, after all, do not exist in a vacuum. But the conditions for commercial exhibition, which include having exclusive access to films, of there being a limited number of competing films available at any moment, of being able to offer conditions in which the films are shown which cannot be duplicated elsewhere, remain pertinent even in the digital age. The approach being taken by the industry – distributors and exhibitors – to agreeing and co-ordinating digital roll-out is sometimes vexed (for example, we have seen with the efforts required for the FFA in Germany to broker an agreement between distributors and exhibitors, and between independent exhibitors and cinema circuits). The UK Film Council is convinced that the industry needs to be allowed to agree the approach, which relates to levels of security, the extent to which any film needs to play on any system; it is then up to the public authorities – not only the UK Film Council but also other bodies involved in the provision of culture, for example, in the UK, the Royal Opera House and the National Theatre, both of which have been using the Digital Screen Network to reach their audience – to intervene to identify where there are gaps in the provision that need to be filled, whether it is a question of geographical coverage or the availability of a broader range of films (and other content). The public authorities cannot be involved in picking standards and they cannot force commercial firms to stay in business if market conditions make staying in business unattractive.
18. This public consultation by the European Commission coincides with other public consultations addressing other aspects of digital cinema specifically

and film policy in general. The UK Film Council may, as we work through these consultations and have further discussions, both inside the UK and with colleagues in Europe, develop further the views set out here.

19. A postscript: the UK Film Council considers that if public money is to be used to support cinema digitisation, the benefit for the public needs to be explicit. This might mean that exhibitors receiving support make commitments for example in terms of programming, education, improving access to the cinema for people with disabilities and participation in other public policy initiatives. We therefore are pleased to note that the Italian Authorities have established standards for programming for some cinemas; we think, though, that there are other cinemas which are currently not asked to make such commitments that might be in a position to fulfil those commitments. We also believe that such commitments need not necessarily be restricted to programming.

**EUROPEAN NATIONAL FILM AGENCIES
SAN SEBASTIAN STATEMENT**

Urgent and comprehensive public support needed for the digitisation of cinemas

The directors of the national film agencies across Europe – the EFADs – are deeply concerned with the problem of digitising Europe’s 30,000 cinema screens: they fear that, without fast and effective intervention, one-third of European cinemas could disappear given the currently-available commercial models for moving from analogue to digital film distribution and exhibition. This would represent a major threat to cultural diversity in Europe and would endanger access to culture for a large number of European citizens.

The EFADs insist that it is in the public interest that the digitisation of cinemas across Europe takes place quickly and effectively, and that the aim of public support is for Europe to maximise the benefits that digitisation can bring, notably a broader access to a wider range of films. The EFADs consider that there is no one-size-fits-all approach which is valid for every country and region in Europe, and every country and region in Europe must be free to operate a scheme which works well in the prevailing markets.

In October 2006 the EFADs issued a Common Declaration in support of public support for the digitisation of cinema (production, exhibition and distribution, including online and archives). Three years later, the picture described in that Common Declaration is still vivid and accurate.

The cinema sector in Europe is in need of financial models that enable countries to advance the general interest of European citizens, in particular access to cinema and circulation of cultural content – the backbone of intercultural dialogue and cultural diversity in Europe. To this end, national and European public authorities need to work together to find solutions to the challenges we find in the market place.

The EFADs understand that the European Commission is not intending to issue its Communication on the digitisation of cinema until 2010; however the criteria by which the Commission assesses the public support for the digitisation of cinemas are being established in a series of decisions in relation to schemes submitted by member states for approval under state aids rules.

This Statement sets out seven points which the EFADs consider to underpin Community and national regulation and support policies for the digitisation of European cinemas:

1. The main purpose of the digitisation of cinemas is to ensure that the public has the best possible access to the widest possible range of films in as good or better quality as the public is used to getting with 35 mm.
2. Public policies are to ensure fast and effective digital roll-out.
3. This is why EU and national support for digitisation cannot be restricted *a priori* to only certain kinds of cinemas in certain localities and only certain approaches to programming.

ANNEX

4. Schemes should not impose a particular technical solution, although schemes should take into account the technological state-of-play in the sector. Whatever the technological solution envisaged, it should offer tangible public benefits, for example, facilitating the circulation of films and access by the public to those films.
5. The level and form of support required will vary from country to country and region to region, and support should be appropriate to national and local conditions. The EFADs would hope that the European Commission, as well as public sector funding bodies throughout Europe will take the opportunity offered by digitisation to help improve cinemas' coverage and the range of films shown.
6. Public intervention should include both EU and national measures. It has so far been left up to European Union member States to come up with arrangements, without a significant contribution at the EU level by way of either a financial backup programme (for example a European credit guarantee system) or a support action with adequate reach provided by the MEDIA programme.
7. The challenge of digitisation is not limited to the digitisation of cinemas but also involves making available digital copies of films and the provision of films online. Public support, therefore, must also address these areas.

The EFADs therefore call for the commitment of national and European authorities to foster a fast and effective digital transition. While some cinema circuits have the resources and have already started their transition to digital, time is running out for many cinemas which are in danger of being left behind.

San Sebastian, 21 September 2009

Signed by and on behalf of the EFADs