

CONSULTATION ON OPPORTUNITIES AND CHALLENGES FOR EUROPEAN CINEMA IN THE DIGITAL ERA

1. Introduction

Cinema has faced up to many challenges, leaving behind silent films, adopting Technicolor, holding its own after a shaky start against the increasingly prevalent and competitive television, video and DVD. The so-called "digital revolution" is the next frontier.

Sound was first to be digitised in the 70's, then the whole post-production chain turned digital and now production is increasingly using digital technologies. New digital distribution platforms are also emerging (VOD, IPTV, mobile phones...) but in Europe theatrical distribution is just starting to move towards digitisation.

Digital cinema offers opportunities because it reduces distribution costs (and therefore obstacles to circulation) and makes flexibility and diversity of programming easier, thus enabling more European films to travel. Digitisation of content and digitisation of cinemas should go hand in hand to achieve that goal. In Europe, digital take-up has nevertheless been slower than foreseen because of technical (standards) and economic (business model) issues.

The European cinema market is characterised by fragmentation, different language zones and a wide variety of operators. The theatrical distribution market is heavily concentrated: the Top 10 distributors had a market share between 82% (France) and 97% (UK/Ireland) in 2005. In respect of exhibition barely 10% of European cinemas are multiplexes. In addition, 31% of European screens are in single-screen cinemas; in the new Member States the average is 60%, and indeed over 80% for some countries.

The digital cinema distribution revolution therefore raises two major issues:

- The (big) investment for digital equipment has to be borne by exhibitors, but the savings will be made by distributors;
- Digital equipment represents a cost that can be borne by cinema chains and multiplexes but that is often out of reach for certain smaller independent (frequently arthouse) cinemas.

In order to solve the first paradox the US film industry supports the so-called Virtual Print Fee (VPF) model. This business model is based on involving third party investors/integrators to address the issue of how to share the costs and the benefits. These third parties collect (part of) the distributors' savings in the form of VPFs to contribute to the digital equipment of the participating screens.

As it is based on the turnover of first-run exclusivity films, it is well adapted to the multiplexes but not to the more diverse range of smaller or single-screen cinemas that programme independent or non-Hollywood films. In terms of distributors, only the US majors have to date signed long-term VPF agreements. The question is why existing integrators and European distributors have so far not been able to sign such agreements.

This could lead to a dual exhibition/distribution market, where only multiplexes and high value commercial films would benefit from the digital cinema revolution. Cultural diversity and renewal of talent however depend on Europe's unique network of cinemas.

2. Public policy issues: National and European

Audiovisual works and cinema in particular play an important role in shaping European identities. To ensure that the national/regional cultures and creative potential are expressed in audiovisual works, Member States' support measures focus on the creation and production phases of filmmaking. Member States are concerned by the digital transition because their national productions will soon need digital masters and digital screens in order to be shown and to reach their potential audience.

The consequences of the digital revolution therefore represent a major challenge for public policy, in particular in respect of:

- Competitiveness and circulation of European works;
- Pluralism and linguistic and cultural diversity.

A wide range of operators (distributors and exhibitors) must be maintained to ensure the circulation of European works and the diversity of European cinema available to viewers. Many are however in danger of being left by the wayside because of the entry barrier represented by the high costs of digital equipment. Access to digital equipment and to digital masters will soon become crucial to remain competitive in a rapidly evolving market.

The Member States are concerned by a number of issues:

- **At local/regional level:** cinemas play an important social and cultural role in municipalities and rural areas; the modernisation and digitisation of cinemas could be supported by local authorities and regional funds. European Structural Funds could also be mobilised to contribute to the digital equipment of cinemas and to training activities in digital technologies.
- **At national level:** access to financing is severely limited because of the current banking stall and VPF deals are not accessible to all cinemas; a number of countries participating in the MEDIA Programme are developing their own economic models, which all include substantial public contributions. They either aim at supporting all cinemas (Norway, France, Germany...) or local cinemas showing independent or national/European content (UK, Poland...).

This must be seen in the context of European Union competition rules (state aid and antitrust):

State Aid

Public support schemes by Member States are subject to State aid control. The first step is to decide whether a measure constitutes State aid in the meaning of Article 87 of the Treaty.

The Commission has taken the view that small amounts of aid (*de minimis* aid) do not have a potential effect on competition and trade between Member States. The *de minimis* rule sets a threshold figure for aid below which Article 87(1) of the Treaty can be said not to apply, so that the measure no longer needs to be notified to the Commission in advance.

To benefit from the *de minimis* rule¹, aid has to satisfy the following criteria:

- The ceiling for the aid covered by the *de minimis* rule is in general €200,000 over any three fiscal year period.

¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32006R1998:EN:NOT>

- The ceiling applies to the total of all public assistance considered to be *de minimis* aid. It will not affect the possibility of the recipient obtaining other State aid under schemes approved by the Commission.
- The regulation only applies to “transparent“ forms of aid, which means aid for which it is possible to determine in advance the gross grant equivalent.
- In view of the current economic situation, the Commission will, for a temporary period², consider State aid of up to € 500,000 per undertaking to be compatible, provided that certain conditions are fulfilled³.

There are a number of cases where State aid could be considered acceptable (the so-called “exemptions”). Following Articles 38 and 39 of the General Block Exemption Regulation⁴, general training measures can be supported up to an aid intensity of 80%. Such training aid, not exceeding €2 million per training project, is exempted from individual notification.

As far as the digitisation of cinemas is concerned, the most relevant exemption clauses are those of Article 87(3)(c) and 87(3)(d) of the Treaty, which the Commission has already used to approve State aid for cinemas showing a high proportion of artistic/cultural films⁵ and for cinemas in small and medium-sized locations⁶.

However, when it comes to aid to multiplexes and cinema chains, the Commission at this point has not determined its policy. To assess the compatibility of such aid with the EC Treaty, the Commission has to consider the necessity, proportionality and adequacy of the measure.

Antitrust

As regards possible antitrust issues, the Commission aims to monitor the transition from analogue to digital cinema in order to ensure that the way this transition takes place complies with EC competition law rules, in particular regarding a prohibition of restrictive agreements contained in Article 81 of the EC Treaty.

3. First Conclusions

Public intervention is essential to create a favourable environment for the cinema exhibition of European works. The European Commission is aware that some types of cinemas are threatened with closure because of digital transition costs and therefore acknowledges the right for Member States to provide support for the digitisation of their cinemas within the existing State aid rules.

The MEDIA Programme has been adapted continuously at a European level to support the European audiovisual industry since 1991. Most recently new technologies have been

² During the period from 1st January 2008 to 31st December 2010

³ Communication from the Commission - Temporary framework for State aid measures to support access to finance in the current financial and economic crisis, (consolidated version of the Temporary Framework adopted on 17 December 2008, as amended on 25 February 2009), OJ C 83 of 07.04.2009, p. 1-15: [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009XC0407\(01\):EN:NOT](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009XC0407(01):EN:NOT)

⁴ Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation), OJ L 214, 9.8.2008, p. 3–47

⁵ State aid N 477/04 – United Kingdom, UK Film Council Distribution and Exhibition Initiatives - Digital Screen Network.

⁶ State aid NN 70/2006 - Aid scheme to cinema in Finland

mainstreamed into the programme, from training to exhibition. One of the training strands supported by MEDIA is dedicated to digital technologies, whether in production, distribution or exhibition⁷. Several pilot projects have also been launched, digital costs for the distribution of European films have been eligible for years and a specific support scheme for digital screenings of European films was set up with Europa Cinemas.

The idea is now to design a support scheme for the digitisation of cinemas screening a substantial share of European (non-national) films. Particular attention will be paid to the situation in the new Member States.

⁷ See "Where to be trained in Europe" (2009 Edition, in particular pages 68-80): http://ec.europa.eu/information_society/media/training/guide/docs/WheretobettrainedinEurope2009.pdf