The Proprietary Rights Initiatives in Canadian Film Distribution Policy

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Third draft: January 31, 2000. Please do not cite without permission. In an earlier version of this paper, given at the Canadian Economic Association meetings on May 29, 1999, we discussed both proprietary rights and regulations of film distribution contracts that were introduced in the same initiatives. In this paper, we have expanded, clarified, and made corrections in our treatment of proprietary rights. We will address the related contractual regulations in a separate paper. We thank Antoine St-Pierre for his comments at the CEA session and absolve him of any responsibility for the views that we express.

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Introduction

In the past two decades, the Canadian federal government, the province of Quebec, and the federal broadcast regulator, the Canadian Radio-Television and Telecommunications Commission (CRTC), have regulated the film distribution industry by adopting proprietary rights policies. The term "proprietary rights" does not describe a characteristic of a film in isolation but a relationship between a potential distributor and a film. A film is proprietary to a potential distributor if that distributor meets or exceeds one of a set of benchmarks, such as ownership of copyright at the time that photography begins, the size of investment in the film, or control of world distribution rights. If none of these conditions are realized, the film is non-proprietary to the distributor.

Under a proprietary rights policy, distributors can be divided into two broad categories. One set of firms, the sheltered group, may distribute all films whether proprietary or non-proprietary to them. All or some of the firms that do not meet the criteria may distribute films that are proprietary to them. This non-sheltered group may be separable into different subsets covered by a different definition of proprietary. A proprietary rights policy redistributes wealth. The "taking" and "giving" can take two forms. Existing distribution business may be reallocated among distributors or a future line of business may be reserved for the sheltered group and denied to other distributors.

We present an analytical account of the evolution of Canadian proprietary rights policies, disciplined by economics, including our working knowledge of game theory[1] and our familiarity with the Canadian regulatory institutions and industry.[2] In part I, we outline the different features and interrelated development of the Canadian proprietary rights initiatives–the Quebec *Cinema Act* of 1983, an Investment Canada directive of 1988, and CRTC regulatory measures introduced as a condition of licence for direct to the home satellite pay-per-view (DTH PPV) and video-on-demand (VOD) services during the second half of the 1990s. In part II, as a background for assessing these policies, we analyse two competing systems of

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1. We do not explicitly use game theory as a thin analytical overlay for a thick description as has been recommended by Bates et al (1998). The rigour of the process of identifying equilibria within a particular specification of a "game" diverts attention from the wide scope for choosing among specifications. There are many degrees of freedom in selecting the number of players to include, their beliefs, the strategy space, the order of play, the information available when decisions are made, the payoffs, what is common knowledge among the players, the way in which learning occurs, and the equilibrium concept to apply. Small changes in protocols can have significant effects on the equilibrium path. See Kreps (1990) for an insightful assessment of the strengths and weaknesses of modern game theory.

2.Mäki (1993) surveys a number of methodological issues arising in institutional, organizational and policy analyses. Williamson's empirical story on the auctioning of a cable franchise (1976) had a significant impact on professional assessment of that policy instrument and its relationship to regulation. It is an excellent example of what we aspire to achieve.

international distribution, an integrated distribution by a major studio and a more decentralized distribution by an alliance of regional studios. The former has a comparative advantage for mass market films and the latter for art-house films. The two systems compete at the margin of the upscale art-house films that may, if successful, crossover and be widely shown in conventional cinemas.[3] The extent of the takings in the proprietary rights initiatives was disciplined by international legal agreements, the likelihood of retaliation by other countries, and strategic options available to those distributors that were the targets of the takings–the Hollywood majors. The design of these policies reflects the *sui generis* process of determining Canadian film policy. All of these elements inform our concluding assessment of these policies.

I. Proprietary rights policies

The impact of a proprietary rights policy depends on its definition of proprietary rights and the criteria defining which firms are eligible to distribute films of each type. All of the Canadian proprietary rights initiatives were bundled with other regulatory measures, in particular regulations of the contracts among producers, distributors, and cinemas. Table 1 provides a chronological list of the Canadian proprietary rights policies that are subsequently discussed in detail.

Table 1. The Proprietary Rights Policy Initiatives

1.	Quebec's *Cinema Act* of 1983 limits the right to distribute non-proprietary films in Quebec to Canadian firms that have their principal establishment in Quebec. Motion Picture Export Association of America (MPEAA) members operating in the Quebec market as of January 1, 1987, negotiated a special status under this legislation.
2.	In 1987, the federal government announces that it will introduce film distribution subsidies, increase direct production subsidies, legislation creating *inter alia* proprietary rights, and limit foreign firms to distribute only proprietary films.
3.	The proposed film legislation is introduced in 1988 and dies on the order table. It is not reintroduced.
4.	A 1988 Investment Canada directive limits the distribution of films with non-proprietary rights to Canadian distributors. The Hollywood majors are exempted from this restriction.
5.	In 1995, the CRTC requires newly licensed pay-per-view (PPV) undertakings, carried by Canadian satellite (DTH) distribution undertakings, to purchase exhibition rights for non-proprietary films from Canadian distributors.
6.	In 1997, the CRTC licenses video-on-demand (VOD) providers. Only Canadian distributors can distribute non-proprietary films to these services.
7.	In 1998, the CRTC suspends the proprietary rights regulation for the PPV DTH services.
8.	In 1999, the CRTC suspends the proprietary rights regulation for the VOD services.

1. The Quebec *Cinema Act*

In late 1982, the government of Quebec proposed legislation requiring distributors operating in Quebec to be at least 80 percent Canadian owned, regulating the terms of distribution contracts, mandating the filing of such contracts with a newly created regulator and making the right to show English-language films conditional on the provision of French language versions of films. The established Hollywood distributors protested and

3. A reader may prefer to read section II before the descriptions of the different proprietary rights policies of section I.

the US government threatened reprisals. A lengthy two-stage process to modify the policy followed. The first stage preceded the passing of the legislation in 1983 and the second ran until major amendments were accepted in 1986. The main participants were the Motion Picture Export Association of America (MPEAA), its related Canadian association, the CMPDA, national and provincial industry associations, cabinet ministers from first a separatist and then a federalist provincial government, and federal politicians. In the second stage, the MPEAA threatened a boycott of the Quebec market.[4] In this political process, distribution policy became intertwined with the larger issue of Quebec's place in or out of the Canadian federation.

Significant changes to the proposed Act were made before the *Cinema Act* was passed on June 23, 1983. Two classes of licences were introduced. General licences for distribution of proprietary and non-proprietary films were reserved for Quebec-based distributors, rather than Canadian distributors, while special permits would be issued for the distribution of proprietary rights films by other distributors. The political agitation then focussed on the meaning of proprietary rights and world rights, which were to be defined by the regulator, La Régie du Cinéma. In September of 1984, the CMPDA's Millard Roth and a negotiating committee chaired by Guy Fournier, representing the government, agreed on a definition of proprietary rights that required an investment of no less than one million US dollars in production costs or for acquiring North American rights. World rights were defined as the entire world, save and except Communist Eastern Bloc countries and their allies.

The Régie and industry spokespersons opposed the agreement and the government refused to accept the decisions of its negotiators. In May 1985, the Régie proposed regulations granting proprietary rights to a distributor holding at least 50% of the financial interest in a film. World rights required a distributor to own the distribution rights for the country of origin of the film, Canada, the US, Belgium, Luxembourg, the Netherlands, Denmark, France, the Federal Republic of Germany, Ireland, Italy, Great Britain, Greece, Spain and Portugal. After the Régie held public hearings, the definitions were again changed. For proprietary rights, a distributor had to own or partly own the film script's copyright on the first day of shooting. World rights required control of the right to distribute the film in all territories. An election was called and the government chose not to proclaim the revised regulations.

A new more federally oriented provincial government assumed power in Quebec and negotiations continued with the Hollywood majors on the contractual regulations, the definition of proprietary rights and

4. See the Trade News section of *Cinema Canada,* October, 1985, which has the headline "Valenti Threatens to Pull-Out if Law Enacted."

the basis for discriminating among different distributors. An agreement was reached in 1986. Section 105.1 was added to the Act allowing a member of an association of distributors as of January 1, 1987 to distribute English-language films according to the terms of an agreement reached with the Quebec government by that date. The only agreement that qualified was the one that had just been negotiated between the MPEAA and the provincial government. Under its terms, a distributor that was a member of the MPEAA at the cutoff date has proprietary rights in an English-language film and is therefore eligible for a licence to distribute it, if any of the following three criteria are met: the firm invested at least C$4.5 million (since increased to C$6.5 million in 1992 and C$8 million in 1996) in the film; provided 50% of the total invested in the film; or owns world rights.[5] World rights were defined as the rights to Canada, US, the European Economic Community countries, Japan, Australia and New Zealand, excluding the country of origin of the film. For distributors not covered by the agreement world rights exist only if the rights to distribute the film throughout the world are held.[6]

The law rather than the agreement binds a member of the MPEAA with respect to a non-English-language film.[7] The condition covering non-English-language films is expressed negatively in the *Cinema Act*: "(N)o licence may be issued" if the MPEAA member has "not invested 100% of the costs of production" unless the member produces a certificate issued by the Minister of Cultural Affairs. The Minister will issue a certificate only if he or she is satisfied "that the application is justified considering the size of the member's investment in the film."[8]

From the perspective of the time, the majors gained a definition of proprietary rights for English-language films that allowed them to distribute most of the films that they had handled before the Act. They received preferential treatment in the Quebec market for English-language films as compared to independent US and European distributors. They also obtained a potential advantage, dependent on a discretionary assessment of their investment in the film, to distribute non-English language films. In 1979 and the early 1980s, the classic divisions of the majors had acquired the distribution rights for a number of foreign and independent films that would have previously been distributed by Quebec distributors. A Film Industry Task

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5. Investment was defined to include negative production costs, negative pick-up costs, and costs for prints, advertising, publicity, and promotion.

6. This definition appears in section 105(2) of the *Cinema Act*, R.S.Q., chapter C-18.1 (updated to 21 November 1995). In the 1983 Act the special distributor's licences were to be governed by "regulations of the Régie.."

7.For these purposes the language of the film is that in which it is originally shot. For example, an English-language film dubbed into French is considered an English-language film.

8.The phrases in quotations are from Section 105.1 of the *Cinema Act*, R.S.Q. chapter C-18.1.

Force hyperbolically described the situation: “The major American distributors have lately increased their volume through the acquisition and distribution in Canada of countless independent American, European and other products.” (1985, 13). In defending the accord with the majors in the Quebec Assembly, Minister Bacon stated: “En vertu de cette entente, nous pouvons maintenant dire que nous pourrons éviter des situations comme celle qu’on a vécue en 1979.”[9] This line of business may have been less profitable to the majors during this period than anticipated, and the revenue generated from the Quebec market that they expected to lose as a consequence of the accord was relatively small.[10]

With the inclusion of the agreement with the MPEAA, the Quebec *Cinema Act* discriminates more against English-language distributors from other parts of Canada than against the majors. The Act only permits Canadian distributors not based in Quebec to obtain special licences to distribute films for which they have proprietary rights if they were doing business in Quebec on December 17, 1982.[11] To our knowledge no non-Quebec-based Canadian firms currently operating qualify for special permits. In consequence, these Canadian distributors cannot distribute any films in the province.

Alliance earned the largest share of Quebec box office revenue of the Quebec-based Canadian distribution companies in1992 at 5.1 percent (Houle,1994).[12] For purposes of comparison, the largest share of the Quebec theatrical release market held by a major studio in 1992 was the 12.4 percent of Warner Bros. and the smallest was 1.3 percent of MGM/United Artists (Houle,1994). We have obtained additional data on distributor shares in the Quebec market for the 1993-1998 period, which are reported in Table 2. The first column lists the distributor who has contracted with the producer (or is part of the same firm that produced

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9. Journal des Debats, 1ere session, 33e Leg., v. 29, June-Nov 1986, 3623.

10. Houle estimates the effect by calculating how much less revenue the majors would have made had this stipulation been in force in 1985 and 1986. He concludes “that at best, the agreement would have meant a transfer of 0.1% to 0.2% of the Majors’ volume of business to Quebec companies” (1987, 21). Since the Bacon-Valenti agreement, the art house and niche films that were distributed by independent firms and the classic divisions of the majors have increased their share of box-office revenue.

11. Requiring for a distributor not covered by a qualifying agreement, i.e., not a major, that it be the producer or hold world rights. Producer in this context is defined as the person who was intended to hold the copyright of the film on the first day of shooting. (See section 105 of the *Cinema Act* R.S.Q. chapter C-18.1).

12. Alliance has merged with Atlantis to become Alliance Atlantis Communications Inc. A July 20, 1998 press release stated that the merged company would be one of North America's top-dozen filmed entertainment companies with projected revenue of $750 million for the fiscal year ending March 31, 1999 (including export sales of more than $380 million). It currently has three releasing labels; Alliance Atlantis Motion Picture Distribution, Odeon Films (75% interest) and a Quebec-based operation Alliance Atlantis Vivafilm . For simplicity, when referring to its distribution and that of its predecessor company we use the term Alliance distribution.

the film) to arrange distribution in Quebec. If that distributor either is required by the *Cinema Act* or chooses to subcontract out distribution to another firm, the sub-distributor is listed in parentheses. For example, Polygram and Dreamworks cannot distribute films in Quebec because they were not members of the MPEAA at the cutoff date. As a result, they contract to have their films booked into cinemas by the Quebec-based distributors, Funfilm and Motion International, respectively. Including these films in the Quebec-based Canadian distributors' total, would raise the share of Canadian distributors in 1997 and 1998 above the figure reported in italics in Table 2. As an example of voluntary subcontracting, Buena Vista, Disney's main distribution arm, hires France Films to book its films in Quebec. If this voluntary subcontracting is also included in the Quebec-based Canadian distributors' share, it rises from 32.5% in 1993 to 47.0% in 1999.

Alliance's share of Quebec box office revenue in each of the six years recorded in Table 2 is the largest of the Quebec-based Canadian firms. As distribution shares are extremely volatile, sustained leadership is strong evidence of dominance.[13] Alliance distribution is also the largest distributor of any nationality in terms of number of films distributed in Quebec with 87 films booked in 1998.[14] Paramount, the only major with a larger box-office share than Alliance in 1998, generated its revenue from 18 films. Alliance distribution has exclusive output deals with Miramax, New Line, and other foreign producers.[15] The output deals typically involve a wider set of services, often including making non-recoupable advances, than those provided by sub-distributors that typically arrange cinema bookings and support an already designed marketing campaign.[16] Under the terms of the Bacon-Valenti agreement, Miramax and New Line could directly distribute their films in Quebec but choose not to do so.[17] This means that a portion of the Alliance distribution

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13.The volatility of shares is evident in the company rows of Table 8 as well as in previous reports of distributor shares (See, e.g., the shares for the seven largest CMPDA members for 1970 to 1978 in Table 10 of Globerman and Vining, 1987).

14. The number of films is not included in Table 2. This information was also provided by Alex Films.

15.Miramax and New Line were US independents that were subsequently acquired directly or indirectly by Disney and Time Warner respectively. Other foreign companies with which Alliance has distribution agreements are Artisan Entertainment, October Films, Destination Films, and Canal Plus.

16.In Table 2, films distributed by Quebec distributors that exercise wider agency responsibilities are attributed to those distributors. For example, films subcontracted to Alliance distribution by Miramax or New Line are assigned directly to Alliance and not to the American distributor with Alliance appearing in parentheses.

17.According to Section 9 of the Memorandum of Agreement entered into at Montreal, Province of Québec, executed on October 22, 1986 between: the Minister of Cultural Affairs of Quebec and the Motion Picture Export Association of America and its Members, member "means the original signatory, its successors, its subsidiaries, entities under its direct or indirect control, entities belonging to the same control group, and any other entity continuing the distribution business of the original member."

market share does not result from provincial regulation but from competition against other firms and in-house distribution by the majors.[18]

Alliance distribution distributes across Canada and in other countries under various organizational arrangements. In Canada, its headquarters are in Vancouver but it has offices in regional markets. It's right to operate in the Quebec market depends on it being classified as Quebec-based. In late 1997, La Régie du Cinéma ruled that Alliance distribution's Quebec division (Alliance Vivafilm) required more independence from the company's other Canadian offices to qualify as a Quebec company under the *Cinema Act* and withdrew its general distribution licence. Alliance Vivafilm entered into negotiations with the regulator and has subsequently had its general licence reinstated.[19]

18.In our judgement this portion would be significant. As of March 25, 1999, Alliance distribution had distributed a total of 124 Miramax films in Canada since 1994 (Alliance Atlantis Communications Inc. press release, March 15, 1999). The New Line arrangement dates from 1989 and has been extended to 2002 (Alliance Atlantis Communications Inc. press release, May 28, 1999).

19.A press release (dated May 11, 1998) by Alliance Vivafilm, its Quebec-based distributor, announcing the reinstatement of its general licence by the Régie du Cinéma stated that it currently employs 25 persons at its Montreal head office and had reorganized to meet the concerns of the Régie.

Table 2: Distributor Shares for Quebec, 1993-1998

Distributor	1993	1994	1995	1996	1997	1998
Allegro	1.0%	1.0%		1.0%		
Alliance	8.0%	11.0%	17.0%	10.0%	11.0%	15.0%
Behaviour	3.0%	3.0%	2.0%	1.0%	2.0%	1.0%
Cineplex Odeon	1.0%	2.0%	1.0%	2.0%		
France Film				1.0%		1.0%
Lions Gate	7.0%	6.0%	3.0%	4.0%	4.0%	7.0%
Montplaisir					1.0%	
Other	2.5%	2.0%	1.0%	1.0%	3.5%	3.0%
Quebec-based Canadian firms	*22.5%*	*25.0%*	*24.0%*	*20.0%*	*21.5%*	*27.0%*
Buena Vista (through France Films)	10.0%	11.0%	12.0%	19.0%	11.5%	12.0%
Columbia	16.0%	8.0%	13.0%	12.0%	19.0%	9.0%
Fox	8.0%	10.0%	7.0%	10.0%	9.0%	8.0%
MGM	1.5%	3.0%	5.0%	3.0%	2.0%	3.0%
Paramount	8.0%	11.0%	6.0%	10.0%	12.0%	17.0%
Universal	15.0%	16.0%	12.0%	10.0%	10.0%	5.0%
Warner	19.0%	15.0%	20.0%	16.0%	10.0%	11.0%
Grandfathered majors	*77.5%*	*74.0%*	*75.0%*	*80.0%*	*73.5%*	*65.0%*
Dreamworks (through Motion International)					1.0%	5.0%
Polygram (through Funfilm)					4.0%	3.0%

Source: Alex Films Inc. Relevant shares may not add to 100% because of rounding. The grandfathered majors include one Canadian-owned firm, Universal, which acquired Polygram after the periods covered in the Table.

Empirically, English-language films dubbed into French are a more important factor in the French-language market than their opposite numbers are in the English-language market. This has generated a demand for protection from the domestic industries in France and Quebec on the one hand and policy gaming between the two centres of French-language production to attract a larger share of dubbing activity. With respect to language concerns in Quebec, more of those watching films that were first shot in English are seeing versions translated into French. The figures in Table 3 show that the Quebec box office of films with a French sound track was about twice that of films with an English sound track in 1998. Films from the United States have 91.9% of the Quebec market for films shot or dubbed into English and 78.2% of the Quebec market for films in French. Of the revenue earned in Quebec by US films 65% was generated by French-language versions. Films from France and Quebec have 15.7% of Quebec's market for French language films and only 0.3% of the Quebec market for films with an English sound track.

Table 3: Quebec Box Office Revenues by Language and Source of Film - 1998

Source of Film	Box office revenues (C$) and percentages					
	French market	%	English market	%	Total	%
France	4,088,461	4.7%	24,647	0.1%	4,113,108	3.2%
Quebec	9,597,356	11.0%	64,912	0.2%	9,733,577	7.7%
Rest of Canada	836,981	1.0%	441,201	1.1%	1,278,182	1.0%
Others	4,422,414	5.1%	2,713,206	6.8%	7,135,620	5.6%
USA	68,005,793	78.2%	36,912,001	91.9%	104,917,794	82.5%
Total	86,951,005	100.0%	40,155,967	100.0%	127,178,281	100.0%

Source: Alex Films Inc.

2. The proposed National Cinema Act

The 1983 task force on film distribution, exhibition, and marketing recommended a National Cinema Act, which would license the right to import, distribute, or exhibit films. It proposed two categories of licence--Canadian owned and controlled licensees and foreign licensees. The former could import and distribute any motion picture in Canada with a limit of 60 percent of its films to originate from one company. Foreign-owned or controlled distributors could only distribute films for which they had "worldwide" distribution rights.

This suggestion was not acted on in this form, but in February 1987 the Minister of Communications announced that federal legislation to regulate the importation of films into Canada would be introduced. A separate Canadian distribution market would be created. The Hollywood majors would be allowed only to distribute films that they had produced or for which they controlled worldwide rights. The range of the expected impact of the proposed new measures is reflected in the estimates of the associations representing the distributors who would gain and lose by the proposal. The National Association of Canadian Film and Video Distributors claimed that this proposal would only transfer about 7 percent of the majors' revenues to Canadian-owned firms (Magder 1993, 224). The MPEAA put the figure at 25% (Cinema Canada, December 1987, 46).

The Canadian government's subsequent interaction with the Hollywood majors included a meeting of the president of the MPEAA, Jack Valenti, with the Canadian Minister of Communications, Flora MacDonald. An annex to a brief, prepared for a congressional committee by the MPEAA and entitled "US Film Industry's Trade Crisis in Canada," lists four suggestions that were presented to Minister MacDonald in the meeting. These were a screen quota requiring Canadian theatres to reserve at least 10 percent of screen time for Canadian films, a box office levy to finance the making of Canadian films, a tax on blank and

pre-recorded videotape (with the funds used for domestic production), and the formation of a Canadian/US Council of professionals from the industry to resolve problems.[20] It is unusual for the MPEAA to support quota and box office taxes in any context. The Canadian government rejected these proposals as being "unworkable."[21]

In response to objections, a revised bill, the *Film Products Importation Act* (Bill C-134), was tabled in the House of Commons in June 1988. The definition of a film product as a work produced by cinematography encompassed educational as well as entertainment films and videos. No film product could be imported without a licence. The Minister could deny a licence if the applicant failed to meet at least one of the following: a contract granting the right to distribute the film in the territory of Canada without any linkage made in the contract or through ancillary contracts to the purchase of distribution rights in other territories; ownership of the rights to distribute the film in all media throughout the world either when principal photography was finished or the film was imported; or an investment in the film covering at least 50% of its production costs incurred before the film was printed (Section 9.(3)). A foreign distributor could only apply for import permits for films that were consistent with its undertakings approved by Investment Canada (Section 9.(4)). Shortly before the tabling of Bill C-134, Investment Canada issued a directive under the *Investment Canada Act* delineating, according to proprietary rights criteria, the scope of operations permitted foreign distributors. This directive exempted the foreign distributors operating in Canada on February 13, 1987. Although the impact of Bill C-134 on the majors was reduced by the exemption from the Investment Canada directive, the CMPDA remained concerned with other clauses and continued to oppose the legislation.

In the internal political debate on Bill C-134, concern was expressed over the authority granted the government to control the importation of films. Michael Bergman, a lawyer who frequently wrote on industry practice and policy in *Cinema Canada*, put it this way:

> The bill does not say that only Canadians can import any film product. It says that everyone, Canadians and foreigners alike, needs to secure the government's permission to import a film product. The definition of film product found in Section 2, Sub-paragraph (1) is broad enough to include news and information films, documentaries, shorts, educational, industrial and religious film products." (Cinema Canada, Nov. 1988, 20)

An election again interrupted the legislative process. Although in this instance the government was returned

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20. *Cinema Canada*, May 1988, 20.

21.See Background notes released in conjunction with a May 8, 1988 Department of Communications press release on a speech by the Minister to the Canadian Films and Television Association. Why a quota or box office tax was unworkable and the proposed legislation was workable was not addressed.

to power, it decided not to pursue film distribution legislation in the new session of Parliament.

3. The 1988 Investment Canada directive

The proposed legislation had been the main element of four federal film policy initiatives introduced at this time. The others were the introduction of film distribution subsidies, an expansion of production subsidies, and the Investment Canada directive, which restricted foreign distributors to handling films for which they were major investors or owned world rights.[22] None of the terms "film," "major investor" nor "world rights" were defined. As a result of the exemption of the Hollywood majors, the federal policy created two classes of foreign firms in theatrical distribution, those with grandfathered rights to distribute their non-proprietary films and those without this status.

A foreign distributor entering the Canadian market after the cutoff date for grandfathering was subject to the *Investment Canada* review process if the investment amount exceeded modest benchmarks. (The Governor in Council can also order a review for an investment that would not be review able if is related to Canada's cultural heritage or national identity.) A reviewable investment that is found to be of net benefit to the country can proceed. The net benefit criteria allow large latitude for discretion. One of the many general guidelines for determining net benefit is the investment's compatibility with national and provincial cultural policies.[23]

4. CRTC decisions on film rights for satellite DTH PPV and VOD undertakings

In 1993, the launch of a new generation broadcasting satellite allowed DirecTV and United States Satellite Broadcasting to offer digital direct-to-the-home (DTH) broadcasting services to US viewers that were competitive with cable. The satellite's footprint included much of populated Canada. That an unregulated foreign alternative to Canadian cable was floating in the air around Canadian television sets captured the attention of the Canadian cable industry and its regulator, the CRTC. Two years of policy agitation followed in which the CRTC asserted its authority to regulate the satellite services received by Canadian viewers and in conjunction with other government agencies, encouraged the launching of Canadian direct broadcasting satellite services.

The larger of the two American services, DirecTV, joined with a Canadian company, Power

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22. The Investment Canada policy is described in the Communications Canada fact sheet (FS-88-3844E).

23.Section 20(e) of the *Investment Canada Act*, Chapter I-21.8 (R.S., 1985, c. 28 (1st Supp.)).

Broadcasting Corporation to form Power DirecTV, a company that met the 80 percent Canadian ownership requirement for holding a broadcasting licence. The new partnership was formed too late to participate in a set of Hearings that preceded a CRTC decision to exempt Canadian satellite broadcasters from licensing requirements if they met specified conditions.[24] The exemption-from-licence conditions included two requirements that were not met by Power DirecTV's business plan. These were that a satellite broadcasting service must deliver all of its programming from a Canadian satellite and provide pay-per-view (PPV) services through a programming undertaking authorized to provide service by the Commission. At the time of the exemption decision the latter stricture meant dealing only with the regional English-language monopoly PPV services then serving cable companies--Viewer's Choice Canada in eastern Canada and Home Theatre in western Canada.[25]

These conditions raised the costs of the new partnership.[26] After complaints from Power DirecTV and intense lobbying, a special panel to review satellite broadcasting policy was established.[27] The government accepted with minor modifications the panel's recommendations that two directives be given to the CRTC[28] requiring *inter alia* open licensing of satellite distribution undertakings and separate and open licensing of PPV DTH service providers for these services. An application by an integrated PPV DTH service would be treated similarly to one by a non-integrated provider. To comply with these directives the CRTC licensed PPV undertakings for satellite television at the end of 1995 (PPV DTH undertakings). In doing so the Commission required the licensees to purchase rights to non-proprietary films from Canadian distributors. The Commission claimed that the provision "would provide strong support for Canada's film distribution industry,

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24. CRTC Public Notice 1994–111, Ottawa, August 30, 1994. A DTH service that did not meet the conditions for exemption could apply for a hearing and receive a licence if the Commission approved its proposal.

25. Home Theatre was the PPV service offered by Allarcom. The two services cooperate in the scheduling and delivery of programming that they offer.

26. The director of investigation and research of the Competition Policy Bureau testified in a subsequent hearing that the CRTC's satellite requirement "would cost hundreds of millions of dollars in additional costs over the average twelve year life of a satellite." (Comments of the director of investigation and research on DTH and PPV proposed directions to the CRTC and the Senate Standing Committee on Transport and Communications, Ottawa, June 7, 1995, 4). Power DirecTV planned to deliver its own PPV service, modified to conform to CRTC content requirements, from its American satellite.

27. Gordon Ritchie, Robert Rabinovitch, and Roger Tassé were appointed as commissioners to examine satellite broadcasting policy.

28. The Broadcasting Act permits directives on matters of policy but not on the detail of decisions. Before implementation a draft directive has to be considered by committees of each house of Parliament, which must report within 40 days of receiving the directive.

which is an important element of the broadcasting system."[29] The CRTC definition of proprietary rights required the distribution company to own world rights or to have financed at least 50 percent of the film. The term "world rights" was not defined. The Commission's initiative differed from the 1988 Investment Canada directive and the Quebec *Cinema Act* in not exempting the Hollywood majors.[30]

The Hollywood majors opposed the regulatory measures imposed in the licensing decisions. The CMPDA and the individual companies appealed the CRTC decision to the courts on the basis that both the proprietary rights regulations and some related contractual constraints violated natural justice and were unreasonable. The plaintiffs also claimed that the CRTC had acted beyond its jurisdiction. The Federal Court of Appeal dismissed the case. Justice Hugessen ruled that the applicants should have appeared at the CRTC hearing to register their concerns and that the jurisdictional and reasonability arguments did not have merit. On the constitutional issue, the justice ruled that the proprietary rights requirement was "directly related to broadcasting" and affected film production and distribution, which is under provincial jurisdiction, "only incidentally and to no greater extent than is necessary for strictly regulatory purposes."[31] Having failed in the courts, the majors showed little enthusiasm to supply the films under their control to the new PPV DTH services. The majors were betting that the new services needed them in their competitive battle with cable more than they needed the services. Given the economics of introducing a satellite broadcasting service in competition with an established terrestrial distribution system that had relatively low variable costs, this wager was not in our opinion a risky one.

Power DirecTV and Power DirecTicket were the only fully integrated satellite broadcasting and PPV DTH services among the set of licences issued on December 20, 1995. The Power DirecTV group examined the CRTC conditions, including the proprietary rights regulations that are our focus, and declined to work its

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29. CRTC98-76, 4.

30.That the CRTC has jurisdiction only over the buyers and not the sellers made enforcement difficult as buyers frequently do not know the details of the financing or the ownership status of rights for a film they wish to broadcast. Affidavits can be provided by the distributor, but in some instances, it may not know the details of the financing even in cases where its advance is the major source of financing. This will occur, for example, if its advance is set as a percentage of the budget rather than the actual cost.

31. Four cases were heard together, the Canadian Motion Picture Distributors Association, Warner Bros. Entertainment Inc., Viacom Enterprises Canada Ltd., Metro-Goldwyn-Mayer Inc., Buena Vista International Inc., Columbia Pictures Industries Inc., Twentieth Century v. the Canadian Association of Film Distributors and Exporters combined with one of the following four co-respondents: (i) The Partners of Viewer's Choice Canada, (ii) Allarcom Pay Television Limited, (iii) Joel Bell, on behalf of a company to be incorporated (Power Directicket), and (iv) Canal Premièrè, a general partnership consisting of Canal Premièrè/Viewer's Choice Canada, Cogeco Radio Télévision Inc., Réseau de Quatres Saisons Télévision Inc., and Télé-Metropole Inc., and Twentieth Century Fox Film Corporation before Justices Hugessen, Désjardins, and Décary of the Federal Court of Appeal on June 26, 1996.

licences. The Canadian satellite services that did launch face the same expense of providing a service of a given quality as their US counterparts. Services from each country reach a substantial part of the market of the other. A Canadian service foregoes a much larger market than a US service when each is restricted to its national market. A service with a larger subscription base can cover the costs of providing better quality service in terms of the number of channels offered and the number of exclusive events available to viewers than one with a smaller base. This is evident from comparing the experience in the two countries. A series of mergers in the United States has reduced the number of major competitors serving that market to two. According to one source (DBSDish.com), DirecTv had 7.9 million subscribers while Echostar had 3.25 million subscribers at January 4, 2000. There are also two services currently operating in Canada. A November 5, 1999 press release of ExpressVu reported 340,000 subscribers while a Star Choice press release of Oct. 14, 1999 reported 241,500 subscribers. The cost disadvantages of the Canadian services arising from the smaller market were augmented by the contractual and proprietary rights regulations imposed on the PPV DTH services.

In 1998, the Allarcom PPV DTH service asked the CRTC to amend its conditions of licence. Among the requests was the removal of the proprietary rights regulation. The CRTC granted Allarcom's request and subsequent ones filed by the other PPV DTH services.[32] In justification of reversing its position on proprietary rights, the CRTC stated:

> When this condition was imposed, the Commission considered that it would provide support for Canada's film distribution industry. At the time, it was anticipated that less than 10% of the feature films exhibited by a PPV undertaking would be subject to this condition, and the licensee was not opposed to the condition of licence, since it followed this practice with its cable pay-per-view service.[33]

This statement is puzzling. We cannot find any reference to the 10% figure in the original decisions. Assuming that it refers to non-proprietary films, we do not understand why the reservation of less than 10% of films to Canadian distributors was good policy but when the reservation affected a different percentage the policy was harmful and should be withdrawn. Contrast Judge Hugessen's opinion in the case between CMPDA et al and the various licensed PPV DTH services and the rationale given by the CRTC in this decision. The Commission clearly states that the primary intention of the proprietary rights initiative was to support the film industry. No mention is made of a broadcasting objective that is sacrificed by its repeal.

32.The Allarcom, Viewer's Choice and Canal Plus decisions were dated March 13, 1998 and numbered CRTC 98-76, 98-77, and 98-78 respectively.

33. All the passages are from CRTC Decision 98–76, Ottawa, March 13, 1998.

Allarcom noted in its application that it had been unable to contract with the Hollywood studios for the necessary films to run a service. We cannot determine whether Allarcom supported the original CAFDE recommendation that proprietary rights regulation be included in the conditions of licence. The proprietary rights measure was unlikely to benefit Allarcom as a buyer. If the majors sub-contracted their non-proprietary films through Canadian distributors, Allarcom would be signing checks made out to different companies. Since the regulation restricted the scope of competition to distribute non-proprietary films and arguably substituted distribution services that were less efficient, buyers of rights would expect to pay either the same or more for their rights. The proprietary rights initiative created no commercial benefit for the PPV DTH services while generating a probability of commercial damage.

Star Choice, ExpressVu and SPTV, all holders of CRTC broadcast licences, intervened in support of Allarcom's request to remove the proprietary rights regulation. Interventions opposing that request were made by individual ACTRA performers, CAFDE, Union des Artistes, Canadian Film and Television Production Association, Association des producteurs de films et de télévision du Québec, Canadian Conference of the Arts, Telefilm Canada and Alliance Communications Corporation (CRTC Decision 98-76, Ottawa, March 13, 1998). In line with the view that the proprietary rights initiative had little to do with broadcasting services, none of the organizations opposing the removal of regulation held broadcasting licences except for Alliance. All of them had professional or business reasons for supporting the protection of Canadian film and television production and distribution. CAFDE appealed the PPV DTH decisions to the Governor in Council. The appeal was rejected (Heritage Canada press release, June 4, 1998).

On July 2, 1997, approximately 8 months before revising the conditions of licence for the PPV DTH services, the CRTC imposed proprietary rights regulation but not compulsory contracting shares on five new video on demand (VOD) services (CRTC Public Notice 1997-83 and CRTC Decisions 97-283 to 97-287, Ottawa, July 2, 1997). Thirteen months later the proprietary rights condition of licence for the VOD services was also rescinded at the request of these licensees. The Commission stated that each service had found the condition "a serious obstacle to the acquisition of feature film feature films for its VOD service, which represent the core of its programming." The CRTC added "that a limited number of films would be affected by this condition of licence and the impact of its removal would be minimal" (CRTC Decision 99-213, Ottawa, August 12, 1999). One of the licensees asking for the proprietary rights measure to be rescinded was a general partnership between Alliance Communications Corporation and Shaw Communications Inc. Alliance had shifted from intervening in opposition to the PPV DTH services request that they be given relief from their proprietary rights regulation to asking for relief when it was an owner of a VOD service that would be

a buyer of rights. Given that the VOD services maintained in their request that the regulation was a serious obstacle to the acquisition of feature films, which represent the core of its programming, the CRTC's description of the impact of its removal as minimal, seems ingenuous.

II. Analysis

An integrated assessment of the Canadian proprietary rights policies requires an understanding of the economics of the film industry, the strategic and legal international constraints, as well as the process of Canadian cultural policy making.

1. Economic characteristics of film distribution

The content of films is non-rivalrous in consumption--one person can enjoy the content without affecting the ability of another to do the same. For content to be distributed widely, it needs to be embedded in a medium. The rivalrous properties of content embedded in different media vary. This variation induces different organizational, legal, and policy responses. In particular, business practices and organizational structure in film distribution respond to the costs of controlling access to the content in different media as affected by different government policies. For a film shown in a cinema, property law allows its owner to control access to the content through limiting entry to the building. Copyright law deters someone with permission to enter the cinema and watch the film from video taping what appears on the screen. A conventional television broadcaster airs a film with advertising spots. In contrast to the cinema owner the broadcaster receives no direct payment from viewers. Revenue is earned from those wishing to gain access to the advertising spots. The broadcaster can control the amount and type of advertising but cannot exclude viewers from receiving the advertising and film content that is broadcast. Alternatively, the television signal can be scrambled so that its owner controls not only what will appear on the signal but who can watch it. In this case, the broadcaster's decision involves more interdependent dimensions–the advertising fee to charge, the films and other programming to license, and the access or subscription price. For a scrambled signal, the costs of controlling access also depend on the partition of the content flow that will be "rented" to viewers. A PPV service allows access for the duration of a particular film while a subscription film service provides access for a period of time, typically a month. Each mode or window of distribution–theatrical, PPV, video, movie channels, and free television–has a different vulnerability to "trespass" or piracy.

Once made a film's market is typically international, whether it targets a mass or specialized audience. Dubbing, subtitles, and editing allow some tailoring of a film's content to different international

markets. For a theatrical release or PPV services the customer has to be persuaded to pay before seeing a particular movie. Value arises from witnessing a novel treatment of a theme within known parameters. A customer chooses among different films based on the coarse knowledge provided by genre, the reputation of the studio, cast, director, and screenwriter, reviews, pre-release promotion on talk shows and magazines, trailers, conversations with friends, and increasingly, television advertising. Films are shown sequentially through the different windows. The positioning in the sequence balances the commercial advantages from creating a favourable "buzz" about the film and the losses from piracy. Distributors often control the film's release across different media and windows. They design the marketing, advertising and promotion (MAP) campaign with an awareness of how those who see the movie affect the assessment of others who have not. Informational externalities also occur across territories. The MAP budget of a mass-market film varies widely but typically is at least half of the production costs. The promotional campaign concentrates on the theatrical release because of its effect on subsequent windows. For a film to be commercially viable, expected revenue must cover production expenses, MAP costs and a risk-adjusted return on capital. Risk management is extremely difficult. A recent empirical study concludes that:

> There are no formulas for success in Hollywood. The complex dynamics of personal interaction between viewers and potential viewers appear to overwhelm the initial conditions. The difficulties of predicting outcomes for individual movies are so severe that a strategy of choosing portfolios of movies may be preferred to the current practice of "greenlighting" individual movie projects. (De Vany and Walls, 1999, 315)

What is encompassed by the term "distribution" varies. It may include participation in defining, financing, marketing, advertising or promoting the film or only involve contracting with cinemas and doing some local promotion. For each film, a distributor contracts with its producer, other distributors, and an array of cinemas. These contracts often share the revenues received. This structure has been attributed to the mitigation of agency problems (Chisholm, 1997) or to transfer risk (De Vany and Walsh, 1996; Weinstein, 1997). Contracts are also affected by regulation. The affected parties can be expected to contract in a manner that meets the strictures with the least impact on profits.

In addition to partitioning distribution into different functions, distribution can be classified by the degree of centralization. To simplify, we consider two alternatives--an integrated studio distribution with limited sub-contracting in some territories and a consortia of regional distributors. The Hollywood majors typify the first set. They are significant players in financing, distributing and promoting high-budget films and extracting value from them internationally. For English-language films that are best launched with a

coordinated world promotion campaign and a wide opening, they currently face little competition.[34] For films that are best released gradually while word of mouth support develops, more competition exists. Consortia of national and regional distributors can provide more decentralized and culturally adapted advertising and promotional programs. Specialized divisions within the majors may participate in and sometimes organize such consortia for the more commercially viable of these films.

The organization of film distribution is also affected by the demand of theatres for films. The viability of cinemas depends on receiving a continuous supply of films with commercial promise. As a result a cinema must commit ahead of time for films, frequently with little specific information about the particulars of each film. Cinemas depend on the distributor to maintain a flow of good "lottery tickets." Commercial success depends on choosing among films and when to end a particular run within the degrees of freedom provided by the relevant contracts. The "loyalty" between a distributor and an exhibitor facilitates adjustments in returns among a set of movies and may explain the unwillingness of cinemas to threaten the relationship to accommodate the sporadic offering of a promising film from a small distributor.

A distributor requires a near global span for an integrated release. The efficient size of the different participants in an alliance of regional distributors is more fluid and usually involves aggregating markets in different countries. The gains of offering cinemas a steady flow of viable films, of developing the specialised talents necessary to identify promising film concepts, of nurturing projects through production, of establishing a professional reputation with cinemas and producers, and of diversifying risk result in a minimum efficient size for distributors that is large relative to the size of most regional markets.

2. International legal and strategic constraints

At the level at which the Canadian government wishes to create a presence in film distribution, the activity is international and is constrained by formal agreements or in their absence by the anticipation of retaliatory actions by other governments. Except for four specific commitments, Canada chose to exempt the cultural industries from the Canada-United States Free Trade Agreement (CUSFTA). The cultural exemption were subsequently incorporated into the North American Free Trade Agreement (NAFTA). What the cultural

34.The breadth of releases has increased to take advantage of saturation television advertising. The average widest point during the life cycle of North American wide releases increased from 1582 theatres in 1994 to 2074 in 1998 (*Variety*, January 4 -10, 1999, 28).

exemption means has been a source of controversy.[35] No special arrangement was made for the cultural industries under the WTO. Canada, like a number of other countries, did not commit audiovisual services to the market access and national treatment sections of the GATS.

To the extent that Canada's film distribution policies are considered indirect means of affecting trade in goods they are not exempted from the discipline of GATT and the WTO Agreement on Subsidies and Countervailing Measures (ASCM). When a good and service are jointly supplied, as is the case with film distribution, the WTO decision in the magazine excise tax case clarified that a member cannot choose the most favourable regime as a justification for its policies. GATT and GATS must be considered as part of a whole.[36] Article III:4 of GATT requires that products of other members should receive national treatment in distribution.[37] After the magazine decisions, the WTO's Appellate Body ruled, in a case brought against the EC concerning its regime for the importation, sale, and distribution of bananas, that the goods-services distinction will be dealt with on a case by case basis (Bernier, 1998, 113). Greater predictability on how cases will be adjudicated that involve both the regime for services and goods must await the development of a thicker case law.

Film distribution involves the international licensing of copyrights. The Berne convention,[38] *inter alia*, requires that a member respect the copyrights of other members and offer national treatment with regard to the exercise and enforcement of those rights. Recent trade agreements have included the exchange of commitments with respect to copyright. Of these, the most important was the agreement on trade-related aspects of intellectual property rights (TRIPS) reached in the Uruguay Round negotiations that established

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35. The controversy concerns the interpretation of articles 2005(1) and 2005(2). 2005(1) states that "cultural industries are exempt from the provisions of this agreement except as specifically provided"and article 2005(2) states that notwithstanding any other provision of the agreement "a party may take measures of equivalent commercial effect in response to actions that would have been inconsistent with this Agreement but for paragraph 1."

36. See World Trade Organization (1997a, 1997b).

37."The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use." (Text of The General Agreement on Tariffs and Trade, GATT, Geneva, July 1986).

38.Berne Convention for the Protection of Literary and Artistic Works, Paris Act of July 24, 1971, as amended on September 28, 1979, World Intellectual Property Organization, Geneva, 1992.

the WTO.[39] Article 13 of TRIPS imposes limitations on regulating copyright based contracts:

> Members shall confine limitations or exceptions to exclusive rights to certain special cases which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the right holder.

Immediately following the Uruguay round, members of the World Intellectual Property Organization (WIPO) negotiated the Copyright Treaty of December 10, 1996.[40] Article 10 states:

> (1) Contracting Parties may, in their national legislation, provide for limitations of or exceptions to the rights granted to authors of literary and artistic works under this Treaty in certain special cases that do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the author.
> (2) Contracting Parties shall, when applying the Berne Convention, confine any limitations of or exceptions to rights provided for therein to certain special cases that do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the author.

Article 10(1) is almost identical to TRIPS Article 13 with respect to measures in the Treaty except that the adjective "exclusive" has been dropped, so that the constraint applies to all rights, and "in their national legislation" has been added. (It is not clear, whether "national legislation" refers to Copyright law or to any legislation.) Article10(2) clarifies that TRIPS Article 13 governs Berne commitments and applies to all Berne rights, exclusive and otherwise. Although Canada has committed to sign the new treaty it has not yet introduced the enabling legislation.

Issues raised by film distribution policy that are not actionable under international trade or copyright agreements are not exempt from retaliatory measures. The absence of mutual obligations gives Canada "freedom" to set policy and the other countries "freedom" to respond. Policy alternatives remain constrained by the anticipation or the reality of retaliatory action. The two freedoms interact so as to discipline policy more tightly for the country with fewer strategic "weapons." In either the English-language or the French-language film market Canada's market is not as important as that of the largest participants. Cultural disputes with the United States have elicited threats of retaliation outside of the WTO or NAFTA framework that have significantly affected the course of Canadian policy (Acheson and Maule, 1999a, 1999b).

39."Agreement on Trade-related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods," Annex 1C of *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, December 15, 1993.

40.WIPO Copyright Treaty adopted by the Diplomatic Conference on Certain Copyright and Neighboring Rights Questions on December 20, 1996 at Geneva, Switzerland.

3. The process of determining Canadian cultural policy

The process of determining film policy differs from that governing the policy of other sectors. Aggressive government policy has coincided with the development of a Canadian industry since the mid 1970s. Successive governments and in particular those which have administered and developed audiovisual polices have viewed themselves as responsible for the development of the Canadian film industry.

The initial instrument of government policy was the subsidisation of production directly and indirectly. Then as now, there was no lack of industries that would have welcomed direct subsidies and generous tax shelter financing. Why was the domestic film industry successful while others were not? Political support for subsidies for film production and distribution was relatively greater because of the widespread belief that Canadian films would contribute to the further development of a Canadian culture. Most individuals believed that what they and their children watched on the screen affected their development. Unfortunately, there is no agreement about what content contributes to the building of an appropriate culture. The electorate was willing to let the state answer that question and regulate the system accordingly. The state sidestepped the difficult issue of defining culturally benign content. Instead it chose to support films based on the nationality of the companies and personnel that made them. Canadian consumers might make inappropriate choices in deciding what they would watch but Canadian producers had the necessary sensitivity. They would produce films that were culturally nourishing and fill a void for Canadian movie goers.

After almost thirty years of subsidised audio-visual production, there are sporadic complaints about the quality of the production, usually oriented at a niche film that offends majority values, but these concerns have not altered the general momentum. Direct and indirect subsidies have been maintained at generous levels or risen. As the flow of Canadian films has increased and a larger stock exists, the number of people watching the films in cinemas remains disappointing to policy makers. The political power of the cultural justification is threatened if the films being placed on the cultural shelf are not watched. Either the same public that supported the subsidisation policies for production was not as enthusiastic about viewing the results or the distribution system was biassed against making these culturally appropriate films available. The structural remedies of distribution that have been introduced include jawboning, antitrust initiatives, the proprietary policy measures and indirect and direct subsidies.

The cultural linkage is most easily made with production. It is more difficult for distribution to claim exceptional status on cultural grounds. Claims are sometimes made that foreign distributors ignore Canadian films that would be more profitable than the ones they choose to distribute. Many of the foreign distributors have been operating in Canada longer than any Canadian distributor. A large number of American films have

been produced in Canada. In 1999, the Directors Guild of America and Screen Actors Guild mounted a campaign against foreign policies that support what they term "runaway productions." The campaign focusses on Canadian tax credits and direct subsidies.[41] It is not credible that American distributors are not well informed about the capabilities of the Canadian industry. Another line of argument is that Canadian distributors cannot fill the void and profit from the myopia of the majors because they are denied bookings with the two leading chains, which are owned by the majors. If the integration is socially harmful, the remedy lies with competition policy. Proprietary rights initiatives provides no leverage on that problem.

The cultural rationale for protecting Canadian distribution that has had the most impact is the claim that Canadian distribution firms will cross-subsidy Canadian production. Proponents of protecting distribution claim that: i) distribution is characterised by significant economic rents protected by barriers to entry; ii) domestic policies by forcing a Canadian presence inside the loop can transfer those rents; and iii) the Canadian recipients of these economic rents will spend them on Canadian production. An alternative view is that: i) any economic rents earned in distribution accrue to the accumulated organizational capital and specific human capital of successful firms; ii) small countries are not well placed to win strategic trade battles over rents and are better served by establishing rules in which competition can transfer rents; iii) Canadian owners like those of other nationalities invest in films that are expected to be commercially viable. As the interactions between Canadian distributors and foreign producers increase, the Canadian distributors, particularly those which are regularly at the core of an international alliance of distributors, will develop an idiosyncratic web of "inside" information about commercially viable projects in other countries. Their investments in production will typically be international.

III. Assessment

We have identified two levels of possible Canadian participation in the distribution of films. These are integrated distribution as characterised by the operations of the majors or as a participant in the more decentralized distribution offered by a consortia of regional distributors. A Canadian company needs to put at risk considerable capital to acquire or start an integrated studio or a viable regional distributor. In contrast to earning a share of an activity through investment or takeover, the proprietary rights policies are takings that generate opposition from the targets and support from the beneficiaries. The legal constraints on takings from

41.The campaign was mobilized around a study, "US Runaway Film and Television Production Study Report" by the Monitor Company, a consulting company.

foreigners are less well defined than those on takings from domestics. The practical constraints lie in the possibility and credibility of private and foreign government responses. The confrontational nature of the proprietary rights policies deflected attention from commercial processes and decisions such as the acquisition of a Hollywood major by a Canadian company, and the development of a dominant Canadian player in international alliances of regional distributors, that were having a much more substantial effect on film distribution in Canada. The political support in Canada for the proprietary rights initiatives rests on the claim that cross-subsidies from Canadian distributors will support the production of more culturally benign content. We examine the available direct and indirect evidence on this thesis. We conclude with a discussion of grandfathering and some suggestions for altering the process of Canadian film policy determination.

1. The unrecognized Canadian major

With respect to integrated international distribution, Seagram, a Canadian company, purchased the film divisions of Universal Studios and Polygram. If the Hollywood studios are responsible for negative externalities on Canada's culture and nationality of ownership has a predictable effect on decisions, they have been partially internalized. In contrast, we expect no predictable effect of the ownership of Hollywood studios regardless of whether they are owned by American, Japanese, French, Australian, or Canadian interests. A major is in the business of offering films that travel well between cultures through their special effects, glamour, or story line. To use its accumulated organizational experience, brand, and international presence to nurture those few films that speak loudly to a national group and not at all to the rest of the world would be to court bankruptcy.

Whatever its effect on content, the Seagram takeover definitely alters the statistics that are part of the cultural debate in Canada. Surprisingly, the rise in distribution by Canadian-owned companies resulting from the Seagram investment has hardly been commented on by those who identify the high percentage of films distributed by non-Canadians as a matter of cultural concern. Government agencies with a cultural mandate have ignored the intitiative. Indeed there is a reluctance to incorporate the change in ownership in the statistical series. Although the takeover of Universal's parent MCA by Seagram was initiated in 1995, Statistics Canada has not integrated Universal with Canadian distributors in its statistical series on Canadian versus non-Canadian distribution. Revenue Canada on the other hand quickly recognized Seagram as a Canadian company for tax purposes.

2. Participation in alliances of regional distributors

The proprietary rights policies were designed to make Canadian or provincial companies players in alliances of regional distributors. Two possible sources of inefficiency arise from these policies. The alliance may have to configure territories in a more costly manner and the Canadian distributor that is included in the alliance may be less efficient than other firms in doing its tasks. If the Canadian firm is not efficient, it will receive the minimal subcontracting necessary to comply with the law. To be successful beyond this level, a Canadian distribution firm has to expand from a Canadian base to cover an area consistent with efficiency and be well managed.

A Canadian film must be distributed by a Canadian firm to be eligible for production subsidies from Telefilm or tax credits. Most Canadian films with aspirations for international release would depend on one or both of these programs for financing. A Canadian distributor that does not have its principal place of business in Quebec and did not have a provincial licence on December 17, 1982 must subcontract distribution in the province to a Quebec-based Canadian firm regardless of whether it has proprietary rights or not. The reverse is not true. For either a Canadian French language or English-language film an integrated North American distribution is only possible if a Quebec-based Canadian distributor covers the United States through expansion or acquisition.[42] Quebec-based distributors are the only Canadian firms that can distribute foreign, non-English language and non-proprietary films in Quebec. The grandfathered majors may obtain special permits to distribute these films in Quebec if the Minister of Cultural Affairs is satisfied with their level of investment but it is our understanding that this has rarely occurred. The grandfathered majors are eligible to offer distribution services for foreign, English-language films throughout Canada, if their financial commitments or control of world rights qualify the films as proprietary under the Bacon-Valenti agreement. For these films, the majors are protected from competition of American independents as well as other foreign distributors. Table 4 summarizes the net effect of the proprietary rights initiatives on a firm's eligibility to distribute different types of films to theatres in Quebec, Canada, and North America.

42.The fear of American government retaliation to the lack of reciprocity of market access raises the expected costs of such a strategy.

Table 4: Proprietary Rights Policy and Cinematic Distribution

Territory	Film type		Canadian distributor		Foreign distributor		Policy
	Lang.	Prop. right status	Non-Quebec based	Quebec based	Grandfathered MPEAA member	Other	
Quebec	Any	P	No*	Yes	Yes	No*	QCA
	Eng.	NP	No	Yes	No	No	
	Non-Eng.	NP	No	Yes	Only with waiver	No	
Rest of Canada	Any	P	Yes	Yes	Yes	Yes	ICP
	Any	NP	Yes	Yes	Yes	No	
Integrated Canada	Any	P	No*	Yes	Yes	No	QCA/ICP
	Eng.	NP	No	Yes	No	No	
	Non-Eng.	NP	No	Yes	Only with waiver	No	
Integrated North American	Any	P	No*	Yes	Yes	No	QCA
	Eng	NP	No	Yes	No	No	QCA/ICP
	Non-Eng	NP	No	Yes	Only with waiver	No	QCA/ICP

Note: QCA refers to Quebec *Cinema Act*; ICP to Investment Canada Policy; P to proprietary; NP to non-proprietary. The grandfathered majors include one Canadian firm, Universal, as noted in the text.
*Assuming firm had no license to operate in Quebec on December 17, 1982.

For the most promising foreign produced films distributed by a consortium, the majors or specialized divisions within them, are effective competitors in providing the North American link.[43] Jake Eberts, a Canadian producer who stitched together effective alliances for distributing a number of films, notes that

> with the exception of a handful of art films, the box office receipts you can generate with a film distributed by a major studio are almost always more than can be generated by an independent. I have tried to stick with the majors in the US ever since. (Eberts and Ilott 1990, 62)

For the higher end of English-language foreign films that have a broad release, the majors are likely to provide distribution in the United States. For films that will predominately be shown in the art house circuits but may cross over to a broader release through the network of mass-market cinemas, either US independents or specialised divisions of the majors will be competitive. If the film is non-proprietary to the majors in Quebec, some distributional functions will be licensed to a Quebec-based Canadian distributor. When a Quebec-based

43. The MPEAA in a Report to the United States Trade Representative: Trade Restrictions Facing the MPEAA Member Companies in Foreign Markets, May 1987 (reprinted in *Cinema Canada* May 1988, 21) reported that two-thirds of the films that their members distributed were made "in-house" and one-third were "pick-ups" that did not grant worldwide distribution rights.

distributor can serve the entire Canadian market at a lower cost to the major than in-house distribution of a major plus hiring some services in Quebec, sub-contracting for the whole Canadian market is likely. If the Canadian distributor has the financial resources and skills to participate efficiently in the full spectrum of distribution tasks, it may act as part of the strategic core of the consortium of distributors rather than acting as a more limited distribution agent.

Table 5 reports the distributors' shares of the French and English language film markets for Canada in 1998. Counting the category other as mostly representing small Canadian distributors, the grandfathered majors have a share of 64.4, 77.8, and 75.7 percent of the French-language, English-language, and Canadian markets respectively. All of the Canadian distributors that are separately listed are Quebec-based for purposes of the Quebec *Cinema Act* and it is our understanding that most in the "other" category are as well.[44] These firms dominate Canadian distribution.

Alliance Atlantis, the most successful of the Canadian distributors, has a significant position in both the English and French-language parts of the industry. It reported distributing almost 90% of art-house films shown in Canada and in conjunction with Famous players, a Viacom company, has vertically integrated into exhibition.[45] In addition to its linkages with Miramax, New Line, and a number of American independents, Alliance Atlantis has also nurtured relationships with distributors in other countries. Kinowelt, the largest independent motion picture distribution company in Germany, recently made a strategic arrangement with Alliance Atlantis.[46] The German company acquired 20 percent of the non-voting shares of Alliance Atlantis and a 50 percent interest in Alliance Atlantis Releasing, its British film distribution unit. Kinowelt and Alliance Atlantis will establish a motion picture development, acquisition and production fund of up to US$150 million "to pursue the production and acquisition of a greater number of high-quality, commercially attractive motion picture projects than either company could previously pursue on its own." (Alliance Atlantis Communications Ltd. press release, Friday July 30, 1999). Kinowelt has the same arrangements with Miramax, New Line and October Films for Germany as Alliance Atlantis has for Canada.

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44. As mentioned before, Dreamworks and Polygram (before being absorbed by Seagrams) do not qualify to distribute either proprietary or non-proprietary films in Quebec or in Canada and subcontract distribution to Quebec-based firms. Firms in this category also have to subcontract their non-proprietary films to other distributors in the rest of Canada because of the Investment Canada directive.

45.The joint venture, Alliance Atlantis Cinemas, specializes in upscale, art-house films. Of the 70 screens planned, 10 have been opened in Toronto and 4 in Montreal (Alliance Atlantis Communications Inc. Annual Report 1999, 22).

46.*Variety* of May 3-9, 1999, 22 reports Kinowelt's share to be 9.2% of the German market in that week.

Table 5: Canadian Distribution by Company 1998

	Canadian box office C$			Canadian box office %		
	French-language	English-language	Total	French-language	English-language	Total
Alliance	$13,587,046	$58,484,037	$72,071,083	15.2%	12.5%	13.0%
Behaviour	$695,532	$3,350,290	$4,045,822	0.8%	0.7%	0.7%
Lions Gate	$8,523,394	$998,668	$9,522,062	9.6%	0.2%	1.7%
Others	$2,799,837	$1,446,474	$4,246,311	3.1%	0.3%	0.8%
Canadian firms	*$25,605,809*	*$64,279,469*	*$89,885,278*	*28.7%*	*13.8%*	*16.2%*
Buena Vista (France Film)	$10,125,263	$76,618,648	$86,743,911	11.4%	16.4%	15.6%
Columbia	$6,860,789	$62,615,966	$69,476,755	7.7%	13.4%	12.5%
Fox	$6,317,240	$47,643,777	$53,961,017	7.1%	10.2%	9.7%
MGM	$2,480,416	$17,030,194	$19,510,610	2.8%	3.6%	3.5%
Paramount	$15,696,496	$98,264,674	$113,961,170	17.6%	21.1%	20.5%
Universal	$6,441,023	$18,078,785	$24,519,808	7.2%	3.9%	4.4%
Warner	$9,505,295	$43,020,915	$52,526,210	10.7%	9.2%	9.4%
Grandfathered majors	*$57,426,522*	*$363,272,959*	*$420,699,481*	*64.4%*	*77.8%*	*75.7%*
Dreamworks (Motion Int.)	$3,850,091	$29,006,931	$32,857,022	4.3%	6.2%	5.9%
Polygram (Funfilm)	$2,323,591	$10,143,403	$12,466,994	2.6%	2.2%	2.2%
Totals	*$89,206,013*	*$466,702,762*	*$555,908,775*	*100%*	*100%*	*100%*

Source: Alex Films

Alliance Atlantis has announced plans to expand the jointly owned UK distribution unit and has signed a three-year exclusive deal for British distribution with the US independent producer, Artisan Entertainment (Reuters, Toronto, Nov. 29, 1999). We interpret the expansion of the company's distribution reach into the United Kingdom as a means of exploiting the managerial skills and reputation that Alliance Atlantis has developed in this activity. The possibility of retaliation adds to the risk of such an expansion or at least restricts the countries in which a Canadian distribution company can invest. Atlantic Alliance Releasing UK will be competing with established distributors in the UK market. The probability that one of them will complain that this Canadian company has exercised an expansion policy in the UK that its UK counterparts cannot exercise in the Canadian market is not zero. That contingency has not prevented Alliance Atlantis from making the commitment in the UK but may restrict the development of a significant film distribution presence in the United States. For the film *Sunshine*, scheduled to be released in the United States in the late spring of 2000, Alliance Atlantis and Serendipity Point films granted the US distribution rights to Paramount Classics (Alliance Atlantis Communications press release, Dec. 8, 1999).

3. Some evidence on the cross-subsidy argument

Has the Canadian experience in film distribution been consistent with the cultural cross-subsidy thesis? Canadian distributors cannot cross-subsidize production without generating profits. The only Canadian distribution company that may have made sufficient profits from distribution to support more Canadian productions is Alliance Atlantis.[47] We believe that its most profitable distribution arrangements have been those with the American companies with which it has output deals but these require significant commitment of funds.[48] Assuming the division has been profitable, have Canadian producers of film benefited? The company is a more important producer and distributor of television than film product. Its television production vies with film for any additional investment funds generated by distribution. Alliance Atlantis has also depended on external financing for its expansion.[49] Alliance Atlantis is unlikely to invest in unprofitable films nor be given much play by financial markets to do so.

The second largest Canadian distributor in 1998 was Lions Gate, which describes itself as active in the development, production and distribution of feature films, television series, movies-of-the-week, mini-series, animated programming and the management of film and studio facilities. The company has invested heavily and to date unsuccessfully in Mandalay Films, an American production company. In the fiscal year ending March 31, 1999 the company lost $9,382,000 on operations and a further $8,543,000 as a result of its investment in Mandalay. That the film production investment was unprofitable is not inconsistent with the cultural cross-subsidy thesis, but that it was made in foreign films is.

The history since 1998 of the third distribution firm of sufficient size to be listed separately in Table 5, Behaviour Communications Inc., reveals how difficult survival is for a small distributor. Behaviour describes itself as an international entertainment company, engaged in the development, production, acquisition and international licensing of feature films. It has 47 employees and offices in Montreal and Los Angeles

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47. Alliance-Atlantis distribution division's profit figures are not public. Only consolidated profits are reported. For the quarter ending September 30, 1999, revenues of its motion picture division rose to C$64.7 million, from C$40.0 million in the previous year. The company attributes this gain "to income from the Canadian distribution of the summer hit "The Blair Witch Project" as well as "Austin Powers: The Spy Who Shagged Me," which was re-released in theaters in the summer." (Reuters, Toronto, Nov. 29, 1999).

48. Among the Miramax films, for example, that Alliance Atlantis (or its predecessor companies) have distributed in Canada are Shakespeare in Love, Life is Beautiful, The English Patient, Good Will Hunting, Scream, Scream 2, Outside Providence, Happy, Texas, The Cider House Rules, The Castle, and Scream 3. (Films noted in the Atlantis-Alliance press release of March 22, 1999.)

49. Alliance Atlantis recently announced the successful closing of a US $150 million public placement of bonds (Alliance Atlantis Communications Inc. press release of November 15, 1999) and an increase of its financing facility with the Royal Bank of Canada. This facility is in addition to a larger, $475 million syndicated credit facility with the Royal Bank of Canada and 13 other banks. (Alliance Atlantis Communications Inc. press release of May 11, 1999).

(Behaviour Communications Inc. press release of Dec. 20, 1999). As of May 31, 1999, Behaviour was looking for buyers of its Canadian distribution operations and subsequently listed it as a discontinued operation. Behaviour's financial results for the quarter ending June 30, 1999 included a charge of approximately $5.8 million associated with the termination of its distribution and multimedia divisions. On Dec. 20, 1999 the company announced the sale of its distribution division for a total consideration of $3,916,000. The company also noted that a week earlier the Superior Court of Quebec had approved the withdrawal of a petition for a receiving order against Behaviour which was filed on November 29, 1999 by the Banque Nationale de Paris (Canada).

Participation by Canadian distribution firms in distribution alliances has been subsidised by Telefilm's distribution fund. Rather than continue to subsidise the marketing of non-proprietary foreign films with the dubious expectation that any profits and rents will result in cultural cross-subsidies these funds could be directly allocated to support the production of Canadian films.[50] It might be argued that the subsidies prime a distributional pump which will later provide a more than compensating flow of culturally benign films, but after over ten years of subsidization the pump seems as thirsty for priming as in 1988. As Bergman commented at the time:

> In other words Canadian productions already heavily subsidized by the government will be distributed by distributors heavily subsidized by the government who will re-invest subsidized revenues to make more subsidized Canadian films. (*Cinema Canada*, June, 1988, 10)

4. International trade, investment and copyright issues

Although the cultural justification for economic policies is inward-looking, the Canadian film industry is international in orientation. Imports dominate on the consumption side and exports are a significant and rapidly growing source of income for producers. The producers of other countries can have a significant strategic effect by altering their willingness to license Canadian broadcasters or exhibitors or through mobilizing their governments to retaliate against exclusionary Canadian policies through formal and informal paths. The suspension of the CRTC's initiatives occurred in response to reactions by the suppliers of films to the PPV DTH and the VOD services. Grandfathering, and the special treatment of the majors under the Quebec *Cinema Act* made bilateral retaliation by the United States government unnecessary. The only formal action against these policies was taken by the European Commission (EC).

On March 13, 1997, the application of Polygram Group Canada Inc. to establish a new film production

50. In 1994-95 this would have raised the total distributed to support the guarantees and marketing of Canadian films by 8.3%.

and distribution business in Canada was approved under the Investment Canada Act. In return Polygram agreed to spend the lesser of $20 million or 20 percent of Canadian revenues over the next five years on entertainment, production, and postproduction in Canada. As a European studio, Polygram was well placed to identify promising non-proprietary distribution opportunities but unlike the grandfathered Hollywood majors it was prevented from distributing non-proprietary films by the 1988 Investment Canada directive. Polygram complained to the EC about its discriminatory treatment. The EC concluded that Canada's treatment of Polygram violated Canada's MFN commitment under General Agreement on Trade in Services (GATS) and began a World Trade Organization (WTO) dispute resolution action by undertaking consultations with the Canadian government.

All WTO member countries are committed to the MFN obligations of the GATS unless they entered exceptions before the agreement was finalized. Canada entered an exception for its film and television coproduction agreements. Canada did not enter an exception for the grandfathering of the majors in the Investment Canada directive nor for the similar treatment in Quebec's agreement with the MPEAA under its *Cinema Act*. The EC argued that the denial to Polygram of rights granted to the grandfathered American-based distributors violated Canada's MFN obligations. The Canadian government's defence was that coproductions were exempted in order to make it possible to sign further treaties of this type in the future. An MFN exception for film distribution was not necessary, as grandfathering is allowed under GATS and Canada intended to treat all new foreign firms equally.

A related aspect of Canadian film distribution policy affecting the EC's case was the transferability of the grandfathered status in a takeover. When Viacom acquired Paramount, Investment Canada approved the transaction including the transfer of the grandfathered status after assessing the "net benefits" to Canada. The EC argued that Polygram, as a Dutch firm, was being granted different treatment from an American firm, Viacom, that had also entered Canadian film distribution after the signing of the WTO agreement. Before the initial stage of the dispute resolution process was complete, Seagram acquired Polygram in late 1998, merging the operating units of the latter with Universal's film operations.[51]

No other formal action was taken by other countries, perhaps because the ultimate impact of the

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51. If a film were ruled to be a good and the reasoning of the WTO magazine decisions applied, Investment Canada policies would be adjudicated under the GATT. If instead a decision deemed that distribution could be treated separately as a service, the adjudication of a complaint such as that brought by the EC on Polygram's behalf would clarify the status of grandfathering and its transferability with respect to the MFN provisions of GATS. The good-service distinction also determines the procedure adopted by the EC in proceeding with a formal dispute. If the dispute is taken under the GATT, then the EC itself can decide whether to initiate a complaint; if under the GATS, all member countries of the EC have to agree to proceed.

policies was small. We suspect that the Canadian policies were vulnerable to a complaint under Article 13 of TRIPS. The proprietary rights initiatives are designed to prejudice the commercial interests of foreign owners of film copyright and as illustrated with the PPV DTH and VOD licensing cases, interfere with normal commercial licensing practices.

It is moot whether legislation such as the Broadcasting Act can impose contracting restrictions on copyright and be consistent with Article 13 of TRIPS and Article 10 of the new Copyright treaty because the regulations are not imposed in copyright law but in the pursuit of other goals. Although the Canadian courts decided otherwise, the rationale for the CRTC PPV DTH and VOD proprietary rights initiatives had more to do with film distribution policy than with the pursuit of the objectives of the *Broadcasting Act*. The Quebec *Cinema Act* and the directive under the federal *Investment Act* also prejudice the interests of copyright holders in the process of pursuing cultural objectives. If the link to broadcasting policy manifested by the PPV DTH and VOD regulations and an imprecise cultural objective exempt Canada from its obligations under these articles, the protection granted foreign authors by copyright law is potentially very weak.

5. The distortions of grandfathering and the process of policy determination

The attempt to carve out a reserved position for Canadian distribution firms for non-proprietary films has been limited by the grandfathering of the majors under the Investment Canada directive and the exception made with respect to English-language films for the majors under the Quebec *Cinema Act*. Although the CRTC did not grandfather the majors from its 1995 proprietary rights policy for PPV DTH and VOD services, these policies have been suspended. Nothing remains of these initiatives.

When Heritage Canada launched its most recent comprehensive review of feature film policy, it invited submissions from the industry. The Canadian Association of Film Distributors and Exporters (CAFDE), which represents seven of the largest Canadian distributors and was a catalyst for the CRTC proprietary rights initiatives, called for the government "to introduce legislation which would once and for all recognise the Canadian market as distinct from the American one for the question of non-proprietary rights to feature films."[52] That request sounds like a simple call to create a separate right for Canada, but that already exists as a copyright holder can partition rights territorially as it sees fit. The meat of its proposal is

52.Brief presented by the Canadian Association of Film Distributors and Exporters *L'Association canadienne des distributeurs et exportateurs de films* to the Department of Canadian Heritage, March 20, 1998. The members of the association are Alliance Releasing, Lions Gate Films, Cineplex Odeon Films, Behaviour Distribution, Motion International, Film Tonic, and TSC Film Distribution. The submission relies on the indirect link in stating: "The only way we can expect Canadian films to have more than a meagre chance to compete in the growing international market is if we have strong Canadian companies with domestic roots that are developing and distributing/marketing Canadian and non-Canadian productions."

the accompanying appeal for the reintroduction of proprietary rights policies without grandfathering.

The majors were protected from potential competition from emerging foreign distributors by the grandfathering under the Quebec *Cinema Act* and the Investment Canada directive of 1988. This discrimination benefited the majors by barring independent US distributors that have an expertise in distributing and supporting smaller budget, art house films from operating in Canada. Canadian producers of films are not benefited if distribution is made less competitive. Although the rhetoric supporting proprietary rights measures emphasises the indirect cross-subsidy link in part as a means of reducing the influence of heavily promoted mega budget films, its implementation encourages the former by keeping foreign independents out. Canadian supporters of these policies identify the Hollywood majors as the villains and policy makers constantly refer to the formation of an alliance to combat what it sees as US film hegemony. The Polygram case reveals that when the dust settled in Canada, the internationally owned but American-based majors were in a protected position vis-a-vis European-based competition. The lesson from the proprietary rights initiatives is that the policies will either not be implemented if no exemption is granted to the majors or will protect them if one is granted.

Grandfathering creates a number of contradictions but the fundamental problem is with a process of policy determination that discourages informative debate about initiatives such as the proprietary rights laws and regulations. In the case of the proprietary rights policies, the process began with rhetorical calls in reports and political speeches for extensive takings using state power. These became distant starting points in a process of negotiation with the majors that ended up with either grandfathering the targets, granting them favourable treatment, or quietly suspending the regulations. The MPA has described itself as the little State department. Canadian policy makers have given that claim credibility by dealing directly with the association rather than through normal diplomatic channels. The MPA's achievements in these negotiations should elicit jealousy from the actual State Department. There is also an unusually close association between the Canadian industry and the federal and provincial governments. We suggest that channelling intercountry negotiations through normal diplomatic channels and establishing a more arm's length relationship between government and industry would improve the policy determination process.

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