



EUROPEAN COMMISSION

Brussels, 19.I.2005

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

Dear Sir,

1 PROCEDURE

By letter of 20 October 2004, registered on 27 October 2004, the UK authorities notified the above mentioned initiatives. Prior to notification a preparatory meeting was held on 6 October 2004. The initiatives contain several measures, two of which have been notified to the Commission, the “Specialised P&A Fund” (NN 83/04), which already was put into effect immediately after the notification and the measure in question, the “Digital Screen Network” (N 477/04).

2 DESCRIPTION OF THE MEASURE

Background of the initiative

The objective of the initiatives is to provide access throughout the UK to the “full range of British and international cinema”. The economics of film distribution and exhibition as they currently operate in the UK mean that films which lie outside the accepted mainstream, particularly those made in a foreign language, receive very limited exposure. Approximately 85% of UK cinema box office receipts are taken by the US Majors (US based film distributors) supplying mainly mainstream product.

The Right Hon Jack STRAW MP
Secretary of State for Foreign and Commonwealth Affairs
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Over a hundred “specialised films” are given theatrical release in the UK each year. These films, however, are not widely shown. The number of film prints available is often limited. By way of comparison, a mainstream film is likely to be released in 300-500 sites in its first week, whilst a specialised film is lucky to be released in 50 sites¹. This is due to:

- the lack of commercial viability and high risk currently associated with the wider release of specialised films due to print duplication costs. The cost of producing 35mm (celluloid) prints/copies of a film (at approximately £1,000-£2,000 each) is prohibitive when a distributor is planning to release a specialised film – as the distributor cannot be certain that the film will attract sufficient audience numbers for it to recover these costs. Instead a small number of prints are produced which means that those cinemas interested in showing the film have to take turns in showing the same film print rather than showing the film at the same time from the same release date;
- the current reticence of a number of commercial cinema operators to risk dedicating screens and time to the exhibition of such films (which they feel will attract a smaller audience resulting in lower box office takings); and
- the additional cost of digital projection installation (which would make such films more immediately accessible) and uncertainty over appropriate business models.

In order to address this “market failure”, the UK Film Council set up its distribution and exhibition initiatives. The UK Film Council wishes to broaden the choice of films for audiences in the UK through increasing the availability of “specialised films” in cinemas. Specialised films are those that are not obviously Hollywood produced or “Hollywood-type” films. According to the UK, ““Specialised” films can often be characterised by an innovative cinematic style and by an engagement with challenging subject matter. As such, specialised films will challenge and educate audiences of all ages and backgrounds. Specialised films, therefore, are likely to be less obviously commercial and more difficult to market since they are economically more risky. Their theatrical release is usually characterised by the limited use of prints and a relatively low level of investment in advertising and publicity. Consequently, the opportunity to reach a wider audience is restricted”.

Examples may include, but are not necessarily limited to:

- Foreign language films;
- Indigenous British films which are not aimed at the mainstream;
- Films which directly address cultural, social and political issues;
- Re-issues of classic and/or restored archive films.

Films may be either factual (e.g. documentaries) or fiction. They may be of any national origin.

The judgement as to whether a certain film can be categorised as ‘specialised’ will be exercised by the UK Film Council as the “UK government’s strategic cultural agency for film.”

¹ In 2003 in the UK specialised films accounted for 4.3% of the total box office. 147 foreign language films were released, accounting for 35% of the total number of films, but they accounted for only 2.5% of the total UK gross box office.

2.1 Detailed description of the measure

A network of cinemas across the UK providing dedicated screen time for the exhibition of “specialised films” through the use of digital facilities (the “Digital Screen Network”) is planned to be set up.

The Digital Screen Network will provide cinemas in the UK with “high end” digital projection equipment which can receive and then play out films onto the cinema screen through high definition digital cinema files².

The UK Film Council will provide funding to equip between 180 and 220³ screens with digital projection facilities (the “Facilities”). The Facilities will cover:

- Purchase of projector and server
- Actual installation of projector and server
- Training of staff for use of equipment
- On-going maintenance.

In return, the cinema owners will be required to:

- Show a specified amount of specialised film,- (the “Programming”). If a cinema fails to deliver the Programming the equipment supplied will be withdrawn. The UK Film Council does not intend to programme the films on behalf of the cinemas. The UK Film Council will include on its website, a list of forthcoming releases that it deems to be specialised and therefore eligible for fulfilling contractual programming commitments;
- Set aside a very limited amount of screen time the programming of which may be co-ordinated by the UK Film Council⁴;
- Cinemas are required to develop a marketing and communication strategy to ensure that local audiences are aware of the wider range of films on offer; and to allocate trailer time and poster space within the cinema for advertising these films.

The UK Film Council invited cinema owners to apply for the subsidised Facilities through an open application process (conducted according to National Lottery regulations) open to all cinema owners for full time cinemas in the UK. The deadline

² The advantage of encouraging digital projection of film in cinemas is the lower cost, and thus lower risk, to the distributor in supplying the film on digital format compared to the cost of duplicating and delivering 35mm rolls of films across the country. The technology has now advanced to a stage where the quality of 35mm and digital projection (particularly at 2k) are comparable.

³ According to the UK, there are currently c 3,500 screens in operation across the UK.

⁴ The guidelines published on the Internet state: “In the first full year of operation of the Network this requirement will be for one evening programming slot per month. In the subsequent years, it may be useful for this to increase. Applicants will be asked to indicate on their application forms the maximum number of such ‘centrally-programmed’ slots they are prepared to accommodate. In addition, as part of the overall strategy to widen audience choice, these could be archive screenings, day and date premieres with the West End of new films, screenings of special educational value, etc. The UK Film Council also intends to organise touring festivals (for example selected highlights from the *bfi* London Film Festival) on a UK-wide co-ordinated basis, and cinemas will be asked if they are willing to allocate programming space for a minimum of seven ‘festival-style’ films in a specified week in any one year (ie seven evening shows in one week at one per day).”

for applications was the 10 December 2004. The UK Film Council will assess each application and will make decisions based on criteria which will include the following:

- Geographic location and population base (to ensure an even spread);
- Screen(s) and seating capacity offered;
- Programming time offered for specialised films compared with that provided at present. Cinemas are required to state the level of specialised film programming undertaken during 2003 and to propose how much additional specialised film programming it is prepared to show in order to become involved in the Network – cinemas will have to evaluate how much they can afford to commit;
- Local marketing/publicity activity;
- Any proposals to work with the local community on informal educational activities such as school film clubs, or screenings of works (such as short films) by local filmmakers;
- Commitment of the cinema manager to promote specialised films to the local audience.
- Proposed use of the equipment to promote cinema going among local audiences with sensory impairments (i.e. through screenings of subtitled or audio-described films).

Applications were made by each individual cinema and before applying each cinema therefore needed to weigh up the opportunity cost of participating in the Network. The UK Film Council will look at the uplift in specialised programming promised by candidate cinemas and determine whether this justifies inclusion of the cinema in the Digital Screen Network.

Any advantage to individual cinemas would depend on whether more people (increased audiences) actually attend specialised film screenings once the access to such films is improved by all of these measures.

The UK Film Council will select cinemas for the Digital Screen Network on a non-discriminatory basis choosing cinemas that ensure the widest possible geographic coverage across the UK or cinemas in areas of high population density but little or no current specialised cinema provision. Not all cinemas will be successful.

All cinemas in the UK (regardless of the nationality of their owners) are entitled to apply for funding. Cinemas owned by companies based in other Member States (and in non-EU countries) will be eligible to benefit from the scheme in the same way as cinemas owned by UK-based undertakings. There will be no discrimination according to the national origin of potential recipients.

The UK Film Council will work with a sole supplier selected through a competitive tender process, and according to the EC public procurement regulations, to provide and install the digital equipment in cinemas. This supplier might comprise of a consortium of companies that are individually involved in the manufacture, installation, maintenance or training elements of the facilities. A number of companies across the world are active in this field and the UK Film Council has received a large number of bids in response to the tender.

2.2 Legal basis

The legal basis is the National Lottery Act 2003, as amended. Furthermore on its webpage the UK Film Council published guidelines.

2.3 Budget and duration

The total budget from the UK Film Council for the Digital Screen Network will be up to [...]*. The amount of funding available from the UK Film Council per cinema screen will be set (the figure is currently estimated to be approximately [...] per cinema screen but may in actuality be lower since there will be a volume discount structure in place). The funding will enable the cinema to lease the digital projection equipment from the supplier but other costs associated with the network will be met by the cinema. These include:

- any adjustments to the cinema's projection booths that are necessary to accommodate the equipment – the costs of which will vary from cinema to cinema;
- a 'usage charge' payable by the cinema to the equipment supplier which will be approximately £14,000 (€20,300) over the 4 year term of the lease;
- the additional costs associated with programming of and reduced 'box office' for, specialised films (please note that such costs are difficult to quantify since until the equipment is installed the cinemas and the UK Film Council can only guess at how the specialised film programming will impact on each cinema's audience attendances – please also note paragraph 30 above); and
- any incremental taxes from the funding award or equipment lease contract with the supplier.

The cinema will be given the option to purchase the equipment at a pre-set price (reflecting its anticipated market value) at the end of the lease period or the equipment will be returned. The amount of funding is estimated to be between 40 and 75% of the eligible cost to the cinema of being part of the scheme. No fee is payable by the cinema to the UK Film Council.

The budget is a one-off initiative. Aid shall be granted before 31 March 2006. In the event that a cinema is in breach of the conditions of award and the equipment is recovered and reallocated to another cinema, aid may be granted until 31 March 2009.

3 ASSESSMENT OF THE MEASURE

3.1 Existence of aid

According to Article 87(1) of the EC Treaty, save as otherwise provided in the Treaty, any aid granted by a Member State or through State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall be incompatible with the common market, in so far it affects trade between Member States.

* Business secret

It follows that in order to ascertain whether the measure constitutes aid within the meaning of Article 87(1) of the EC Treaty, the Commission has to assess whether the financial support:

- is granted by the State or through state resources;
- favours certain undertakings or the production of certain goods;
- distorts or threatens to distort competition and,
- affects trade between Member States.

3.1.1 Transfer of state resources

There are state resources involved. The funding of the scheme is based on “the National Lottery Distribution Fund”, maintained under the control and management of the Secretary of State. The granting authority, the UK Film Council is accordingly awarding state resources.

3.1.2 Favours certain undertakings or the production of certain goods

The initiative concerns three different levels of economic actors (cinema owners, suppliers of the technology to the Digital Screen Network and the producers and distributors of the specialised films). State aid within the meaning of Article 87(1) EC could in theory be involved on all three levels.

3.1.2.1 At the level of the supplier

The supplier of the technology will be selected through a competitive tender process in accordance with EC public procurement regulations. Accordingly at this level, no State aid is involved.

3.1.2.2 At the level of the producers and distributors of films

The judgment as to whether a certain film can be categorised as “specialised” will be exercised by the UK Film Council. In the following the demand for such a film could increase and accordingly the producer and distributor might have a higher income. Therefore, theoretically one could argue that there is an aid element at the level of the film producer and distributor. However, first of all any film (worldwide) could qualify for being categorised. Furthermore, a part from a set small number of ‘time slots’ which the UK Film Council may choose to programme centrally, it is the choice of the cinema as to which of the films categorised as “specialised” it will release. Finally, eventhough the demand for a certain film might increase; the cinemas are still paying a “market price” to the distributor for releasing it to the public. Therefore neither a possible advantage nor the aid beneficiary could be clearly determined. The measure is too indirect to be considered State aid at the level of the producers and distributors of films.

3.1.2.3 *At the level of the cinema owners*

At the level of the cinema owners, they will be required to show a specified amount of specialised film on the digital equipment and audience attendance for such films is likely to be lower than for more mainstream films (which would “normally” be shown). One could argue that the provision of the equipment is a compensation for such shortfall in revenue. However, since it is hardly possible to predict any such shortfall in revenue, cinemas would be reluctant to sign up for the Digital Screen Network unless a certain contribution to the cost were available from public funds.

Accordingly the initiative favours one particular branch of activity, the cinemas, and can be considered as favouring certain kinds of undertakings within the meaning of Article 87(1) EC.

3.1.3 Distortion of competition and effect on trade between Member States

The supply of equipment to cinemas is not expected to have any appreciable effect on trade between Member States, since cinema customers are typically local and do not travel between Member States in order to see a certain film. However, the Commission notes that all cinemas in the UK will be entitled for funding, amongst them some belonging to international groups, such as UGC and UCI. It could be argued that the aid may allow such groups to exploit this extra funding to build up or expand activities in other Member States and accordingly to distort competition and affect trade between Member States. This potential indirect effect on trade appears a rather theoretical possibility; given the size of the aid. Furthermore, any effect on trade between Member States will be to stimulate trade in films, not to reduce it.

3.2 Compatibility

To the extent that the measure could be deemed to constitute State aid within the meaning of Article 87(1) EC, the Commission considers that the measure is to be found compatible with the common market under the cultural derogation in Article 87(3)(d), for aid to promote culture. The Cinema Communications⁵, do not apply, because they only refer to the production of films. In the case at hand however no support for film production is involved. Therefore the measure is directly assessed on the basis of Article 87(3)(d) EC. According to this provision aid to promote culture and heritage conservation may be considered to be compatible with the common market where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest.

⁵ Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on certain legal aspects relating to cinematographic and other audiovisual works (COM(2001)534 final of 26.09.2001, OJ C 43 of 16.2.2002).
Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on the follow-up of the Commission communication on certain legal aspects relating to cinematographic and other audiovisual works of 26.09.2001 (COM(2004)171 final of 16.3.2004, http://europa.eu.int/eur-lex/en/com/pdf/2004/com2004_0171en01.pdf).

The aid must be directed to a cultural product. In the present case, in order to benefit from the initiative, a cinema needs to commit to show films which are selected on the basis of genuine artistic merit. The UK Film Council wishes to broaden the choice of films for audiences in the UK through increasing the availability of “specialised films” in cinemas. These films, including foreign language films, are clearly cultural products.

There will be no stipulation that the money be spent on UK-technology or on UK-owned cinemas or for UK-produced films.

The amount of funding is estimated to be between 40 and 75% of the eligible cost to the cinema of being part of the scheme. However, as described before, in return the cinema has to dedicate time to show a specified amount of “specialised films”.

The aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest. The potential indirect effect on trade appears a rather theoretical possibility; given the size of the aid. Furthermore, any effect on trade between Member States will be to stimulate trade in films, not to reduce it. Accordingly the exchange and distribution of cultural goods is being promoted.

3.3 Conclusion

The Commission has therefore come to the conclusion that the UK Film Council Digital Screen Network, which might constitute an aid measure within the meaning of Article 87(1) EC, is compatible with the common market pursuant to Article 87(3)(d) of the EC Treaty.

4 DECISION

The Commission has accordingly decided:

- to consider the aid to the “Digital Screen Network” to be compatible with Article 87(3)d of the EC Treaty for a period of approximately four years, until 31. March 2009.

The Commission reminds the UK authorities to submit an annual report on the implementation of the scheme.

The Commission further reminds the UK authorities that all plans to modify this aid scheme have to be notified to the Commission.

Apart from the figure of [...] ⁶ indicated in the notification, if this letter contains any further confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://europa.eu.int/comm/secretariat_general/sgb/state_aids/. Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
Directorate State Aid II
Rue de la Loi/Wetstraat, 200
B-1049 Brussels
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Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission

⁶ The UK believes that the disclosure of the full amount of funding available could prejudice the ability of the UK Film Council to obtain « value for money » from suppliers under the public procurement process.