Competition Act 1998

Decision of the Director General of Fair Trading pursuant to section 14(2)
No. CA/98/10/2002

Notification by the Film Distributors' Association Ltd (formerly the Society of Film Distributors) of its standard conditions for licensing the commercial exhibition of films

1 February 2002
**(Case CP/1321-00/S)**

## SUMMARY

On 15 August 2000, the Film Distributors' Association Ltd (FDA), formerly the Society of Film Distributors[1], notified its Standard Conditions for licensing the commercial exhibition of a film or films, dated 14 August 1997, to the Director General of Fair Trading for a decision under Section 14 of the Competition Act 1998. The Office identified a number of clauses in the notified Standard Conditions that infringed the Chapter I prohibition of the Competition Act 1998. The FDA deleted or suitably amended the offending clauses in the Standard Conditions. The amended Standard Conditions were approved by the FDA Council on 6 December 2001 and submitted to the Office on 12 December 2001. They will enter into effect on 1 February 2002.

The Director has concluded that the amended Standard Conditions do not impose restrictions on exhibitors that would have an appreciable effect on competition in the exhibition of films.

The Standard Conditions, as amended, therefore do not infringe the Chapter I prohibition of the Competition Act 1998.

[1] The Society of Film Distributors changed its name on 21 December 2001. For the purposes of this Decision the new name, the Film Distributors' Association Ltd is used.

# I THE FACTS

## A Background

1 On 15 August 2000, the Film Distributors' Association Ltd (the "FDA"), formerly the Society of Film Distributors, notified its Standard Conditions for licensing the commercial exhibition of a film or films, dated 14 August 1997, (the "Standard Conditions") to the Director General of Fair Trading (the "Director") for a decision under Section 14 of the Competition Act 1998 (the "Act"). The FDA requested a decision that the Standard Conditions do not infringe the prohibition imposed by Section 2 of the Act (the "Chapter I prohibition") or that, in the alternative, the Office grant the Standard Conditions an individual exemption under Section 4 of the Act.

2 A summary of the notification was placed on the public register of the Office of Fair Trading (the Office) and published in the Office's Weekly Gazette[2].

3 The Office identified a number of clauses that infringed the Chapter I prohibition. The FDA were informed that they would need to delete or suitably amend those clauses that caused the infringement in order for the agreement to be cleared.

4 The FDA amended the notified Standard Conditions accordingly. These were approved by the FDA Council on 6 December 2001 and submitted to the Office on 12 December 2001. They will enter into effect on 1 February 2002.

5 This decision is issued under the Act in accordance with Rule 15 of The Competition Act 1998 (Director's Rules) Order 2000[3]. It states the facts on which the Director relies and his reasons for the decision.

## B The parties

6 The parties to the Standard Conditions are the members of the FDA: Buena Vista International (UK) Ltd; Columbia Tristar Films (UK); 20th Century Fox Film Company Ltd; United International Pictures (UK) Ltd; Warner Bros Distributors Ltd; Entertainment Film Distributors Ltd; Film Four Distributors Ltd; Feature Film Company; Gala Film Distributors Ltd; Icon Film Distributors Ltd; Momentum Pictures; and Pathe Distribution Ltd.

[2] Issue 30/2000, 16-22 September 2000.
[3] Rule 15(1), Director's Rules

7 These distribution companies fall into two categories. The first five members listed at paragraph 6 are vertically integrated with Hollywood studios and distribute primarily the films of their parent companies or those produced as a result of co-production and co-financing arrangements with other studios. They also distribute films of third party film production companies. The remaining seven members are either vertically integrated with smaller production companies or distribute films for production companies not affiliated to a distributor.

8 The main functions of a distributor are determining release dates, the promotion and advertising of a film, securing bookings from exhibitors and agreeing with exhibitors the terms and conditions on which films are supplied.

## C The agreement notified

9 The FDA has since the 1960s published Standard Conditions. The Standard Conditions were not registered under the Restrictive Trade Practices Act 1976.

10 The version of the agreement notified to the Office on 15 August 2000 was adopted by the FDA Council on 14 August 1997. The Office identified the following clauses which had the effect of restricting or distorting competition:

a) Clauses limiting the ability of exhibitors to determine their admission prices and promotional activities (namely clauses 2(b) and 2(d)), and
b) Clauses limiting the ability of exhibitors to determine the use made of their screens, for example, showing different films on the same screen over a given period and moving the film from one screen to another (namely clauses 5(a) and 5(b)).

11 At the Office's request, the FDA deleted or suitably amended the clauses identified above in the Standard Conditions. The FDA Council approved these changes on 6 December 2001 and submitted the amended Standard Conditions to the Office on 12 December 2001. They will enter into effect on 1 February 2002.

12 The amended Standard Conditions no longer restrict the ability of exhibitors to determine their admission prices and promotional activities or the use made of their screens. The amended Standard Conditions are now limited to administrative and accounting procedures, the protection of distributor's rights, the circumstances in which agreements might cease or be terminated and the consequences for the parties, the obligations in the event of third party legal proceedings and dispute resolution.

13 Use of the Standard Conditions is not mandatory. Clause 1(a) states they shall apply except where 'a particular agreement otherwise specifies'. In practice, however, almost all films are licensed in accordance with the Standard Conditions without variation.

# II LEGAL AND ECONOMIC ASSESSMENT

## A Introduction

14 Section 2(1) of the Act prohibits agreements between undertakings, decisions by association of undertakings or concerted practices which may affect trade within the UK and have as their object or effect the prevention, restriction or distortion of competition within the UK. An agreement which falls within the scope of the Chapter I prohibition may be exempted if it satisfies the criteria set out in Section 9 of the Act.

15 The notified Standard Conditions came into effect on 14 August 1997. The Act came into force on 1 March 2000. Therefore the Act can only be applied to the Standard Conditions from 1 March 2000.

## B The relevant markets

THE RELEVANT PRODUCT MARKETS

16 The relevant product market comprises all those products, which are regarded as reasonably interchangeable by reason of the product's characteristics, price or intended purpose.[4] The Standard Conditions affect the terms on which distributors license films to exhibitors. They therefore affect the distribution of films to exhibitors and the exhibition of those films.

17 The Office concluded that the distribution and exhibition of films are separate markets as they operate at different levels of the supply chain. The 1994 Monopolies and Mergers Commission (MMC) report into the supply of films also

[4] Case 27/76 *United Brands v Commission* [1978] ECR 207 [1978] 1 CMLR 429. In the application of the Chapter I prohibition the Director is required to ensure that there is no inconsistency with either the principles laid down by the EC Treaty and the European Court or any relevant decision of the European Court. The Director must also have regard to any relevant decision or statement of the European Commission.

considered them as separate markets.[5] The scope of each of these markets was concluded as follows:

*Exhibition*

18 Market research provided by exhibitors showed that watching a film at home, either on video, free to air or pay television, and other leisure activities are not considered by cinema goers to be substitutes for going to the cinema. Despite technological developments, seeing a film in a cinema remains a different experience. Similarly films are released for cinema distribution before they are shown on video or television. Exhibitors of films are not therefore competitively constrained by other means of watching films or leisure activities and are therefore in a separate market.

19 The Office also considered whether there are separate markets for the exhibition of 'mainstream' films and 'art' films. The FDA and exhibitors generally argued that, even if it were possible to agree which category films would fall into, the exhibition of these different types of films are not separate markets. In particular, they argued that cinema-goers do not fall into discrete groups watching only one type of film, and that this suggests a degree of substitution on their part between different types of film. Whilst noting these arguments, the Office has not found it necessary for the purposes of this inquiry to form a definitive view as in any event there is an appreciable adverse effect on competition.

*Distribution*

20 For exhibitors, a distributor will be the only source of prints for films as film production companies grant distributors exclusive rights in licensing the commercial exhibition of a film.

21 Distributors' behaviour towards exhibitors is not competitively constrained by consumers switching from watching film at the cinema to other leisure activities (see above). Consumers may therefore be adversely affected by the conditions imposed by distributors on exhibitors, such as those relating to admission prices.

22 The Office also considered whether the distribution of 'mainstream' and 'art' film are separate markets. The FDA argued against separate markets as distributors of different types of film are often competing for the same screens and ultimately the same viewers. Whether there are separate markets does not,

[5] Monopolies and Mergers Commission, "Films: A report on the Supply of Films for Exhibition in

however, affect the assessment of the notified agreement. Whatever the market definition, members of the FDA distribute a high proportion of films in the UK. For all films their share is 67%. For a narrower market definition of the distribution of mainstream films their share would be even higher.

GEOGRAPHIC MARKET

23 The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas[6].

*Exhibition*

24 The relevant geographic markets for exhibition are local because a key factor determining a cinema-goers choice of cinema is location. The admission charges of exhibitors, in particular those set by the major chains, are influenced by the strength of local competition.

*Distribution*

25 The relevant geographic market for the distribution of films is the UK.

26 The exclusive rights to licence the commercial exhibition of films are assigned by production companies nationally. For UK exhibitors, the only source of prints will therefore be UK distributors. UK distributors are not therefore competing in an international market.

27 Distributors and exhibitors generally agreed that the relevant geographic market is national rather than local. The same distributors are competing across the UK for screens and audiences with the same films. Although the 'nut' and 'break figures'[7] are negotiated with exhibitors individually for each screen, competition

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Cinemas in the UK", 1994, CM2673.

[6] Case 27/76 *United Brands v Commission* [1978] ECR 207 [1978] 1 CMLR 429.

[7] There are two main methods of calculating rental payments – the *nut method* and the *sliding scale method*, both of which involve some element of revenue sharing. With the *nut method*, a figure is negotiated which reflects the cinema's costs for a given screen (including a contribution to overheads and a profit margin). The rental payment for that screen is then the greater of (i) 25% of the weekly box office receipts and (ii) 75% to 90% of what is left of the box office receipts after deducting the nut.

between distributors for booking takes the form of decisions on release dates, promotional activities and the percentage figures in the rental formula. All these are determined at a national level. The cinema chains, which account for 80% of box office receipts, will also be negotiating at a national level.

## C The Chapter I prohibition

28 Section 2 of the Act prohibits any agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the United Kingdom and have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom.

EXCLUSIONS AND EXEMPTIONS

29 The Standard Conditions do not benefit from any exclusions or exemptions from the Chapter I prohibition.

AGREEMENTS BETWEEN UNDERTAKINGS, DECISIONS BY ASSOCIATIONS OF UNDERTAKINGS AND CONCERTED PRACTICES

30 The FDA is an association of undertakings for the purposes of Section 2 of the Act.

31 The Standard Conditions are a decision of this association. A 'decision of an association' includes resolutions of committees and recommendations[8]. The Standard Conditions notified to the Office on 15 August 2000 were formally adopted by FDA Council in August 1997. A joint covering letter from the FDA and the Cinema Exhibitors' Association to members of both associations dated 13 November 1997 said that the "revised Standard Conditions provide a framework for the licensing of FDA members' films to exhibitors". By virtue of this and clause 1(a), the Standard Conditions amount to a recommendation by the FDA to its members.

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With the *sliding scale method*, the percentage of weekly box office takings for each screen paid to the distributor rises as the box office takings rise over the pre-set break figures for the screen. The exhibitor may agree a guaranteed minimum payment.

The distributor and exhibitor agree the precise formula at the start of each license period.

[8] See for example, Case 45/85 *Verband der Sachversicherer v Commission* [1987] ECR 405, [1988]

EFFECT ON TRADE WITHIN THE UK

32 The Standard Conditions apply to the licensing of films by distributors to exhibitors throughout the UK. They will therefore affect trade within the UK within the meaning of Section 2 of the Act.

THE OBJECT OR EFFECT OF PREVENTING, RESTRICTING OR DISTORTING COMPETITION IN THE UK

33 The Office has considered whether any of the provisions of the Standard Conditions as originally notified, either alone or taken together, have as their object or effect the prevention, restriction or distortion of competition within the UK or any part thereof.

34 FDA members are not required to use the Standard Conditions. Under clause 1(a) the Standard Conditions apply except where 'a particular agreement otherwise specifies'. In practice, however, almost all films are licensed in accordance with the Standard Conditions without variation.

35 A requirement to adhere to standard conditions in the licensing of films by members of the FDA may restrict competition between distributors to the extent that they will not freely determine the commercial relationship between themselves and exhibitors.

36 That all exhibitors are subject to the same conditions in the commercial licensing of films may also restrict competition between exhibitors in limiting the scope for exhibitors to gain competitive advantage by negotiating improved terms of supply.

37 The Office identified the following clauses in the Standard Conditions that had the potential to restrict or distort competition between distributors and between exhibitors:

a) Clauses limiting the ability of exhibitors to determine their admission prices and promotional activities (namely clauses 2(b) and 2(d)); and
b) Clauses limiting the ability of exhibitors to determine the use made of their screens, for example, showing different films on the same screen over a given period or moving a film from one screen to another (namely clauses 5(a) and 5(b)).

38 The Office considers, however, that the remaining clauses of the Standard Conditions do not restrict or distort competition as they relate to administrative and accounting procedures, and would not restrict the commercial freedom of exhibitors.

*Conclusions*

39 For the reasons set out above the Office concluded that clauses 2(b) and (d), and 5(a) and (b) of the Standard Conditions had the effect of preventing, restricting or distorting competition.

APPRECIABILITY

40 The FDA estimates that the films distributed by its members account for about 90% of cinema box office receipts in the UK and about 67% of all films distributed in the UK. In 2000 cinema box office receipts in the UK amounted to £621 million.

41 Given the high market shares in film distribution, the effect of the Standard Conditions set out in paragraph 37 above clearly has an appreciable effect on competition by limiting the commercial freedom of exhibitors with respect to pricing, promotional activities and use of screens. Furthermore, given the vertical integration of film distribution and production with the major studios, only the business of smaller independent studios is available to new entrants for distribution and this is insufficient to act as a significant constraint. The FDA identified a number of new entrants at the independent distribution level, but acknowledges that distribution of films is an expensive and risky business. Barriers to entry are therefore high and the limited extent to which new entry is possible will not eliminate the anti-competitive effect of the Standard Conditions as they were before the amendments described below.

42 The Office concluded that the Standard Conditions identified would have an appreciable adverse effect on competition in both the film distribution and exhibition markets.

AMENDMENTS TO THE AGREEMENT

43 The Office informed the FDA of the clauses that gave rise to competition concerns. The FDA amended the notified Standard Conditions by deleting or suitably amending those conditions identified. These are listed in Appendix A.

These amendments removed the restriction on exhibitors to set their own admission prices, their promotional activities and use of their screens.

44 The Office therefore concludes that the Standard Conditions as amended no longer have the effect of restricting, preventing or distorting competition. A summary of the clauses in the amended Standard Conditions is attached at Appendix B.

45 The Office concludes that the amended Standard Conditions do not impose restrictions on exhibitors that would have an appreciable effect on competition in the exhibition or distribution of films in the UK.

CONCLUSIONS

46 On the basis of the facts and for the reasons set out above the Director concludes that the Standard Conditions as amended do not have the object or effect of preventing, restricting or distorting competition in the United Kingdom or any part thereof. Therefore they do not infringe the Chapter I prohibition.

## III THE DECISION

47 On the basis of the FDA having amended the Standard Conditions in the manner described and on the basis of the facts and for the reasons set out above, the Director has decided pursuant to Section 14(2) of the Act that the notified agreement, as amended, does not infringe the prohibition imposed by Section 2 of the Act.

## Appendix A: Amendments to the Standard Conditions

| Condition | Original Condition (1997 edition) | Amendment proposed / made | Condition to read from 1 February 2002 |
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| 2(b) | No person shall be admitted to the cinema without a ticket or sit in a seat with a higher price than he has paid without a proper duly paid transfer ticket. No person shall be admitted free of charge to a performance at the Cinema except within the normal issue of complimentary tickets at the Cinema. Subject always to giving not less than 48 hours notice, the Distributor may require that in the first two weeks of exhibition of any Film the Exhibitor shall not issue more complimentary tickets than agreed in advance with the Distributor. | Last sentence deleted. | No person shall be admitted to the cinema without a ticket or sit in a seat with a higher price than he has paid without a proper duly paid transfer ticket. No person shall be admitted free of charge to a performance at the Cinema except within the normal issue of complimentary tickets at the Cinema. |
| 2(d) | The Exhibitor shall clearly and prominently display at the pay box the current admission prices including reserved seat prices (if any). The Exhibitor shall charge such admission prices at the Cinema during the Licence Period as shall be agreed by the Distributor. In the absence of agreement the Exhibitor shall charge admission prices not less than those in force at the Cinema | Last two sentences deleted | The Exhibitor shall clearly and prominently display at the pay box the current admission prices including reserved seat prices (if any). |

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| | when last the Exhibitor signed an agreement with the Distributor for a similar type of film. | | |
| 5(a) | The Exhibitor shall exhibit the film such number of times during each of the morning, afternoon, evening and night as shall be agreed with the Distributor (and in the absence of such agreement, such number of times as has most recently been agreed between the Distributor and Exhibitor for a film of similar type and length to the Film). The Exhibitor shall not exhibit the Film in a programme which includes more than one feature film and a supporting programme without the consent of the Distributor. The agreement of the Distributor to a variation in such arrangements may be sought after the signing of the Agreement. The Distributor's agreement in respect of varying the number of performances at different times of the day shall not unreasonably be withheld. | Deleted entirely. | |
| 5(b) | The Exhibitor shall exhibit the Film in the Screen specified in the Agreement. The Exhibitor shall not exhibit the Film at any | Deleted entirely. | |

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| | other screen in the Cinema without the prior agreement of the Distributor. If the Distributor agrees that the Film may be moved to a screen other than the Screen specified in the Agreement, the Exhibitor must ensure that each daily return indicates the correct screen number for each performance. | | |

## Appendix B: Summary of Clauses in Amended Standard Conditions

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| **1. Introductory** | |
| (a) | Apply to film licensing agreements between FDA members and exhibitors except where and to the extent otherwise specified |
| (b) & (c) | Definitions |
| **2. Tickets for admission to the viewing of a film** | |
| (a) & (c) | Exhibitors must have appropriate administrative procedures in place for issuing and recording ticket sales |
| (b) | No person shall be admitted without a ticket or use a seat with a higher price than paid for. Free admittance only allowed with complementary tickets. |
| (d) | Exhibitors shall clearly and prominently display at the pay box the current admission price. |
| **3. Returns** | |
| (a), (b) & (c) | Exhibitors must prepare, sign and send to the distributor daily returns on ticket sales, reservations, numbers of complimentary tickets issued etc |
| **4. Distributor's rights of inspection** | |
| (a) | A distributor may take reasonable steps to satisfy itself that all matters relating to admissions, returns, payments and the exhibition of the film have been carried out as agreed. |
| (b) & (c) | Concerns the obligation on exhibitors to notify the FDA and the Distributor of any irregularities and the investigation of irregularities by the FDA |
| **5. Scope of licensed rights** | |
| (a) | The film must be exhibited in its entirety and without transmissions or breaks except where agreed with the Distributor. |
| (b) | The exhibitor shall not permit any musical or sound accompaniment other than that which is part of the film |
| (c) | All copying of the film is prohibited and the exhibitor shall take reasonable security precautions |
| **6. Advertising** | |
| (a) & (b) | An exhibitor shall advertise the exhibition of a film as agreed with the Distributor and will bear the expenses of in cinema advertising unless otherwise agreed |
| **7. Equipment** | |
| (a) & (b) | The exhibitor shall ensure that all equipment is in good working order. The distributor has the right to carry out inspections and to require the exhibitor to carry out necessary adjustments, repairs or renewals. |
| **8. Music license** | |
| | It is the exhibitor's obligation to acquire the necessary Performing Rights Society Ltd licence |
| **9. Materials supplied** | |
| (a) & (b) | The distributor will use reasonable endeavours to supply prints and other materials in satisfactory condition and best endeavours to ensure promotion materials conform with the law. The distributor will assist the exhibitor in the event of a complaint that proves to |

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| | be actionable. |
| (c) | The exhibitor shall return materials as agreed with the distributor and will bear the transport costs. |
| **10. Payment terms** | |
| (a) & (b) | Concerns payment dates and termination of contracts in the event of non-payment. |
| **11. Restraint on performance** | |
| (a), (b) & (c) | Concerns the obligations on the exhibitor and the responsibilities of the distributor in the event of legal proceedings concerning the exhibition of a film. |
| **12. Performance** | |
| (a), (b) & (c) | Concerns the circumstances when the agreement will cease to have effect and the implications for the parties |
| **13 and 14. Default by Distributor and Exhibitor** | |
| 13 (a) & (b) | Establish the basis on which a distributor will make payments to an exhibitor if it fails to supply the film |
| 14 | Establishes the basis on which an exhibitor will make payments to the distributor if it fails to exhibit the film |
| **14 and 15. Termination and consequences of termination** | |
| 14 | Concerns the circumstances when the distributor may terminate the agreement |
| 15 | Concerns the rights of the distributor and the liabilities of the exhibitor in the event of termination |
| **17. Assignment** | |
| (a) & (b) | Establish the circumstances when the distributor or exhibitor can assign the Agreement to another distributor or exhibitor |
| **18. Television** | |
| (b) | Establishes the circumstances when the warranty given to the exhibitor under 18(a) does not apply |
| (c) | Establishes the circumstances when an exhibitor may terminate the agreement in the event that a film is shown on free television before the licence period |
| **19. Arbitration** | |
| (a), (b) & (c) | Establish the type of disputes that will be resolved through arbitration and the arrangements for the appointment of an arbitrator or arbitrators |
| **20. Miscellaneous** | |
| (a), (d) & (e) | Concerns the relationship between an agreement and English Law, The Films (Exclusivity Agreements) Order 1989, the terms of a cinema's licence and any national or local legislation. |
| (b) | The granting of time or indulgences shall not prejudice the distributor's rights |
| (c) | The agreement shall be deemed to be a separate contract in respect of each licensed programme |
| **21. Ireland** | |
| | These Standard Conditions shall apply to agreements for the licensing of the exhibition of a film in a cinema in Northern Ireland or the Republic of Ireland |