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19 December 2017

Darrell Channing  
Director, Adjudication Branch  
Australian Competition and Consumer Commission  
Level 20  
175 Pitt Street  
Sydney NSW 2000

**By Email**

Dear Mr Channing

**Twentieth Century Fox submission in response to the Draft Determination (Independent Cinemas Australia Inc Authorisation Application)**

As you are aware, we act for Twentieth Century Fox Film Distributors (**Fox**) in its response to Independent Cinemas Australia's authorisation application. Fox makes this further submission in response to the Draft Determination dated 28 September 2017. Fox also responds in this submission to:

- the further submissions made by the Independent Cinemas Australia (**ICA**), dated 30 August 2017, 31 August 2017, and 1 December 2017; and
- points raised at the 8 November 2017 Pre-Decision Conference between interested parties.

Fox disagrees with the Draft Determination and sets out in this submission a number of reasons why the ACCC should reconsider the conclusions at which it has arrived in the Draft Determination. The issues that Fox raises in this submission supplement those already set out in its initial submission dated 31 July 2017 (**July submission**) which responded to the Application for authorisation lodged by ICA on 13 June 2017 (**Application**).

At the outset, Fox wishes to state that it believes that it offers reasonable commercial terms to all exhibitors and is always willing to discuss terms with exhibitors. Fox also supports the Code of Conduct for Film Distribution and Exhibition (**Code**) as it has proved to be a helpful framework that should be retained and improved if necessary. Since it was first implemented in 1998, there have been 220 disputes under the Code. Only ten of these have gone to conciliation – in ten years (4.5%), with 78% (171) have been resolved prior to conciliation by the Secretariat and/or the relevant parties.

However, Fox is open to improving the Code in conjunction with exhibitors and believes that going forward ICA could play a greater role in educating ICA members about the role of the Code and the option to use the Code's dispute resolution mechanisms. There may also be a need to address the concerns raised by ICA about the fear of retaliation. While Fox has not been aware of such situations, if they do exist, that is not in the spirit of the Code, and mechanisms are in place to address such behaviour.

In summary, Fox believes that any benefits do not outweigh the detriments that will result from authorisation:

- The benefits mentioned in the Draft Determination, namely transaction cost savings and improved input into negotiations, are unlikely to be realised for the following reasons:

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- Standard and legitimate confidentiality protections will significantly limit the likelihood of achieving any of the claimed public benefits.
- The ability to collectively negotiate standard terms will have minimal if any efficiency gains, as discussions with exhibitors are generally in relation to the number of screens or locations, marketing support and screening times, which are very specific to each cinema and better handled – as they have been successfully for many years – on an individual basis.
- In fact, it risks making the process of negotiating terms more lengthy and onerous as ICA will now involve itself in negotiations between cinemas and distributors.
- The ACCC states that cost savings resulting from the proposed conduct may allow independent cinemas 'to reinvest into their cinemas, creating a better experience for consumers'. However, Fox does not believe there is a basis for assuming that any benefit will be passed on to consumers; nor does it accept that it is necessary for the viability of the independent cinema industry, which is strong based on traditional market measures.
- There is no market failure and exhibitors can and do protect their interests during negotiations. Independent cinema exhibitors compete effectively with other exhibitors on price and product offering. Exhibitors have bargaining power and the Australian exhibition industry is strong and growing. At the same time, pressures on distributors to extract value from costly productions is steadily increasing. There is a reliance by distributors on the performance of exhibitors in the success of their movies and there is finely balanced risk sharing. The ACCC should not intervene in a well-functioning market with no evidence of failure.
- The proposed conduct could be detrimental to the cinema industry by encouraging coordination between competitors and creating an environment that could lead to a boycott. Fox acknowledges the ACCC expresses in the Draft Determination its confidence that ICA and its members will abide by the scope of the authorisation and will not engage in secondary boycott activities. However, Fox remains concerned that the authorisation creates an incentive for ICA members to boycott distributors. Arguably, smaller titles are more likely to be boycotted which may influence diversity of product which is not in the public interest.

Fox understands that ICA may have provided purported examples of such conduct to the ACCC on a confidential basis. However, neither Fox, nor other distributors, will have the opportunity to respond to such assertions. The ACCC must therefore give limited weight to these examples and recognise that it may not have the full context of those matters.

## **1 Scope of Application now clarified**

The scope of the conduct for which ICA sought authorisation was initially uncertain. These concerns were raised in a number of submissions responding to the Application, including Fox's July submission. The scope of the Application was also the subject of much discussion during the Pre-Decision Conference and a subsequent request for information from the ACCC.

In its 1 December 2017 submission, ICA clarifies that in the Application it seeks authorisation to engage in the following broad classes of conduct:

- '[the] ICA and its members... shar[ing] information about the terms and conditions or proposed terms and conditions of film licensing arrangements'<sup>1</sup>; and
- '[collectively negotiating] any of the terms and conditions from time to time, if requested to do so by ICA's members'.<sup>2</sup>

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<sup>1</sup> Independent Cinemas Australia, *Supporting submission*, 1 December 2017, p.5

<sup>2</sup> Independent Cinemas Australia, *Supporting submission*, 1 December 2017, p.7

ICA's recent submission therefore confirms the initial contention by Fox (and others) that the Application constrains neither the classes of information that ICA and its members could exchange, nor the circumstances in which ICA can seek to collectively bargain.

This breadth of scope does not appear to have been contemplated by the ACCC when it made the Draft Determination, as it stated:

'the ACCC understands that ICA is not proposing to negotiate the standard terms and conditions for film supply or the initial season, sessions and film rental fee. ICA acknowledges that these arrangements are determined by distributors. However, ICA does wish to collectively negotiate with distributors on behalf of exhibitors, or a subset of exhibitors, on certain common issues such as where there are material changes in terms and conditions for a particular film.'<sup>3</sup>

The Application seeks authorisation well beyond 'material changes' to any aspect of Standard or Film Specific terms and Policy. The ACCC therefore must consider the alleged public benefits and likely detriments in this context. As is set out under the heading below, this extremely broad scope for information sharing and negotiation will introduce delay and cost inefficiency to film licencing and has the potential to cause detriment to the industry.

## **2 There will be no material transaction cost savings**

### **2.1 Alleged benefit**

The Draft Determination alleges that the Application will result in a public benefit of reduced transaction costs for cinemas and distributors. Fox submits that the Application will not produce such benefit.

### **2.2 Fox's terms and policy process**

ICA asserts that distributors regularly withhold film supply terms or supply terms until an unreasonably short time prior to the commencement of film.<sup>4</sup> Fox disputes that it does not supply its terms and conditions or supplies them in an untimely manner. Fox sets out below the film booking process and indicative timelines, adopting the nomenclature in the ICA submission regarding Standard Terms, Film-Specific Terms and Policy. All exhibitors have a copy of Fox's Standard Terms (as does FEDCAC). Fox supplies Film-Specific Terms to exhibitors depending on the basis upon which they exhibit films (eg first-run, second-run).

As an experienced distributor of its content, Fox makes its supply decisions pursuant to its own commercial strategy and objectives as to the best distribution approach to ensure the long term viability and success of the film. There are limited circumstances in which Fox departs from this process and timeline.

- **Application & Standard Terms phase:** Exhibitor requests supply from Fox.
  - Fox provides the exhibitor with a 'New Account Application Form';
  - Once Fox agrees to supply an exhibitor, the exhibitor signs 'New Account Application Form' which includes Fox's Standard Terms and Conditions (the **Standard Terms**).
- **Film-Specific Policy:** Fox notifies the exhibitor of a new or upcoming film available for booking, usually 6 to 8 weeks prior to a film's release.
  - Fox provides exhibitor with film-specific Policy eg, number of sessions, marketing support etc.

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<sup>3</sup> ACCC, *Draft Determination*, para 98 (p.14).

<sup>4</sup> Independent Cinemas Australia, *Supporting submission*, 1 December 2017, p.6

- The Exhibitor agrees to exhibit the film.
- **Film-Specific Pricing:** Fox notifies the exhibitor of the exact splits for the film hire terms. This generally occurs 2 weeks out from film release.

This process is consistent in most jurisdictions around the world and provides both parties with sufficient certainty and flexibility given that predicting the success of a film is not an exact science.

### 2.3 Standard confidentiality protections will remain in future

The public benefits that the ACCC and ICA assume, proceed from the premise that information-sharing may occur among exhibitors and thus assume a future where either:

- distributors do not enforce existing confidentiality obligations;
- confidentiality in any previously confidential information is extinguished by conduct; or
- exhibitors negotiate a position with distributors that removes standard commercial confidentiality protections from the agreements between distributors and exhibitors (without the ability to collectively boycott).

If confidentiality protections for distributors continue in their present form, there remains only a potential narrow class of relevant information that ICA and its members could legally share (ie, that not protected by confidentiality). No public benefit could arise from sharing between ICA members the narrow class of information that is not otherwise subject to confidentiality protection.

In its December submission ICA argues, at least in respect of title-specific policy, that confidentiality is extinguished by publication of session times.<sup>5</sup> However, such disclosure does not render public the policy agreed confidentially between exhibitors and distributors. This is because, policy, such as the number of screenings per-film per-day, is negotiated as a 'floor'. Figures are not fixed. Exhibitors can (and routinely do) screen titles at times and frequencies in excess of the minimum agreed policy. Knowledge of session times is not indicative of the minimum policy.

In light of the above, Fox submits that the ACCC should consider the proposed Application in the context where ICA and its members remain subject to confidentiality terms that are materially consistent with those in place at present. Therefore, when looking at potential public benefits, the ACCC should only consider those that could potentially flow from collective bargaining conducted by ICA on behalf of its members in the absence of shared information from ICA members. However, even if the ACCC does not assess the Application in this way Fox submits that any public benefits do not outweigh the detriments.

### 2.4 Exhibitors are diverse and collective negotiation will be unproductive

The diversity of independent exhibitors means there are unlikely to be significant efficiencies or cost savings from the Application. In the event that Fox and ICA cannot agree on terms for all or a sub-group of its members, negotiation will ultimately revert to bilateral discussion.

ICA has highlighted that negotiation of film policy and terms is a 'time consuming' and 'exhausting' process for exhibitors.<sup>6</sup> Exhibitors are not alone in their experience of this process. Distributors negotiate with many hundreds of exhibitors to ensure release of their films, naturally a time consuming process. ICA references confidential examples provided to ICA to prove its point – providing distributors with no opportunity to refute these examples – as well as examples of particular terms it may wish to negotiate on behalf of its members. The examples (eg, p9) provided are impractical. Fox already takes into account differences between exhibition venues when

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<sup>5</sup> Independent Cinemas Australia, *Supporting submission*, 1 December 2017, p.7

<sup>6</sup> Independent Cinemas Australia, *Supporting submission*, 1 December 2017, p.7, p.14.

supplying films. There is no need for an additional party (ie, ICA) to operate as an intermediary in negotiations.

ICA's submission asserts that there is a vast difference in the perspectives and objectives of exhibitors and distributors during the booking process.<sup>7</sup> This is not the case. Distributors have an interest in the success of the exhibition industry and are equally invested in ensuring the maximum choice of film offerings to consumers. Distributors take great risks with the production and marketing investment of each film and craft their film hire terms and policy carefully to maximise the success of those films. They are best placed to do this and to do otherwise potentially puts at risk the theatrical release and production of films. The success of films is shared by distributors and exhibitors alike under the longstanding shared revenue and risk model that the industry is underpinned by.

In its December submission, ICA points out that speed is essential in the context of negotiating exhibition terms.<sup>8</sup> Fox agrees. ICA suggests that it will negotiate on behalf of like-for-like cinemas before agreeing on consistent terms. However, the terms for a particular film depend upon the unique features of each cinema (such as local audience demographics and seasonality, historical financial performance, number of screens, marketing commitment).

Taken together, these factors mean that, far from recognising the need for fast resolution of contractual matters and assisting parties to come to an agreed position, ICA's proposal risks interposing an intermediary, past which contracting parties must bypass before settling back to productive bilateral negotiation. There is benefit to neither exhibitors, distributors, nor consumers. This position is reflected in the submissions made by distributors, which, with the exception of Icon, do not support the Application.<sup>9</sup>

ICA asserts that this desire to avoid additional 'bureaucracy' demonstrates that distributors are not willing to negotiate or engage with exhibitors.<sup>10</sup> Far from it. Fox does and will discuss terms with individual exhibitors based on their individual needs. Fox objects to being forced to attempt to negotiate something collectively, given they have been able to continuously and successfully negotiate mutually agreeable outcomes individually with exhibitors over many years.

ICA further asserts that it will operate in the same or substantially similar way that group booking companies already operate in the industry.<sup>11</sup> This is not the case. Film bookers perform a largely administrative function acting on behalf of, at times, small groups of cinemas to align screening times and film release dating with the available capacity of particular exhibitors. In short, film bookers deal with policy. Film bookers do not deal with other contractual terms that are agreed between exhibitors and distributors. This much broader class of terms is however within the scope of the proposed application, as set out in section 1 above.

## **2.5 Unsupportable 'flow on' benefits**

In the Draft Determination, the ACCC also took the view that the distinct 'transaction costs' public benefit will give rise to a series of additional related public benefits. ICA also repeats a number of these 'flow on' benefits in its December submission. However, these benefits are not likely consequences of either the Application, or the 'transaction costs' public benefit.

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<sup>7</sup> Ibid, p.4

<sup>8</sup> Ibid.

<sup>9</sup> Unlike other Australian distributors, Icon operates a vertically integrated distributor/exhibitor model. For this reason its submissions do not reflect the impact on standalone distributors, such as Fox.

<sup>10</sup> Ibid, p.6.

<sup>11</sup> Ibid, p.14.

First, the ACCC appears to accept that alleged transaction cost savings to exhibitors will be re-invested by exhibitors in their businesses, to the benefit of consumers. While ICA has argued that cost savings are likely to be passed on to consumers due to 'the pressure from on-line entertainment',<sup>12</sup> there is no evidence of any such pressure or that ICA's member exhibitors will respond to any cost savings from the Application in this way.

As set out in Fox's initial submission, Australian exhibitors, including ICA members, are profitable, strong and growing. In this environment, the far more likely result of any cost savings to ICA members is increased retail margin. The ACCC should give such private benefits little, if any, weight.

Second, the ACCC seems to have accepted ICA's position that the Application will prevent cinemas from closing and, in an inverse way, concluded that retaining these cinemas is a public benefit. There is no evidence that the likely future without the Application is one where ICA exhibitors are more likely to close. ICA mentions that the Application guards against future disruption – without evidence that this will negatively impact its members, or that the Application will necessarily assist its members' predicament.

By contrast, as set out in its initial submission, Fox's observation of the industry is that exhibitors Australia-wide are investing in more seats and screens. This contradicts the suggestion that industry is struggling with existential uncertainty. Further, there is no systematic evidence of exhibitors closing. If a future disruption crisis were on the horizon, there would be some market effect at present. The absence of any pattern of exhibitor closures indicates that the industry is facing no such crisis.

Finally, in its December submission ICA claims that reduced transaction costs also support the ongoing health of the Australian cinema industry<sup>13</sup>. This claim is without evidence and rests upon an assertion that the interests of Australian cinema are advanced largely by ICA-affiliated exhibitors. Promotion and development of the Australian cinema industry occurs at all levels of the industry, including both exhibitors and distributors and is not isolated to a particular class of exhibitors. Indeed, Australian cinema increasingly relies for its success and growth upon the support of distributors and their linked production studios.

### **3 No market failure or imbalance in bargaining power**

In the Draft Determination, the ACCC characterises the majority of ICA's members as small businesses.<sup>14</sup> While this may be true in terms of fitting the legal definition of small business, unlike many industries, small businesses in the exhibitor context have bargaining power that is proportionate with larger firms.

ICA members are often monopoly suppliers of cinema experiences to large regional communities. Even in cities with multiple exhibitors, ICA members often attract a loyal 'sticky' clientele, which visit a particular exhibitor as much for the experience that the exhibitor offers as the film on show. Distributors large and small have an interest in at all times ensuring that their content is screened to as many consumers as possible during increasingly short playing windows so as to recoup increasingly high production costs.

Expanding production costs and associated risks are factors that ICA does not raise in its application. The financial investment required to produce a popular feature title are higher than they have ever been. Audiences are increasingly attracted to expensive franchises that feature popular actors and have high special effects and post-production costs. Marketing costs to draw audiences

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<sup>12</sup> Independent Cinemas Australia, *Supporting submission*, 31 August 2017, p.2.

<sup>13</sup> Independent Cinemas Australia, *Supporting submission*, 1 December 2017, p.13.

<sup>14</sup> ACCC, *Draft Determination*, para 107 (p.16).

to see films have also grown with an increased number of films on the market at any one time for viewing audiences. Distributors that are aligned with a production studio, such as Fox, therefore begin supply of a film from day one having sunk significant costs into the project. Having incurred these costs, with each release, there is always material risk as to whether Fox will recoup its costs – let alone book a profit. Highly experienced studios are still routinely surprised by both film successes and failures. For Fox, launching each film is akin to launching a start-up – it is often a gamble how it will be received by consumers and whether Fox will recoup its costs. In this context, the pressure is on the distributor.

#### **4 Material detriment from collective boycotts among ICA members**

Allowing ICA and its members to share sensitive pricing, policy and other film licencing terms and negotiate as a collective block carries material risk of facilitating collective boycotts by exhibitors.

The Draft Determination and the various ICA submissions make clear that a collective boycott by ICA members would remain illegal – and is not within the scope of the Authorisation. This may be so, however, Authorisation would provide ICA and its members with a clear mechanism by which to coordinate such activity. In the course of collective bargaining, ICA members will necessarily engage with each other on multiple occasions, discuss terms they want and do not want, share information on previously available terms and come to an agreed position from which to negotiate with distributors.

Against this background, it is inevitable that parties will discuss how best to ensure that distributors accept their proposed terms. Collectively refusing to accept terms less favourable in the context of bilateral negotiation is the clearest and most readily available option in this regard. This also undermines any notion that collective bargaining will be 'voluntary'. If the only terms a counterparty is willing to accept on a bilateral basis match exactly the terms offered in a collective bargaining package, it is irrelevant whether or not a distributor has 'opted in' to the collective negotiation. The effect is the same.

As the ACCC is aware, it is difficult to distinguish a series of independent boycotts from a collective boycott. This is certainly the case once any information is shared – at that point the horse has arguably bolted. Certainly, distributors will be ill placed to prove such conduct. Relying in this way upon ex-post detection of anti-competitive conduct is always a less satisfactory option for regulatory compliance compared to establishing structural market conditions limiting the potential for competition issues to arise. In this case, the status quo is that structure and is productive of those conditions. Fox respectfully submits that the ACCC should not intervene in a well-functioning market to engineer new industry dynamics that facilitate and incentivise otherwise prohibited anti-competitive conduct.

#### **5 Conclusion**

For the reasons set out above, Fox considers that the ACCC should not grant authorisation to ICA.

Yours sincerely

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