

## Getting It Out There – The New Contractual Landscape for Film Distribution

### 1. INTRODUCTION

Barry Diller interviewed a few months ago by his life long friend and nemesis Michael Eisner described the complexity of the broadband media challenge as follows:

“In this interactive, internet world, I mean you have a headache twenty minutes into the day.... Films and televisions are not a business that so to speak confounds you – you are telling stories. But this is.... We are in a revolution. We are absolutely in a radical revolution.”

The Hollywood studio system is indeed preparing for yet another major transformation. After the changes imposed to its business model by the US antitrust authorities in the late 40's, the rapid take up of television in the early 60's, VCR's in the 80's and DVD's in the 90's, it is now the turn of “digital technologies” in the production and distribution segments of the movie value chain.

The impact of digital technology threatens a shake up not only in the studios' prospects but also those of their associated partners and stakeholders – indeed the entire film and TV industry. It, together with the proliferation of broadband and multimedia devices on the consumer side, is enabling more dynamic and cost-effective methods of film financing, production and distribution.

Does this dynamism mean the end of the studio systems as has been predicted by some? Will the studios be replaced by new giant media players such as Google and Yahoo? How will the business model change and develop? I will look at current changes in the film distribution landscape, examine the latest technology developments, and consider the implications for the industry. I will then consider the changes from a legal perspective to consider what issues will need to be reflected in distribution deals.

## 2. TECHNOLOGICAL INFRASTRUCTURE AND RECENT DEVELOPMENTS

The major development that is the catalyst for the dynamic change is the exceptional expansion in recent years of the number of broadband connections in the developed world. In the UK the number of broadband connections exceeded dial up connections for the first time and it is predicted that over 10 million UK homes will have access to broadband within the next four years. The number of broadband connections worldwide rose by 37% last year to 221 million at the end of 2005. Reports estimate that almost two thirds of consumers in Western Europe will have adopted broadband by early 2008. The message is clear – there is an incredible appetite for broadband-enabled services and the infrastructure is in place.

## 3. OPPORTUNITIES

The arrival of broadband film distribution channels is as Chris Anderson wrote in *Wired* “the start of a long tail”. Content owners will be able to exploit their entire libraries on digital platforms, which will create infinite shelf space for their product.

In addition, the new platforms provide additional exploitation markets for content owners. For film producers the theatrical window is becoming increasingly less important with more emphasis on the smaller screen. Until 2005 the distributors principal access to the home market came through pay TV, free television, video rentals, and DVD sales. However, now there are new products such as apple video ipod, Microsoft X-Box 360, and new reception equipment such as TIVO and Sky Digital set top boxes, which will add further IP distribution networks. Added to these are portable devices such as 3G mobile phones, ipods, play station devices and pda’s that also provide opportunities for content exploitation to the masses.

#### 4. SEIZING THE MOMENT

Are rights holders jostling for position to deliver their content on the new delivery systems?

The answer is that the studios have to date been rather reticent. Perhaps this is due to the concerns over piracy, the fact that the technology has not been widely available as yet and also having to recalculate its business model. The main motivation to date has been less about the desire to enhance its revenues, but fear about repeating mistakes of the music industry; the fear of being beaten to it by services which allow for widespread copyright infringement.

#### 5. DEALS IN 2006 – CURRENT LANDSCAPE

There has been a flurry of new deals and services in the last 12 months which are the beginnings of a new business arena. Only last week Channel Four unveiled plans to start selling its entire programme over the internet, and both BBC and ITV intend to follow suit.

##### U.K

In the U.K. the year started with Sky launching a broadband service to allow sky subscribers to legally download films from Sky Movies back catalogue for no additional charge. “Sky Broadband” allows a subscriber 30 days to view a film as many times as they like, but it is only possible to play the film on the PC which the film was downloaded and items cannot be downloaded or transferred to DVD or any other permanent storage mechanism.

Such services differ from electronic sell through (EST) services otherwise known as “download-to-own” digital retail services. EST services allow content owners and distributors to offer consumers permanent downloads of films or television programmes, thereby allowing users to keep a copy of

movies they download and play back an unlimited number of times on their computers hard drive or set-top box.

In April this year it became possible for consumers to take advantage of EST as until this time the only downloads the major studios had offered in the U.S. were online rentals which were only available for a 24 hour period. In early April, however, Movielink and CinemaNow edged out by name competitors, Apple, Amazon, Google and others to become the first to offer permanent digital downloads in the U.S.

CinemaNow announced a deal with Sony, MGM and Lionsgate whereby it offers a download-to-own service, allowing movies to be downloaded for \$20 to \$30 at the same time as the DVD release. Older titles cost as little as \$10. An important qualification is that the ability to download is limited to the download device.

The day after CinemaNow's announcement, Movielink launched a download-to-own service on its website backed by Warner Bros, MGM, Paramount, Sony Pictures and Universal. The user can buy movie downloads which can be viewed on up to 3 PC's, transferred to a DVD (using a windows media format) and streamed around the home via home networking. However, the DVD can only be played on a computer and not a set-top DVD player and copies cannot (yet) be transferred to portable media devices.

In the U.K. a few days after the U.S. announcements Universal Pictures UK announced that it had joined with DVD rental company Lovefilm to offer download-to-own films via AOL.co.uk and Lovefilm websites. Other distributors such as Warner Bros, ICON and Momentum have also negotiated deals with Lovefilms. Customers using the download-to-own service pay for a film which is provided to them in 3 formats:

- Two digital files for instant download – one for a PC or laptop and one for a windows “play4sure” certified portable video device; and

- A physical DVD of the same material sent through the post.

The service is novel in that it is the first to offer two digital files (one for the PC/laptop and one for a portable video device).

### BitTorrent

Perhaps the most interesting and groundbreaking of the recent deals is the Warner and BitTorrent.

Some interesting facts about BitTorrent. One it has 45 million users. Another is that BitTorrent – related activity accounts for an estimated 35 % of all internet traffic – more than all other P2P networks combined. Its popularity is due to the fact that it is possible to download copies of large files such as TV and movie files in a fraction of the time it takes on regular P2P networks.

The deal marks a huge shift away from the previous response of the Hollywood majors to P2P networks – that of vehement antagonism and litigation. However, the groundwork for the deal was made last November when Bram Cohen, the founder of BitTorrent agreed with Motion Picture Association of America (MPAA) to remove the links of pirate copies of films from BitTorrent's search engine.

The service has been described as follows; downloads of films and TV programmes will be made available on the same day the film or programme becomes available on DVD. The price for a film download will be approximately the same as a DVD and a TV programme as low as \$1. However, there are several restrictions: downloads will only play on the actual computer used to make the download; it will not be possible to make copies or burn the file onto a DVD; and the file will not be transferable to other PC's or standard DVD players.

### Other Developments

Apple announced in September the launch of its ITV gadget. The gadget will allow the user to apply movies and other media bought from the iTunes store via the PC to be screened on other devices around the home including the TV.

Recently Microsoft announced that it would offer movies and episodes of TV shows for downloading through its Xbox live online service starting on 22 November 2006. What makes this opportunity exciting is that the Xbox connects direct to the TV – there is no computer and no downloading. Microsoft has negotiated the rights to rent or sell more than 1000 hours of material from CBS, MTV, Networks, Paramount, Warner Bros and Turner Broadcasting. The video store will work similar to Apple iTunes, but with some important differences. While users will be able to keep TV shows, movies can be rented for only a limited period. The videos will not be playable on other devices and cannot be burned onto DVD's.

## 6. CHANGES TO THE BUSINESS MODEL

What is the impact of digital technology to the business model?

Over the past 18 months release windows have already compressed significantly, initially because of the pressure to ensure the success of the DVD's which account for a significant proportion of revenues and profits and to optimise marketing budgets; more recently the emphasis has been on combating piracy. What the studios were doing was pouring money into the theatrical release of a picture creating enormous consumer demand for a product that was not legally and commercially available to satisfy demand, either because the consumers could not afford to go to the cinema or because they live in territories where the film will not be available on any platform for months.

In January of this year, 2009 because the first distributor to experiment with a day and date release across platforms in the U.S. with "Bubble" a low budget digital film directed by Steven Soderberg. One problem "Bubble" had in its

release is that most of the larger exhibitors refused point blank to screen the movie on the basis that date and date model ultimately threatens their livelihood.

## DIGITAL CINEMA

Simultaneous global releasing is the other logical inevitable trend in release patterns. Studios have felt pressure to go in this direction for a number of years because of the DVD piracy but at present the prohibitive costs of prints have limited this strategy to all other than the biggest blockbuster titles such as Lord of the Rings and The da Vinci Code. With the advent of digital cinema the prohibitive cost barrier will no longer be relevant and global releases will be the norm. Whether we will eventually see the demise of all windows is unlikely. We will see a virtual window release with different price points set across the timing of a release. For example the first VOD window will run concurrently or even before the theatrical release and will be available at a premium price and may be not to own or shift to a separate device. When compression improves, the first premium download could be high definition.

## 5. IMPLICATIONS

What does that mean for distributors, sales agents and in the independent film world.

### Distributors

The introduction of digital technology including the advent of digital cinema will have dramatic implications for film distributors. At a recent industry event Josh Berger SVP of Warner Brothers Europe predicted that US studios would be "less distributors and more focused on marketing and advertising in the next ten years". The advent of digital exploitation means that film producers will have access to distribution channels at little cost.

However, to make any projections one has to look at the economic reality.

Currently approximately 50% of worldwide film revenue is coming from DVD, 23% from various forms of television, 21% from theatrical releases and the balance from other sources.

Most of the analysis I have seen projects that while internet delivery will slowly start to grow and will slowly start to supplant the current forms of television over the next few years, DVD will continue to be the most dominant single revenue source for quite some time. For example some figures I have seen project DVD at 46% of all worldwide film the revenue in 2014. Presumably this will be buoyed partly by the roll out of high definition DVD formats but it's also a consequence of the enormous worldwide DVD player penetration rate which is currently estimated at almost 30%.

But the impact of download will soon be upon us, Informa Media Group predicts that one third of the worlds homes will be buying films on demand by 2010. The number of movie buying VOD households will reach 327 million worldwide by 2010 and the VOD market will be worth £6.45 billion in four years time! I am not sure that such figures are accurate. It will probably be quite some time before broadband uptake is at that level considering in many territories sufficient networks are still a long way from even being available. *At the moment for example, even Australia only has a 10.9 % broadband penetration with leading markets in the world like Korea at 25.5%.*

However, I am confident that in the longer term the projections that approximately 75% of the total revenue pie for feature films, will come from internet delivery via its various virtual windows is accurate.

In terms of what this means for sales agents and distributors I envisage that in the short term as long as DVD and video revenues continue to dominate it will mostly be business as usual.

As Nigel Palmer has pointed out earlier, financing of independent films will continue to be secured on territory by territory revenue projections largely based on the value of locally DVD and television rights and sales agents will continue to sell films on a territory by territory basis. There will be the occasional disputes about who gets to own the internet rights but in most cases they will be sold to territorial distributors along with everything else and distributors will make deals with the content aggregators as they believe is appropriate to maximise revenue.

There have already been a few exceptions to this in the independent world. For example Morgan Freeman's new film "*Ten Items or Less*" was financially driven by Clickstar, the deals were structured so that Clickstar retained worldwide internet rights with only the remaining rights available for territory by territory sale. It would be interesting to know what this restriction does to the value of sales achieved considering the non-internet rights represent most of the potential revenue that will ever come from that movie considering the infancy of the internet market. However, I anticipate that most Distributors will insist upon the internet rights are available. Like everything it no doubt depends on the price (and the movie).

Once the internet delivery market starts to mature things are likely to evolve. As the online delivery platform eventually supersedes DVD and television, which will occur at different rates in different places, it should be possible for producers and sales agents to secure financing for films based on the internet revenue projections for those territories. In such an environment sales agents will enter into deals with service providers directly for selling internet rights in those territories. As the internet market continues to mature territorial distinctions for internet delivery will become less relevant and sales agents will extend to become global distributors. The local distributors role may be more limited and more adapted to more of a marketing services role supporting a release campaign which will be coordinated at a global level by the worldwide distributor.

The future of film distribution for the high profile films will require a globally coordinated marketing campaign to support day and date releasing across platforms and territories using local expertise for marketing and other services in the manner I have described. Of course the internet delivery market is going to mature in different territories at different rates so the current form of local distribution will continue to be relevant in some territories for a long time. I suppose inherent to the model is that the worldwide distributor will bear the brunt of marketing and release costs in each territory.

### **The role of producers.**

There has been a lot of speculation that in the new world of distribution, producers will now finally be able to make some money by distributing from their own websites and by making deals with service providers directly cutting out the distribution middle people. This may be true but only to a point. It is only going to be viable or make sense for certain types of content. For example, where a film has a particularly unique and strong marketing hook or an existing strong brand which will ensure that word of mouth creates all the publicity that will be needed for success.

For the majority of independent movies it is a lot more difficult to stand out in the marketplace. It will still be essential to appoint a distributor who can coordinate a systemised release marketing campaign and strategy providing the expertise to hopefully ensure that revenue for the film will be maximised.

The other instance in which it is going to make sense for a producer to go direct to a service provider where a film does not otherwise have distribution. There are already companies which are set up to do this for example. At Cineclix, a Canadian company which sells video downloads of feature films internationally, films must have been screened in an international film festival. Other aggregators are much more flexible. With google video for example, currently still in the beta testing phase, anyone can upload content to the site for sale. The content owner set their own price with google taking a share of any revenue estimated at 30%. It's designed to be a completely open marketplace. This provides opportunities for filmmakers who otherwise

would not get a look in to make money from their content and hopefully to find their audience however small.

## 7. RIGHTS MATRIX

When considering the key components for licensing in a digital world it is important to consider the following questions:

- What delivery system and service will be used?
- What will need to be delivered to the distributor?
- What is the nature of the content?
- What are the commercial deal points?
- How can content be properly protected?

Let us consider these in more detail.

### *A. What delivery system and service will be used?*

Convergence is a bit of a misnomer perhaps the better expression is fragmentation: We have currently the following available platforms:

- Theatrical
- Non-theatrical
- Imax
- Free to air analogue broadcast
- Digital terrestrial television
- Analogue and digital cable
- Analogue and digital satellite
- Hi definition TV
- Internet Protocol TV (IPTV)
- Mobile Phone Networks – GSM/GPRS/3G Network
- WiMax
- ADSL
- Video
- DVD
- HD (High Definition) / Blue Ray
- Consoles – PSB / Xbox 360

- PDA
- Apple ipods
- VCD

The rights can be defined by reference to carriage on all or any of these platforms. Most distributors will insist upon acquiring as many of the above platforms as possible. However, in the new business model all have detailed it may be possible for producers to be able to fund their movies by pre-selling certain platforms such as TV and theatrical and be able to appoint or even exploit other platforms independently.

When licensing product it is important not only to consider the delivering system but also the reception equipment. You may need to state whether the receptor device is limited to TV screen, VDU, ipod or mobile telephone handsets or PDA's or any combination of the above. It may be possible to make the delineation in the distribution agreement by referring specifically to the end user device but when separate devices merge into one it may become too complicated.

A major issue will be when some of the above platforms go head to head. For example the French Government have introduced draft legislation to encourage inter-operability between digital musical systems. The aim would be to remove the "lock and key" on all systems which allow users of itunes content to be solely played on ipod devices.

*B. What are the delivery requirements?*

The next matter to consider will be what content the distributor requires in order to exploit the content on its particular media. The long list of delivery materials is going to be replaced by different forms of delivery requirements, probably on a computer file. However, the new digital world requires delivery of more than just the Film. In order to properly market the Film, the film producer will have to consider providing additional shots, behind the scenes

footage, making of, digital biographies and content that can service the fan's websites.

Sony has just launched the Blue Ray technology. With this technology there are two separate viewing plains for the DVD. One for hi definition movies, the second for scene specific features such as commentaries, music videos, and games. This opens the door to creating parallel universes, which the viewer can navigate. Disney for example plan to introduce scene specific education lessons on children's movies while Sony plans scene specific games. The Internet would provide further interactive material including altered endings to tradition action sequences, which can be loaded on the re-writable layers of the disc.

Budgets will need to be enhanced to develop these market strategies and producers will need to develop more complex offerings to satisfy distributors requirements. The new digital age will mean that viewers will be considered more like consumers therefore more information and enhanced products will be necessary to strengthen and develop the commercial relationship.

Each studio now has its own new media department specifically assigned to create viral campaigns targeting everything from the internet to I pods to X boxes.

## GRANT OF RIGHTS

In terms of rights the specific rights that a service provider requires clearly depends on exactly what it intends to offer the consumer. I have touched on the different types of services that have been launched in the market place. In general terms, it is important for the service provider to negotiate the widest rights possible including the right to offer the content for permanent download, to allow users to burn the download content more than once to a DVD or other storage disc and the right to share the content download with other PC's. The service provider will need to obtain the rights to make material available to the user on the same day and date as it is released on DVD and to allow users to

download and retain one file of the EST content on the user's set top box PVR/PC or laptop hard drive to which the EST content is initially delivered. Service providers also seek the right to allow users the right to transfer the content download onto portable video devices.

Will the service allow the end user to adapt or modify the content and polymorph the product? In such scenarios there may well be intellectual property issue relating to such adaptations which require planning.

*C. What is the nature of the content?*

The Producer will need to examine exactly what content will be exploited. Will it be the audio visual, audio, still pictures, or text or some combination? Will the still images for example is used for wallpapers, screen savers or ecards? If so, do the Artist/ Performer agreements allow the Producer the right to exploit name and likeness?

*D. What means of charging will be used?*

The means of charging will need to be carefully considered and negotiated. The content owner will need to determine how payment is to be made, i.e. via subscription, pay per view or pay per period or indirectly through advertising or sharing telecoms revenue. Will you negotiate on a royalty basis or by way of net receipts? Will you have access to important ancillary products such as the database for the fan club or end users? It is extremely unlikely that in the digital distribution world that there is going to be a one-off licence fee.

*E. Will your content be properly protected?*

As a rights owner it is important that you ensure that the licensor has implemented an effective Digital Rights Management (DRM) system. For example, both the Cinema Now and LoveFilm services are based upon Windows XP Media Centre software, that contains DRM tools that can be programmed to ensure that the EST content cannot be duplicated, burnt to

disc, uploaded to the web or emailed in anyway shape or form. This should provide for on-line real time reporting system that enables the licensor to track the operation of the distribution rights. The licensee should allocate and create a dedicated directory from those licensees Internet server and map all necessary domain and sub-domain uses for the distributors content.

Clearly the licensor must be able to satisfy that the licensees DRM systems prevent illegal and all unauthorised copying. As an example with the Apple ipod, one of the primary obstacles to redistribution of files is that the name and apple id of the person who purchased the music are embedded in each purchased song. The fingerprinting discourages redistribution of songs since if a song finds its way onto a Peer 2 Peer system songs can be traced back to the person who purchased the song.

## 8. OTHER CONSIDERATIONS AND RESERVATIONS

### A. *Technology*

With new technology there are always going to be technical hurdles to overcome. As a rights owner it is important that you grant your rights to a service, which is capable of performing the function it set out to achieve, and there is sufficient back up for when the technology breaks down. A TV audience is far less patient with technological error than a computer user. Therefore it is important to check that the licensee has sufficient computer back up to deliver the service. It is important to check the service provider's track record.

### B. *Future Technology*

In a fast changing world with the introduction of new technology arriving at a prodigious pace, distributors will no doubt try to negotiate "catch all" provisions and try to negotiate a disposition of rights that include:

*"in all media known or hereafter devised"*

This kind of wording is most common where you are acquiring all rights in exchange for fully financing the project, rather than on a limited licence of rights.

It is also worth inserting a word of caution here. Laws in some jurisdictions, like Germany, do not consider this sort of provision as binding on parties in respect of rights, which could not have been in their contemplation at the time of contract. If you are doing a deal in Europe where German law may be relevant, you should take appropriate local advice.

C. *Define your terms:*

One issue is whether you should even try to define the rights granted extensively or whether you might get away with using the headline description like “video-on-demand” or “online” as a term of art, and postpone an argument as to what exactly you meant to a later date should a problem actually arise.

This is certainly likely to be a cheap option for the 99% of contracts, which expire uneventfully. It is not a cheap option if there is a problem. Nevertheless some lawyers are quite happy to support that approach and the alternative method, of defining terms at length, is not free of problems either.

Personally I think it is difficult for anyone to advocate a policy of not defining rights as being in their best commercial interests.

D. *Risk management*

Next, as a licensor in the digital world you are likely to find yourself in new markets where you lack the confidence you have been used to in the old markets to be sure you are getting the best deal. One of the key issues then is to find a way of increasing your “comfort zone” with these deals. There are a few suggestions that may add to this;

*Short term licences:* The trend in the new digital era especially for 3G exploitation is to see licence periods becoming increasingly shorter. With such rapid changes in the market place people are not comfortable with the old 3 – 5 year terms, and are more willing to grant a licence of 12 months with an option to renew three (3) months before the expiry of the Term.

*Most favoured nation (MFN) provisions:* MFNs are also becoming increasingly sought after because they give the licensor comfort that nobody else is going to steal a march over them and get a better deal with the licensee. These clauses are often resisted because they can cause havoc for

licensees not only because the licensee would prefer not to have any, but also because it can be difficult for licensees to maintain the same form of MFN between different suppliers.

*Track record:* It may be of comfort to you to know that nobody has got a better deal from the licensee than you, but then that is no comfort if everyone has got a bad deal based on miscalculation of the market.

You can get some comfort and protection here by obtaining information from your licensees to enable you to understand the success of your licensee's business.

This ties back to one of the key commercial issues in a converged market place.

In an ideal world this means you need to be supplied with a lot of information. For example, if you're licensing materials to a service, which uses a digital management system, there is a great amount of information that can be gathered from the user and there is of course great value in the database.

- *Consider non-exclusivity:* Next consider non-exclusivity as a way of avoiding tying your hands in particular markets

## 10. Conclusion

To wrap up I want to distil a list of key questions from points I have made, to act as a checklist when you frame your licences. Here goes:

- What delivery systems can be used to transmit the service?
- What service can the rights be exploited on?
- Can the licensee adapt the content?
- Will the licensor have obligations regarding the content after delivery?
- Can the viewer interact with the content?

- How will the viewer be charged for receiving it?
- What comfort can you get that no one else is getting a better deal than you? (short term agreements, MFNs, statistics, etc)?