‘*It is dangerous for an entertainment industry to become a prisoner of its own past*.’[1]

A Report on the British Film Industry for Shadow DCMS

November 2009

Maud Mansfield

[1] Federation of British filmmakers. Annual Report 1960/61

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Introduction

It is the purpose of this independent report on the British film industry to address some of the key issues relevant to film policy at the end of the analogue era. Primary research has involved taking soundings from a broad sweep of the film industry and various stakeholders, beneficiaries, trade bodies and other interested parties, initially gathered over a series of informal sector-specific roundtables[2] and then consolidated during an intensive set of meetings conducted between May and October 2009.[3] It is hoped that by virtue of its independence, research and representation, this report can effectively help inform the shadow Department for Culture, Media and Sport (DCMS) as to the ideas, concerns and proposals most pertinent to the British film industry at this time.

It is important to note that the breadth of representation has dictated that many different subjects have been raised and it has been impossible – at this point – to discuss all of them in the kind of detail they undoubtedly deserve. By the same token, no claims are made to the report being an exhaustive account of all matters relevant to British film policy.

Maud Mansfield

This comprehensive report presents several interesting ideas, which I will consider carefully. I would like to thank Maud Mansfield, and all the people both she and I met during the course of research, for taking the time to contribute to our thinking on film policy.

Ed Vaizey, Shadow Minister for Culture and the Creative Industries
November 2009

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[2] These meetings, covering Production, Finance, Post-Production, Skills & Education and Sales, Distribution & Exhibition, were held between November 2008 and April 2009.
[3] A full list of contributors is annexed.

The Context of Analogue

The issues and proposals raised by this report should be placed into an appropriate historical context:

1. The most significant 20th century government interventions into the British film industry were triggered by the cyclical failure of sustainability, generally marked by falls in film production.[4] The consequent policy initiatives overwhelmingly coalesced around methods of boosting production rather than addressing industrial sustainability, signifying the failure to grasp that the supply of production must meet the demands of distribution, not the other way around.[5] A critical consequence of this unbalanced policy focus has been the emergence of a distinctive behavioural dynamic among parts of the British production community, a temperamental development that Alan Parker has characterised as, 'a serious production habit…and like any addict [the production community] has obsessively gone about feeding its addiction in any way that it can.'[6]

2. It is an acknowledged maxim that the structural difficulties faced by the mainly asset-poor, non-vertically integrated British film production community – the 'cottage industry'[7] – stem from its historical failure to build up capital generating interests in distribution and exhibition. Equally, the most characteristic aspect of market failure has been a disconnection between production, distribution and exhibition, which has uncoupled production from

[4] For example, the quotas introduced by the 1927 Cinematograph Act, the post-WW2 Eady levy, the Capital Allowances write-off in 1979 and the National Lottery funds in 1995.
[5] The quotas favoured producers over distributors and exhibitors, the Eady levy took money away from exhibitors to give to producers, Capital Allowances attracted investment into production only, the limited sums of Thatcher-era subsidy trickled into the budgets of the production community and the Lottery/tax bonanza of the 1990s and early 2000s was poured into British film production.
[6] Alan Parker. 'Towards a Sustainable UK Film Industry' (2002) p.7. It is worth noting that Parker was saying nothing new. The 1949 Gator Report on Film Production Costs talked of the post-war British production community's, 'general atmosphere of extravagance and unreality…leading to a complete disregard of expense which would not be tolerated in other forms of business.'
[7] Culture, Media and Sport Select Committee Session 2002-2003 Sixth Report: The British Film Industry 18.9.03 para 46. It is worth noting the number of British film and video production companies in 2008 stood at 7,970, compared to 435 distributors and 230 exhibitors (UKFC RSU Yearbook 2009).

the value chain, driven fragmentation, consolidated Hollywood market domination and consistently undermined ambitions for industrial sustainability.[8]

3. The policy agenda has always been, (in no particular order), complicated, boosted and hindered by the macroeconomics of Hollywood, usually dictated by dollar drain, the dollar-sterling exchange rate or recession. Film policy has rarely been able to square the economic and political desirability of a self-supporting industry with a shared language market and an acknowledged dependence on inward investment from the Hollywood majors and/or their controlling position in the market.[9]

4. The idea that film policy should specifically encourage culture entered the policy idiom in the later 1970s,[10] and a 'culture versus commerce' debate has since become a defining fault line, driving an expedient but unhelpful bifurcation of film policy and a tendency for it to be conceived as either/or: either industrial and charged with economics and sustainability, or cultural and concerned with public value and audience engagement. The evolution of the Creative Industrial paradigm in the 1990s, which categorises creatively-led industries in terms of their benefit to the economy, and the profoundly influential McKinsey philosophy of measurable management that quantifies public policy in terms of its impact rather than inherent value, have reinforced this tendency.[11]

[8] In their 1990 British Film Institute (BFI) paper 'The View from Downing Street' Headland & Relph suggest the link began to fail in the 1960s when the two vertically integrated British majors of the era, Rank and ABPC, opted out of production; however as early as the 1930s there were indicators of aversion to risk-heavy production. The successful IPO of Odeon Theatres in 1936 (in the middle of a depression) was attributed to its stated intention not to be involved in film production.

[9] The most recent UK Film Council (UKFC) figures are for 2008 when the six Hollywood majors (Warner Bros, Paramount, 20th Century Fox, Universal, Walt Disney Studios and Sony), accounted for 78.5 per cent of the UK box office. Mark Batey of the Film Distributors' Association (FDA) argues that the majors do recognise the importance of local content however, and engage in specialised British film e.g. Sony released David Peace's The Damned United (2009). Distribution statistics for 2008 bear this out: of the top 20 UK films, a Hollywood major released 15.

[10] The Terry report of 1976 and the reports of the Interim Action Committee in 1979 gave specific nods to the cultural aspects of British film, concluding policy should henceforth encourage both the commercial and the cultural. This was a telling departure from earlier quality or propagandist stipulations (for example, the Moyne Committee of 1936 suggested a quality test for British quota films; this was roundly rejected by the industry in favour of minimal spend requirements. The Report on the Imperial Conference in 1926 desired more Empire films of Empire production).

The Subtext of Digital Conversion

5. Lord Carter's *Digital Britain* report states that, 'public policy objectives [for] film remain the same in the digital world as in the analogue: widening the audience for cultural film and enhancing the sustainability of culturally specific British films.'[12] However, the public policy issues for film are broader. A truly digital Britain could morph the anachronistic culture versus commerce debate into one that addresses public access, IPR value and clarifies the purpose of copyright protection in the digital age.[13] The challenges of balancing the protection of IPR with the expectations of digitally enabled consumers must also engage with the primary policy objectives of industrial sustainability, the highly varied research needs of the education sectors and the ongoing importance of film as an artistic medium.

6. The consequences of the digital age for traditional film revenue models are enormous, and as new paradigms emerge the corresponding focus for film policy must not be on the status quo but on protecting original UK content of the highest quality, created by inspired, incentivised British talent with a stake in their income-generating IPR.

7. The problem of piracy via illegal peer-to-peer file sharing dominates both the creative industrial and policy agenda,[14] and the Department for Business, Innovation and Skills (BIS) has indicated its intention to adopt a tougher stance

[11] For example, the report of the Film Policy Review Group in 1998 stated 'this report focuses on the measures needed to build the infrastructure of a self-sustaining, commercial film industry; specifically cultural objectives [are] outside the remit of the review.' A Bigger Picture: The Report of the Film Policy Review Group March 1998 para 1.6. In the UKFC's second strategic three-year plan (2004-07) the only reference to culture is under 'Diversity and Inclusion,' which defined it in terms of the composition of the industry's workforce.
[12] *Digital Britain*. June 2009.
[13] Peter Buckingham at the UKFC summarises the debate as, '…a struggle between the ease that consumers enjoy to access the content that digital offers, and the system of licensing and copyright protection that content owners need to obtain value for their work.'
[14] Respect for Film estimates that film piracy cost the film industry £235 million in 2008; the British Phonographic Institute estimates piracy cost the music industry £180 million in 2008. Even though illegal music downloading is more prolific than film piracy to date, film is far more expensive to produce than music and correspondingly has more to lose, particularly as broadband speeds improve.

on piracy than the measures outlined in *Digital Britain*.[15] The rationale behind what BIS characterise as the 'evolution' in their thinking is congruent with the wishes of many of the largest players within the creative industries,[16] but it is important to acknowledge that piracy is a cultural as well as a technological issue, and pursuing the most punitive technical measures will do little to educate consumers and so discourage piracy in the first instance, nor galvanise the need for competitive pricing by the market.[17]

8. Consistency in the relationships between government and industry is critical to the battle against piracy.[18] For example, despite constant lobbying by the Film Distributors' Association (FDA), the Cinema Exhibitors' Association (CEA) and the Alliance against IP theft, that illegal camcording in cinemas must be made a specific criminal offence, *Digital Britain* failed to make any such recommendation.[19]

9. *Digital Britain* has started the compelling work on how re-thinking certain aspects of copyright legislation within a public policy framework might generate unforeseen or presently untapped forms of access and value, and shift the default legal framework on legitimate 'fair dealing' from restrictive to

[15] The Digital Economy Bill proposals put a far greater onus on ISPs to respond to illegal P2P file sharing by including the suspension of individual accounts as a final measure. *Digital Britain* proposed a written warning process that had the potential to lead to so called 'technical measures' including blocking or bandwidth capping repeat offenders.

[16]There is notable opposition however. The Featured Artists Coalition, the British Academy of Songwriters, Composers and Authors and the Music Producers Guild have issued a statement of their 'vehement [opposition to] the proposals being made and suggest that the stick is now in danger of being way out of proportion to the carrot. The failure of 30,000 US lawsuits against consumers and the cessation of the pursuit of that policy should be demonstration enough that this is not a policy that any future-minded UK government should pursue.'

[17] It is also questionable whether suspending individual accounts is legal under proposed EU telecommunications law, which holds that Internet access is a fundamental human right. The French 'three strike' proposal was rejected on the grounds of freedom of expression and presumption of innocence.

[18] The Alliance Against IP Theft, a coalition of trade associations and enforcement bodies from across the creative industries, make the point that since Summer 2007 alone there has been a new Prime Minister, a newly created Minister for Intellectual Property (which has already been held by three different people), a re-branded Patent Office (now the UK Intellectual Property Office) which has been moved to BIS and which has both a new chief executive and director of copyright enforcement.

[19]The Motion Picture Association estimate that nine out of ten illegally copied films that enter the market are derived from illegal camcording in cinemas. The CEA say that there has been a significant reduction in illegal camcording in countries like the US and Canada where it has been criminalised.

positive.[20] The proposals for orphan works[21] and the legislative possibility for copyright collection societies to exercise the same assumption that underpins the Nordic extended collective licensing agreements[22] exemplify this. Within a film specific context, the potential benefits of these kinds of provisions for the UK's moving image archives, much of the contents of which have been publicly funded and yet are inaccessible due to underlying copyright issues, would be significant.[23]

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[20] Acts of copyright infringement are strict liability for works with identifiable owners. A more flexible position on orphan works, (i.e. works still in copyright but with owner(s) unknown), should be explored.

[21] *Digital Britain* proposes changes in the law enabling use/copies of orphan works for purposes including commercial gain.

[22] In Nordic copyright law there has long been an assumption of collection society membership in the absence of explicit opt-out. This assumption allows societies to collect fees on behalf of all rights holders, even those who have not specifically signed up, simplifying the clearance process for mass use and benefiting both rights holder and end user.

[23] The BFI would be able to restore and copy the estimated 10 per cent of its archive that is made up of orphan work. Any money made from exploiting these works would be held back to cover the cost of clearances, should the original rights holders come forward.

10. However exciting, discomfiting and/or radical the advances and opportunities presented by the digital age, the immediate, mid-recession realities faced by the vast majority of the British film industry still revolve around raising production finance and the ongoing collapse of traditional distribution revenue models. These are major problems; they are also market-led and the market – both financial and digitally realised – will play the defining role in the terms of their resolution.

11. It should be noted that these problems are characteristically sector-specific, generating their own hydra-like sub-issues, and are very much a product of those historical, industrial axioms discussed above that have cyclically reinforced industrial disconnection. The failure of cross-industrial consensus has undermined coherent policy for the film industry as a whole,[24] and reinforced the cultural/industrial separation that has confused the policy agenda. And so, despite the initial research phase for this report being conducted via sector-specific roundtable meetings, it is important to identify the wider policy headlines – sustainability, finance, public value – and examine the particular concerns of the industry within these areas.

[24] E.g. When challenged to explain the limited agenda of the 1970 Films Act, Gwyneth Dunwoody, then parliamentary secretary to the Board of Trade, responded by saying she, 'had received so many conflicting suggestions from so many quarters of the film industry that their effect was to cancel each other out.' See Baillieu & Goodchild, p.96.

Sustainability

12. The advent of digital means many of the old adages will no longer have to apply to the British film industry: for example, shooting on a digital format frees apprentice film makers from the need to source prohibitively expensive physical stock. Moreover, digital distribution provides the tools to re-engage production with the value chain and, more specifically, clear the way for end-user integrated, sustainable business models that revolve around the relationship with target audiences.[25]

13. The British film companies which have achieved sustainability have done so by pursuing integrated business models, the most successful with a Hollywood major: e.g. Working Title's relationship with Universal, Ruby Films' with Miramax, DNA's with Fox Searchlight. The next tier is represented by independent television production companies owning the underlying assets which allow them to diversify into film, e.g. Kudos Film and Television, (who have an output deal with Elisabeth Murdoch's Shine), Celador Films and Ecosse Films;[26] the distribution/exhibition and sales entity Curzon Artificial Eye, and the production/distribution integrated Recorded Picture Company which works symbiotically with the sales agent, HanWay. Integration joins up the value chain, feeds into IPR retention and drives sustainability.

14. It is debatable whether it is the job of policy to compel industrial integration. However laudable the ambition for both the National Lottery film franchises[27]

[25] As Adrian Wootton, Head of Film London puts it: 'Film-makers… can't afford to think, 'my problem is to realise my artistic vision and then it's somebody else's problem to give it to an audience' Observer Film Magazine. 31.08.09

[26] Kudos produce the television series Spooks, Life On Mars and Ashes to Ashes; recent films include Eastern Promises (2007) and Miss Pettigrew Lives for a Day (2008). Celador make Who Wants to be a Millionaire? and co-produced The Descent (2005) and Slumdog Millionaire (2008). Ecosse Films produced Mistresses for BBC One and released Becoming Jane (2007) and Brideshead Revisited (2008).

[27] In 1996, the Middleton committee on film finance recommended that c. £100 million of National Lottery funds be put towards a distribution-led studio, attracting £200 million more in matching funds from the commercial sector. Instead, Pact (and others) successfully argued that the money would be better spent on creating mini-studios, integrating development, production and distribution in the form of film franchises, i.e. the Film Consortium, DNA and Pathé. DNA and Pathé survive post the 6-year

and the super-slate experiment,[28] both suggest that using public money to galvanise cross-industrial partnerships has been the wrong approach, as the motivation for working together arguably skews too much towards accessing the money rather than a market (and aesthetic) attuned decision to collaborate. There is, however, clear responsibility to encourage best practice behaviourally, and the legislative authority[29] to pursue equitable dealings between the Public Service Broadcasters (PSBs) and the film industry.

15. The Communications Act 2003 introduced Codes of Practice (aka Terms of Trade) that changed the way PSBs acquired programming from independent television producers, limiting the PSBs to the purchase of a broadcast licence. This consequently enabled television producers to retain their IPR, generate new forms of exploitation and build more sustainable businesses.[30]

16. The film arms of the PSBs[31] have consistently maintained that the Terms of Trade model is inappropriate for the film industry, contrasting not only the necessarily mobile British film industry with the highly regulated nature of the broadcast paradigm and its correspondingly pro-forma relationship with the financial services industry, (which, for example, discounts TV sales contracts due to their guaranteed broadcast status), but also the actual purpose of the money spent.

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tenure of the franchises, and DNA has an output deal with Fox Searchlight. Little structural benefit accrued from the narrowly focussed exercise however, and as one unnamed distribution executive was quoted in 2004, '[the government] might as well have taken £100 million into the street and set alight to the fucking lot, for all the good it's going to do.'

[28] In March 2005, the UKFC awarded £7.5million to be shared over three years between seven 'super slate' development partnerships. The rationale was that pulling together producers, distributors, sales agents and financiers (who could bring matching funds), would enhance the chances of lottery-developed scripts being more effectively distributed. This attempt to galvanise broad-spectrum partnerships proved problematic and was undermined not only by the levels of contractual compliance but by the vastly differing funding and aesthetic priorities of those involved.

[29] The Communications Act 2003 included an obligation on Ofcom to take account of Public Service Broadcasters' contribution to film as a part of their remit.

[30] Pact, the trade association for independent film and television producers, states in its annual yearbook that global exports of UK television content have grown nearly 39 per cent since 2003 (Pact submission to the House of Lords Select Committee on Communications, 2009).

[31] BBC Films and Film 4.

17. The broadcast licence fee paid by a PSB to a television producer equates, more or less, to the cost of production, and the great majority of television programming produced will be for a domestic audience. Film is not only much more expensive but also inherently more valuable, as it has the potential to be sold internationally and so attract commercial investment. The film arms of the PSBs have developed a flexible business model whereby, in addition to purchasing the right to transmit a film for one of their channels via a broadcast licence fee, they also have the option to invest some level of equity in order (potentially) to generate additional income. The film arms' key argument against Terms of Trade is that limiting their financial relationship with the film industry to a set fee would effectively 'de-fang' their credibility in the commercial market.

18. In acknowledgement of this, Pact has altered its previous position on campaigning for formal Terms of Trade to be applied to film production and re-focused on methods that could drive greater benefit for film producers from the UK's film tax credit,[32] both in and of itself and within the net profit revenue stream of a given film.

19. Pact and BBC Films have signed a Memorandum of Understanding, whereby BBC Films will treat the UK tax credit as producer equity, to be recouped pro-rata and pari-passu alongside its own equity investment. The ambition for this deal structure is for producers to share in any potential revenue in proportion to other equity investors, rather than their usual subordinate position. In practice, however, it is proving hard to convert because commercial lenders and investors (e.g. banks, Hollywood majors or equity funds) won't accept the deal structure as valid, considering the tax credit to be 'soft' money.[33] This is reflected in BBC Films' caveat that they will treat the tax credit as equity 'wherever within our gift.'[34]

[32] The UK tax credit, discussed in the next section, came into force on 01.01.2007
[33] i.e. subsidy. It is worth noting that the Hollywood financing model does not recognise either subsidy or tax credits as valid revenue.
[34] BBC Films Policy Note, 2008.

20. Accordingly, Pact and BBC Films have further agreed that where – as is most likely – the UK tax credit is not recognised as producer equity by other commercial financiers, in cases where a producer has his/her own equity to invest, the producer shall receive an 'equity corridor' alongside BBC Films' own equity recoupment. This ensures a more advantageous position than has previously existed[35] and, according to Pact, reflects the same core principle that underpinned the application of Terms of Trade on the TV production sector, i.e. increasing the commercial standing of producers by allowing them (in theory at least) a greater opportunity to see return.

21. A Memorandum has been agreed on the same terms with Film 4 and is in the final stages of agreement with the UK Film Council (UKFC).[36] It is unclear how commercially advantageous these measures shall ultimately prove to be – commercial lenders will rarely endorse the subsidising of another party's equity – but they clearly signify the engagement of the main corner stones of public money for film with the some of the realities faced by the British production community.

22. The UKFC and NESTA launched the *Take 12* initiative in March 2008 with the aim of identifying how independent film companies could adapt to the challenges of digital. The programme paired twelve film businesses (from a start-up to an established distributor[37]), with so-called 'innovation partners' who each allocated circa £40,000 worth of their time with the remit to focus on encouraging experimental digital distribution and developing future business models. An interim progress report[38] identified the importance of integrating the digital consumer (as opposed to just the companies involved in the industrial chain) into the process, utilising social media and other free internet tools; it

[35] The traditional recoupment order starts with the exhibitor taking anything up to 75 per cent of box office, the distributor then recouping its fee and advance, then financiers and equity providers in direct proportion to their investment, and finally any remaining share of profit to producers.
[36] The UKFC has been the government's strategic agency for film since 2000.
[37] B3 Media, BreakThru Films, Film Export UK, Hollywood Classics, Lux, Metrodome Distribution, Mosaic Films, onedotzero, Revolver Entertainment, Vod Almighty, Warp Films and Zini Limited.
[38] The interim report was launched at the Edinburgh International Film Festival, 23.06.09

also flagged the potential of different sources of funding e.g. Shane Meadows' Eurostar-financed *Somers Town*.

23. The *Take 12* initiative represents a more sophisticated use of public money in the quest for sustainability than the earlier methodology of the franchises or the super-slate project. By encouraging research-led experimentation around future business models across the value chain of the industry, the UKFC and NESTA can track emerging practices, not least as the lessons of the initiative are applicable for every size company, not just the largest entities.

24. Some of the Regional Screen Agencies (RSAs) represent an interesting model for the future sustainability of the SME film production community.[39] Of the nine RSAs, three – Film London, Screen East and Screen South – facilitate roughly 75 per cent of the film business in the UK.[40] Film London was established five years ago to develop coherent strategies and a raft of practical measures, including legislation, to better serve the dominant industrial film base that has long existed in London. Screens East[41] and South attract business mostly by virtue of their proximity to, respectively, Leavesden Studio and Pinewood Shepperton. With the remainder of the UK's film business split between six regions and the three National Screen Agencies,[42] some of the RSAs have morphed their business models and diversified into the broader digital screen industries. This kind of adaptive behaviour is not only an effective use of public money, but also sets an example to SMEs who could – where appropriate to their skill set – similarly diversify into the digital, games and broadcast media and open up new revenue streams. On the basis that 59 small film companies have gone out of business in the past 18 months,[43] the need to adjust is critical.

[39] There are nine Regional Screen Agencies in England: Northern Film & Media, North West Vision, Screen Yorkshire, Screen West Midlands, EM Media, Screen East, Film London, Screen South and South West Screen.
[40] Film London statistics for 2007.
[41] NB: Screen East also invested equity into 11 films in 2007 and 2008. Screen England Statistics.
[42] Scottish Screen, Film Agency Wales and Northern Ireland Screen
[43] PricewaterhouseCoopers report on corporate insolvencies in the UK, August 2009.

25. Parts of the industry are already actively working on adaptive, cost saving and digitally optimal business models. BSkyB and Curzon Artificial Eye (CAE) recently collaborated on a simultaneous release strategy on two films – *The Edge of Heaven* (2007) and *Julia* (2008)[44] – both of which took higher than forecast returns and have fed stronger than anticipated DVD sales, rather than undermined them. Revolver Entertainment undertook a similar deal for the micro-budget horror film *Mum & Dad* (2008) which was simultaneously released on Boxing Day last year by City Screen theatrically, Sky Box Office and Virgin Media on premium PPV, and by Revolver on DVD, thus drastically reducing the usual discrete, window-specific chunks of marketing spend. Justin Marciano at Revolver acknowledges that the extent to which they were able to collapse the standard windows[45] was due to the exceptional trading nature of Boxing Day in the UK.

26. It is noteworthy that none of these films were theatrically released by any of the major circuits.[46] The majority view of the CEA[47] is that the standard exhibition window is what keeps cinemas viable as businesses, allowing them to capitalise on current releases before the shift to DVD. Given that simultaneous release strategies not only represent cost-effective models for sustainable business practice, but also offer significant anti-piracy benefits, there is, this position can appear counter-intuitive.

27. It is also of note that whereas the critically important US market for mid and low-budget British films is presently very weak, the US independent distributor IFC Entertainment's model, which is mostly predicated on PPV revenue, recently released *In the Loop* (2009) both theatrically – in its own branded cinema – and via PPV in the same week.

[44] The films were released in Curzon cinemas and on Sky Box Office on the same day (Sky BO charged a premium of £9.99 for 17 days; the films were then to be made available within the standard 6 month and 12 month Sky BO/Movies windows).
[45] The standard theatric exhibition window runs exclusively for the first 16 weeks after release. Additionally, cinemas usually require a print for Friday release, retailers want new DVDs on a Monday and Video-on-Demand service providers, although less prescriptive, prefer weekends.
[46] Odeon, Cineworld and Vue account for 60.9 per cent of all screens in the UK (UKFC RSU Statistics, 2009)
[47] The Cinema Exhibitors Association represents circa 90 per cent of the UK's cinema operators.

28. There is an argument that sustainability could be reinforced via the availability of export credit guarantees to the independent film sales sector on the same basis as those currently available to manufacturing industries. Every sales agent can cite examples of foreign buyers failing to pay on time, creating cash flow problems and even forcing smaller entities out of business. The only security a sales agent has is contractual and – pre-digitally – withholding the physical handover of the film stock, but this is a collapsing and anti-commercial practice. Export credit guarantees made applicable to film sales contracts, albeit with a test for establishing the level of counterparty risk the guarantee should reasonably cover,[48] could protect sales agents from slow or absent payment.

[48] One way of achieving this would be by limiting the guarantee to sales made to Hollywood majors and established international distributors (buyers) whose corporate financials are open to scrutiny.

Finance

29. Fiscal policies for film tend to have three ambitions:

    (i) To support indigenous production;
    (ii) To galvanise inward investment;
    (iii) To encourage international co-production.

30. The incentives and schemes that are charged with delivering these ambitions fall into three categories:

    (i) Public money made available via discretionary funding from the UKFC, the film arms of the PSBs and the NSAs and RSAs;
    (ii) The UK tax credit;
    (iii) Measures to induce private or institutional investment.

31. Policy makers must actively engage with the behavioural dynamic that inevitably flows from interventions that provide discretionary public money, and/or create automatic fiscal measures for the film industry.

Public Money

32. The UKFC was established in 2000 and is financed by the National Lottery, DCMS grant-in-aid and self-generated income. Its Annual Report for the financial year ending March 2008 records the UKFC's income for 2007/08 at £57,640,000 and expenditure of £48,531,613.[49] National Lottery income makes up the greatest proportion of its income at around 46 per cent, grant-in-aid accounts for 40 per cent. Its expenditure is split between National Lottery and grant-in-aid; the largest outgoing sum is paid as grant-in-aid to the British Film Institute (BFI).[50] The UKFC also funds a variety of enabling bodies e.g. the UK MEDIA desk, the British Film Commission, the First Light Movies initiative for young filmmakers and the National and Regional Screen Agencies. It also operates discretionary National Lottery funds, examined below.

33. The main discretionary funds provided by the UKFC are for development, production – split between the New Cinema Fund and the Premiere Fund – and distribution & exhibition.[51] The research undertaken for this report has made it clear that the UKFC's discretionary funding role, in particular the production funding via the Premiere Fund, remains an essential resource for the British film industry. Interestingly, it also remains the fixed reference point of industry's relationship with the agency. This has been an issue for the UKFC since its inception: its first strategic review in 2003 noted it was, 'labelled primarily as a production financier rather than a strategic body.'[52] This is something the UKFC would do well to address, particularly as it faces funding drops from April 2010. The UKFC's strategic and public value work (which other organisations like the

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[49] The UKFC's 2007-10 spending plan identifies an average annual income of c. £60million. See Film in the Digital Age, which documents the UKFC's most recent policy and funding priorities.
[50] In 2007/08 this amounted to £16,078,389. The annual average is c. £16 million.
[51] The Development fund is allocated £4million annually for nascent talent and project (both single and slate) development, including the well-regarded First Feature Film strand. The New Cinema Fund has £5million to support innovation and new filmmakers. The Premiere Fund has £8million for commercial feature films with international appeal, and the Prints & Advertising Fund has £4million to support specialised distribution and e.g. digital marketing. There are also funds for film festival support, publications and sponsorship.
[52] Three Years On. UKFC. October 2003. p.11

BFI and the RSAs are seen to deliver) must be better articulated and therefore better understood, not only by the industry, but also more generally.

34. The UKFC acknowledges that its development and production funds – the Premiere fund in particular – are less fit for purpose than they have been and have started the process of reconfiguring them. They also suggest the primary purpose of the funds henceforth must be to foster first and second time filmmakers.

35. There is much conjecture as to the future of the UKFC's development and production funding in light of the a 20 per cent drop in National Lottery funds from April 2010. Various proposals have been put forward during the course of research as to how the UKFC could adapt its role. The most persistent refer to the need for flexibility when it comes to recoupment expectation, with percentages being re-set periodically to reflect the health of the market, and for a proportion to be returned directly to the funds to reward success. Other common suggestions were that funding be restructured to grant awards to production companies as well as (or even instead of) specific films; that the UKFC should re-address its last-in funding position, stop insisting on a proportion of any (theoretical) underspend and set maximum funding caps to reflect the reality of a film's chances of success, either commercially or critically.

36. There is also the desire for the Prints & Advertising fund to be made available sooner, although given that the P&A fund is the only demand-end fund available to the industry, its basic continuation is the greater priority.

37. However the UKFC's funding is reconfigured, there is a strong argument for a small proportion of public money being used as a magnet for the best projects and the most financially literate producers, perhaps attracting matching funds from the private sector – e.g. BSkyB, or a bank or equity fund. Such

commercialism could not only release the balance of the UKFC's discretionary funding from this ambition, but also generate a degree of public value engagement (via the prism of the UKFC's investment criteria) from the most commercial end of the market.

38. In its March 2009 submission to the ongoing *House of Lords Select Committee on Communications hearing into UK film and television content*, Pact refer to the UKFC's 'commercially aggressive,' attitude to British producers in fixing recoupment positions on the Premiere Fund and New Cinema Fund at 50 per cent and 25 per cent respectively.[53] Pact argue that placing this level of recoupment expectation on public money makes it harder for producers to approach commercial financiers, who – as with the struggle to have the UK tax credit treated as producer equity – refuse to subordinate their recoupment positions to 'soft' money (i.e. subsidy). This, Pact say, contributes to the funding difficulties faced by the majority of the film production sector.

39. In mitigation of the 'commercially aggressive' argument, the point should be made that husbanding a proportion of public money for film reasonably commercially should be protected, not least because it can compel a matching degree of market awareness in the producers who seek to access it. The UKFC sees the highest return on investment of any public film agency in the world – it self-generates around 13 per cent of its income and uses these returns to contribute towards its own overhead.[54] If all commercialism were removed from the funding remit, the overhead would have to come out of the public purse.[55]

40. Jonathan Olsberg[56] queried whether the UKFC's production funding should, in part, be automatic – beyond the automatic mechanism for the film industry that

[53] Pact Submission to the House of Lords Select Committee on Communications. Inquiry into UK Film and TV Content. March 2009. Para 16.
[54] See Film in the Digital Age. Op Cit. Page 37.
[55] It is worth noting that although the UKFC's funds are more commercial than other European countries, it is responding to the conditions of the British market. The French and Spanish markets are far more subsidised, with levels set in response to, amongst other factors, guaranteed broadcast and exhibition subsidy: the export budget alone of uniFrance is twice the entire budget for the UKFC.
[56] Jonathan Olsberg of Media Consultancy Olsberg Spi

already exists via the UK tax credit.[57] The UKFC has sought external legal counsel on the possibility of providing automatic or semi-automatic schemes. The advice received suggested that even semi-automatic funding could be contra-indicative to the basic purpose of National Lottery money being put towards 'good causes'[58] and potentially expose the UKFC to the risk of judicial review for breach of administrative law.

41. In its role as a National Lottery distributor to an industry, the UKFC has to strike a particularly fine balance, ensuring that the public value of its potential investments and the financial viability of projects outweighs the inevitable degree of private benefit that accrues to companies in receipt of funds. National Lottery legislation requires the UKFC to distribute its Lottery funds on a discretionary basis,[59] and these types of judgement are necessarily subjective; they could not be achieved if eligibility for funding were based on a set of automatic criteria.[60]

42. As a public body, the UKFC must operate within the principles of administrative law and failure to do so might give rise to judicial review of its activities. An automatic funding scheme could lay the UKFC open to charges of procedural impropriety on the basis of failing to exercise discretion as per National Lottery legislation. It could also create what is referred to as a 'legitimate expectation,'[61] of success in applicants, the numbers of which already far exceed the sums available for discretionary distribution.

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[57] The most common points of comparison for automatic funding (i.e. that which is not an automatic tax credit) are the French avance sur recette system, where producers get a percentage of box office for their next film, based on the success of their previous film, and the German FFA (Filmförderung Anschtalt) which operates on the same basis.

[58] The National Lottery Commission is charged by DCMS with running the Lottery properly, protecting players' interests and ensuring the maximum amount of money is raised for good causes. The designation of what qualifies as a good cause must a priori involve a discretionary judgement.

[59] National Lottery Act 1993. s.26(1)

[60] There is also a technical risk that the guidelines for an automatic fund might comprise an offer of funding and a contract would be formed on submission of a fully eligible application form. On the basis the UKFC has only limited Lottery funds already spread widely, it could theoretically be held in breach of contract should no funds be available.

[61] The administrative law principle of legitimate expectation is based on the idea that public bodies must act fairly and reasonably, and deliver according to their offer.

43. Discretionary funding for development and production are offered by the various NSAs and RSAs. There is no uniformity in terms of size of fund, allocation procedure or recoupment expectation: the NSAs' funding is mainly derived from various departments of their devolved parliaments, and the RSAs' money for production funding is invariably sourced from the relevant Regional Development Agency, not the UKFC. Screen England figures show that the RSAs invested £19.598 million on development and production between 2006-09. It is worth noting that Film London, Screen West Midland and Film Agency Wales all return any production profit to their funds.

44. Additional discretionary public money for film is available through either Film 4 or BBC Films, the respective film producing arms of Channel 4 and the BBC. Film 4 presently has £8 million (down from £10 million in 2007) and BBC Films £12 million to invest annually, on development and production.

45. BBC Films and Film 4 have no ambition simply to provide funds in the form of subsidy to secure future broadcast rights, but rather will negotiate hard to split their investments between the licence fee for broadcast and a strong equity position. Taking an equity position allows the two companies to leverage a degree of creative input and control, reinforcing the BBC and Film 4 brands. It also means that any potential profit based on box office performance will be reinvested in the British film industry and talent development.

46. Both BBC Films and Film 4 see themselves as research and development units for the British film industry, albeit with different target audiences.[62] Their internal, non-commercial organisational structures mean they can develop projects which might not attract other forms of investment, (or indeed be made at all), on the basis of their respective audience demographic. That said, BBC Films also sometimes buys into Hollywood studio projects where they had a role in development (e.g. Sony's *The Other Boleyn Girl* (2008), and both

[62] Jana Bennett recently announced that BBC2 would become the primary output platform for BBC Films' product; Film 4 has long had its own output channel in the eponymous Film 4, and a tendency towards a more contemporary demographic.

companies have had their films distributed by studios (e.g. Fox Searchlight distributed Film 4's *Slumdog Millionaire* (2008), which maintain their brand within the commercial marketplace and deliver tent-pole films for their theatric and television audiences[63]. This is a fine balancing act, and whereas Film 4 should have its funding pot returned to its 2007 level of £10 million as soon as practicable, too much more money for either has the potential to distort the market, either by flooding it with films for niche audiences, or using public money to compete with commercial investors.

47. The UKFC's provision of discretionary funding that is not driven by the brand profile requirements of a parent broadcaster and its ultimate television audience demographic is crucial. The public and industrial value offered by the purely film-calibrated investment paradigm of the UKFC is a prime example of successful plurality within public money for film, and every effort must be made to ensure its continuance.[64]

48. The BFI has no discretionary funding role for the British film industry. The BFI is a charity and consequently subject to the 'public benefit' test introduced by the Charities Act 2006.[65] This is a key factor in addressing the tentative argument that has been put forward for a renewed funding role for the BFI. National Lottery discretionary funding for the film industry has a clear potential to confer a degree of non-public benefit to the individual film companies in receipt of funds, and it would be hard for the BFI to square this with its charitable status.

[63] It is worth noting that Film 4 had to fight for their branding not to be taken off Slumdog Millionaire by Fox Searchlight: Brand visibility is of particular importance when public money is being invested.
[64] UKFC supported films (without PSB involvement) are as diverse as Adulthood, Gosford Park, London to Brighton, St.Trinian's, The Magdalene Sisters, The Wind that Shakes the Barley, Vera Drake and Young Adam.
[65] s. 2 (1) (b)

The UK Tax Credit

49. It is worth noting the key features and weaknesses of the most recent iterations of UK tax incentives for qualifying British film (QBF), generally known as Section 42 and Section 48 relief.

50. Section 42[66] provided that any QBF with a budget over £20million could access income tax relief at 33.3 per cent per annum over three years. The relief was applicable to the whole budget and accessible over the, 'income-producing life of a film, or [could be] set off pound for pound against income as it [arose.]'[67] It was an initiative to promote inward investment, attracting big budget, mainly Hollywood features with the financial resources to be able to wait for income to materialise, in stark contrast to the majority of British producers. In conjunction with a beneficial dollar-sterling exchange rate, its success was pronounced: by 2003 the relief amounted to around 12 per cent of an average Hollywood budget and delivered UK£1.17billion to Treasury.[68] The relief was repealed on 31st December 2006.

51. Section 48[69] granted 100 per cent tax relief on production expenditure or acquisition of QBF with budgets of £15 million or under, to be written off fully at completion[70] and applied to the whole budget. The significance of the tax write-off being available at completion, (as opposed to over the income-producing life of the film) meant investors and producers could recoup earlier and the costs of filmmaking, in theory, be reduced. The underlying motivation for Section 48 was laudable, but it was predicated on the ability to cash-flow production and reach completion before the need to access the write-off. This was an impossibility for the great majority of SME, asset-poor British film

[66] Finance Act (No.2) 1992
[67] Inland Revenue Press Release 02.07.1997 available at http://archive.treasury.gov.uk/pub/html/budget97/ir11.html
[68] UKFC press release, 12.1.04, available at www.ukfilmcouncil.org.uk/news
[69] Finance Act (No.2) 1997
[70] The 1996 Middleton advisory committee on film finance recommended that an expansion of Section 42 would have an immediate and beneficial effect on investment into British film. The Conservatives rejected the proposal, but Gordon Brown put the idea into effect in July 1997.

producers whom banks were reluctant to cash flow, and led to a transfer market where middle-men – usually a tax specialist or accountant –manipulated highly specialised sale/leaseback mechanisms[71] to access, and benefit from, the relief. The complexity and consequent expense of accessing the sale/leaseback market drastically reduced the intended financial benefit of Section 48 to the producer, and led to an uncomfortable industrial truism, expressed by John Woodward as, 'no tax experts, no British film industry.'[72] Section 48 was also repealed on 31st December 2006.

52. The UK tax credit was introduced at the beginning of 2007. It takes the form of an enhanced tax deduction and is payable as a tax credit in two tiers for QBF: for films budgeted below £20 million, the credit is worth up to 20 per cent (i.e. 25% of 80 per cent) of qualifying UK core spend; for higher budget films, it is worth up to16 per cent (i.e. 20 per cent of 80 per cent) of qualifying UK core spend. UK core spend is defined as money spent on services performed, or goods 'used and consumed' in the UK; a minimum of 25 per cent of the production budget must be spent in the UK.

53. To qualify as British, the film must pass a cultural test,[73] or qualify for one of the bi-lateral co-production agreements in place, or the European Convention on Cinematograph Co-Production. There was some delay to the introduction of the tax credit after the first version of the cultural test was rejected by the European Commission on the basis it was overly skewed towards attracting inward investment as opposed to supporting 'culturally British product.'[74] The Commission substantially amended the cultural test now in place under Schedule 1 (as revised).[75]

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[71] The sale/leaseback deal structure involved producers selling their film's negative to an 'acquirer' who would then lease it back for commercial exploitation. Acquirers could then set off the cost against their own tax liabilities and pass on benefits to the producer through the terms of the lease – usually providing a proportion of cash flow for production.

[72] John Woodward has been CEO of the UKFC since its inception in 2000. He made this remark during a keynote address to the European Audiovisual Observatory at BAFTA in October 2003. (Mansfield Notes)

[73] Previous tests for QBF were economic, and involved labour and spend tests under Schedule 1of the Films Act 1985.

[74] See State Aid for Films - A Policy in Motion? Competition Policy Newsletter 1/2007.

54. The tax credit sought to bring the inward investment and indigenous support ambitions of the previous incentives under one mantle, and specifically addressed the structural weakness of Section 48 by making it possible for producers to claim the relief in instalments at the end of each accounting period rather than having to wait until completion.

55. The tax credit is generally agreed to be a positive by the film industry, which cites the benefits of a settled incentive after the turbulence of the late Section 48 era and its straightforward certification and payment structures. There has, however, been a well-publicised drop in international co-production activity since it came into force[76] and many suggest this is a negative reaction to the tax credit not being available on the whole budget, wherever it might be spent (as under the previous mechanisms), but rather on 80 per cent of UK 'core' spend only, so as to better encourage as much on the ground activity as possible.

56. The first draft of the tax credit attached a so-called 'Brits abroad' stipulation to the core spend definition in recognition of the cost and cultural requirements of overseas film making. HMRC rejected this as it was apparently felt it would not survive EU state aid rules on territorialisation. There is significant conjecture that HMRC took the position that they were satisfied with two out of three fiscal policy ambitions (attracting inward investment and supporting indigenous production) being covered, and the cost benefits and consequences of a 'Brits abroad' extension, (e.g. British personnel working abroad would still be paying tax in the UK), were not as evident as they have subsequently become.

57. The co-production drop has been characterised by John Graydon[77] as 'fiscal symmetry,' by which he means that a dynamic developed during the previous

[75] A revised Schedule 1 sets out the four criteria for the cultural test as content, contribution, hubs and practitioners (including a 'golden points' rule), with a pass mark of 16 out of a possible 31 points.
[76] UKFC figures show a drop from 51 in 2006, the last year of the old incentives, to 20 in 2008, and corresponding UK expenditure dropping from £109 million in 2006 to £48 million in 2008. UKFC Submission to House of Lords Select Committee.
[77] John Graydon is Head of Media at Tenon and was involved in structuring the tax credit.

Section 48 era whereby producers whose films would fail to qualify as British under the old Schedule 1 spend test,[78] would instead structure films as international co-productions – which allowed for lower UK spend – to qualify as British and so access the tax benefit through a different route. This situation no longer exists as those same films would almost always pass the new tax credit's cultural test,[79] and producers are thus incentivised to spend their money in the UK. It is hard to dis-aggregate the proportion of this type of 'financial co-producing' from genuine co-productions in the recent fall, but 'financial' co-producing must be unlamented and is an ineffective use of public money. The real question is the degree to which genuine co-production has dropped due to the tax credit's core spend limitations, and how much the drop is also due to the economic downturn.

58. This question notwithstanding, if there could be a carefully widened definition of UK core spend to include some aspects of overseas activity within the 'used and consumed' stipulations – albeit limited to the requirements of the screenplay (as per the German tax credit) to ensure that the motivation is genuinely to do with making the best, rather than cheapest, film possible – then co-production levels should improve and provide a boost to producers, enabling them to go into the international market with renewed credibility. This could also have a positive impact beyond the production community: the UK Screen Association[80] suggest that it could have notable benefits for the SMEs which make up the great majority of their membership and tend to work on the greatest proportion of co-productions.

59. Development is a very low priority for public money[81] and is excluded from the tax credit. A formal extension of the UK tax credit to cover some aspects of reasonable development costs, such as script writing and acquisitions of IPR, would be beneficial to the British film industry.[82] It would be a domestic policy

[78] The old spend test required 70 per cent spend in the UK. This is now 25 per cent.
[79] The Last King of Scotland (2006), The Constant Gardener (2005) and Casino Royale (2006) were all structured as co-productions but would now pass the cultural test.
[80] The UK Screen Association is the trade body for postproduction and facilities houses.
[81] The total net public spend on film in the tax year 2007/08 was £284million. Of this, 2.7 per cent was apportioned to script development (56% was spent on production).
[82] For example, Qwerty Films took seven years and spent circa £250,000 worth of development costs on The Duchess (2008).

decision for the Treasury, not the European Commission, and in any event, the Commission has already decided film development is so strongly linked to production that the principles of the state aid rules laid down in its *Cinema Communication*,[83] can be extended to encompass it.

60. Any extension of the tax credit to cover reasonable development costs would have to carefully consider if it could be limited in its applicability to films with budgets below £20 million.

61. The greatest priority however must be consistency in provision of the tax credit as it stands, and therefore work must done on encouraging producers to co-produce *smarter* and seek out the co-production territories that work most efficiently with the benefits of the tax credit. For example, the tax credit for films with budgets below £20 million is applicable on 25 per cent of the first 80 per cent of qualifying UK spend (which nets down to 20 per cent of a 100 per cent). If, therefore, a film budget is £10 million, a producer gets 25p in the pound on the first £8 million, which builds up to £2 million (or the 20 per cent tax benefit). There is no incentive on the remaining 75p in the first £8 million, and nothing thereafter. Accordingly, Tenon advises their clients to spend this last £2 million (aka the 20 per cent part of the budget that doesn't attract any proportion of incentive) in a co-production jurisdiction that can offer an additional incentive.

62. An increase in the UK tax credit, to create a 'super' tax credit that delivered up to 30 per cent, has been mooted; the suggestion being it is a better use of public money than limited, discretionary Lottery hand-outs. Whereas such an extension would have obvious benefits for film producers and, eventually, Treasury and HMRC (through increased VAT and taxation), it also raises a number of questions that require further investigation. The first is whether increasing the

[83] 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 (26.09.2001) As amended by more recent decisions in 2004 and 2005. See State Aid for Films – a Policy in Motion?

tax credit should be the focus over and above widening the definition of UK core spend: to attempt to increase the incentive without addressing its key structural problem is problematic.

63. There is also the question of whether the broader appetite for an enhanced tax-credit – or to even re-open negotiations on ‘used and consumed’ – exists within HMRC and Treasury at such a poor time for public sector spending. Any amendments would also have to be approved by the European Commission. Given the Commission is reviewing State aid rules in 2012, there is an argument that potentially little could be lost if a considered, evidence-based submission were put in beforehand, but, as with Treasury and HMRC, the tax credit must be recognised as a privilege, not a right, and consistency the priority.

Private Investment

64. The question of BSkyB's (BSB) involvement in the British film industry came up repeatedly during the course of research, and in particular why – given film has been so significant in the take up of its subscription service – BSB no longer invest in original British film for cinematic release. BSB take the view that they have no incentive to invest where the state already provides, and that they occupy a different part of the value chain, providing industrial value in the form of securing the confidence of the Studios and their ongoing inward investment into the UK via guaranteed broadcast on the various BSB channels.

65. In sharp contrast to continental Europe, successive British governments have shown zero appetite in compelling subscription-based audio-visual services to contribute towards indigenous culture via a levy or a quota.[84] BSB have been experimenting with traditional release windows, and making forays into high-end original UK television drama,[85] and there is a debate to be had about how this work could be developed to the greatest advantage of the British film industry as a whole.

66. The private investment sector has, through a combination of HMRC intervention and the economic downturn, contracted since the tax-driven boom of the early 2000s. Sideways loss relief schemes, which utilise GAAP,[86] have been whittled down to a few sole trader or corporate structures, and must not be retooled.

67. GAAP is the most efficient, and preferred, mechanism for private investors. If, however, they could be incentivised to invest in less efficient models, for example the Enterprise Investment Scheme (EIS) – particularly if it were to be

[84] And, for example, the provisions of the AVMS directive that could be interpreted along these lines are hedged by the caveat that they are transposable only 'where practicable'.
[85] The BSB deals with Curzon Artificial Eye and Revolver, discussed earlier. Sky One broadcast the Tim Roth starring single drama *Skellig* in April 2009, and Martina Cole's *The Take* in June 2009.
[86] Generally Accepted Accounting Principles.

enhanced from 20 per cent to 40 per cent (or even 30 per cent) – there would be a considerable boost in entrepreneurial investment into film. EIS is complicated to put together,[87] but it stimulates high net worth individuals to invest in companies/films and it is a true investment, not tax avoidance. The amounts involved are not huge and the investment is not high risk, but it is still capable of yielding significant reward.

68. The 50 per cent tax rate due to be imposed in April 2010 will lead to a new boom in tax avoidance. According to Martin Churchill, editor of the *Tax Efficient Review*, the higher rate of tax makes the EIS more attractive to high-net-worth individuals.[88]

69. EIS could also be re-configured to force some attention onto the underlying nature of the investment as well as the tax relief aspect, and so act as a break on irresponsible investor behaviour.

70. An EIS enhancement would inevitably result in a burst of SME creation, but this would correct fairly quickly due to nature of the market (i.e. films fail), but those companies backing successful films would see a sustainable business emerge.

[87] The qualifying trade stipulations for EIS are complex; it ties up its 20 per cent tax relief for 3 years at least and is capped at £2 million per individual company.
[88] For example, £100 from an EIS investment is actually tax-free: an investor would have to earn £150 at 50% tax rate to earn the same £100.

71. As previously noted, the UKFC should prioritise and enhance the way it communicates its strategy and public value work. Similarly, it is essential that both government and industry recognise the actuarial work[89] at the heart of the UKFC and that its use of public money to create schemes beyond its own discretionary production funding, such as the *Take 12* initiative and the rural cinema pilot,[90] feed into this work and ensure its ongoing relevance in terms of public policy and congruence for industry.

72. The costs of the 2012 London Olympics mean drops in National Lottery funding are imminent across the creative industries and the UKFC is presently engaging in various scenario-planning exercises to establish how and where it can most efficiently shave circa 20 per cent from the Lottery share of its budget from April 2010.

73. One of the scenarios being debated is the potential merger of the BFI[91] and the UKFC, and negotiations between the two bodies are underway. The ambition is for a more, 'streamlined organisation, which can spend more of its money on film and services and less on infrastructure, and in turn offer better support for Britain's film culture and promotion of its film industry.'[92]

74. There is absolute acknowledgement from both the UKFC and the BFI that maximising the opportunities presented by the digital age must be a priority. This shared recognition has the potential to convert the historically problematic

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[89] Embodied by the Research and Statistics Unit at the UKFC.
[90] See below.
[91] The BFI was established in 1933 and incorporated by Royal Charter in 1983. Its core remit is to support that which the market cannot (or will not) support; its Charter also specifies duties to promote the 'arts of film, television and the moving image…as a record of contemporary life and manners… their impact on society…access to and appreciation of the widest possible range of British and world cinema and to establish, care and develop collections reflecting the moving image history and heritage of [the UK].
[92] DCMS press release. 20.08.09

idea (which has largely defined their relationship to date[93]), of the UKFC as an 'industrial' body, strategically enabling and funding the BFI as a 'cultural' delivery agency – an anomaly within the creative industries. This awkward bifurcation has undermined the significant cultural work done by the UKFC, unbalanced the key role of the BFI in supporting film which the market cannot (or will not) and fed confusion as to which agency 'leads' on education.

75. The case for merger has, so far, been mostly predicated on the short-term need to pool resources in a time of diminishing funding. However, it is the longer-term potential of a strategically integrated body providing a single point of contact, and in particular that single body's ability to expedite the digital optimisation of the National Film and Television Archive (NFTVA), which is more important.[94] The NFTVA is a microcosm of the broadest digital debate, in that it exemplifies the public policy issues of public access, the value of IPR and the varied research requirements of the education sectors. It also suggests a new model for the UKFC/BFI's relationship, as it is not possible to dis-aggregate the 'industrial' from the 'cultural' in the important debate about who facilitates the nation's moving image heritage.

76. As John Whittingdale noted in 2006, UK archives have tended to be viewed as the 'poor relation of the cultural sector'[95] and the BFI's key role as guardian of the NFTVA has, not only due to its sheer size but also temperamentally, tended towards the custodial and curatorial rather than facilitative. Or to put it another way, it has tended to concentrate on the *what* of maintaining its materials[96] rather than the *how* of making its materials available to the public, despite a good proportion being funded by the public purse. Digital redefines this aspect

[93] In the UKFC's first public statement in May 2000 (Towards a Sustainable UK Film Industry), the BFI was delegated the job of delivering cultural and educational opportunities for the public.
[94] The NFTVA is the largest moving image archive in Europe. It is made up of circa 50,000 fiction titles, 100,000 non-fiction and 625,000 television programmes.
[95] BSAC Briefing note. 16.11.06
[96] Rough estimates of the NFTVA suggest that about 1 per cent of both the underlying IPR and materials are fully owned by the BFI, about 10 per cent represent orphan works and the rest has an original, identifiable IPR owner or owners, but that the BFI owns the greater proportion of the physical materials. Work needs to be done on developing a commercial strategy around the materials owned by the BFI; the meta-data alone that exists within the archive, and is already owned by the BFI, is extraordinarily valuable.

of the BFI's guardianship of the NFTVA: its ongoing public value lies in its ability to meet the demands (and expectations) of a digitally enabled audience – whether a research student, a film enthusiast or a Year 5 teacher – and this should no longer be deemed 'cultural' work in isolation.

77. A merged UKFC and BFI as a strategy and delivery body would have a better chance of advancing this public value principle than the BFI alone. Merger could re-integrate public policy issues which have been separated along notionally cultural/industrial lines, and which the digital era re-invigorates: e.g. media literacy, education, vocational skills training and deterrents to piracy.

78. Merger would also reflect the growing consensus that partnerships between major cultural institutions must become the standard across the creative industries. The industrial/cultural iteration of the UKFC and BFI reinforced a degree of institutional exceptionalism that diluted the engagement and effectiveness of both, in the first instance with certain constituencies within the film sector, and, perhaps more significantly, with other public bodies and institutions. For example, the NFTVA has been specifically excluded from the current *Archives for the 21st Century* consultation.[97]

79. There has been a suggestion that the BFI has neglected the tertiary education sector and that the NFTVA would serve a greater research purpose if it were given to the British Library (BL).[98] The BL has huge expertise in digital archiving but there is debate about the suitability of placing the NFTVA within a library: the research community's gain could be at the expense of broader public access. Dame Lynne Brindley is clear that the BL does not harbour the ambition to duplicate archival activity that is being effectively undertaken

[97] The consultation is a joint initiative between the MLA and The National Archives (TNC). The MLA and TNC feel there is likely to be a need for partnerships for delivery once a strategy is in place, but excluding film from the strategy development in the first place seems a mis-step.
[98] An example has been given of an Edinburgh University lecturer who is only able to access her film research material at the BFI in London. Were this material accessible via the web, or copies permissibly made by the University library, or similar body, she would save the HE sector £600 travel expenses payable each time she has to travel to London.

elsewhere. Film is a complex synergy of art and commerce, and a merged film body, with clear strategies for the NFTVA and a National Film Centre as a focal point of access for all, should be the preferred choice for the archive.

80. There is scope for a Memorandum of Understanding between the BL and the BFI/UKFC (and the BBC archive) on clarifying responsibility and shared objectives for archiving audio-visual content on the web.

81. There is very little information as to how the BFI would continue if the merger proposal fails. It is clear that there are no additional government funds (beyond the recently announced £45 million capital sum contribution towards the circa £166 million National Film Centre), to support an independent BFI facing the enormous challenge of digitally archiving the NFTVA. It is struggling to perform beyond a subsistence level on its current grant-in-aid, and the pressure to self-generate income is additionally confusing its purpose.

82. The BFI is proscribed by charity law from borrowing money; it is also unable to do anything in terms of fund raising that might put the NFTVA at risk.[99] Amanda Nevill states that the BFI has to work on an extremely tight budget of between £32-36million per annum to stay afloat. Each year it receives around £16million grant-in-aid from the UKFC and £1million in the form of a levy from the commercial terrestrial broadcasters to fund its Television archiving.[100] It self-generates roughly 55 per cent of its income via the screens at the BFI Imax and BFI South Bank, the Times BFI London Film Festival, the Gay & Lesbian Film Festival and the BFI DVD distribution arm. The NFTVA generates no income. Of the BFI's total income stream, circa 50 per cent goes towards maintaining the NFTVA.

[99] DCMS brought the NFTVA within the government accounting net in 2007

[100] It is worth noting that the BFI keep only 20 per cent of the material they archive in this capacity. The BBC Redux prototype (which was developed at the same time as iPlayer) is currently archiving 100 per cent of all five terrestrial broadcasters for free, but at this time there are no plans to make it available to the public.

83. There is industrial concern about the BFI's level of self-generated income. A recent letter from the Cinema Exhibitors' Association (CEA) to the BFI talked of the BFI's 'mission creep' with reference to the BFI Imax showing Hollywood tent pole features like *Madagascar 2*, *Night at the Museum 2* and *Harry Potter* 6, films clearly supported by the market. This confusion of the BFI's remit has [it has been acknowledged] possibly caused its self-generated margin to reach higher levels than is appropriate, but this is justified by the BFI on the grounds that its budgetary margin is so tight. By dint of the same justification, there is a further acknowledgment by the BFI that they have been more cautious with potential licensing opportunities from the NFTVA because the short-term financial gain does not justify the potential cost of IPR clearance.

84. There is a strong public policy argument for freeing the BFI from the pressure to self-generate income, thus allowing it to focus attention on its core remit of supporting films that the market cannot sustain, facilitating access and opening up the NFTVA. Merger with the UKFC, and the corresponding clarification in strategy, would serve this purpose.

Public Value: Other Areas

85. The Communications Act 2003 included a requirement for Ofcom to take account of PSB's contribution to British film.[101] The BBC Charter commits the corporation to write a film strategy; this strategy has now been written and the Charter commitment should be extended to cover investment in original British film. The wording should match the *Digital Britain* proposals that Channel 4 update its statutory remit to include investment in a, 'wide range of original, innovative, high-quality audio-visual content, including film'. Tessa Ross at Film 4 is lobbying hard to ensure that the wording specifically refers to the 'origination' of film.

86. There is an opportunity to bolster the Communications Act requirement by including a matching PSB commitment to British film into the Audiovisual Media Services Directive (AVMS), provisions, which must be transposed into British law by the 19th December 2009.

87. Assets in the public sector must be managed coherently in the digital age, and the UKFC, the BBC, the BFI, ITV and the BL have been in discussion about the urgent need to adopt a unique numbering system for audio-visual content. There is an ISAN (International Standard Audiovisual Number) system[102] but there is growing consensus between the UKFC and the BBC that there are substantial issues that would need to be addressed before it could be adopted. The advantages in terms of identifying IPR holders, streamlining IPR clearance and tracking revenue streams should make the adoption of a standardised system for audio-visual content a public policy priority.

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[101] Section 264 (6) (b) of the Act requires Ofcom, licensed broadcasters, the BBC and the Welsh Authority, to ensure that, "cultural activity in the United Kingdom, and its diversity, are reflected, supported and stimulated by the representation in those services (taken together) … by the inclusion of feature films in those services."

[102] The ISAN is the audio-visual equivalent of the ISBN system, the common standard used around the world for books (see also the ISRC for music).

88. *Digital Britain* identified digital switchover in cinemas as a public policy issue. The public value of digitisation is inherent not only in the quality and diversity of programming possibilities, but also in re-imaging cinemas as valued community spaces, particularly in rural areas, where opera, theatre, live music and sport could be viewed in a way not currently possible.[103] Digital screening cuts the cost of releasing a film by about 90 per cent, but the greatest barrier to digitisation is the short-term cost: a digital projector and new sound system that conform to Digital Cinema Initiative (DCI) standards presently costs around £60,000 for one screen; 3D capabilities, which now represent circa 90 per cent of newly converted DCI screens, increase this amount.[104] The CEA cautions that the process of switchover could entail a severe rationalisation of the exhibition market, and, with no notable economies of scale, even the largest circuits are facing potentially huge conversion costs.

89. The first wave of the UKFC's prescient Digital Screen Network (DSN) programme concluded in late 2008 when its apportioned funding was spent.[105] Over the course of its operation, 239 screens across the UK were converted, accounting for 77 per cent of all DCI screens in the country and 17.6 per cent of DCI screens worldwide, the highest outside the US.[106] The UKFC regards the transition to digital as a key strategic priority, most particularly in rural areas which account for only 3 per cent of the UK's screens, and has been running a rural cinema pilot as part of its rural exhibition strategy that picks up where the DSN left off. The pilot is running in co-ordination with Screen West Midlands in Shropshire, Screen Yorkshire in north Yorkshire and South West Screen in Wiltshire (and the adjoining Test Valley in Hampshire).

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[103] Rural areas account for only 3 per cent of all screens in the UK, with an average of 1.4 screens per cinema site.

[104] Tim Richards, CEO of Vue Cinemas, makes the point that so far, 3D is generating disproportionately higher amounts of Box Office than the 2D versions of the same film: Up in 3D has taken almost double that of 2D, on half the number of screens.

[105] When the UKFC was set up in 2000, certain monies were carried over from the Arts Council England, including a capital lump sum which formed the great majority of the DSN fund: the project was never factored into the main UKFC budget.

[106] There are 726 cinema sites and 3610 screens in the UK. Multiplexes represent 37% of sites and 74% of screens. Of all screens, 310 have so far been converted to DCI standard, and of these 22 per cent are 3D capable. UKFC RSU 2009 Statistical Yearbook.

90. The CEA has stated that there is no desire for public money to play a central role in digital transition at this stage.[107] This is clearly the case for the major circuits: the 90 per cent saving in releasing a film digitally accrues to distributors, most significantly the Hollywood studios, which no longer have to physically produce and distribute reels of film. The largest exhibitors are therefore well placed to negotiate assistance from distributors in meeting the costs of digital conversion.

91. The CEA recently announced the establishment of the Digital Funding Group (DFG), headed by Steve Perrin, to negotiate financial support for small and medium-sized (non-circuit) exhibitors who lack the commercial leverage to effectively negotiate with distributors. Representatives of more than 600 screens have provisionally committed to joining the DFG, and the CEA are encouraging the additional non-circuit screens they represent to join the initiative as soon as possible.[108] The aim of the DFG is to secure funding on a commercial basis in the first instance; the time-consuming process of securing public funds can act as a disincentive to potential commercial investors.

92. The CEA envisage the only potential role for public money is for a so-far unidentifiable number of exhibitors for whom no commercial deal is viable, e.g. small rural cinemas, part-time cinemas and film societies.

93. In a reflection of the way the film industry perceives the UKFC primarily as a production financier, the NSAs and RSAs are predominately conceived as funding bodies. There is important public value in the ability of the NSAs and the RSAs to develop talent regionally, to reach rural or disadvantaged audiences that are traditionally harder to engage with – in particular through their involvement with initiatives like the rural cinema pilots – and in the educational and culturally reinforcing use of the regional film archives.

[107] Phil Clap, CEO of the CEA. Minutes of CEA Board Meeting. 5.5.09

[108] There is some reluctance from smaller exhibitors – e.g. Brian Bull, Chair of Circle Cinemas, who, costs issues notwithstanding, sees no clear argument for conversion on the basis that 35mm projection works perfectly well and is a proven business model.

94. The regional archive role of the UKFC, the RSAs and BFI should be articulated more clearly. The BFI currently has no formal mechanism to work with the RSAs on archival work and there is duplication, lack of clarity and, anecdotally, a degree of institutional recalcitrance towards co-operation between the BFI, the RSAs, the Film Archive Forum, the Regional Film Archives,[109] the UKFC's Digital Film Archive Fund (DFAF)[110] and the national Screen Heritage Strategy (SHS).[111] The DFAF was established to facilitate the Regional Film Archives' move towards digital and preceded the SHS.[112] The UKFC is currently working on the idea that DFAF should merge with the *Revitalising the Regions* and *Delivering Digital Access* objectives of the SHS.

[109] There is roughly one Regional Film Archive per region and they are funded by the local RSA (via UKFC) as well as local University funding, but this is extremely variable.
[110] The Digital Film Archive Fund (DFAF) aims to increase public access to regional screen heritage.
[111] The Screen Heritage Strategy should eventually deliver a one-off £25 million lump sum under the Screen Heritage UK banner, roughly broken down into £16million to secure the NFTVA, £4million for 'Revitalising the Regions' (aka RTR), £4million for 'Delivering Digital Access' (aka DDA) and £1million for 'Demonstrating Educational Value' (aka DEV). Treasury has however, to date, only agreed limited spending.
[112] The DFAF was not coordinated with BFI digital initiatives like Screenonline or Mediatheque.

Public Value: Skills & Education

95. Skillset and the UKFC launched a five-year training and education strategy for the film industry in 2004, under the headline *A Bigger Future* – the first comprehensive skills strategy for film in the world. Its aims were to provide careers advice, further and higher education information, training for new entrants, professional development for industry practitioners and research and labour market statistics.

96. A late 2008 review of *A Bigger Future* identified a number of areas where the strategy could be strengthened.[113] The biggest area for concern has been the Skillset academy network,[114] which has been felt to be controversially expensive in the absence of evidence of effectiveness. The flagship Film Business Academy at the Cass Business School[115] will graduate only one class of its MBA, which has now been suspended. It may however re-emerge under the City University banner.

97. Ben Gibson, director of the London Film School, feels that due to a lack of funding opportunities and the way public money is calibrated with an eye on the market, the UK is a, 'bad place to graduate as a film-maker.'[116] The UK Screen Association stresses that the biggest limiter for the Post Production and Facilities House sector is a shortage of sufficiently skilled labour, and bemoans the lack of standardised vocational skills training meaning new graduates must be retrained upon joining the industry.

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[113] The review suggests a failure effectively to communicate strategy to industry, an overemphasis on higher education over skills training and a need for greater co-ordination between Skillset and the NSAs and RSAs.

[114] The Skillset academy network aims to offer the highest quality skills training for the television and interactive (media academies) and film (screen academies) industries.

[115] The other screen academies are incorporated into the London Film School, Bournemouth, Edinburgh, Wales, the National Film & Television School, the London College of Communications and the Ealing Institute of Media.

[116] Quoted in 'Take a Short Cut to the Cinema'. Killian Fox. Observer Film Magazine. 31.08.09 Interestingly, the Post Production and Facilities House sector have voiced their frustration that Film schools represent where the industry was, not where it is going, and are churning out graduates who are ill prepared for digital.

98. Vocational skills are central to what the UK's film industry has to offer, and government must ensure that skills needs are being met by the secondary and tertiary education sectors, and aligned with the requirements of industry. This must go beyond self-regulation and statutory checks, which primarily aim for a representatively diverse workforce; it must address the need to integrate a cultural, industrial and technological understanding of film as a visual medium. One obvious solution is to ensure that HE sector trainers have not only worked, but also retain a level of professional involvement, within the industry.[117]

99. Skills training must encompass the market as well as technology. The London-based Production Finance Market recently held its third annual event. Its creditable aim, in addition to matchmaking between producers seeking finance and financiers seeking product, is to address low levels of financial literacy among the film production community and promote a stronger understanding of the market. A recent report on Film London, which co-sponsors the PFM, noted that the event, '[has] value in creating forums within which individuals and businesses can learn how to pitch for and access funding.'[118]

100. There is a commensurate opportunity to address the apparently low levels of technological and market literacy among new film school graduates.[119] This type of talent development is investment in infrastructure.

101. The Media Literacy Task Force[120] was established by DCMS in January 2004 and its Chartered ambitions are to ensure that people have the skills to communicate, create and participate effectively in the digital world.

102. *Digital Britain* 's suggestion that the idiom *media literacy* be replaced by 'digital participation,' which is turn is classified in terms of technological reach

[117] E.g. the UK Screen Association should perhaps encourage its top companies to offer their apprentices to the BFI and so assist in digitising the archive.
[118] Impact Evaluation of Film London. Executive Summary 1.14. Adroit Economics Ltd. January 2009.
[119] For example ensuring film schools are encouraging their students to utilise social media to connect with potential audiences for their work.
[120] The Task Force is chaired by Alex Graham and comprised of the BBC, the BBFC, the BFI, Channel 4, ITV, the Media Education Association, the UKFC and Skillset.

to achieve ‘economic and social benefits,’ is problematic. It suggests that the digital consumer is simply utilising technology, rather than making a cultural, subjective and therefore informed choice about how, and why, he or she engages with content. If the failed industry/culture separation can teach policy makers anything, it must be that the reductive reasoning that suggests it is possible to cleave technology – and attendant policy measures – from culture is redundant.

103. The EU MEDIA programme is developing a policy for media literacy development and funding which will include ‘audio-visual media literacy’ (meaning mainly film) as one of its strands. The UK is widely regarded as a world leader in the quality, range and extent of media and film available here.[121]

104. There is very little cross over between vocational skills courses and the academic study of film and media. Film studies courses are popular, increasingly relevant and yet lack any standardising quality stipulations. They also do not necessarily prepare graduates for employment within the film industry, which would matter far less if they enjoyed the same degree of academic status within curriculums as, for example, English literature or history. There is no automatic expectation that an English graduate become a writer or a history graduate an historian, whereas film studies graduates tend to find their options are limited to specialist teaching opportunities, which the variable quality of film studies courses, and its perception as a second tier subject, further limits.

105. Film studies is a key concept in the development of literacy, media based and otherwise, and yet the opportunity is being missed to coherently integrate it into formal education from the early years foundation stage (EYFS) onward,[122] and

[121] For information comparing the UK’s media literacy activities with those of other European nations, see http://ec.europa.eu/avpolicy/media_literacy/docs/studies/study.pdf.
[122] According to Cary Bazalgette children’s pre-school experience with film and television gives them a head start in understanding key literacy concepts such as narrative, genre and setting, and helps them learn about inference and prediction.

consequently improve its cultural status. *Film: 21st Century Literacy* is the UK-wide film education strategy and proposes that society has the same responsibility to help children use and appreciate moving image culture as it does teaching them to read and write.

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