ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS

COMMITTEE ON COMPETITION LAW AND POLICY

RESTRICTED

Paris, drafted : 11-October-1995
OLIS : 12-Oct-95
dist. :

DAFFE/CLP/WD(95)7

English text only

HORIZONTAL CONCENTRATION AND VERTICAL INTEGRATION IN CINEMA AND TELEVISION FILM DISTRIBUTION

(NOTE BY THE UNITED STATES DELEGATION)

This note is submitted to the Committee on Competition Law and Policy FOR DISCUSSION in connection with the mini-roundtable discussion on this subject at its next meeting on 9 and 10 November 1995.

Antitrust and Relations Between
Film Distributors and Exhibitors in the United States

1. The business of licensing movies for exhibition in cinema houses (called "theatres" in the U.S.) has traditionally been handled by "distributors," many of whom are operated by major film studios. By the 1930s the major distributors, and through them the studios themselves, were vertically integrated into exhibition, or ownership and operation of movie theatres. In the late 1930s and 1940s the Antitrust Division brought a series of cases against eight distributors alleging various horizontal and vertical violations of the Sherman Act. Eventually, judicial decrees were entered in the cases, collectively called the "*Paramount*" decrees (Paramount, Inc. was one of the defendant distributors). The decrees are not identical, but they share many common elements.

2. Those distributors that were vertically integrated into exhibition were required to divest their theatre assets, and some (but not all) were prohibited from re-entering the exhibition business. The decrees also contained certain injunctive provisions intended to prevent discrimination against small, independent exhibitors, and to prevent vertical re-integration by contract. The distributors could not engage in "block booking," or conditioning the licensing of a desired film on the simultaneous licensing of other films, or in other specified types of contractual arrangements that effectively bound a theater or chain of theatres to a distributor. *See U.S. v. 20th Century Fox*, 882 F.2d 656 (2d Cir. 1989), *cert. den.* 110 S. Ct. 722 (1990). Most of the decrees contained a requirement that defendants license their films "theater by theater, solely upon the merits and without discrimination ... ." This language gave rise to much litigation under the decrees.

3. The decrees remain in effect, but in the intervening almost half century the markets have changed significantly. Film distribution has remained moderately concentrated, with eight to ten large distributors existing at any given time. Individual market shares are not stable, however. In one year a distributor may have a highly successful "blockbuster" film; in another it may have several failures. Further, as noted above, not all distributors are subject to the constraints of the *Paramount* decrees. Some of the original *Paramount* defendants no longer exist, although all the big distributors today were *Paramount* defendants fifty years ago (with the exception of Disney, which took over distribution of its own product in the 1950s). Some distributors are vertically integrated while others are not.

4. The exhibition business has changed significantly as well. In the years following the entry of the *Paramount* decrees, movie exhibition markets were characterized by the existence of small, independent theater operators, though there were a few very big chains even in the 1950s. The operators were considered to be disadvantaged in their dealing with the distributors, upon whom the operators depended for films ("product") to exhibit. Distributors often required exhibitors to bid against one another for films. Moreover, the bidding was often "blind;" exhibitors had to bid without having seen the film, knowing only what they had learned from the advance publicity, such as the story line and the cast. Blind bidding was considered so onerous that exhibitors succeeded in having the practice declared illegal in several states. Where films were licensed through negotiations instead of bidding, however, the distributors were thought to have undue leverage against the independent exhibitors.

5. To counteract this perceived imbalance, exhibitors instituted the practice of "splitting" in many markets. (Geographic markets in exhibition were, and probably still are, localized, consisting of towns or metropolitan areas.) Splitting was simply a form of horizontal market allocation. Groups of exhibitors in

a market met periodically and allocated ("split") among themselves those films that were coming up for licensing. Subsequently, the members of the cartel negotiated for only those films that were allocated to them. Splitting was conducted more or less openly, and was condoned by the antitrust authorities in situations where the distributors acquiesced. In the 1970s, however, the Antitrust Division declared that it considered splitting to be *per se* illegal and would begin to prosecute it, initially in civil suits. This effort culminated in the *Capitol Services* case (*United States v. Capitol Services, Inc.*, 568 F. Supp. 134 (1983), *aff'd* 756 F.2d 502 (7th Cir.), *cert. denied*, 474 U.S. 945 (1985). It was held that splitting was indeed a per se violation of the Sherman Act. Subsequently the Division brought several criminal suits against splitting, and the practice has effectively ceased.

6. More recently, exhibition markets have undergone changes resulting from another phenomenon -- horizontal mergers. Where there used to be many individual theater operators or small chains of theatres, today there are more large independent chains of theatres that operate regionally or nation-wide. The major studios dominated many markets in the 1950s, and today many individual markets are still highly concentrated. Even in large metropolitan markets where there are many theatres there may be a relatively few distinct owners, sometimes only one or two.

7. In the *Syufy Enterprises* case the Antitrust Division unsuccessfully challenged a series of theater acquisitions by a chain in Las Vegas, Nevada, which resulted in the defendant having virtually all of the theatres suitable for "first run exhibition" in the city. The government argued that the acquisitions gave the defendant monopsony power in the film licensing market, and introduced evidence tending to show that the defendant undertook the acquisitions for that purpose, at least in part. Nevertheless the court ruled in the defendant's favour. The principal basis for its holding was that entry into movie exhibition was easy, requiring little more than some real estate and funds to construct a building. *United States v. Syufy Enterprises*, 712 F. Supp. 1386 (N.D. Cal. 1989), *aff'd* 903 F.2d 659 (9th Cir. 1990). Despite what the courts said in 1989 about ease of entry, Syufy still dominates the market for first run exhibition in Las Vegas today.

8. Changes have also occurred in the methods by which films are licensed. Today there is very little bidding by exhibitors for exhibition rights. Negotiation is the preferred method. Further, many of the terms of film licenses have become fairly standard. Longer term, formal and informal arrangements between distributors and exhibitors are much more common.

Current Issues

9. There has been relatively little antitrust litigation recently in the U.S. involving these markets, but there are some interesting new issues that may arise in a competition analysis of the movie business today.

10. Traditionally the relevant product market in movie exhibition cases has been "first run movie exhibition," that is, exhibition of new, mass market films in movie theatres. ("First run is to be distinguished from "sub run," or re-release of older films.) Some have argued that the relevant market must now include video tape rentals, television movie channels and/or television pay-per-view, or, for that matter, non-movie television entertainment or even other forms of entertainment.

11. Clearly, a first run exhibition market still exists from the perspective of distributors. Most new films are first exhibited only in theatres. It is said that the success of a film in the theater is vital to the later stages of exhibition on home video, network television, or cable, even if theater exhibition no longer accounts for the bulk of the income from a film. Thus, for these reasons distributors who suffer an anticompetitive five or ten percent decline in theater rentals might not forgo first run theater exhibition in favor of direct sales to cable or video tape.

12. An interesting question is whether a discrete first run exhibition market exists for consumers, or theater-goers. Again the question of substitutability of video tapes, movie channels, or television entertainment for consumers is relevant. It could be of interest currently, given the concentration in ownership of movie theatres in many markets today.

13. Consideration of conditions of entry into movie exhibition might also bear re-examination under current circumstances. In many metropolitan markets it may not be so easy to acquire the necessary land and official permits to construct new theater buildings, at least in the center city. The trend toward longer term formal and informal relationships between film distributors and exhibitors could also inhibit entry by new exhibitors.