COMMENTS ON SCREEN AUSTRALIA
DRAFT PROGRAM GUIDELINES & DRAFT TERMS OF TRADE

December 22, 2009

AUSTRALIAN SUBSCRIPTION TELEVISION & RADIO ASSOCIATION

CONTENTS

1. Overview

ASTRA appreciates the opportunity to provide comment to the Screen Australia Draft Terms of Trade (**Terms of Trade**) and Draft Program Guidelines (November 2009) (**Guidelines**).

ASTRA acknowledges Screen Australia's stated goal to contribute to the development of a vibrant, successful and dynamic screen industry, which is responsive to audiences and provides an interpretation of Australian culture both in Australia and overseas. ASTRA also acknowledges that Screen Australia's functions are to support and promote the development of a highly creative, culturally relevant, innovative and commercially sustainable Australian screen industry.

It is ASTRA's position that provisions set out in the Screen Australia Terms of Trade and Guidelines need to evolve to recognise the change in consumption patterns by Australian audiences and the need for flexibility in financing. Further that the Terms of Trade and Guidelines provide little incentive to private equity and, in their application, discriminate against Subscription Television (**STV**) in favour of commercial Open Broadcast Television (or, Free-To-Airs) (**FTA**) and the National Broadcasters (**National Broadcasters**).

In summary, ASTRA makes the following points:

- greater distinction in the treatment of feature films and TV series drama is required, as well as other forms of screen production (such as the new limited form TV drama model)

- TV series drama funding mechanisms need to be more flexible

- new and evolving forms of TV production and financing need to be taken in to account

- discrimination against STV is caused by limited appreciation for differing commercial models and regulatory regimes under which STV and FTA and the National Broadcasters operate

- opportunity to facilitate continued and/or increased private sector financing.

2. ASTRA and the Subscription TV Industry

The subscription TV industry is the undisputed market leader of digital broadcasting. A dynamic sector that is constantly evolving and growing, it is received by 32% of Australians through their homes and many more through hotels, clubs and other entertainment and business venues. It is the future of broadcast entertainment and is represented by ASTRA.

ASTRA was formed in September 1997 when industry associations representing subscription (multi-channel) television and radio platforms, narrowcasters and program providers came together to underpin and propel the new era in competition and consumer choice that these new services have brought to broadcasting, communications and entertainment in Australia.

Subscription broadcasting and open and subscription narrowcasting services were new categories of broadcasting services introduced by the Broadcasting Services Act 1992 (Cth) ('**BSA**'). These new services added to the mix of existing categories of service, those being the national broadcasting services; commercial broadcasting services (commercial television and radio); and community broadcasting services.

ASTRA's current membership includes the major subscription TV platforms as well as the many channels that provide programming to these platforms. Other members include communications companies such as OPTUS and Telstra. A complete list of ASTRA members can be found at www.astra.org.au/members.asp.

Today, subscription TV channels provided by ASTRA members are broadcast on the FOXTEL, AUSTAR and OPTUS subscription TV platforms. These channels are available to over two million residential subscribers[1] and are directly accessible by more than seven million[2] people.

Since its inception, over $A9 billion dollars has been invested in infrastructure, capital, facilities, productions, programs and services in order to establish and develop the subscription TV industry. ASTRA's members are responsible for the bulk of this investment which has been distributed throughout metropolitan, regional and remote markets. Consequently, the sector has created an enormous number of jobs, investment, infrastructure and production content throughout Australia.

The industry continues to invest heavily in its own growth and the growth of the Australian film and television broadcast sectors including the continuing investment in television programming and production.

[1] XYZ Basic Subscribers, 30 June 2009
[2] OzTAM NatSTV UEs, 2009Q2

2. DISTINCTION BETWEEN FEATURE FILMS AND TV DRAMA & OTHER FORMS OF PRODUCTION

While ASTRA notes the assumed policy of the cultural imperative of feature films, ASTRA questions the extent of its continued relative weighting.

The varying forms of screen productions now available represent changed consumption by Australian, and global, audiences who are increasingly drawn to both the traditional TV drama productions provided by FTA and the innovative short-form TV drama productions that have been rolled-out by STV.

The commissioning and production models pioneered over the last decade by organisations (such as HBO, FX Showtime) demonstrate an ability to produce highly creative and innovative programming. Such programming provides strong audience appeal, and has achieved high levels of critical and audience success. Such programming demonstrates a rich narrative that is able to reflect a broad range of cultural issues and artistic merit and achievement. The shift in the narrative has been away from feature films into the STV commissioned drama. These productions have also deployed new and varied methods of financing which Australia should position itself to take advantage of.

Australian programs such as ***Satisfaction, Tangle*** and ***Love My Way***, and international programs such as ***Dexter***, ***True Blood*** and ***The Sopranos*** are illustrative of this shift.

ASTRA's position is that the relative commercial and audience success of the TV drama and other production sectors and their ability to consistently appeal to audiences and provide a consistency of employment and skills acquisition can empower and provide an economic and creative base that is required for a successful feature film industry. A clearer distinction between feature film and TV drama within the Guidelines and Terms of Trade could assist in the creation and expansion of a stronger and more vibrant TV drama series sector – and, by extension, a more vibrant and successful feature film sector.

As both an investor in, and broadcaster of, both feature films and TV production, ASTRA and its members have a very strong interest in seeing the advancement of both the feature film and TV production sectors.

Disparities are evident in the following areas of the Guidelines and the Terms of Trade.

<u>Development Programs</u> - while available to all other areas, no development programs are provided in relation to TV drama.

<u>Production Financing – Level of Funding</u> – the contribution cap (which combines the Producer Offset and Screen Australia investment noted below) creates a disincentive to non-Government funding. This, in turn, further compounds the position of private equity that no longer has access to the former 10B and 10BA ITAA tax provisions.

- 65% for feature film
- 40% for "adult mini-series" (tv series drama 13 episodes or less)
- 45% for children's drama
- 75% for documentaries.

4. DIFFERING MODELS OF STV AND FTA

The mass appeal and mass target market of FTV and the niche nature of STV create a fundamental difference that impacts the way each industry operates, is regulated and meets the needs of its audience. STV codes of practice are designed with the expectations of the audience in mind, about program and advertising content of particular channels, at particular times. A distinctive feature of subscription television is the direct contractual relationship between the service provider and the subscriber.

ASTRA makes the observation that the relationship between STV and its subscribers is very similar to that between a theatrical distributor and the audience at the box office, a direct contractual one.

<u>Differing economic models</u>

STV and FTA operate on completely different economic models. In broad terms, the FTA targets the mass market with broad appeal programs that are acceptable to advertisers. FTA has no direct relationship with its viewers. STV targets specific audiences with innovative programming hoping to win and maintain the support of subscribers.

This economic difference is seen in the type of programming that is commissioned and the funding that is available. STV has only recently entered the black after over a decade of investment to build the industry and offering in Australia.

<u>Differing regulatory regimes</u>

STV and FTA operate under completely different regulatory regimes: FTA under the "quota" and STV under the "expenditure obligation".

The current regulatory regime requires that a TV drama series program run first on FTA and then second on STV (in order that it may satisfy both the FTA quota obligation that includes Australian drama, and, the STV new eligible Australian drama expenditure rules). This regulation often forces STV to finance TV series drama productions in a way that does not meet the Guidelines which assumes that the two should have identical license fee structures.

ASTRA comments that, given the differences in audiences and economic models, this produces a result that is mismatched to the market and audiences.

ASTRA notes the statement contained in the Terms of Trade (under the section 1. GENERAL MATTERS, 1.2 Project eligibility) that *"[t]elevision projects must also be quota-eligible programs in relation to commercial broadcasters' compliance with the Australian Content Standard, as detailed on the ACMA website <u>or the equivalent requirements applying to subscription TV</u>."* (emphasis <u>added</u>) and comments that the "*equivalent requirements"* are vastly different between STV and FTA and therefore create a disadvantage for STV.

There is a need to create clarity of the fundamental difference between STV and FTA which could be embraced in the following areas of the Guidelines and the Terms of Trade.

License Fee requirements

The Production Financing section of the Guidelines draws no distinction between STV or FTA license fees.

All references are in the form of *"Screen Australia will expect a local free-to-air or pay television presale of not less than x% of the budget, with a floor price of $y per hour, or part thereof"*. The percentage and dollar requirement varies depending on the type of programming:

> TV drama – 35% and $400,000
> children's TV drama - $95,000
> documentary - Screen Australia investment matched to a *"domestic broadcaster's license fee"* and, in relation to an International program, $100,000 for a *"domestic network"* (emphasis added).

ASTRA's comment is that this provision carries the implication that there is no distinction in the commercial terms offered by a FTA and an STV service. This is not correct – neither with respect to license fees per se nor with respect to overall financing and deal structures.

Further, the quantum of the license fee sought to be mandated to STV does not represent the economics of the STV market place. A large (and exceptional) audience for an STV TV drama (on its premiere screening) is approximately 150,000 viewers. A large (and not unexceptional) audience for an FTA drama is 2,000,000 viewers. An FTA is able to access 100% of the audience.

As a further aspect of the above point, ASTRA comments that the license fees paid by FTA and STV for third party international product are significantly different – with FTA paying a multiple (mostly a significant multiple) of the license fee able to be paid by an STV service.

5. CHALLENGES FOR COMMISSIONING BROADCASTERS

As a general proposition, commissioning broadcasters have a closer and more immediate relationship with their audience than feature film producers. This is particularly so with STV which has a direct contractual relationship with each viewer. Further, commissioning broadcasters are involved in the development of slates, with decisions as to which project(s) go into production being a function of numerous and changing factors.

The STV model is comprised of both broadcasters and channels. Channels are either on the basic platform or on a tier. All have different relationships with each other and subscribers. All are capable of commissioning programming.

ASTRA comments that the requirements that:

- key executives be sourced only from the freelance market (and not *"from the staff of free-to-air or pay television channel[s]"*; and
- Screen Australia will not finance drama where the project has been developed by a broadcaster and sub-contracted at a later stage to a producer;

need to take into account the evolving market, and provide the flexibility necessary to ensure a green light to the largest number of projects possible.

ASTRA makes the general comment that the industry goal is to generate economic activity and create and maintain the related environment for continued and increased production. To this end, it should not matter whether a broadcaster works in partnership with a producer (including by way of whole, partial or joint funding) of the difficult, costly and risky process of development. Further, it is legitimately within the nature of the relationship between a commissioning broadcaster and an independent producer that a commissioning broadcaster might have developed a project, partially or wholly, by finance and/or dint of the broadcaster's creative executives.

In many instances, the risk and cost of development is borne by the commissioning broadcaster at no cost to the independent producer.

6. TREATMENT OF THE PRODUCER OFFSET & RECOUPMENT STRUCTURES

ASTRA understands Screen Australia's desire to balance the mix of direct and indirect funding. Also, ASTRA notes Screen Australia's policy decision to accord the producer a level of equity in return for cash-flowed Offset brought to a production by the producer.

ASTRA notes Screen Australia's position that Screen Australia *"… expects the producer to make a contribution towards the cost of production for Offset projects. That contribution will be at least 90% of the projected value of the Offset for feature films and television, and at least 85% of the projected value of the Offset for documentaries"*. And further, *"[t]hat proportion of the Offset which becomes a contribution to the budget will be deemed to be producer's equity in the project, equal to the value of the Offset contributed"*.

ASTRA also notes Screen Australia's position in relation to recoupment of investment (equity), and specifically the statement that *"[t]he recoupment structure for a project will be determined on a case-by-case basis taking into account Screen Australia investment and the investment of others, both equity and non-equity investors"*.

ASTRA still further notes Screen Australia's continuing, though now modified, requirement that the producer be accorded a minimum equity entitlement of 35% and a 50% share of profits.

ASTRA makes the following comments.

ASTRA states that it does not wish or intend to direct the manner in which Screen Australia requires its funds to be recouped. ASTRA does comment that Screen Australia should avoid imposing recoupment structures that distort the market or make it unattractive for private equity to become involved in financing. This is especially critical during a period that has demonstrated the market's reluctance to become involved in film and TV financing and following the recent changes of 10B and 10BA ITAA provisions.

ASTRA notes that Screen Australia's position allows producers, who are cash-flowing a third party loan (against the Producer Offset) into a production budget to be accorded a minimum 35% position in the product (ASTRA makes no per se comment on this as part of this point). Further, that the financing structure approved by Screen Australia involves the following further elements:

(1) that the Producer Offset, when paid, flows directly to the discharging of the third party loan; and,

(2) that the producer is accorded a notional 50% of the copyright and profit position (with all equity investors, including the producer, to share pro rata, pari passu to share in the other 50%).

ASTRA's comments are as follows:

With respect to point (1) above – the producer's third party loan is discharged by a segregated and discreet pool of money (the Producer Offset), whereas private equity is left to recoup from proceeds that flow down from gross receipts. The treatment of the "recovery" of the producer money and private money is not equitable. Such treatment has the effective result of giving the producer a corridor against private equity (and thereby delaying private equity's timing and ability to recoup).

ASTRA's comment is that either the producer's cash-flowed third party loan against the Producer Offset is treated as a loan (and therefore not given a corresponding equity position), or, if it is to be given equity status, then such should not delay recoupment by private equity. This could be achieved by either putting 100% of the Producer Offset into gross receipts (and thereby all investors sharing the same risk), or, the effect of the corridor against private equity being separately catered for.

With respect to point (2) above – under a practice that appears to continue from The Film Finance Corporation, the producer is given a 50% share of copyright and profit. This was a policy formulated and applied at a time that did not include the Producer Offset but did provide private equity with 10B and 10BA tax provisions. On its own, and in conjunction with point (1) above, the result is a large disadvantage, and disincentive, to private equity.

ASTRA's comment is that the above, while being an arrangement that may facilitate the producer gaining a particular position and Screen Australia satisfying certain policy objectives, does not attract or encourage private equity to feature film and TV production financing.

7. THEATRICAL DISTRIBUTORS

The MARKETING section of the Guidelines propose the introduction of access to financing by Distributors. These are in the form of the proposed "THEATRICAL P&A" and "INNOVATIVE DISTRIBUTION".

ASTRA does not oppose an initiative which seeks to bring a product to the attention of an audience or to a wider audience. ASTRA does make the following observations in relation to the Theatrical P&A:

- the previous requirement of the Film Finance Corporation that a distributor must contribute, initially, a set percentage of the financing to a production (5% then down to lower levels), then a *"significant"* amount of financing to production, has, over time, been reduced and eliminated;

- the Guidelines now propose a pre-requisite of a *"significant"* P&A from a distributor (which will not be subsidised by this Theatrical P&A fund);

- that funding will be recoupable on terms *"negotiated by Screen Australia with the applicant"* on a case-by-case basis.

ASTRA comments that Distributors are in a not dissimilar position, as exploiters of copyright material, to a television broadcaster. Yet no comparable restrictions are placed on Distributors with respect to access to Screen Australia funding nor does Screen Australia purport to prescribe the terms on which a Distributor be involved in a project that receives Screen Australia funding.

ASTRA comments that a Distributor, which has no obligation imposed under the Guidelines nor the Terms of Trade to contribute equity or any form of "at risk" money (including any minimum Distribution Advance of Distribution Guarantee), will gain the benefit of the Theatrical P&A fund from Screen Australia. This, in turn, contributes to ensuring the recovery of the Distributors "first out" money (but does not necessarily assist in, and may delay, the recoupment of equity).

Also, as P&A is classified as debt in the financing matrix, it will be retired before equity (and therefore ahead of equity investors). Therefore, any discussion on the recoupment of a Theatrical P&A should involve all equity participants (and not just Screen Australia and the party receiving the Theatrical P&A, as is proposed in the Draft).

One practical effect of this proposed new arrangement is that the desire to take private equity positions may be diminished in proportion.

8. CONCLUSION

It is ASTRA's position that provisions set out in the Screen Australia Terms of Trade and Guidelines need to be more flexible in order to embrace new and evolving forms of TV production and financing opportunities.

Screen audiences, in terms of tastes and methods of consumption, are rapidly changing. Increasingly sophisticated TV drama is being consumed in many different ways. ASTRA's comment is that, in their present form, the Guidelines and Terms of Trade are reflective of old consumption and distribution models and need to better acknowledge the new dynamics.

The distinction in the treatment of feature films and TV series drama needs to be balanced to incentivize private equity funding which will create advantage for all forms of television production.

ASTRA's position is that, if able to work with Screen Australia on terms that reflect current and evolving industry practice, and in-turn attract private equity, a larger pool of money may be created from which to finance TV productions.

ASTRA believes discrimination against STV is caused by limited appreciation for differing commercial models and regulatory regimes under which STV and FTA and the National Broadcasters operate, which should be addressed.

The creative, craft and producorial skills required to train and sustain a successful film industry benefit from a strong TV market. The biggest audiences and the most innovative programs are being generated by television. This is a global trend that Australia needs to embrace. ASTRA's comment is that the skills and expertise, as well as financing models, that are known and employed by television, would form the basis for a better and more sustainable film industry.

We welcome the opportunity to comment on the Screen Australia Terms of Trade and Guidelines. Please do not hesitate to contact ASTRA if you require further information or clarification of the matters raised.

Please contact:

Petra Buchanan
CEO, ASTRA
02 9776 2685