

# **Review of Trade Barriers in the US Audiovisual Market**

## **Advice provided to British Screen Advisory Council**

**Reed Smith LLP – June 2013**



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**1. Introduction and Overview**

- 1.1 This paper reports the findings of our research aimed at identifying legislative and regulatory barriers to trade that may restrict or impede the participation of UK firms in the audiovisual industries in the United States of America (the ‘US’).
- 1.2 The barriers we have been able to identify exist in the mature sectors of the industry: film and television. We have not found barriers in the field of Internet-delivered audiovisual services.
- 1.3 Trade barriers in the film and television industries can take a variety of forms: for example, tax incentives and production subsidies available only to domestic firms; quotas for domestic productions in television channels; incentives for cinemas to show domestic productions; public financing of and spectrum allocations to broadcasting services; requirements for prominence to be given to public service channels in electronic programme guides; restrictions on foreign ownership of transmission platforms. Although tax incentives and some funding subsidies exist in the US, we do not consider that they act as barriers to trade, for the reasons given below. We have not been able to identify any other potential barriers to trade in the US, save for the restriction on foreign ownership of a terrestrial broadcasting platform.
- 1.4 Our conclusion is that only the restriction on foreign ownership of a US terrestrial television broadcasting licence can be described as a true barrier. However, the economic conditions in the US market are such that, even were this barrier to be removed, UK firms would find it extremely difficult to enter this market. Such licences are awarded on a localised, not a national basis. Assembling a portfolio of stations and making carriage arrangements with third party-owned ones to achieve national coverage would be a daunting prospect. Buying into the market by acquiring an existing network player does not appear to be feasible; the four existing national broadcasting networks are businesses of such a scale that they would be beyond the

economic reach of all but a few potential UK purchasers. Further, as we describe below, there are now other means available for UK firms to supply television channels to US audiences. In consequence, this barrier does not in reality appear significantly to inhibit participation in the US market.

## 2. **Tax Incentives**

- 2.1 All but a few states within the US offer tax incentives for film and television programme production to be carried out within their respective states. In many states the incentives are available also for production of interactive entertainment such as videogames and for production of audiovisual advertising<sup>1</sup>.
- 2.2 These incentives generally take the form of a right to claim credit against US tax liability for 20% and in some cases for up to 30% of production costs incurred in the state. As these incentives are of use only to persons with US tax liabilities, it might appear at first impression that they are not available to UK producers. If that were the case, they would represent a form of subsidy to US producers, giving them an advantage over foreign producers in the market.
- 2.3 The reality is that UK producers are able to gain the benefit of these tax incentives even if they have no US tax liabilities against which to set off the relief. First, many of the states allow the tax credits to be transferred, enabling the creation of funding structures which result in production funds becoming available. Second, by co-producing with a US partner a UK producer can ensure that the tax relief obtainable by the US producer can be converted into funding for the production.
- 2.4 As an example, Georgia offers tax incentives to draw film-making away from Hollywood. Georgia offers film, television and interactive entertainment producers a 20% transferable tax credit if they spend more than \$500k in the state, plus an additional 10% if they feature a Georgia peach logo in the credits. To tap into the tax incentives, in April 2013 Pinewood Shepperton announced plans to build studio facilities near Atlanta, Georgia targeting US productions. Pinewood Shepperton is co-venturing in the project with US investment firm River's Rock. As this demonstrates,

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<sup>1</sup> For a listing of the tax incentives, see <http://www.entertainmentpartners.com>

these state tax incentives can open up opportunities for UK firms to participate in the US market.

- 2.5 We conclude that the tax incentives offered by US states for film, television and other audiovisual production do not represent a barrier to trade. This conclusion is reinforced by the fact that ITV, BBC Worldwide and several UK independent production companies have acquired or established production companies in the US.

### **3. Film exhibition**

- 3.1 We have found no legislative or regulatory barriers that restrict the exhibition of UK films in the US market. The domination of the US cinema market by US films is a reflection of market forces, not of protectionist measures such as a requirement that a certain minimum proportion of films exhibited be of US origin, or the subsidising of cinemas to show US product.

- 3.2 Nor are there indirect barriers such as might arise if there were restrictions on foreign ownership of cinema chains. The absence of any such protectionist measures is graphically illustrated by the fact that the second largest share of the US cinema market is now owned by the Chinese group, Dalian Wanda. In September 2012 it closed a \$2.6 billion deal to purchase AMC's 347 cinemas in the US and Canada.

### **4. Broadcasting**

- 4.1 There is a barrier to trade in the broadcasting sphere, but to understand its significance it is necessary to distinguish between relevant platforms and also between platforms and content services. We preface our account of these with the comment that, because of the conditions in the US television market, we do not consider that removal of the barrier would to any significant degree facilitate the entry of UK firms into the US broadcasting market.

#### **Platforms**

- 4.2 First as to transmission platforms, the US has through its telecommunications regulator, the Federal Communications Commission (the 'FCC'), implemented the market-opening commitments it made in the World Trade Organisation (WTO) Agreement on Basic Telecommunications Services concluded in 1997.

- 4.3 Those commitments did not, however, extend to satellite systems providing direct broadcasting satellite (DBS) and direct to home (DTH) services, the most relevant for the purpose of broadcasting of television channels. For such satellite services, the FCC initially determined that for all requests to provide such services to the US using a non-US licensed satellite, an evaluation was needed to determine whether effective competition opportunities for US satellite systems were available in the country in which the foreign satellite service was licensed. This rule was subsequently modified so that in the case of WTO members it was assumed that such opportunities existed. The FCC now has a Permitted List on which many non-US licensed satellite operators are included as being permitted to provide services in the US.<sup>2</sup>
- 4.4 In the case of US-licensed satellite services, the US market is also effectively open to foreign firms. For the provision of a US-licensed DTH satellite system, there is no restriction on foreign ownership. For the provision of a US-licensed DBS system, the FCC concluded in 2002 that there were no public policy justifications for continuing to impose foreign ownership restrictions on such DBS providers, principally because this would prevent DBS from achieving a more equal regulatory basis with cable platforms. Those are not subject to foreign ownership restrictions.<sup>3</sup> The restriction on foreign ownership was accordingly lifted.
- 4.5 At the satellite and cable platform level, therefore, there appear to be no significant legislative or regulatory barriers to entry that stand in the way of provision of such platforms by UK firms.
- 4.6 In relation to terrestrial over-the-air broadcasting platforms there is a different picture. An operator of a terrestrial broadcasting platform will require a spectrum allocation licence. These are granted by the FCC. Under section 310(b) of the Communications Act of 1934, which we have set out in the Appendix to this note, non-US ownership of a terrestrial broadcasting spectrum licence is restricted. In summary, such a licence may not be granted to or held by
- A non-US citizen or their representative

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<sup>2</sup> FCC Satellite Competition Report. Paragraph 141, Third Report, December 2011. IB Docket 10-99

<sup>3</sup> FCC MB Docket No 03-124. News Corporation/Direct TV at paragraphs 27 and 28. See also: 2002 DBS Report and Order. 17 FCC Rcd at 11348.

- a foreign corporation;
- a US corporation more than 20% of the stock of which is owned or voted by non-US citizens or by a foreign government or by a foreign corporation;
- a US corporation that is directly or indirectly controlled by a corporation more than 25% of whose capital stock is owned or voted by non-US citizens or by a foreign government or corporation if the FCC finds that the public interest will be served by the refusal or revocation of such licence.

Clearly this restriction does represent a barrier to entry for UK firms wishing to enter the US market to provide a terrestrial over-the-air broadcasting transmission service.

- 4.7 It must be recognised, however, that even if this barrier were to be removed, it would remain very difficult from a logistical perspective for a UK firm to enter this market because licences for such services are granted for individual cities and other localised areas, not on a nationwide basis. As it would be a slow and uncertain process to acquire a portfolio of such licences by bidding for them as they come up for renewal, the usual entry route into the market is via the acquisition of an existing holder of such a portfolio. Such opportunities as arise to do this at scale are infrequent. Licences for major conurbations are held by the four US networks (ABC, CBS, NBCUniversal and Fox), businesses of a size that put them beyond reach of all but a few potential UK purchasers: Comcast's purchase of NBCUniversal valued the latter at some \$30 billion. Given such market conditions, obtaining the removal of the barrier to foreign ownership of terrestrial broadcasting licences would seem unlikely to result in market entry by a UK firm.
- 4.8 Further, the significance of the barrier is reduced because other means of delivering a television channel, such as via satellite, cable and the internet, offer other entry routes for UK broadcasters to the US market, as described below.

### **Television channel provision**

- 4.9 Turning from platform provision to content service provision, the question arises as to how it is possible for a UK broadcaster to provide a television channel within the USA which is aimed at US audiences. In theory at least, based on the account set out above, it could own and operate its own satellite or cable platform and carry the channel on that system. It could not, as things stand, own and operate a terrestrial broadcasting system. In reality, though, given that owning and operating such platforms would seem to make little economic sense for a UK channel provider, what such a channel provider would do is negotiate carriage agreements for its channel to be transmitted on third parties' cable, satellite and terrestrial transmission platforms. There is no barrier to entry to a UK firm wishing to follow this course, as BBC Worldwide has shown. Its BBC America channel is available to some 80 million US homes.
- 4.10 As to content regulations applicable to providing a television channel in the US, we have not been able to identify any provisions which represent a barrier to entry of a kind that a free trade agreement could usefully remove. For example, there are no requirements that television channels provided to US audiences must include a certain minimum proportion of content made by US producers or with US personnel.
- 4.11 There is one type of potential barrier to trade in relation to channel provision, namely public subsidy for US broadcasters. The Corporation for Public Broadcasting (CPB) is a private corporation created by the federal government. It receives appropriations from the federal government under the Public Broadcasting Act of 1967. The CPB provides support to the PBS network, to local television stations and for the production of television content. Its budget for 2012 provided for allocations to these three sectors of \$26.6 million, \$222.4 million and \$79.9 million respectively<sup>4</sup>. The PBS network is the public service television broadcaster in the US. The PBS network is owned and operated by its member stations, some of which are operated by State agencies and local authorities (such as municipal boards of education). Approximately 41% of PBS's revenues in 2010 derived from sources other than commercial advertising and sponsorship<sup>5</sup>, that is, from the CPB, local grants and from private donations. Given the public service mission of the PBS service and its limited

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<sup>4</sup> <http://www.cpb.org/aboutcpb/financials/budget>

<sup>5</sup> Alternative Sources of Funding for Public Broadcasting Stations. Corporation for Public Broadcasting, June 2012 at page 17

market share, we do not consider that such subsidies for this service create barriers to entry for a UK broadcaster wishing to enter the US market.

## **5. Production personnel**

- 5.1 UK artists, directors and other talent wishing to work in the US in the audiovisual industries are subject to US visa and work permit requirements. We are not aware of any evidence that these are used systematically to reduce such participation.
- 5.2 The US talent guilds, namely the Screen Actors Guild, the Directors Guild of America and the Writers Guild of America, have requirements for the engaging of foreign talent by US producers; they must be engaged on the terms set out in the Guilds' agreements with producers. These agreements are not government-endorsed and are not therefore matters that are appropriate to be dealt with in an international free trade agreement. In any case, they are not seen by the UK talent industry as barriers to participation in the US market; UK talent generally will benefit from having to be engaged by US producers on US terms.
- 5.3 Conversely, UK producers wishing to engage US actors, directors or writers – in other words, wishing to enter the market for US talent – have to accept that US talent is bound by the membership rules of their Guilds only to work on the terms specified by the Guilds. This results in a number of administrative burdens for the UK producer, requiring special arrangements to be made to ensure that the Guilds' requirements are met. This does mean that UK producers are not quite on a level playing field with US producers, who will have organised their administrative arrangements to meet the Guilds' requirements. Again, however, these requirements are not legislative or regulatory measures of a kind that a free trade agreement can modify or remove.

## **6. Other subsidies**

- 6.1 The National Endowment for the Arts, an agency of the federal government, makes grants of funds to support not-for-profit arts projects. In the audiovisual field the beneficiaries include film festivals, archive digitisation and preservation projects and some television series. Although these grants are only available to US tax-exempt



organisations, the scale of this form of public subsidy is small: only \$1.5 million went to such audiovisual projects in 2011.<sup>6</sup> As a trade barrier it is therefore insignificant.

## **Appendix**

### **Communications Act 1934**

#### **§310. License ownership restrictions**

##### **(b) Grant to or holding by alien or representative, foreign corporation, etc.**

No broadcast or common carrier or aeronautical en route or aeronautical fixed radio station license shall be granted to or held by—

- (1) any alien or the representative of any alien;
- (2) any corporation organized under the laws of any foreign government;
- (3) any corporation of which more than one-fifth of the capital stock is owned of record or voted by aliens or their representatives or by a foreign government or representative thereof or by any corporation organized under the laws of a foreign country;
- (4) any corporation directly or indirectly controlled by any other corporation of which more than one-fourth of the capital stock is owned of record or voted by aliens, their representatives, or by a foreign government or representative thereof, or by any corporation organized under the laws of a foreign country, if the Commission finds that the public interest will be served by the refusal or revocation of such license.

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<sup>6</sup> National Endowment for the Arts, Annual Report 2011. See <http://www.nea.gov>.