Antitrust Law Blog

March 11, 2011 by Sheppard Mullin

U.S. Film Studios Agree to Modify "Most Favored Nations" Clause in EU Contracts to Encourage Financing and Installation of Digital Equipment

On March 4, 2011, the European Commission ("EC") announced that it had closed an investigation into whether the contracts of several major U.S. film studios for the financing and installation of digital projection equipment in European cinemas infringed the EU's competition law banning anticompetitive agreements and practices (Article 101 of the Treaty of the Function of the European Union). The EC was concerned that the contractual arrangements - which required each studio to be offered the most favorable terms agreed with any film distributor - could have the effect of restricting the access of smaller independent film distributors to cinemas with new digital equipment. The major U.S. film studios agreed to amend their contracts to address the EC's preliminary concerns and to avoid a more lengthy and detailed formal antitrust investigation.

To encourage European cinemas to install high-cost digital equipment, the major U.S. film studios exported a virtual print fee ("VPF") model under which both film distributors (which include the major U.S. film studios) and European cinemas contribute towards the costs of investing in digital projection systems. Under the VPF model, an "integrator", a third party intermediary, obtains financing, pays upfront for the digital equipment and installs it in cinemas. The film distributor then pays the integrator, who remains the owner of the equipment until its repaid over time. Every time a digital film is shown in a cinema, the film distributor pays a VPF towards the recoupment of the equipment cost. VPF payments cover the majority of the costs, with the remainder paid for by the cinema exhibitors, which make an upfront payment to the integrator. Most VPF payments are made by the major U.S. film studios.

The EC was concerned that many of these contracts gave the film studio the right to benefit from the most favorable terms, including lower VPF payments, that had been agreed between a given integrator and film studio or distributor. These "most favored nation" clauses were intended to ensure that competitors, primarily the other U.S. film studios, would not contribute less to the digital switchover while still obtaining equal access to the digital projection equipment in European cinemas. While the EC recognized that the contracts provided incentives to encourage the roll out of digital projection equipment in European cinemas, it was concerned that the "most favored nations" clauses could hinder integrators from signing contracts with distributors of independent/art house films whose business models differ from the major U.S. film studios and, thereby, restrict independent distributors' access to cinemas with digital equipment.

Following the EC's investigation, several U.S. film studios revised their contracts with integrators and cinema exhibitors for the financing and installation of digital projection equipment in European cinemas. The EC believes that the revised provisions will facilitate the release of independent and art house films in new digitized cinemas. Joaquín Almunia, Vice-President of the EC in charge of Competition Policy stated: “I am pleased that Hollywood studios considered our legitimate concerns and modified the contracts so that cinemagoers can watch both Hollywood blockbusters but also small budget and art house films with the latest state-of-the-art technology”.

The EC previously investigated the major U.S. film studios' use of “most favored nation" clauses in European pay-tv contracts. These contracts gave each studio the right to enjoy the lowest payment agreed by a particular European pay-tv company with any studio. The EC was concerned in that case that the cumulative effect of these clauses would be the restriction of price competition. The investigation was closed in October 2004 after the U.S. studios similarly agreed to withdraw such clauses from their contracts.

Authored by:

Neil Ray
(619) 338-6595
NRay@sheppardmullin.com