

State aid for films – a policy in motion?¹

*Jérôme Broche, Obhi Chatterjee, Irina Orssich and Nóra Tosics*²

In late 2006, the Commission approved the new UK and German film support schemes. This article explains the application of the State aid rules in these two cases, in particular in view of the recent trends such as the global competition to attract large budget films. It also considers the future perspectives of the Commission's State aid policy in this field.

US productions generally dominate European screens. It is commonly believed that, in the absence of public support to film production in most Member States, most European productions would already have disappeared. In the four years 2002-2005, they provided over € 6.5 billion of State aid for film production³, which helped to produce over 3,600 films. France provides the highest overall amounts of State aid for films, followed by the UK, Germany, Italy and Spain. Public support in these five countries is accounting for 83% of the total. According to the European Audiovisual Observatory, there are over 600 film support schemes operating across the EU.

Legal basis for State aid control

Cinema and TV production support mechanisms are assessed on the basis of Article 87(3)(d) EC which was introduced by the Maastricht Treaty. This provision specifically deals with State resources being dedicated to culture. Following this provision "*aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest, may be considered to be compatible with the common market*". Since the introduction of this article into the Treaty, it is clear that, in principle, culture is not excluded from the application of the Community State aid discipline.⁴

In 2001, based on its experience of assessing various national film support schemes and particularly the French system, the Commission published a Communication setting out the conditions for the application of Article 87 (3)(d)⁵ to the production of "*cinematographic and*

¹ Article appeared in the Competition Policy Newsletter 1/2007

<http://ec.europa.eu/competition/publications/cpn/>

© European Communities 2007. Reproduction is authorised provided that the source is acknowledged.

² European Commission, Directorate-General for Competition, Unit H-3. The content of this article does not necessarily reflect the official position of the European Communities. Responsibility for the information and views expressed lies entirely with the authors.

³ Copenhagen Think Tank / European Audiovisual Observatory: http://www.dfi.dk/NR/rdonlyres/1BE19F2D-F61F-403F-934C-B0AB2447D9D8/0/CTT_Information_Notes_300606.pdf

⁴ The issue of whether or not the Treaty, and hence State aid rules, is applicable to culture at all has been settled a long time ago. Already in one of its early cases, the Court of Justice dismissed the argument that the Treaty was an economic Treaty and would not apply to cultural goods (case 7/68 Commission v Italy [1968] ECR 617). Moreover, despite the fact that prior to the introduction of Article 87(3)(d) EC, it was a frequent assumption that culture in general should be exempted from the application of State aid rules, the Commission actually examined and approved a range of aid mechanisms for culture under Article 87(3)(c) EC, including aid to the audiovisual sector. See also Rapport présenté par la Commission au Conseil sur la prise en compte des aspects culturels dans l'action de la Communauté européenne of 17. 4.1996, COM(1996) 160 final, page 22.

⁵ 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 (COM(2001)534 final of 26.09.2001, OJ C 43 of 16.2.2002); prolonged by Communication



other audiovisual works, (the 'Cinema Communication'). This Communication requires the so-called general legality principle to be respected and sets out four additional specific compatibility criteria according to which aid for cinema and TV production can be approved as cultural aid under the exception in Article 87(3)(d) EC:

a) The general legality principle

The general legality principle is essentially enshrining into the Cinema Communication the established case law according to which State aid incorporating conditions which contravene other provisions of the Treaty cannot be approved by the Commission⁶. For example the benefit of aid schemes cannot be restricted on the basis of nationality. Also, schemes of aid to cinema and TV production financed by parafiscal charges are incompatible with the Treaty when such schemes benefit solely national producers.

b) Aid must benefit a cultural product

The aid must be directed at a cultural product. Each Member State must ensure that the content of the aided production is cultural according to verifiable national criteria (in compliance with the application of the subsidiarity principle). Therefore, the Commission does not assess what is culture and what is not. The Commission only verifies that the national authorities have drawn up a verifiable selection system which ensures that only cultural products, as defined by the national authorities, will benefit from the aid. It is only where the Commission considers that there is a manifest error in the definition of the cultural products concerned that the Commission might question the substance of the cultural definition.

c) Territorialisation

This criterion foresees that the producer must be free to spend at least 20 per cent of the film budget in other Member States without suffering any reduction in the aid provided for under the scheme (so-called territorial conditions).

d) Aid intensity

The aid intensity must in principle be limited to 50 per cent of the production budget with a view to stimulating normal commercial initiatives inherent in a market economy and avoiding a bidding contest between Member States. Difficult and low budget films are excluded from this limit. Under the subsidiarity principle it is up to each Member State to establish a definition of difficult and low budget film according to national parameters. For example, a derogation might be granted for works in a language which is not widely spoken.

e) Aid supplements

from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on the follow-up of the Commission communication on certain legal aspects relating to cinematographic and other audiovisual works of 26.09.2001 (COM(2004)171 final of 16.3.2004, OJ C 123 of 30 April 2004.

⁶ Case 73/79 *Commission v Italy* [1980] ECR 1533, paragraph 11; Case C-225/91 *Matra v Commission* [1993] ECR I-3203, paragraph 41; Case C-156/98 *Germany v Commission* [2000] ECR I-6857, paragraph 78.

Finally, the last criterion stipulates that aid supplements for specific film-making activities (e.g. post-production) are not allowed in order to ensure that the aid has a neutral incentive effect and consequently that the protection/attraction of those specific activities in/to the Member State granting the aid is avoided.

It should be noted that the Cinema Communication only refers to the production of films. In its more recent Decisions the Commission applied the Communication by analogy also to the development of film projects, including the writing of screenplays,⁷ as well as to the promotion and distribution⁸ of films. This approach is motivated by the idea that these activities are so closely linked to the production of films that the principles developed in the Communication are also applicable to them⁹.

While the Commission's approach in assessing these criteria has not significantly changed over the 5 years since the Communication was first published, various new trends have emerged in the funding policies applied across the EU.

Films as cultural goods

In the past, State aid for the film industry was mainly given in order to promote a 'national cultural film industry' and it is against this background that the current rules were drafted. One recent trend however has been the global incentive 'war' to attract large budget films. Two analyses, one for the UK¹⁰ and one for California¹¹ illustrate the economic advantages of attracting and the costs of losing large budget films, respectively. The first analysis concluded that the UK film industry contributed £3.1 billion (EUR 4.5 billion) to UK GDP in 2004. Both analyses stress that this is a highly mobile industry and the Californian analysis begins by noting that "*... a growing number of states and countries have recognized the value of employment and government tax revenues generated by film and television production and are aggressively courting the business with tax credits and other enticements. ... [They] have started building their own studio facilities, launched training programs for their residents, and implemented relocation and outreach programs for experienced non-residents. The result has been to create real competition for motion picture production.*"

⁷ For example State aid N 181/2004 – Germany, *Förderung von Film- und Fernsehproduktionen in Baden-Württemberg: Medien- und Filmgesellschaft Baden-Württemberg mbH.* http://ec.europa.eu/community_law/state_aids/comp-2004/n181-04.pdf.

⁸ For example State aid N 368/2005 - Spain, *Ayudas a la promoción de obras audiovisuales por Andalucía,* http://ec.europa.eu/community_law/state_aids/comp-2005/n368-05.pdf

⁹ On the other hand, measures favouring activities not linked to the production of films have been assessed under Article 87(3)(d) EC directly. Furthermore, undertakings in the film and television programme production sector may, depending on the circumstances, also benefit from other aid types granted under national horizontal aid schemes, not aimed directly at cultural activities, but more widely at assisting types of economic activities or regions which happen to also encompass undertakings in the audiovisual sectors (e.g. regional aid, aid for small and medium sized enterprises (SMEs), research and development aid, training aid, employment aid).

¹⁰ *The economic contribution of the UK film industry* published by Oxford Economic Forecasting, supported by the UK Film Council and Pinewood Shepperton plc, September 2005: <http://www.ukfilmcouncil.org.uk/get/?doc=117>

¹¹ *What is the cost of run-away production? Jobs, Wages, Economic Output and State Tax Revenue at Risk When Motion Picture Productions Leave California* published by the California Film Commission and the Los Angeles Economic Development Corporation, August 2005: http://www.film.ca.gov/ttca/pdfs/link_overview/cfc/California_Film_Commission_Study.pdf



In view of the fact that the attraction of (foreign) film productions to a certain national territory is driven often by more economic than by cultural considerations, and that these film productions would sometimes receive considerable financial support, the Commission has to ask itself whether the schemes it assesses meet the cultural condition for the application of the cultural derogation. It is for the Member States to define the concept of culture, albeit along the lines of the Cinema Communication, i.e. that "*Each Member State must ensure that the content of the aided production is cultural according to verifiable national criteria*". The Commission shall thus ensure that the Member States have not committed a manifest error in defining the cultural purpose of their schemes, and that the criteria they have established ensure that this goal will be met. In any event, since the Cinema Communication is based on Article 87(3)(d) EC, any aid that could not be argued to go to cultural activities, cannot be declared compatible with this Communication.

It is in this perspective that the Commission examined the new £ 120 million per year UK and EUR 60 million per year German film schemes at the end of 2006. These schemes apply both points-based cultural tests as part of their eligibility criteria, which were closely analysed by the Commission to see whether they effectively ensure that the aid is directed towards a cultural product. In fact, the approval of the UK film tax incentive¹² was based on a revised UK Cultural Test submitted by the UK authorities in November 2006, rather than on the original UK Cultural Test which they had notified to the Commission.

UK film tax incentive

In the UK film tax incentive case, the aid takes the form of an enhanced tax deduction and a payable film tax credit. The enhanced tax deduction allows a film production company to benefit from a higher deduction for certain production costs than the normal UK tax rules would allow. The payable film tax credit allows the film production company to receive a cash payment of up to 25% of any tax loss.

To select the eligible films, the UK authorities have drawn up a point-based test called the UK Cultural test. The original UK Cultural Test was divided into three sections, two of which referred to certain technical costs (such as studios and visual effects) and the geographic origin of certain categories of cast members. In view of this, only the criteria in the first section of the original UK Cultural Test could be used to ensure that the aid was directed towards a cultural product. However, the first section only accounted for 4 points out of 32 (one of which for the use of English in the film's dialogue). A film could achieve the pass mark of 16 points without picking up any of the points in this section. It therefore was not clear that the original UK Cultural Test would always ensure that the aid would be directed towards a culturally British product.

¹² http://ec.europa.eu/comm/competition/state_aid/register/ii/by_case_nr_n2005_450.html#461

The revised UK Cultural Test which has subsequently been included in the relevant legislation is substantially different from the original UK Cultural Test:

Section	Revised UK Cultural Test		Original UK Cultural Test	
A - Cultural content	16	52%	4	12%
B - Cultural contribution	4	13%	0	0%
C - Cultural hubs	3	10%	15	47%
D - Cultural practitioners	8	26%	13	41%
Overall maximum	31	100%	32	100%

The Cultural content section comprises four criteria: extent to which the film is set in the UK; what proportion of the main characters are British citizens or residents; whether or not the subject matter or underlying material of the film is British; and extent to which the original dialogue is in English. The new Cultural contribution section comprises three criteria: cultural diversity, cultural heritage and cultural creativity. These two sections account for 65% of the overall points available (20 out of 31 points). Therefore a film satisfying only these two sections could achieve the 16 points required to pass the test.

In addition, in case of the extreme scenarios of a film obtaining most if not all of the 11 points in Sections C and D and all the four points for the use of English, (as English is widely spoken internationally, it could be argued that the use of English in a film's original dialogue would not necessarily guarantee that the film would be culturally British), a film could not pass the test without fulfilling at least one additional cultural criterion from the first two sections. The Commission therefore concluded that the revised UK Cultural Test ensures that the content of this film could reasonably be found to be cultural, according to the UK definition.

German Film Fund

The new German Film Fund, also approved by the Commission at the end of 2006,¹³ represents a different model both in its form and in its definition of cultural content. From the point of view of its form, it is a selective scheme which awards direct grants. Moreover, there is a maximum financial limit to the grant available per film, which is as a rule, EUR 4 million, or up to 10 million in exceptional cases. These characteristics make it already inherently less attractive for large budget films than the UK scheme.

In addition, the eligibility test designed by the German authorities respectively for feature films, documentaries and animation films focus not only on German, but also on European cultural content and contain specific criteria for films promoting universal cultural heritage. This test include three different parts: "*cultural content*", "*creative talents*" and "*production*", each of which is attributed a number of points..

¹³ http://ec.europa.eu/comm/competition/state_aid/register/ii/by_case_nr_n2006_690.html#695

The "*cultural content*" part contains a number of criteria, including the following :

- Content, motives, film locations, principal characters, storyline are from Germany, the German culture or language area or from Europe or the EEA,
- One of the final versions of the film is in German,
- The film is an adaptation of a literary work or originates from traditional fairy tales or legends,
- The film is about artists, art genres, significant personalities, historical achievements, religious or philosophical questions, issues of socio-cultural relevance, way of living of people and minorities, scientific issues,
- In the case of animation films, the storyline is meant and appropriate for children's or youth film
- The film is made with the contribution of a contemporary artist.

The "*production*" part clearly relates to commercial aspects and attributes points based on the production phases carried out in Germany. The part on "*creative talents*" reflects the participation of creative talents from Germany or the EEA.

In order to qualify for the aid, a film has to first fulfil a minimum number of criteria in the "*cultural content*" part (the "pre-test") (this number varies according to the type of production). Additionally, the candidate film has to achieve a minimum score of the total points available in the test.

In its assessment, the Commission examined in detail the different criteria proposed by the German authorities, the structure of the tests as well as the individual points attributed to the different aspects. Taking into account the pre-test specifically designed to ensure the cultural content of the films financed under the scheme and the truly cultural character of the criteria in the "*cultural content*" part of the tests, the Commission came to the conclusion that aid is indeed directed towards a product with cultural content. In this case, the relevant criteria aimed either at supporting German culture (eg, content, motives, film locations, principal characters, storyline/artworks from the German culture, the German language requirement, etc.), or promoting European culture (eg, European content and motives, film location or principal character), or strengthening cultural heritage in the general sense (eg, adaptations of literary works, films about artists, art genres, significant personalities, historical achievements, etc.).

Extended outlook and the question of territorial conditions

As explained above, the new UK and German schemes were, like any other audiovisual and TV production support system, assessed on the basis of the Cinema Communication. This Communication will expire on 30 June 2007. The Commission had announced that "*in advance of the next review of the Communication, the Commission intends, in addition to further analysing the arguments of the sector, to carry out an extensive study on the effects of the existing State aid systems. The study should examine in particular the economic and cultural impact of the territorialisation requirements imposed by Member States, in particular taking into account their impact on co-productions.*"¹⁴ This study was launched in August

¹⁴ Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on the follow-up of the Commission communication on certain



2006 and is expected to be completed in autumn 2007. The preliminary results will be discussed at a workshop in summer 2007 to which stakeholders such as funding bodies, film producers, exhibitors and distributors will be invited. In order to allow time to complete the study and the subsequent review of the Communication, the Commission will continue to apply the rules of the current Communication until such time as new rules come into effect, or, at the latest, until 31 December 2009. The current Cinema Communication will be prolonged accordingly.

Territorial conditions, which require that a proportion of the film production expenditure is incurred in the territory providing the aid will thus be among the central issues of the review. As noted above, the relevant criterion in the current Communication is that film producers must be able to spend at least 20% of the film budget in other Member States without suffering a reduction in the aid provided for under the scheme. In other words, the Commission accepts that territorial conditions may require expenditure of up to 80% of the production budget of an aided work to be spent in the territory providing the aid.

On the one hand, such conditions may be justified to ensure the continued presence of human skills and technical expertise required for cultural creation. On the other hand, the clauses obliging producers to spend a considerable amount of the film budget in the territory offering the aid are likely to constitute a barrier to the free circulation of workers, goods and services across the European Union.¹⁵ They may also strengthen the fragmentation of the European film sector and some film producers have called for territorial conditions to be removed. Finally it is not at all clear why certain cost categories should be considered to have to have an impact on the expertise needed for cultural creation: for example costs for catering are often considered to be part of the film production budget, hence are subject to territorial conditions.

Indeed, the Communication also states that territorialisation requirements must be limited to the minimum degree required to promote cultural objectives. The maximum territorial requirement of 80% was set in 2001 when few Member States imposed territoriality requirements in order to qualify for aid. However, the recent trend has been for most new schemes to apply territorial conditions and to set them at or close to this limit, as in the UK film tax incentive scheme and the German Film Fund.

In this context, the question arises to what extent should the cultural derogation in Article 87(3)(d) EC allow the Member States to support their 'national cultural industries' to the detriment, for instance, of the Treaty's fundamental freedoms. This question goes to the heart of the relationship between 'culture' as a nationally defined concept and the internal market freedoms. To strike the right balance between these two elements, the new rules that the Commission will adopt will have to consider these issues as reflected in the results of the study concerning territorialisation. The review of the Communication could also take account of other recent trends affecting the sector. These include the growing number of State aid schemes offering aid for aspects such as film distribution and development, the global incentive 'war' to attract large-budget productions, and investment in digital

legal aspects relating to cinematographic and other audiovisual works of 26.09.2001 (COM(2004)171 final of 16.3.2004, OJ C 123 of 30 April 2004.



distribution/projection facilities. The Commission will aim at ensuring that its policy is suited to the current environment of the sector.