APPENDIX 2*

Joint Submission of ACTRA, APFTQ, CMPA, DGC and WGC
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FOREIGN OVER THE TOP SERVICES AND THE CREATION, ACQUISITION AND EXHIBITION OF CANADIAN CONTENT

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1. Introduction

The current study attempts to provide an early snapshot about the implications of the arrival of unregulated foreign OTT services in Canada. It focuses particularly on Netflix Canada, which has experienced unprecedented success in its inaugural year in this country. However, the issues raised are likely to apply to other foreign services currently operating in Canada or being contemplated and to some extent to domestic OTT services as well.

The study provides a broad strokes analysis of Netflix Canada's content acquisition and exhibition practices so far to demonstrate that it is operating in Canada in a manner that differs very little from that of incumbent Canadian broadcasters and that, in a very short time, it has become a real "player" in the Canadian broadcasting system. Based on a review of Netflix Canada's current Canadian programming offerings and the results of interviews with Canadian content producers, the study also demonstrates that the service is contributing very little to the Canadian broadcasting system in comparison to those incumbent Canadian broadcasters.

2. Netflix Canada is a "Player" in the Canadian Broadcasting System

There is little denying that the arrival of OTT services in Canada has taken root in a very short time. Throughout this discussion, we will be focusing on Netflix, an Internet delivered subscription programming service that has achieved enormous and immediate success in Canada in less than a year. Netflix is but the tip of the iceberg, however, as numerous other OTT services may take aim at the Canadian market, including domestic-focused services and those which may look to their experience in Canada as a sort of litmus test for expansion to the rest of the world.

For $7.99/ month, Netflix Canada subscribers have access to a wide variety of movie and television programming, which can be streamed at the convenience of the viewer, and easily viewed on television screens, PCs, iPads and mobile phones. This subscription model is akin to that of Canadian Pay TV services which rely on monthly subscriptions as their sole source of revenue (albeit at close to double the price[1]), or to subscription VOD (SVOD) services, which are authorized in Canada only if not competitive with Canadian linear discretionary services.[2]

TMN and Movie Central are the two biggest premium Pay TV services operating in Canada. The two services have been operating in Canada for almost 30 years. According to the latest CRTC financial summaries for 2010, total revenue for TMN last year was $136.5 million; for Movie Central, it was $107.8 million.

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[1] Ironically, once the monthly subscriber fee is split with the BDU providing the service, Canadian Pay TV operators probably end up with about the same amount as Netflix receives in monthly revenue per subscriber.
[2] Broadcasting Regulatory Policy CRTC 2011-59.

Comparing these numbers to those of Netflix Canada is informative. Launched in Canada in September 2010, Netflix Canada claims it will attain its one millionth Canadian subscriber by the end of this summer and thus before one full year of operation has been completed.[3] At $7.99 per subscriber per month, this means Netflix Canada will earn over $100 million in revenue from Canada over the next year. In other words, Netflix Canada will accomplish after just one year of operation what it has taken each of Canada's original premium Pay TV services almost 30 years to accomplish.

Notably, Netflix's almost 23 million subscribers in the US puts it well ahead of US pay TV service Showtime (18.2 million) and approaching HBO/Cinemax at 28.6 million.[4]

Given its current practice of acquiring primarily older movies culled from various catalogues, Netflix Canada could also be compared to the 'classic' movie Pay TV services, MPix and Encore Avenue, as well as specialty and digital services that rely on catalogue movies to fill out their schedules. Hundreds of titles currently being offered on Netflix Canada, such as *Easy Rider, Patton, Butch Cassidy and the Sundance Kid, Bye Bye Birdie, Dr. Strangelove,* etc... have also played on MPix and Encore Avenue. For comparison purposes, MPix reported revenue of $24,055,487 to the CRTC in 2010 and Encore Avenue had revenue of $19,175,770 for the same period.

Netflix Canada's content acquisition activities also resemble those of Canada's Pay TV operators. In fact, Netflix Canada wasted little time in going after some premium Pay windows, in order to access more current content. They recently signed an output deal with Paramount Pictures for exclusive Canadian Pay television rights, have a shared window deal with Superchannel for Twentieth Century Fox Pay titles, and have a day-and-date commitment with Mongrel Media to simultaneously premiere selected art-films on Netflix, Superchannel and in theatres. Notably, in the case of the Paramount deal, that means that a foreign OTT service has acquired full Canadian linear rights to these titles for the length of the Pay TV window, essentially taking them out of the market for Canadian broadcasters.

By buying out linear territorial rights in Canada for the duration of the Pay window on an exclusive basis, Netflix Canada advanced the rules of the game. At the very least, the threat of Netflix Canada being able to outbid Canadian premium Pay TV operators for premium Pay TV windows will have repercussions for years to come, driving up prices for foreign output deals and squeezing profit margins for the Canadian Pay operators.

Comparisons can also be made between Netflix Canada's practices and those of the Canadian specialty service Showcase in terms of acquiring and exhibiting TV series. Showcase was selected for review because of its focus on premium drama series from around the world. Of the thousands of TV series to choose from, it is worth noting that

[3] 'Netflix seeks to reassure Canadian media producers', Marsha Lederman, Globe and Mail, June 15, 2011.
[4] 'The Impact of Over the Top Platforms on Filmed Entertainment', Salter Group Report, March, 2011.

Netflix Canada is already offering earlier seasons of many of the same shows that subscribers are paying to watch on the Showcase linear service, examples of which are as follows:

Damages
Drop Dead Diva
Hawthorne
Jekyll
Kenny vs. Spenny
Rescue Me
Saving Grace
Survivors
The L Word
Trailer Park Boys
Weeds

Showcase also has its own video streaming service, and it is interesting to note the extent to which Netflix Canada is offering similar titles, as the examples in the following chart demonstrate:

Showcase	**Netflix Canada**
Weeds: Seasons 3 – 6	*Weeds*: Seasons 1 and 2
Rescue Me minisodes	*Rescue Me*: Seasons 1-4
Kenny vs. Spenny: Seasons 2-6	*Kenny vs. Spenny*: Seasons 1 and 2
Trailer Park Boys: Seasons 6 and 7	*Trailer Park Boys*: Seasons 1-5

As a subscription-based aggregator of content from various sources, Netflix's operations have also been compared to those of a BDU.[5] In this respect, with 800,000 subscribers projected to grow to a million by the end of the summer, Netflix Canada is already comparable to Cogeco Cable (at 881,000 subscribers) and Shaw Direct (formerly Star Choice) at 900,000 subscribers. If Netflix continues to grow at its current rate in Canada, in a year's time it will be approaching the size of Rogers Cable (2,296,000 subscribers as of first quarter 2011) and Shaw Cable (2,313,104 subscribers). Videotron has 1,732,600 subscribers and Bell Satellite TV has 1,800,000.

To put these numbers in context, Netflix in the US now has more subscribers than US cable companies Comcast (12.9 million) and Time Warner Cable (12.6 million).

3. Netflix Canada and Canadian Content

At the recent Banff World Media Festival, Ted Sarandos, the chief content officer for Netflix, is reported as having argued that Netflix "supports Canadian content through lucrative licensing deals and that roughly 10% of Netflix's offerings are Canadian."[6]

[5] 'Who are we kidding? Of course it's Netflix vs. cable', Janko Roettgers, Gigaom, June 14, 2010.
[6] 'Online CinemaNow service eyeing 'significant' amount of Cancon: Best Buy', Mark Burgess, The Wire Report, June 16, 201

A content analysis of Netflix Canada's offerings, however, fails to support that claim. It is somewhat difficult to accurately compile statistics about the number of titles on the Netflix Canada site, as no master list is provided, and titles are lined up according to genres. Many titles are listed over and over again in different sections, with a title such as Patricia Rozema's 1995 *When Night Is Falling* reappearing on lists of Canadian movies, gay and lesbian movies, lesbian movies, romantic movies, and steamy romantic movies. Nevertheless, in these sections, after eliminating duplicates, we counted 46 indie dramas, 14 documentaries and 25 comedies, as well as 45 TV shows, for a grand total of 130 titles. We totalled the overall number of titles listed within the various genre sections to arrive at a number of 5547 programs (including duplicates). Note that this does not account for multiple episodes for a TV series, simply the number of box images offered on the site within each genre. Dividing 5547 by 130 yields a grand total of 2.3% for Canadian content on the site, a far cry from the 10% claimed at Banff.

Admittedly, the overall numbers may be slippery due to duplications between genre listings, so we attempted to analyze the amount of Canadian content present within each genre, as listed on the site. Skipping over some genres (such as foreign fare) which by definition would not have any Canadian content, we focused in on the genres most favoured by Canadian filmmakers (and Telefilm).

In the area of 'drama', we counted 35 Canadian titles out of a total of 1050 (3%). In the 'horror' genre, we counted 2 titles out of 200 (1%). The other calculations: 5 titles out of 157 for social documentaries (3%); 5 out of 79 for gay films (6%); 34 out of 534 for indie drama (essentially the same 35 titles we encountered under 'drama')(6%); 17 out of 505 for romance (3%); 4 out of 337 for thrillers (1%); and 6 out of 174 for sci-fi/fantasy (3%).

According to Netflix's Sarandos, 60% of Netflix viewing goes to television programming[7], and with a recent deal with CBC granting them rights to such shows as *Being Erica*, and day-after broadcast rights to *Republic of Doyle*, it was anticipated that there would be a much higher representation of Canadian titles within the television category. The number comes to 45 out of 621 titles (7%).

These numbers of course only represent the selections offered. They do not factor in the actual number of downloads per title, or time spent viewing, so the best estimate is that Canadian content on Netflix Canada is about 3% of the offerings, well below the 10% claimed at Banff. This is commensurate with the percentage of Canadian content found in other unregulated delivery systems, such as the theatrical marketplace. According to Telefilm Canada's Annual Report 2009-2010, the percentage of theatrical boxoffice that went to Canadian films in 2009 was 3.3%, up from 2.9% the previous year.

Perhaps Netflix Canada has a number of Canadian titles waiting in the wings. But they probably also have many other non-Canadian titles lined up as well, so proportionately, it seems unlikely that Cancon will ever attain 10% of their selections in English Canada.

[7] 'Netflix in Canada: Friend or Foe?', wordpress.com, June 16, 2011.

4. Netflix Canada and Canadian Producers

For the purposes of this study, we spoke to about a dozen members of the CMPA to ascertain their opinions and experiences regarding whether or not Netflix Canada presented them with new opportunities to make or sell their Canadian programs (a list of questions asked is included in the Addendum).

Not one Canadian production company that the author spoke to has been able to make a direct sale of its catalogue material or get any kind of financing for new product from Netflix Canada. In fact, a number tried to set up meetings while at Banff with Netflix representatives, but to little avail.

One producer did acknowledge a significant prebuy for a Canadian TV series with Netflix in the US. He had to share the revenue with the US broadcaster, but it was a win-win in terms of more money flowing into the production budget, and a happy US broadcaster with a first window and a lower license fee. Another producer has made a number of sales of television shows to Netflix in the U.S., but sales of the same shows to Netflix Canada have not been possible as Canadian broadcasters own the rights. Another producer of children's programming was putting together a large package of kids' shows for the US Netflix market. He is hoping that once the package is accepted, he'll be able to talk them into an additional buy for Canada. He fears, however, that they will try to leverage their US buy and 'throw in Canada for free'.

Another analysis we attempted was to track approximately 50 Canadian-produced MOWs (movies of the week) produced between 2009 and 2011 and all presently available on Netflix USA. None were available on Netflix Canada. The most recent Canadian MOWs on Netflix Canada go back to the year 2008. Yet newly released non-Canadian MOWs were frequently available on both Netflix Canada and Netflix USA. If Netflix Canada is not licensing material from Canadian producers within the two years following date of production, then they are not contributing in any meaningful way to the triggering of any new production in Canada. According to Premiere Bobine's (a major producer of Canadian MOWs) written submission to the CRTC in response to the call for comments prior to the recent group broadcast licensing renewal hearing, most (though not all) prefinancing of content comes from the first two year cycle of exploitation following production. Licensing older catalogue material does have a value, of course, which flows back to distributors on shows that have already been financed, but it does not trigger any title specific new production.

Netflix isn't the only OTT game in town south of the border, of course. One producer had managed to license season three of his hit Canadian series to iTunes in the US through a US broadcaster, on a shared revenue basis. Another producer of high-profile mini-series and TV movies estimates that his company averages $8000 to $9000 a month in iTunes revenue. It's not a significant amount of money, but it's consistent and doesn't seem to detract from any other revenue sources. Finally, we spoke to one innovative company that made a successful web series that was downloadable to iPhone apps, funded by the digital fund when it was at Telefilm. They didn't make any money on the series' $40,000 budget, but they didn't lose much either.

All of this to say that Canadian producers seem to be actively exploring all possibilities for new models and markets for delivering their product to consumers, but so far it seems like digital pennies will not be replacing analog dollars anytime soon. And despite Netflix claims that they are entering into lucrative license deals for Canadian content, nothing appears to be flowing into the creation of new content or directly into the hands of producers.

It would seem that the only immediate beneficiaries of the arrival of Netflix in Canada to date have been the CBC and large Canadian film distributors.

Certainly, the highest profile acquisition for Canadian content to date has been the deal with CBC announced in December. Shows including *Heartland*, *InSecurity*, *Being Erica*, *The Tudors*, *The Nature of Things* and day-after premiere showings of *Republic of Doyle* were part of the deal. We spoke to two producers involved in the shows within this package, and both confirmed that none of the money from the sales flows back to them.

It is worth noting that Bell Media, Rogers, Corus and Shaw Media have not made any such sales to Netflix Canada.

For large Canadian film distributors, Netflix represents a new customer, especially at a time of declining sales of movie packages to TV operators. At the Banff World Media Festival, Victor Loewy, the head of Alliance Films, "insisted Netflix Canada was acquiring library product that Canadian broadcasters and distributors were not buying up. 'Netflix is paying more for Canadian films and I don't understand how that isn't helping the system continue', Loewy questioned."[8] One Canadian distributor that we spoke to sees benefits to the arrival of OTT services in Canada, commenting that they add competition to the marketplace, create another buyer for library/catalogue programs and provide a platform for audiences to find older titles. The distributor noted that Netflix's presence also allows distributors to pick up third party titles in addition to their own catalogue titles for sale to Netflix Canada. However, none of these sales have been in respect to the pre-sale financing of any Canadian series or feature films.

If nothing else, Netflix has provided large Canadian distributors with some leverage to negotiate with Canadian Pay TV and specialty operators. If Canadian Pay TV and specialty operators don't purchase packages of content at what the distributors believe to be reasonable prices, the distributors with desirable American titles can always threaten to go across the street and make a deal with Netflix Canada.

Smaller distributors in Canada, however, have not fared so well with Netflix. They have complained that Netflix will not acquire small numbers of titles, and that they must give

[8] 'Banff TV Panel Turns Into Food Fight', Etan Vlessing, The Hollywood Reporter, June 13, 2011.

up their product to bigger aggregators of product, which take a percentage of the smallish license fees. One distributor complained that he was offered $500 for a two year, non-exclusive window for a Canadian film on Netflix, which wouldn't even cover the costs of technical encoding (which runs from $800 to $1200, depending on the title and the volume of business a distributor might have with a given lab).

5. Conclusions

According to Profile 2010 (an annual snapshot of the production industry jointly financed by the CMPA, the APFTQ and the Department of Canadian Heritage), the volume of Canadian production was just under $2.3 billion in 2009-10. Canadian production generated GDP of $3.1 billion and employed 54,700 FTEs in 2009-10. The export value of Canadian productions in 2009-10 was $214 million. Close to 72% of the financing for Canadian product comes from a combination of television license fees, various tax credits and the Canada Media Fund.[9]

By any measure of success, the above numbers attest to the efficacy of the various public policies that have been put in place over the years whose goal was to create, nurture and support Canadian production and self-expression, in the shadow of the largest cultural behemoth in the world.

The arrival of unregulated foreign OTT services in Canada becomes a direct threat to the system that we have so successfully built up here when they start using deep financial resources to purchase exhibition rights to product that would otherwise be sold to broadcasters within our territory, and to use these purchases to compete with Canadian broadcasters directly: in other words, when OTT services become "players" in the Canadian broadcasting system, as Netflix Canada has clearly become in a very short period.

When you choose to do business with Canadian customers on Canadian soil, with a monthly subscription model that is directly analogous to Canadian Pay TV and specialty services, you have effectively crossed a border. And if your financial activity in that foreign land is perceived as being potentially detrimental to local interests, be they financial or cultural, it is only natural to expect some kind of return or reinvestment that flows from that activity. As this study demonstrates, however, a significant amount of money is flowing out of Canada - to Netflix Canada - but the Canadian broadcasting system is not benefiting from any corresponding return or reinvestment flowing from that activity.

[9] 'Profile 2010', CMPA, Heritage Canada.

Addendum: Producer Questionnaire

Questionnaire circulated to Canadian producers for the purpose of this study:

1. Have you directly licensed any content to an OTT service (one delivered by Internet, for cellular phones, computer or iPads) operating in Canada?

2. Have you indirectly licensed any content to OTT services operating in Canada through a broadcaster or a distributor/aggregator?

3. Have you directly licensed any content to OTT services operating outside of Canada?

4. Have you indirectly licensed any content to OTT services operating outside of Canada, through foreign broadcasters and/or distributor/aggregators?

If you answered 'yes' to any of the above:

5. What was the nature of the rights granted? Exclusive or non-exclusive, territory specific or worldwide, streaming rights for subscription VOD or pay-per-transaction rights?

6. How did these sales affect traditional 'windows'? Were there holdbacks while first-run windows played out, were these in lieu of first-run or pay windows, etc...?

7. Have you made any pre-sales to OTT operators (commissioned works, development, etc...) such that they are participating in the creation and financing of new works?

8. Approximately what percentage of your company's annual sales revenues currently derive from OTT licensing?

9. Please add any additional comments you may have, particular if you perceive that current and/or future OTTs might provide a real business opportunity for you.

About the Author

Paul Gratton has over 25 years experience as a programming executive in the Canadian television industry. He played an instrumental role in the launch of Pay television in this country, starting with Superchannel in 1982, and moving over to First Choice when Astral purchased the fledgling service in 1983. He remained with First Choice as VP of Programming for eight years. He was also on the ground floor of the launch of the second wave of specialty channels in Canada, squiring Bravo! from concept to successful launch in 1992 and taking on the Space Channel a few years later. At the end of his 13 year career with CHUM, he was Vice-President of nine specialty and digital channels, including Drive-In Classics, a channel he created to honour his « misspent youth » as an avid film buff. He also served as Vice-President of Original Programming for the entire CHUM organization.

Mr. Gratton also has extensive experience on the public sector policy side of the industry, having served three years as CEO of the Ontario Film Development Corporation, and as Chair of the Canadian Television Fund in its final year.

Mr. Gratton has served on numerous boards in various capacities, including as Chair of the Academy of Canadian Cinema and Television, Chair of the First Weekend Club, and board member for Bravofact, Maxfact, the Independent Production Fund and the National Screen Institute.

He has consulted in recent years for a number of broadcasters and organizations including: Canal V (Quatre Saisons), CHCH-TV, APTN, HiFi HDNet, CFTPA, CMPA, CAB, APFTQ, DGC, Bell/CTV and Premiere Bobine Productions.