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on State aid for films and other audiovisual works

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Introduction

This Impact Assessment explores the options in view of the expiry of the existing Communication on State aid for films and other audiovisual works by the end of 2012.

1. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

1.1. Context

Under the State aid rules of the TFEU, the Commission assesses the financial support offered by Member States for the production and dissemination of films, TV productions and other audiovisual works. Following a complaint, the Commission took a landmark decision in 1998 on a French aid scheme for film production¹. In this decision the Commission established specific criteria to assess whether state aid to audiovisual production qualifies under the culture derogation of Article 107 (3) d TFEU. In 2001, these criteria were taken over in the so-called "Cinema Communication" which provides guidance on how the Commission intends to assess such State aid under the Treaty². These criteria had initially been designed to be reviewed in 2004 but have subsequently been extended successively up to the end of December 2012.

The Treaty recognises the importance of promoting culture for the European Union and its Member States. It incorporates culture amongst the policies specifically referred to (Article 167 TFEU) and includes in Article 107 (3) d TFEU a specific possibility of exception to the general incompatibility principle of Article 107 (1) TFEU for aid to promote culture.

The addressees of the Communication are the Member States which are asked to design their support schemes accordingly. Interested parties are the recipients of State aid, primarily producers of films and other audiovisual works, distributors or others who are engaged in the commercial activity to produce or distribute or promote films, their employees, and finally the customers, the audience.

1.2. Organisation and timing

The review was launched on 20 June 2011 by the first of three rounds of public consultation. The first round took place on the basis of a paper seeking views on the relevant issues; the other two on drafts of the Communication developed by the Commission services.

The project has been led by Directorate General for Competition. The chronology of the project is presented in Annex 1.

The Steering Group for this Impact Assessment was formed by representatives of a number of services of the European Commission, namely SG, SJ, DEVCO, EAC, ECFIN, ELARG, EMPL, ENTR, ENV, HOME, CNECT, JUST, MARKT, REGIO, TAXUD and TRADE. This Group met on 24 March and 10 November 2011, 26 January, 8 May, 5 July and 30 August 2012. At the last three meetings a draft of this report was discussed. All members were invited to join multilateral meetings with the

¹ Decision of 29 July 1998 (N 3/98).

² Communication from the Commission on certain legal aspects relating to cinematographic and other audiovisual works, COM/2001/0534 final, OJ C 43 of 16 February 2002 p. 6.

Member States and informal meetings with representative bodies from the European film sector.

The Impact Assessment Board reviewed a draft of this report and issued on 5 October 2012 its opinion. Following the recommendations of the board, the problem definition was amended to identify the most important problem drivers and the mechanisms by which the different problem elements influence each other; a broader range of policy options was developed, and a more detailed analysis of the expected impacts of the various options, in order to be in a better position to compare the options with respect to their effectiveness, efficiency, and coherence in achieving the stated objectives.

1.3. Previous steps in the revision process, including consultations

- **Member States and Stakeholder Consultations**

On 20 June 2011 DG Competition launched a first public consultation on an issues paper which identified the considerations involved in reviewing the Cinema Communication³. 110 contributions were received during the 3-month consultation period. They came mainly from Member States, film funding bodies, producers, directors, script writers, distributors, suppliers of technical services, cinema owners, and individuals.

On 14 March 2012, DG Competition launched a public consultation on a draft Communication text⁴. 100 contributions were received from a similar range of contributors to the first public consultation. A third public consultation launched on 30 April 2013 on a revised draft received a similar attention⁵.

Furthermore, on 14 September 2011, 5 June 2012 and 14 May 2013, DG Competition hosted multilateral meetings with Member States.

Overall, the attitude of participants throughout the consultation was very constructive. The participants found the issues proposed to be relevant and exhaustive. Regarding the design of a future Cinema Communication, Member States and the sector expected long term legal certainty. The participants insisted that future rules must keep intact the ability of Member States to develop and support independently their identity-enhancing national and regional cultural activities.

- **Meetings with interested parties**

Apart from the multilateral meetings with Member States, the Commission services met notably with the organisation of the European Film Agency Directors (11.7.2011, 13.1., 13.2., 26.4.2012, and 29.5.2013), the organisation of regional funds, CineRegio, (9.8.2011, 10.1., 13.2. and 18.4.2012), with representatives of producers, distributors, directors and cinema owners (7.9.2011, 18.1. and 7.5.2012) and of game developers (29.5.2012).

³ http://ec.europa.eu/competition/consultations/2011_state_aid_films/index_en.html.

⁴ http://ec.europa.eu/competition/consultations/2012_state_aid_films/index_en.html.

⁵ http://ec.europa.eu/competition/consultations/2013_state_aid_films/index_en.html.

- **External studies**

In 2007, the Commission commissioned a study on the economic and cultural impact of territorialisation clauses of State aid schemes for films and audiovisual productions⁶. The final report, which was published in 2008, found that a wide variety of territorial conditions are imposed in film support schemes.

Another relevant study was carried out for the MEDIA/Creative Europe impact assessment by WIK Consult in 2011⁷. It provides the analysis of the European film sector used for the sector description in this impact assessment.

2. POLICY CONTEXT, PROBLEM DEFINITION AND SUBSIDIARITY

2.1. Sector description

Although some figures are available, a description of the audiovisual sector is hampered by the shortage of comparable data on the cultural sector at European and national level. As the Impact Assessment Report on the Creative Europe Framework Programme states, there is considerable difficulty in assessing the sector's current state, due to lack of comparable information on its turnover, sales and employment, mainly due to the lack of statistical data.⁸

Member States provide an estimated €3 billion of film support per year⁹. This may be one of the reasons why the EU has become one of the largest producers of films in the world. The EU (27) cinema industry produced 1,299 feature films in 2012 compared to 817 in the US (2011), 1255 in India (2011) and 745 in China (2012). In 2012, Europe was the third largest cinema market in the world with 933,3 million admissions, compared to 3,000 million in India (2011), 1,358 million in North America and 470 million in China.¹⁰ In 2008 the European audiovisual market for filmed entertainment was valued at € 17 billion.¹¹ Over one million people are employed in the audiovisual sector alone in the European Union.¹²

Europe's feature film production capacity is concentrated in France, Germany, Italy, Spain and the UK (the so-called "Group A" countries) representing 75% of films produced in the EU in 2011.

Although the European Union produces a large volume of films and television productions, the market share of these works is low compared to non-European works. In particular, US films attract a high share of audiences and revenues on all audiovisual distribution channels. As illustrated in the table below, US films

⁶ See http://ec.europa.eu/avpolicy/info_centre/library/studies/index_en.htm#territorialisation

⁷ *Impact assessment integrating ex ante evaluation requirements in view of the preparation of a proposal for the next MEDIA Programme after 2013*, Study under a Framework Contract for the Provision of Impact Assessment and Evaluation-Related Services to DG CNECT.

⁸ http://ec.europa.eu/culture/creative-europe/documents/impact_en.pdf.

⁹ €2.1 billion of support is provided annually by European film funds (<http://www.obs.coe.int/about/oea/pr/fundingreport2011.html>). According to the study into the economic and cultural impact of territorial conditions in film support schemes, a further, estimated €1 billion is provided annually by Member States through film tax incentives, cf. footnote 5.

¹⁰ Source: *Focus 2013 – World film market trends*, European Audiovisual Observatory, May 2013.

¹¹ PWC Global Entertainment and Media Outlook 2009-2013, June 2009, p. 193.

¹² Study by KEA European Affairs, *Multi-Territory Licensing of Audiovisual Works in the European Union*, Final Report prepared for the European Commission, DG Information Society and Media, October 2010, p. 21, <http://www.keanet.eu/docs/mtl%20-%20full%20report%20en.pdf>.

accounted for 68% of cinema admissions within the EU in 2010 (with less than 20% of the total number of films released), compared to 25.3% for European films (though they represent over 60% of the total number of films released).

Table 1: Breakdown of admissions in the EU according to the country of origin¹³

Region	2007	2008	2009	2010	2011	2012
U.S.	62.6%	65.6%	67.1%	68.0%	60.1%	61.1%
European films	28.1%	28.2%	26.7%	25.3%	28.5%	35.2%
Europe / U.S. inc ¹⁴	7.5%	4.4%	4.2%	7.9%	9.7%	2%
Others	1.8%	1.8%	2.0%	1.3%	1.6%	1.6%

Non-national European films only account for 12% of market share. On average, each European film is only released in two countries including the country of origin, or 4.6 countries in the case of co-productions involving producers from several countries. The proportion of European films that gain distribution in any EU market outside their national market ranges from 38% in the “Group A” countries to 18% in other Member States.

European films do not benefit from the same distribution and exhibition conditions as those distributed by US majors. The latter are released on a much larger scale, and are in principle accompanied by important global marketing campaigns. European films usually have smaller budgets, and are often screened in smaller cinemas, benefit from fewer weekly screenings over a shorter period of time, leading to a much lower total number of admissions per film released (see figures above). As a result, the market share of US films is largely dominant in almost all European countries. European films also have a low market share on foreign markets. In 2012, their market share for example in the USA (out of the Top 250 films) was 7,9%.¹⁵

Today, the audiovisual sector faces profound changes as a result of the digital revolution. The most obvious example is in cinemas, where films have been presented in 35mm film for more than 100 years. In due course, films will be released in Europe exclusively in digital form¹⁶. At the end of 2012, 74% of European cinema screens have been equipped with digital projection equipment¹⁷. In addition, widespread, fast internet access across the EU will lead to video on demand (VOD) growing in importance¹⁸.

¹³ Source: European Audiovisual Observatory – Lumiere database.

¹⁴ Films produced in Europe with incoming US investment. Example: Harry Potter

¹⁵ Source: European Audiovisual Observatory (Focus 2013).

¹⁶ See study "Digital Agenda for European film heritage", <http://www.dae-filmheritage.eu/final-study.html>. See also the European Digital Cinema Report of the European Audiovisual Observatory of 2011: “Distributors in Belgium, Luxembourg and Norway ... are expected to end 35mm distribution as early as 2011/2012.”

¹⁷ Source: European Audiovisual Observatory (Focus 2013).
<http://www.obs.coe.int/about/oea/pr/digitalcinemareport2011pdf.pdf.en>.

¹⁸ According to the KEA study mentioned in footnote 11, more than 700 video on demand services were available in Europe in 2009.

2.2. Why is Commission action considered?

2.2.1. European films are subsidised

Sectoral State aid to the film industry in Europe became a firmly established phenomenon in Western Europe by the end of the 1950s.¹⁹ Member States insist that State aid has been indispensable to the production of almost all European films. Left purely to the market, many of these films would not have been made because of a combination of the high investment required and the limited audience for European audiovisual works. In any case the consultation revealed that there is no intention on the part of Member States to discontinue public funding of films.

Also producers and directors confirmed in the consultation that they need public funding even for the films which eventually were a commercial success.

2.2.2. Why does the Commission control support for audiovisual production?

Each year, the Commission is required to assess a number of audiovisual support schemes of Member States. Since film producers are acting on an international level and audiovisual works are traded internationally, such support is liable to affect trade between Member States. Those producers and audiovisual works which receive such support are likely to have a financial and hence competitive advantage over those which do not. Consequently, such support may distort competition and is regarded as State aid pursuant to Article 107 (1) TFEU. According to Article 108 TFEU the Commission is obliged to assess the compatibility with the internal market of any aid measure.

Therefore the question addressed in this impact assessment is not whether the Commission should assess such aid, but rather on which conditions it should do so.

2.2.3. Why maintaining sector-specific guidance?

Sector specific guidance has been in place since 2001. It was introduced because the Commission identified at that time a need for transparent rules for the audiovisual sector, based on the cultural derogation to the general incompatibility of State aid which had been introduced by the Maastricht Treaty. Experience shows that such rules were helpful for the Commission's assessment of film related State aid projects and for the shaping of relevant State aid schemes by Member States.

The current State aid assessment criteria expired on 31 December 2012. Without further action by the Commission, there would not be sector specific rules in place any more. Accordingly, the baseline ("no policy change") scenario would be to extend the application of the current assessment criteria.

2.3. Problems linked to the specific characteristics of the sector

The European audiovisual industry is subject to a number of problems and challenges which make it dependent on subsidies for film production. These problems are mainly linked to the structure of the sector and the market. The European audiovisual market is inherently fragmented along linguistic and cultural lines, in terms of production, distribution, and the general framework in which they

¹⁹ For details cf. European Audiovisual Observatory Report 2011, Public Funding for Film and Audiovisual Works in Europe, Strasbourg, 2011, p.131 et seq.

operate. This is also one of the causes why the sector is mainly composed of SMEs²⁰. The fragmentation results in a culturally diverse and highly independent production industry, providing a voice for the different cultural traditions. This diversity is also a key driver for Europe's rich cinematographic production.

On the other hand, this market structure adds various challenges to the sector which go beyond the usual handicaps suffered by SMEs. While access to finance is a common challenge for SMEs in general, the fragmented production and distribution structure of the sector makes access to upfront financing significantly more difficult for the SME operating in the audiovisual sector.

While US film producers can count on an important homogeneous domestic market and on own global distribution networks to recoup the costs of production, this is not the case for EU films, where domestic markets are smaller and heterogeneous and where they are generally distributed successively on a country by country basis, only after successful release on one territory. The national basis for EU films is often insufficient to make up for the costs of production, especially in countries with a restricted linguistic or geographical area.

Linguistic and cultural differences limit also the transnational circulation of audiovisual works because audiences have a preference for national productions in their own language and stories related to their own culture with stars they know. Low consumer demand for non-national European works may also be caused by low awareness and appreciation of these works, also caused by a low level of media coverage of non-national European works. This low potential to generate profits represents a risk for distributors to buy the rights, in particular on a non-national film which in addition implies marketing, dubbing and subtitling costs. This problem of lacking access to finance causes also that audiences have limited opportunities to see the large numbers of films produced in Europe. The low level of knowledge of other European cultures and lack of availability of foreign works²¹ is a problem in terms of cultural diversity.

According to producers' comments, also presales of audiovisual works to television channels or co-production deals which have traditionally constituted a key resource for the production of audiovisual works are getting scarcer. The multiplication of the number of channels and changed viewing habits has led to a drastic reduction of advertising revenues. Buying fewer programmes for lower prices, television channels and film distributors have reduced their contribution to the sector, with important consequences on the economic models of audiovisual production, as well as those of sales and distribution.

Another particular aspect of film production in this context is that, unlike other industrial products, audiovisual works are generally not mass-produced. Every film is a unique prototype. The perceived high risk of lending to single audiovisual productions, where only a small proportion of works generate strong revenues, and a lack of risk sharing instruments or guarantee funds to offset this risk make banks

²⁰ Around 80% of enterprises are sole traders or small enterprises employing only a handful of people, see *Study on the Entrepreneurial dimension of CCIs (2011)*, http://ec.europa.eu/culture/key-documents/doc3124_en.htm.

²¹ An Eurobarometer survey on cultural values within Europe of 2007 shows that only a minority of European people access foreign cultural products, with only 19% of European people watching foreign language TV/movies, <http://ec.europa.eu/dgs/education.culture/pdf/culture/baometer.en.pdf>.

reluctant to provide upfront financing for audiovisual projects. The value attached to the intangible assets of producers, particularly their artistic creations, is usually subject to low expectations of future revenue.²²

2.4. Problems identified within the context of applying the State aid rules for audiovisual production and during the consultation

In 2009, while extending the duration of the criteria for assessing State aid for film production in the 2001 Communication²³, the Commission noted that there may be a need to address in the future a number of different trends which had emerged. These trends include the support some Member States grant to other activities than film production, like script-writing, development, film distribution or promotion, or for cinemas, which is not addressed in the current rules. In these cases, the Commission applied the criteria of the Cinema Communication by analogy to assess the necessity, proportionality and adequacy of the aid. The trends also include the competition among Member States to use State aid to attract inward investment from large-scale film production companies of third countries.²⁴

The 2004 extension already identified territorial spending obligations in film funding schemes, which impose that a certain part of the supported film budget is spent in the aid granting Member State, as problematic under the Treaty. The current Cinema Communication allows Member States to tie 80% of the entire film budget to local spending. However, territorial requirements fragment the Internal Market for the provision of goods and services and the free movement of workers.

The Commission accepted that, in principle, Member States may require a certain part of the film production budget to be spent on their territory, for the reason that a certain degree of territorialisation of the expenditure may be necessary to ensure the continued presence of the human skills and technical expertise required for cultural creation. To examine further the maximum level of admissible territorial conditions, the Commission commissioned an external study on territorial conditions which was completed in 2008.²⁵

Accordingly, in the public consultation concerning the review of the Communication, the Commission presented the following policy issues:

²² Study on the role of banks in the European film industry, PeacefulFish, May 2009.

²³ Communication from the Commission concerning the State aid assessment criteria of the Commission communication on certain legal aspects relating to cinematographic and other audiovisual works (Cinema Communication) of 26 September 2001, OJ C 31 of 7 February 2009, p. 1.

²⁴ In 1995, Ireland became the first Member State to introduce a film tax relief. Luxembourg then introduced a tradable film tax certificate in 1998, which started to attract mid-sized US films to Luxembourg. After 2000, the UK offered tax relief. In 2004, Hungary followed. The loss of productions to Hungary led the Czech Republic to introduce one in 2010. In 2006, the German Film Fund was introduced as a scheme to make both German producers and film technology companies competitive on the international market and Germany an attractive production location. When, in 2009, Ireland increased the budget and extent of its tax relief, it hoped to improve its competitive position as a location for international film production. See also Morawetz, *Finance, policy and industrial dynamics – the rise of co-productions in the film industry*, section 5 "Impacts of tax incentives on the film industry", paper published under <http://www2.druid.dk/conferences/viewpaper.php?id=1671&cf=9>, June 2007.

²⁵ 2008 Study on the Economic and Cultural Impact, notably on Co-productions, of Territorialisation Clauses of state aid Schemes for Films and Audiovisual Productions, http://ec.europa.eu/avpolicy/docs/library/studies/territ/final_rep.pdf.

- The cultural test;
- Territorial conditions or spending obligations;
- Subsidies to attract foreign film productions;
- Scope of activities;
- Scope of audiovisual works to be supported;
- Aid intensities; and
- Impact of digitisation and new distribution channels on State aid rules

In addition, the consultation asked which other issues ought to be addressed. The consultation confirmed that these are the relevant issues to be addressed and that there would not be any other field of action which Member States, companies, or consumers wished to see addressed by State aid rules for audiovisual production.

Accordingly, these issues, which include also those identified by the 2004 and 2009 prolongations just described, have been submitted to closer scrutiny.

2.4.1. *The cultural test*

Background

The compatibility of aid to film production is assessed under Article 107(3) d TFEU which provides for the possibility to grant aid "to promote culture". The 2001 Cinema Communication states that "Each Member State must ensure that the content of the aided production is cultural according to verifiable national criteria." The Commission's recent detailed scrutiny of the single criteria to qualify films as culture or of the selection procedure applied by Member States in film support schemes has been very controversial, particularly in view of the subsidiarity principle.

Comments received

The public consultation demonstrated agreement that the primary aim of film funding is cultural. It supports cultural diversity and the cultural and artistic expression of this diversity on regional, national, and European level; it contributes to the preservation of cultural European identity and heritage.

Member States and the sector suggested abolishing the existing, burdensome "cultural test". They argue that the task of the Commission should be limited to ensuring that Member States have relevant verification mechanisms in place. The Commission should not assess for every scheme whether the various elements of a Member State's list of criteria meets the requirements of a "cultural" product. This would be also in line with the subsidiarity principle. Each audiovisual production, or at least each film, would have the quality of a cultural product..

2.4.2. *Territorial spending obligations*

Background

In its judgment in case *Laboratoires Fournier* (C-39/04) of 2005²⁶, the Court of Justice underlined that fiscal advantages have to comply with Article 56 TFEU guaranteeing the free provision of services. According to the judgment, legislation

²⁶ Judgment of the Court of Justice of 10 March 2005 in case *Laboratoires Fournier* (C-39/04), ECR 2005 I-2068.

which differentiates according to the place from where the services are provided to an aid beneficiary is contrary to Article 56 TFEU. This reasoning applied by the Court with regard to fiscal advantages to research, which was conditioned on using national research facilities, can also be applied to the territorial conditions in film support schemes. If they differentiate according to the place where the services or goods originate which are used for the film production, they may infringe the fundamental freedoms under the TFEU contrary to Articles 34 (free movements of goods), 45 (free movement of workers) and 56 TFEU (free provision of services).

However, according to the case law of the Court of Justice, a national measure which hampers the exercise of fundamental freedoms guaranteed by the Treaty may be acceptable when complying with several conditions: it has to pursue an overriding reason of general interest, it has to be suitable for securing the attainment of the objective which it pursues and must not go beyond what is necessary in order to attain it²⁷.

The specific characteristics of the film industry have also to be noted (in particular, the extreme mobility of productions). The promotion of cultural diversity and national culture and languages may constitute an overriding requirement of general interest capable of justifying a restriction on the exercise of the fundamental freedoms. This restriction needs to be necessary, suitable and proportionate. It is, however, doubtful whether a limit on territorial spending obligations which is unrelated to the aid amount is proportionate.

The study referred to in chapter 1.3 was intended to help in this assessment. The study found that in the Member States with high territorial requirements the audiovisual sector had a higher turnover²⁸. In addition, the costs of film production seem to be higher in those countries which apply territorial conditions than in those which do not. Regarding co-productions, the study found that territorial conditions may cause some problems for co-productions and may make them less efficient. The study also reported that removing altogether the possibility to impose explicit territorial conditions might lead to an increase in implicit territorial conditions, reducing the transparency for film producers.

Overall, the study was inconclusive, in the sense that it could not confirm either positive or negative effects of territorial conditions. It did not demonstrate that higher territorial conditions lead to sufficient positive effects to justify maintaining the current levels of restrictions nor did it demonstrate the necessity of these conditions in view of the objectives pursued.

Comments received

The comments received in the public consultation provided a mixed picture. A limited number of Member States (FIN, SK, EL) were against such conditions, while most, as well as the sector, were in favour of allowing territorial conditions (including DE, FR, IT, UK, and the film funding agencies). The justification would be that these conditions are necessary to maintain a critical mass of infrastructure for film production in the various Member States, thereby contributing to cultural

²⁷ Judgement UTECA, case C-222/07, §25.

²⁸ However, it is unclear whether the higher level of turnover per capita is caused by the higher level of territorialisation, or whether the political interest in territorialisation is caused by the greater importance of the audiovisual sector in countries where this sector is relatively large.

diversity. They would also be necessary to justify the spending of public funds for film production. Their absence would limit the willingness of governments to invest public funds in film production.

However, there were different views regarding the appropriate level of territorial tying. The large Member States were very strongly in favour of maintaining current levels, or to reduce them to a limited extent only. Others, acknowledging the need to adjust the rules to internal market standards, prefer the approach presented in the consultation to link the local spending obligations to the aid amount. Some find 100% acceptable; others would also accept a lower level. The large Member States would advocate higher levels (e.g. 150%). The industry offered a similar spread of opinions.

The public consultation revealed in particular some confusion about which territorial spending obligations would be inherent in a State aid context and what the territorial criterion of the Communication allowed beyond this. The background is that some Member States have funding schemes in place which define the amount of the aid as a percentage of the spending of the producer in the aid granting Member State (e.g. 20% of local spending). For these schemes a condition to spend at least 100% of the aid amount is logically not applicable (the example of 20% of local spending would indirectly tie 5 times the aid amount to local activities). These Member States were concerned that they could not continue such schemes at all. In the discussions during the consultation it became clear, however, that such schemes may be incompatible with internal market principles only if they imposed a link with the territory of the granting Member State which goes beyond what is inherent in State aid for production, which naturally is linked to local production activities.

It is also notable that most producer organisations opposed any change although one would assume that they would prefer more freedom where to spend the money. However, like Member States and film funding bodies, they share the concern that, without high levels of tying, Member States would feel compelled to reduce funding.

In spite of this general resistance to change, contributors agreed that linking the territorial criterion to the aid amount would not have any significant impact on 'selective' film support schemes²⁹, which provide the majority of European State aid. Moreover, the leading film producer associations confirmed that films tend to be produced on home ground due to factors that are not primarily economic, but creative and/or cultural: the majority of stories and scripts require local talent and locations.

2.4.3. Subsidies to attract foreign film productions

Background

The phenomenon that several Member States introduced incentive schemes to attract major foreign film projects to be produced in their territory seems to suggest that there is a subsidy race not only between Europe and third countries but also between certain EU Member States. These subsidies could not only determine whether a film

²⁹ In 'selective' film support schemes, the projects to be awarded aid are selected by an evaluation process from among the proposals submitted. In contrast, in 'automatic' film support schemes, all projects fulfilling certain administrative criteria are eligible for aid and there is no evaluation process, other than to verify that the project satisfies the criteria.

is produced in the EU or elsewhere but may also determine where in the EU such productions will be located.

Regarding the possible effect on European cinema, one has to distinguish between countries with an established and recognised own film production and infrastructure in terms of technical expertise and facilities and others which may just offer locations. For the first group, foreign production is likely to have a lasting impact as it usually makes wide use of this local infrastructure or of local actors. This may thus have an overall positive effect on the national film industry. The second group would just finance "runaway productions" with a local effect primarily on local catering services, hotels and follow up shooting site tourism. It should also be noted that many of these films which are considered to be major US projects are in fact co-productions involving European producers.

Accordingly, the consultation discussed applying lower aid intensities for non-European works, to address the alleged subsidy race.

Comments received

In particular large Member States and the European film funds claimed that there was no evidence of a subsidy race and that film production would not shift in the EU due to aid. If it existed at all, this would be a problem of minor importance. The main issue would be the competition between Europe and third countries, not among Member States.

Comments from Member States and the sector suggest that the principal objective of this type of aid is to attract high profile productions to Europe, in global competition with New Zealand, Canada, Australia, or South Africa. They claimed that certain major studio productions would not have been produced in Europe without attractive and competitive subsidies. If such films had been produced elsewhere, their authenticity and cultural value would have suffered considerably.

Member States and the sector unanimously underlined how important such productions are for the competitiveness of the European film sector. These productions would be necessary to maintain a high quality film infrastructure, to contribute to the employment of high class studio facilities, equipment and staff, and to contribute to transfer of technology, know-how and competences. The partial employment of facilities by foreign productions would also help in ensuring the existence of facilities necessary to realise high quality and profile European productions. Thereby these subsidies would contribute also to the promotion of European Cinema and to sustaining facilities for national productions. Also a major US producer confirmed that public support is one of the aspects taken into consideration when looking for a production location, in particular in cases, where the principle photography is not dependent on a specific location.

Therefore, contributors to the consultation questioned the unintended consequences of lower aid for these productions. The limitations on the possibility to attract foreign film productions would marginalise Europe as a production location. In any case many Member States found it problematic to introduce a sometimes difficult distinction of European and non-European work.

2.4.4. Scope of activities

Background

So far, the Cinema Communication only addressed aid for the production of audiovisual works. Nevertheless, many aid schemes of Member States also include support measures for film distribution and for cinemas which have been approved by analogous application of the Cinema Communication.

The Commission has previously approved aid for digitisation of cinemas in the UK and in Finland. In each case, the analysis depended on the specific cinema market of the Member State concerned³⁰. In addition, the aid was not always approved under the cultural derogation (Article 107(d) TFEU) but under the sectoral derogation (Article 107(c)).

Comments received

Among stakeholders there was broad agreement that films only contribute to Europe's cultural diversity if they are seen by an audience. The participants in the consultation supported the suggestion that new rules should cover all aspects of film creation, from story concept to delivery to the audience. This would also enhance transparency and legal certainty.

Some Member States and sector representatives, in particular cinema organisations, also asked for the inclusion of rules on aid to cinemas, in general, or for rural or arthouse cinemas, or for digitisation or for the establishment of video on demand (VoD) platforms. Others found that *de minimis* support would be sufficient for this. Many also agreed that the switchover of cinemas to digital projection will be done by the end of 2013 and that it would not be of any use to introduce respective rules which would start to apply in that year.

In any case, Member States and distributors were not able to forward an argument why VoD platforms should require aid. Many of them exist already without funding.

2.4.5. Scope of audiovisual products to be supported

Background

In the recent years of application of the 2001 Cinema Communication, the issue has arisen of which products are to be considered as an audiovisual work and thus within the scope of the Communication.

Comments received

In the consultation, some Member States suggested extending the scope of the relevant rules from film and TV productions to other types of audiovisual products, in particular interactive products like "transmedia"³¹ or video games. Also parts of the private sector are in favour of extending the scope of products falling under the future Communication, most notably games developers. They maintain that games are also cultural products. However, games developers accepted that currently the limited relevant decisional practice of the Commission would not yet allow developing general rules applicable to such aid.

³⁰ Each Member State has a different profile for cinema-going, types of cinemas (multiplex/subdivided/single-screen), types of films shown (arthouse/commercial), geographical distribution of cinemas (rural/urban/metropolitan) and cinema chains.

³¹ Transmedia storytelling (also known as multi-platform storytelling or cross-media storytelling) is the technique of telling stories across multiple platforms and formats using digital technologies, like films and games. Importantly, these pieces of content are linked together.

However, other Member States consider that it is in general difficult to design lasting rules for the rapidly changing scope of new media. In fact, in particular games have other characteristics regarding production, distribution and consumption than films. The rules applying to film production would therefore not fit. The games sector itself underlines that the video games sector has enjoyed a two digit growth per year since two decades; it would be the most dynamic digital content industry in Europe, and European SME would compete globally.

2.4.6. *Aid intensities*

All comments were in favour of maintaining current possible aid intensities. Also the suggestion to allow a higher intensity of 60% for productions involving at least two Member States was welcomed.

2.4.7. *Challenges for improving the circulation of European films and audience choice*

Background

The audiovisual sector faces challenging new technologies and changing consumer behaviour. The consultation addressed whether a State aid text could address, by way of a recommendation, issues regarding the conditions for the circulation of subsidised films, like mandatory release windows for film circulation (e.g. the minimum period for exclusive exhibition in cinemas before DVD or TV distribution, the online distribution rights), or promoting the cross-border availability of European films through mandatory release to third parties of the online rights for unused cross-border exploitations, or requiring the deposit of a film copy for archiving purposes.

Comments received

While some contributors questioned the need for the Commission to make such recommendations, others supported them or did not comment. Most contributors recognised the impact of the digital revolution on film production and distribution as well as on film financing. However, Member States generally did not feel the Commission should impose related mandatory obligations on aid schemes. For some, recommendations could be acceptable. Other Member States were against such recommendations. They argue that the relevance of such recommendations for the Commission's assessment of schemes is unclear and would undermine legal certainty. Other contributors asked for even more detailed relevant provisions or referred to on-going related Commission policy initiatives which are not yet concluded, like the follow up to the Audiovisual Green Paper.

2.5. **Subsidiarity**

EU State aid control is the exclusive competence of the Commission according to Articles 107 and 108 TFEU.

A particular aspect in the assessment of aid to promote culture is that culture and the definition of what constitutes a cultural activity are primarily a responsibility of Member States. According to Article 167 TFEU action for culture on EU level is limited to support and supplement national policy. In line with the subsidiarity principle, the task of the Commission is limited to verifying whether a Member State has in place a mechanism to identify the cultural quality of supported projects. The commercial value of a film does not exclude this qualification.

3. OBJECTIVES

EU State aid control is aimed at ensuring that Member States only implement State aid that contributes to an objective of common interest, is well designed and proportionate and does not distort competition and trade between Member States.

3.1. General objectives of State aid policy with regard to audiovisual production

The Treaty recognises the importance of promoting culture for the European Union and its Member States in general and also specifically film production by incorporating this amongst the policies in the Treaty. Article 167 (2) TFEU provides that action by the Union in the field of culture shall be aimed at encouraging cooperation between Member States and, if necessary, supporting and supplementing their action inter alia in the area of artistic and literary creation, including in the audiovisual sector. This acknowledges that audiovisual works play an important role in shaping European identities.

As set out in sections 2.2 and 2.3, the audiovisual sector is facing specific challenges which make it difficult for it to fulfil this role. It is difficult for film producers to obtain a sufficient level of upfront commercial backing to put together a financial package so that production projects can proceed. The high risk associated with their projects and the film sector's perceived lack of profitability makes it dependent on State aid. The general objective of State aid for audiovisual production is to offset these challenges.

Article 107 (3) d TFEU recognises the importance of the cultural objective of the Treaty and provides for a specific possibility of exception to the general incompatibility principle of Article 107 (1) TFEU for aid to promote culture. The general objective of the Cinema Communication is therefore to offer a framework for the assessment by the Commission of film aid schemes under the Treaty, with a view to avoid undue distortions of competition while maintaining the sector's contribution to cultural diversity among Member States.

3.2. Specific objectives of the review

The fostering of audiovisual production by the Commission and the Member States has a role to promote continued European film production and the transnational circulation of audiovisual works. It should help to overcome the problem of fragmentation and to ensure that culture and creative capacity can be expressed and the diversity and richness of European culture reflected in audiovisual works of quality for the benefit of audiences.

As audiovisual creation depends on a solid infrastructure (in terms of talent, expertise and technical facilities), the preservation of such infrastructure is also essential. Aim is therefore also to generate the critical mass of activity that is required to ensure soundly based production undertakings and the development of a permanent pool of human skills and experience. This is also in the interest of preserving the global competitiveness of the European audiovisual sector (regarding its infrastructure) and the attractiveness of European films for audiences.

An objective of any future regulatory framework for aid to audiovisual production is to provide a transparent relevant State aid assessment system which is easy to understand by Member States and other stakeholders and which can be applied

without unnecessary administrative burden on the part of Member States or the Commission.

In addition, a regulatory framework should assure legal certainty by addressing the evolving practice and problems which arose during 10 years of application. It should avoid distortion of competition and trade between Member States to an extent that is contrary to the common interest and acknowledge that, under the principle of subsidiarity, cultural policy is primarily the task of Member States. It should enhance the respect of internal market principles on the free circulation of goods, services and workforce and clarify the scope of activities and products falling under the rules.

Accordingly the objectives may be summarised:

- a) Preservation of European film production and cultural diversity;
- b) Quality and range of choice for audiences;
- c) Promotion of the transnational circulation of European audiovisual works; and
- d) Preservation of a solid infrastructure for audiovisual creation and of the competitiveness of the European audiovisual sector.
- e) Transparency;
- f) Legal certainty
- g) Reduced administrative burden on the part of Member States or the Commission;
- h) Reduced distortion of competition and trade between Member States;
- i) Respect of internal market principles;
- j) Respect of the principle of subsidiarity;

4. POLICY OPTIONS

It is clear that the quality and number of films produced in Europe today could not be sustained without public support. In smaller Member States, the very existence of feature film production might even be jeopardised. The Commission has not therefore objected in principle to this kind of sector-oriented aid and Member States will continue notifying relevant State aid schemes to the Commission.

Against this background, there are a number of possible scenarios facing the Commission when reviewing the Cinema Communication:

4.1. Baseline Scenario: Option 1: No policy change

The Commission could continue its current policy towards the sector by prolonging the existing Communication and current criteria for assessing aid to audiovisual production. All other options are assessed in comparison to this status quo.

4.2. No action scenario: No new Communication

The 2001 Cinema Communication expired at the end of 2012. The "no action" option would mean that there would no longer be sector specific criteria for the assessment of State aid for audiovisual production by the Commission. Instead, State aid for audiovisual production would have to be assessed directly under Article 107 (3) d TFEU, which addresses aid to promote culture, and, if applicable, under Article 107

(3) c TFEU (aid to facilitate the development of certain economic activities or areas) and the rules implementing it.

These general State aid rules comprise investment support measures in the form of regional aid, SME investment and employment aid, aid in the form of risk capital, for research and development and innovation, or training aid. Some may be relevant for supporting businesses in the European film sector if they undertake respective investment. However, they can be relevant only for investment with these horizontal objectives, assessed under Article 107 (3) c TFEU.

Aid for film production, on the other hand, is sector specific production aid which cannot be assessed under these general rules, firstly because of its nature as production aid, and secondly because of the need to assess them as aid to promote culture under Article 107(3) d TFEU. The general rules do not refer to this objective. So the horizontal State aid rules are not of help if aid to the film production activity needs to be assessed.

Also so called de minimis aid (aid of up to €200 000 which Member States may grant to a single company within three years without notification) will in most cases not be of help. The average support by film in the EU is more than €200 000³².

The Commission decisions approving European film support schemes have been based on the 2001 Communication criteria for over a decade. Letting the current rules expire without specific rules replacing them is likely to create significant legal uncertainty for the European film sector. The decisional practice would be considerably more labour-intensive and controversial. The "no action" scenario would not necessarily mean that the Commission would simply continue applying the assessment criteria used under the 2001 Communication. It may revise in individual decisions its assessment approach in light of the identified need to address certain issues which were put to public consultation. With regard to the controversial topic of territorial conditions, it would be up to the Member State to justify why applying territorial conditions to production support schemes is necessary and proportionate. In the absence of a Communication, the Commission would not anymore be able to approve film production schemes which included territorial spending obligations without a formal investigation under Article 108(2) TFEU.

Transparency, predictability and legal certainty would therefore be reduced, the cost of time and human resources resulting from the need to define the Commission's approach for each notified scheme would be high both for the Member States and the Commission. With each scheme, Member States may explore how much scope they have to deviate from previous practice. The absence of predefined standards would limit the Commission's ability to discourage certain plans before a notification.

In the public consultation, the expected increase of the length of procedures, lack of transparency and legal certainty led Member States and the sector to advocate the continued presence of specific rules. They prefer having a durable legal framework for their projects and some planning certainty.

Therefore the no action scenario is discarded as an option.

³²

In 2010, EU Member States gave around €3 billion support for 1285 feature films (cf. footnote 8).

4.3. Option 2: Amendment of the current rules for certain or all of the issues identified by way of a new Communication

This option depends on the conclusions drawn from the analysis of possible approaches regarding the various issues identified in section 2.4. and 2.5.

4.3.1. Issue 1 - The cultural test

The Commission Communication on a European agenda for culture in a globalizing world of 10.5.2007 states: "Culture is and will primarily remain a responsibility of Member States.... Article 167 does not provide, for example, for harmonisation of the laws and regulations of the Member States. Action at EU level is to be undertaken in full respect of the principle of subsidiarity, with the role of the EU being to support and complement, rather than to replace, the actions of the Member States, by respecting their diversity."

Sub-option is to deviate from current practice and to clarify in a new Communication that the Commission will not assess each and every criterion a Member State is applying to qualify a film as cultural. The Commission's role in verifying that film aid schemes pursue a cultural objective would be limited to noting that verification takes place as such, without assessing each single criterion.

4.3.2. Issue 2 - Possible approaches towards territorial spending conditions

As illustrated in section 2.5.2., the legal assessment on the basis of the *Laboratoires Fournier* and other judgments clarifies that territorial spending conditions may violate internal market principles. Under the current rules, Member States are entitled to impose that 80% of the aided film production budget is spent locally, no matter the actual amount of aid.

Sub-option 1 is a strict approach in defence of internal market freedoms. Accordingly, the Commission could require the utmost respect of these freedoms and decide not to accept any explicit or implicit condition regarding the origin of goods or services or workforce used or employed for a supported film production.

Sub-option 2 is a solution which, on the one hand, seeks to further open up the internal market, and, on the other hand, considers the specificities of the audiovisual sector. According to the conditions developed by the Court of Justice, restrictions on the exercise of the fundamental freedoms may be acceptable for reasons of public policy, like the promotion of culture and cultural diversity, if they are necessary and proportionate. In particular the extreme mobility of the actors and activities involved in film production may justify that Member States require a part of the film production budget to be spent on their territory. This may be necessary to produce works with a link to their culture and to ensure the continued local presence of the human skills and technical expertise required for cultural creation.

This would mean not to abolish but to reduce the level of territorial restrictions. A possibility would be to set it, for schemes which define the aid amount as a percentage of the entire production budget, at the level of the actual financial commitment by the Member State granting the aid, e.g. by submitting 100% of the aid amount to local spending obligations. In the consultation, there were proposals to accept a higher level, like 150% of the aid amount.

For schemes, where the aid amount is determined on the basis of the expenditure on activities in the territory of the granting Member State (e.g., a 20% film tax

incentive), a Member State may make the aid amount dependent on the expenditure on production activity in its territory.

4.3.3. *Issue 3 - Possible approaches towards subsidies to attract foreign film productions*

Commission experience with Member States' film aid schemes and comments of contributors to the consultation suggest the existence of a global competition of film production locations. This may call for Commission action to avoid undue distortions of trade and competition, however without driving productions away from Europe.

Sub-option 1 is to take a strict approach towards possible competition among Member States to attract foreign film productions and to prohibit such incentives altogether, thereby excluding these productions from eligibility.

Sub-option 2 is to introduce for aid to foreign films a lower aid intensity than for European productions, in order to at least reduce a possible impact of these subsidies on trade between Member States.

4.3.4. *Issue 4 - Scope of activities eligible for State aid*

In view of the objective to increase audience choice and to improve the circulation of films among Member States, the scope of activities covered by the new rules could be extended from covering purely production to covering all aspects of film creation, from story concept to delivery to the audience.

Sub-option 1 is to include in a new Communication possible aid for the distribution of individual audiovisual works which have, so far, difficulties to find suitable ways of distribution – instead of dealing with it on a case by case basis. This would acknowledge past practice which applied the current rules by analogy.

Sub-option 2 consists in further extending the scope of the general rules to include aid to cinemas and/or video on demand (VoD) platforms.

4.3.5. *Issue 5 - Scope of audiovisual products falling under sector specific rules*

The discussion around this issue concerned the inclusion of games in the scope of supported products under the Cinema Communication. Occasionally Member States notified aid for games. In this case there is a possibility to apply the Cinema Communication by analogy, where appropriate.

Sub-option 1 is to specify that games are excluded from the audiovisual products falling under the Communication.

Sub-option 2 is to specify that video games will be treated like other audiovisual products. This would give Member States the possibility to finance games production in the same way as films. Alternatively one could develop specific rules for aid to video games.

4.3.6. *Issue 6 - Aid intensities*

The current rules provide for a maximum aid intensity of 50% of the production costs and no limit for low budget or difficult productions.

Sub-option 1 is to lower this intensity threshold.

Sub-option 2 is, as discussed in the public consultation, to raise the possible aid intensity for European co-productions to 60%.

4.3.7. *Issue 7 - Improving the circulation of European films and audience choice*

Finally, regarding possible not competition related additional conditions Member States should impose regarding the circulation of films or the limitation of the exploitation of the intellectual property rights of right holders, the mixed reactions received illustrate that it is confusing to mix conditions for the compatibility of State aid under the Treaty with recommendations concerning areas not affecting the compatibility. It is more appropriate to include these recommendations instead in the forthcoming Commission Recommendation on European film in the digital era. The deliberations on it are still on-going and should not be anticipated by the State aid Communication. Therefore this issue will not be further assessed.

4.4. **Option 3: Temporary extension of the current rules with a view to include them into a future block exemption regulation**

Even if a change of the current rules would appear necessary, it could be an option to include new rules in a new Block Exemption Regulation. The State aid modernisation plans of the Commission include proposing to the Council to enable the Commission to include aid to culture in the areas covered by block exemption regulations³³. One could consider extending the current rules until the entry into force of a Block Exemption Regulation on aid to promote culture.

5. ANALYSIS OF IMPACTS

As noted in section 2.1, quantitative estimates are difficult due to the lack of data to underpin European policy development in this area, which contributes to uncertainty about the current state of the sector and about the evolution of current problems. Due to these reasons the impact assessment adopts an essentially qualitative approach to analyse the expected impacts of the identified options for changing the current policy. The impact of options 2 (policy change by way of a new Communication) and 3 (policy change later, by a Block Exemption Regulation) is assessed in comparison with option 1, the baseline no policy change scenario.

5.1. **Option 1: Baseline scenario – no policy change**

The baseline scenario will not lead to changes for the sector but maintain a situation of legal fragility because a central part of the current rules, the territorial spending obligations, is in violation of internal market principles.

The Option will also lead to controversies with Member States regarding the objectives of their cultural policy. More importantly, it would not respect the subsidiarity principle.

The baseline scenario means also keeping in place rules from 2001, which were published as a small part of a document that covers also other aspects of audiovisual policy than State aid which are not any more up to date.

5.2. **Option 2: Amendment of the current rules for certain or all of the issues identified by way of a new Communication**

The Treaty obliges the Commission to assess State aid. It is furthermore established by the decisional practice of the Commission that, exceptionally, sector specific aid

³³ Commission Communication EU State Aid Modernisation (SAM) of 8.5.2012, COM(2012) 209 final, p.7.

for audiovisual production is in principle compatible with the Treaty under the cultural exception of Article 107(3) d TFEU. Therefore, the Commission has to assess such aid following sector specific standards. An amendment of these standards would be necessary if one or more issues have to be addressed by a change of rules.

In case of an amendment of the current rules, according to Article 108 (1) TFEU the Commission would have to propose appropriate measures to Member States, to bring existing film funding aid schemes in line with the new rules. Temporarily this would lead to the need for the Commission to review the adjustment of around 40 to 50 schemes.

5.2.1. Issue 1 - The cultural test

The heavy workload involved in the current detailed scrutiny of "cultural" criteria is administratively burdensome and entails the risk of the Commission intruding into the Member States' prerogative to define what they consider to be culture; Union action for culture is regulated by Article 167 TFEU according to which Commission action on cultural issues should always respect the principle of subsidiarity. Culture is primarily a responsibility of Member States.

This leaves the Option to change the current practice and to clarify in a new Communication that the Commission will not assess each and every criterion a Member State is applying to qualify a film as cultural. Limiting the Commission's role in verifying that film aid schemes pursue a cultural objective would simplify the assessment of State aid schemes for Member States and the Commission. Less strict conditions on the "cultural test" will allow Member States to simplify their national administrative procedures by which they determine eligibility of films for aid. This contributes to the objective to reduce administrative burdens and will in particular be for the benefit of SME.

5.2.2. Issue 2 - Territorial spending obligations

As illustrated in section 2.4.2., territorial spending conditions violate internal market principles. If the conditions developed by the Court of Justice justifying this type of restriction are not met, it would be contrary to the Treaty to continue permitting Member States to request that nearly the entire production budget is spent in their territory.

However, the current level of territorial spending obligations appears to be unnecessarily and unjustifiably high. The study mentioned in section 1.3 did not demonstrate any tangible advantage of the current limitations. On the contrary, it showed that the number and complexity of these conditions can cause conflicts between the rules applied by schemes of different Member States which may contribute State aid to the same film. However, Member States imposing spending restrictions have to demonstrate that they are proportionate in the sense that they are not more restrictive than necessary to maintain the production of national films.

Therefore there is no choice left but to review the current level of tolerated restrictions of internal market freedoms imposed in State aid schemes of Member States. The objective is to establish a situation which is bringing the design of territorial conditions in line with the internal market principles of the Treaty.

5.2.2.1. Sub-option 1: Strict enforcement of internal market freedoms

This approach would exclude the possibility to link State aid with territorial spending obligations. However, Member States and film funding bodies maintained that, in particular in times of budgetary constraints, territorial conditions are necessary to justify the spending of public funds for film production. Their absence would limit the willingness of governments to invest public funds in film production. This fear is also shared by the sector. It is at least possible that such an effect takes place because culture oriented support policies of Member States usually have also in view the development of the economic sector involved. State aid schemes of Member States usually also cite this aid objective.

Most contributors to the public consultation underlined that such conditions indeed contribute to maintaining a critical mass of infrastructure for film production in the various Member States. They insist that local production activity makes it more likely that films also reflect local languages, involve local actors and other participants and thereby contribute to diversity.

This option could therefore have the impact to limit the access of film projects to financing and thereby put in danger the objectives to preserve a diversity of European film production and relevant technical infrastructure.

5.2.2.2. Sub-option 2: Applying the internal market rules with a view to the specificities of the sector

This option seeks a solution which, on the one hand, further opens up the internal market, and, on the other hand, ensures the achievement of the objectives of film funding and takes into account the specific characteristics of the sector.

As described, a certain level of local spending obligations can be justified for reasons of public policy. A lower possible level of restrictions to the free circulation of goods, services and workforce would further open up the internal market for them. At the same time it allows the Member States to ensure sufficient local effect to justify spending of public funds on national productions. In order to become more proportionate, any limit on territorial spending obligations should be related to the aid amount (eg, x% of the production budget)³⁴. This ensures that only in case where the Member States grants the full maximum 50% aid intensity, the territorial linking can attain a considerable part of the budget. With less state financial commitment it becomes lower. This would be a step to make the territorial conditions more proportionate and more in line with the treaty requirements.

As producers' comments in the consultation revealed, for most European feature films there are rarely significant cost advantages if any part of the production is located away from the geographical base. In addition, many filmmakers tend to stick with the crews, laboratory technicians and editors with whom they have worked in the past and on whose skills they have come to rely best to interpret their creative intentions. The majority of stories and scripts require local talent and locations. Linking the territorial criterion to the aid amount would therefore not have any

³⁴ Under the 2001 Cinema Communication, a Member State may require that 80% of the film production budget is spent in its territory. If for example a producer is making a film with a budget of €10 million and applies for aid to a scheme offering at most €1 million per film. It is disproportionate to exclude the film from the scheme on the grounds that the producer does not expect to spend at least €8 million of the production budget in the territory offering the aid.

significant negative impact on 'selective' film support schemes³⁵, which provide the majority of European State aid.

In any case, if Member States will have less room for imposing territorial restrictions, internal market freedoms will be enhanced and the positive effects of funding films may be easier shared by the sector throughout the internal market. All Member States' companies involved in the production of films would benefit from the schemes more than is currently possible.

5.2.3. *Issue 3 - Subsidies to attract foreign film productions*

A strict approach towards possible competition among Member States to attract foreign film productions (sub-option 1) would exclude these production from eligibility and thereby any possible effect on trade.

A lower aid intensity than for European productions (sub-option 2) would at least reduce a possible impact of these subsidies on trade between Member States. However, limiting the possibility of Member States to attract foreign film productions, or even prohibiting such incentives altogether, would be likely to lead to a loss of many high profile productions which would then be produced in one of the few high quality production sites outside Europe. The UK mentioned two to three major productions par year which would not use the UK as production location in the absence of the tax incentives offered.

European producers would benefit less from high profile productions which require large studio capacities and modern equipment which would not be sustainable with European productions alone. European actors would have less chances to get high profile roles in these productions.

Apart from driving productions away from Europe, different aid intensities for non-European works would require a difficult distinction between European and non-European Films, to be verified by Member States and reviewed by the Commission. This distinction could not be made according to the place of establishment of the producer, because all large production companies have Europe based subsidiaries. A long list of other criteria would need to be used to judge whether a film is European.

This option therefore implies the risk to increase, on the one hand, the administrative burden for Member States. It would furthermore put at risk the objectives to maintain a solid infrastructure for film production in the EU.

5.2.4. *Issue 4 - Scope of activities eligible for State aid*

5.2.4.1. Sub-option 1: Including in a new Communication aid for the distribution of individual audiovisual works

Member States notify aid for film distribution and for distribution platforms, like cinemas and ask for an assessment by analogous application of the Cinema Communication. Aid for the distribution of audiovisual works will help films to eventually reach an audience. This applies in particular to non-national European films. The low level of knowledge of other European cultures and lack of availability

³⁵

In 'selective' film support schemes, the projects to be awarded aid are selected by an evaluation process from among the proposals submitted. In contrast, in 'automatic' film support schemes, all projects fulfilling certain administrative criteria are eligible for aid and there is no evaluation process, other than to verify that the project satisfies the criteria.

of foreign works³⁶ is a problem in terms of cultural diversity because people are unable to fully benefit from the cultural and social value that European cultural works convey, especially with regard to building social cohesion and inter-cultural understanding. The aid may, overall, increase the potential for these films to generate revenues.

This aid would be in support of the objective to have European films produced which are seen by audiences and to increase transnational circulation. The aid may be necessary because some of them have difficulties to find suitable ways of distribution. The option would not change the outcome of already established decisional practice, but it would acknowledge this Commission practice which applied the current rules by analogy, and thereby increase transparency, legal certainty and predictability.

5.2.4.2. Sub-option 2: Further extending the scope of the rules to include aid to distribution platforms like cinemas and video on demand (VoD) platforms.

The current rules do not fit for application on aid to distribution platforms by analogy because the concept of the Cinema Communication oriented towards aid to single audiovisual works and not towards the financing of certain firms or infrastructure. Aid to distribution platforms may support better circulation of films and maintaining a theatrical infrastructure, but it would require a different set of provisions for investment and/or operating aid for these companies. Furthermore, it is not apparent what specific market failure would need to be addressed by sector specific rules covering all platforms.

Regarding cinemas, there is only a limited amount of evidence as regards past Commission decisions on state aid for theatrical exhibition. It would therefore be difficult to develop criteria that would allow the inclusion of aid for a diverse range of cinemas across all EU Member States in the Cinema Communication. Each Member State has a different profile for cinema-going, types of cinemas (multiplex/subdivided/single-screen), types of films shown (arthouse/commercial), and geographical distribution of cinemas (rural/urban).

Regarding possible aid for the acquisition of digital equipment by cinemas, according to UNIC, the International Union of Cinemas, a major share of EU cinemas will have digitally converted their theatres by the time the new Cinema Communication would apply, making specific rules concerning digital roll-out obsolete.

For rural and arthouse cinemas, financing the investment in digital projection equipment may be an insurmountable hurdle. For such cinemas, especially in low population density areas, a market failure may be demonstrated. Many of them should be sufficiently served by the levels of aid which fall under the *de minimis* exception. In other cases the Commission should be open to proposals to provide aid, if the necessity of such aid can be demonstrated.

Consequently, a case-by-case approach to such aid would appear to be more appropriate than attempting to establish general rules. A possibility would be to include wording in the Communication which clarifies that the Commission would

³⁶ An Eurobarometer survey on cultural values within Europe of 2007 shows that only a minority of European people access foreign cultural products, with only 19% of European people watching foreign language TV/movies, <http://ec.europa.eu/dgs/education.culture/pdf/culture/barometer.en.pdf>.

not in principle object to aid to cinemas where the necessity of such aid has been demonstrated, and that it would assess them under Article 107(3)d as aid for the promotion of culture. This would increase legal certainty as it sends a clear signal to Member States that such aid is possible. In particular smaller and arthouse cinemas will benefit from this.

Regarding VoD, the Commission has not approved any State aid for VoD platforms to date. From the consultation it became not apparent why VoD platforms should require aid. Many of them do already exist without funding. As noted in section 2.1., in 2009 there were over 700 such services. There are also prominent commercial VoD platforms operating in Europe, such as YouTube and iTunes. In this competitive market context, financing the creation of new VoD platforms is unlikely to give European films and other audiovisual works greater visibility. The increased fragmentation caused by a larger number of specialised VoD platforms may even push audiences towards the major VoD platforms.³⁷

In comparison, the option of a film related public funding is focussing more on the qualitative objective to ensure that European films and audiovisual works are displayed in cinemas and on existing VoD platforms. Distribution platforms would benefit indirectly from the extension of the scope to cover aid to the distribution of eligible works.

For transparency reasons, the Communication could mention that aid to VoD platforms is not covered

5.2.5. *Issue 5 - Scope of audiovisual products falling under sector specific rules*

The discussion around this issue concerned the inclusion of games in the scope of supported products under the Cinema Communication. Occasionally Member States notified aid for games. In that case, the Commission applies certain parts of the Cinema Communication by analogy.

5.2.5.1. Sub-option 1: Specify that games are excluded from the Communication

This option would give a clear signal to Member States games are not among the audiovisual products falling under the Communication and that the Commission is not assessing State aid under the same criteria as aid for film production. This does not exclude that aid may be supported directly under the Treaty. This contributes to transparency and legal certainty.

5.2.5.2. Sub-option 3: Specify that games will be treated like other audiovisual products under the Communication or develop specific rules for aid to video games

Games have other characteristics regarding production, distribution and consumption than films. Therefore, the rules designed for film production cannot apply automatically to games. Not all games necessarily qualify as cultural products.

It is also not clear what other, more specific State aid compatibility criteria could be conceived for these products in a rapidly changing technological environment with no obvious need for aid. No market failure could be demonstrated which justified specific new state aid rules. While aid to film production is there to support the creation of European films of quality, which most likely would not exist without aid, the video games market would not suffer from such handicaps. The games sector

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This phenomenon is explored in the CineRegio report *Digital Revolution – the active audience* (2012).

itself underlines that it has enjoyed a two digit growth per year since two decades; it would be the most dynamic digital content industry in Europe, and European companies would compete globally.

Furthermore, contrary to the film sector, the Commission does not have a critical mass of decisions on State aid to games which would allow it to develop a set of generally applicable rules. Also Member States were divided regarding the desirability to include rules on aid to games.

Not including games would not rule out that they may receive aid. If Member States wish to support the production of a very particular game specification which they think is essential for certain desired purposes, like education, such aid could be addressed on a case-by-case basis, as is currently the case. Furthermore, aid to games developers is usually relatively modest in comparison to aid for film productions. This could often be covered by the de minimis rules.

It would therefore be premature to integrate this sector in the present communication. Aid might unduly affect trade and competition in the sector.

5.2.6. *Issue 6 – Aid intensities*

5.2.6.1. Sub-option 1: Lowering the aid intensities

This option would reduce the already limited possibilities of producers in particular of less commercial films from obtaining sufficient funding. For them it is already now very difficult to receive funding from private sources. It would limit thereby audience choice. The current intensities do also not affect trade between Member States in a way that they feel that they should be reduced. Furthermore, all Member States and stakeholders were satisfied with the current level of the permitted aid intensities.

5.2.6.2. Sub-option 2: Raising the possible aid intensity for European co-productions to 60%.

An increased 60% aid intensity for productions involving funding by more than one Member State may increase the number of European co-productions, which in turn may foster the circulation of European films in more than just one Member State.

5.3. **Option 3: Temporary extension of the current rules with a view to include them into a future block exemption regulation**

The option to include new rules in a new Block Exemption Regulation would require extending the current Communication. The adoption of a relevant enabling regulation and the amendment of the General Block Exemption Regulation will not take place before 2014, well after the expiry of the present rules. Therefore this option would not produce any benefit, compared to the current situation, but it would lead to the legal and political drawback that it would leave open for an uncertain further period in particular those issues which may be problematic under the Treaty.

If a need for changes has been identified and the present rules are about to expire before a possible adoption of a block exemption regulation, it seems more appropriate to explain the Commission's future approach towards aid for films in a new Communication. If, at a later stage, culture aid may be covered by a block exemption, it will be easy to transpose the revised rules. Otherwise, with the identified deficits of the current rules, it will not be possible to simply take them over

into a Regulation. Furthermore, if Member States are not yet familiar with the criteria applied in a block exemption regulation, the risk of errors and misuse increases.

6. COMPARING THE OPTIONS WITH THE BASELINE SCENARIO

6.1. Option 2: Amendment of the current State aid assessment criteria for the identified issues

Under this option, various approaches regarding the different issues identified during the consultation could be possible. Under the assumption that the current rules should be changed, one possibility would be to define a package of amendments which imposes itself due to the need to ensure a better respect of the principles of the internal market and of subsidiarity in the area of culture (Package 1). Alternatively, the set of amendments could include, in addition, the elements which are subject to Commission discretion in the assessment of State aid (Package 2).

6.1.1. Package 1 – Amendments to reinforce principles of the Treaty

6.1.1.1. Issue 1 - The cultural test

It would be nearly impossible to argue convincingly for any imaginable feature film that it could not be considered a cultural product, or to establish examples of films that should be a priori excluded. Furthermore, such an approach would be intruding into Member States' prerogative to define what they consider cultural expression.

These legal considerations strongly suggest that the Commission should give up its present practice. It will also reduce the current level of administrative burden for Member States and the Commission. Member States will no longer be obliged to develop for the purpose of review by the Commission extensive lists of criteria describing what makes a film "cultural". It will also reduce administrative burdens for SME applying for aid.

6.1.1.2. Issue 2 - Territorial spending obligations

Not tackling the territorial criterion would leave all Commission decisions based on the Communication legally vulnerable as being in breach of the internal market rules. A limit to the possibility for the territorial spending obligations is therefore necessary.

Not allowing them at all (sub-option 1) would be a strong reinforcement of internal market freedoms. But it would jeopardise in some Member States the existence of film funding, as budgetary authorities would not see an economic justification of the aid. It would also put at risk achieving the objectives of preservation of European film production and maintaining a local industrial base for it, both essential for the preservation of cultural diversity. It would put jobs at risk.

Compared to this, a lower admissible level of territorial spending obligations linked to the aid amount (sub-option 2) will not only enhance the internal market for film producers, allow more business opportunities for the sector offering services for film productions and their staff, and for sectors. It will also preserve the achievement of the objectives mentioned in the previous paragraph. This will be in any respect an improvement to the current situation.

6.1.1.3. Interim result

The two amendments will enhance respect of Treaty standards, reduce the administrative burden for Member States, the Commission and SME, and open job and business opportunities in the internal market for staff and companies which offer their services while continuing to ensure Member States' willingness to fund films in the interest of cultural diversity and audience choice. This package will be an overall improvement compared to the current situation.

6.1.2. *Package 2 – Including further elements in the amendment*

6.1.2.1. Issue 3 - Subsidies to attract foreign film productions

As regards aid for foreign film productions, the option not to allow aid at all would be difficult to justify under Article 107 (3) d which does not limit the term "promotion of culture" to purely European contents or actors. The possibility to provide for a reduced aid amount for non-European productions would require a complicated distinction between European and non-European films and may lead to a weakening of the industrial base for major film productions.

Maintaining the current situation would mean that foreign productions would be treated in the same way as European productions. This may keep in place the overall positive effect of this aid on the European film sector. European producers are benefiting from high profile productions which require large studio capacities and modern equipment which would not be sustainable with European productions alone. They are also benefiting from a transfer of technical knowhow. European actors find additional chances to get roles in these productions. European consumers benefit from these productions which add to the choice for audiences. The aid does have an incentive effect because it attracts productions which otherwise would choose production locations outside Europe.

In the case where Member States would have less room for imposing territorial spending obligations, positive effects of funding films may be easier shared by the sector throughout Europe. Steps to reduce limitations to the free circulation of goods and services in Europe would make it possible that national support for film production may be more beneficial for the sector throughout the internal market, and not primarily in the granting Member State only. The Commission had already noted in section 2.5. of the 2001 Cinema Communication that a possible distortion of competition created by aid to film production would originate more from territorialisation requirements rather than from the level of aid itself.

In this case the effect of such schemes on trade between Member States may not be significant enough to justify a differentiated approach and to offset the shared interest in attracting major film productions. This would also avoid the difficult distinction between European and non-European works, additional administrative burden and damage to the competitiveness of the sector.

6.1.2.2. Issue 4 –Scope of activities eligible for State aid

Aid to distribution of individual films has been approved in the past by applying the Cinema Communication by analogy because it is serving the objectives of aid to film production. Leaving the rules unchanged would maintain the current legal uncertainty regarding this point. An explicit inclusion in future rules (sub-option 1) increases transparency and legal certainty, while acknowledging current decisional

practice. Including cinemas and VoD platforms (sub-option 2) would require a new set of rules for which the Commission has not sufficient case practice to develop them. Also the general necessity and therefore the compatibility of aid for VoD platforms are not clearly demonstrated.

6.1.2.3. Issue 5 – Scope of products falling under sector specific rules

Regarding the coverage of games by the rules, leaving it without mention would maintain the current legal uncertainty regarding this point. An explicit mention in future rules that they are not covered (sub-option 1) increases transparency and legal certainty. Including games, either by treating them like films or by devising new rules (sub-option 2), would not be justified by a general necessity of this aid. Furthermore, the Commission has not sufficient case practice to develop a new set of rules.

6.1.2.4. Issue 6 - Aid intensities

In the interest of improving the circulation of European films in several Member States a higher possible aid intensity for European co-productions (sub-option 2) appears to be justified. It would be an improvement of the current situation in terms of circulation of European films in more than one Member State. Apart from this aspect, keeping the current intensities would not alter the contribution of State aid to the identified objectives of the rules. Lowering them, however, (sub-option 1) would risk that many films will not obtain sufficient funding.

6.1.3. *Result*

The amendments to the current rules, which are imposed by package 1, could be flanked by further changes of package 2 which are of minor importance but incorporate the experience collected in past practice and address identified shortcomings. They clarify the scope of the rules for the benefit of transparency and legal certainty. Not to adopt such amendments would render the review, which had to take place in any case, incomplete. A combination of the two packages is preferable for stakeholders and for the services of the Commission.

Stakeholders will be able to know what decisional practice they may expect. This allows them to design the rules for notification with some reliability. The Commission will benefit because it will henceforth apply standards it has discussed with Member States and the sector. They are therefore likely to reflect the particularities of the sector. The more standardised the assessment, the greater the legal certainty for Member States and the sector, and the lower the implication of Commission resources.

This option would also be in line with the principles which guide the State aid policy modernisation initiative of the Commission.³⁸ They are reinforcing internal market principles and introduce changes to make rules viable for the future so that they can be easily taken over into a possible Block Exemption Regulation on aid for culture.

6.2. **Option 3: Temporary extension of the current rules with a view to include them into a future block exemption regulation**

Eventually, the Commission would have to address in any case the identified shortcomings. A temporary extension would leave them unaddressed for an uncertain

³⁸ Cf. footnote 32.

period of time. Regarding issues like the scope of activities and the form of products covered, the Commission would adopt a decisional practice as discussed for a new Communication, applying the present rules by analogy. This would not contribute to legal certainty. Also a transposition of the current rules in a possible later block exemption regulation would be more difficult, as their identified shortcomings would persist. Therefore it appears to be preferable to address the issues now, as they come up anyway at the occasion of the expiry of the current rules.

6.3. Summarising the comparison

Therefore, compared to the baseline scenario, **Option 2**, package 1 will, with issue 1 (cultural test) be effective in contributing to a better respect of the subsidiarity principle, legal certainty, and reduced administrative burden for all stakeholders. This will improve efficiency of enforcement and coherence with the Treaty principles. Regarding issue 2, sub-option 1, not to allow any territorial condition, would certainly strictly enforce internal market principles; but it would not be effective, because it would jeopardise important objectives of film funding. Sub-option 2 would these objectives to be achieved and still contribute to coherence with internal market principles.

Package 2 would add to this with issues 4, 5 and 6. Issue 4, sub-option 1 would include, in the interest of consumer choice and transparency, distribution of individual films among aided activities; sub-option 2 would add to this aid to distribution platforms like cinemas and VoD, where the need for aid is less apparent. Sub-option 1 of Issue 5 would in the interest of transparency exclude games from the type of audiovisual products covered by the Communication. Sub-option 2 would include them although it is doubtful that games need aid in the same way as films, and that this aid is compatible with the internal market. Regarding issue 6 on aid intensities, lower aid intensity (sub-option 1) would make it more difficult to achieve the objectives of film funding and not be coherent with the Treaty objective to support cultural diversity. Sub-option 2 would however support more strongly these objectives, in particular with regard to transnational production and circulation of European films.

Thereby, Package 2 would improve transparency and predictability of Commission decisional practice for Member States and companies; it would slightly reduce the current workload for Member States and the Commission. This would increase efficiency of State aid enforcement and outweigh the administrative burden for the Commission and Member States caused by bringing in line existing schemes with the new rules within a year following their adoption (appropriate measures procedure according to Article 108 (1) TFEU). Keeping the same standards for aid to European and non-European film productions (issue 3) will avoid additional administrative burden and contribute to consumer choice and maintaining a performing production infrastructure.

Overall, therefore option 2, package 2, with amendments according to issues 1, 2 (sub-option 2), 4 (sub-option 1), 5 (sub-option 1), and 6 (sub-option 2), and no changes regarding issue 3, offers most benefit in terms of effectively achieving the objectives of film funding, of more efficiency through transparency, legal certainty and less administrative burden, and of coherence with Treaty principles.

In comparison to this, **option 3** would leave in place the legal uncertainty regarding the cultural test and the scope of the rules. The conflict of the rules with the internal

market freedoms would persist, thereby maintaining a lack of effectiveness and efficiency of Commission practice and legal uncertainty despite an identified need to restore general legality of State aid enforcement. This would not be coherent with Treaty objectives. For a yet unknown period, because of the need to apply the rules by analogy, decisional procedures would be longer and slower, increasing the workload for Member States and the Commission. The transparency would be lower. Issues which should be addressed are left open.

Options 2 and 3 compared to the baseline scenario (option 1)	Effectiveness	Efficiency	Coherence
<u>1. Amendment of rules by a Communication (option 2)</u>			
<u>Package 1</u>			
Issue 1	++	++	++
Issue 2, sub-option 1	-	=	+
Issue 2, sub-option 2	=	=	+
<u>Package 2</u>			
Issue 3	+/-	-	-
Issue 4, sub-option 1	+	+	+
Issue 4, sub-option 2	-	+	=
Issue 5, sub-option 1	+	+	+
Issue 5, sub-option 2	-	=	-
Issue 6, Sub-option 1	-	=	-
Issue 6, Sub-option 2	+	=	+
<u>2. Waiting for a Block Exemption Regulation (option 3)</u>	=	=	-

Magnitude: ++ strongly positive; + positive; -- strongly negative; - negative; +/- both positive and negative; = neutral; ? uncertain; 0 baseline scenario

Effectiveness refers to the extent to which options achieve the objective. Efficiency refers to the extent to which the objective can be achieved for a given level of resources / at least cost (cost-effectiveness). Coherence refers to the extent to which options are coherent with the overarching objectives of EU policy.

7. MONITORING AND EVALUATION

Progress towards the objectives described in chapter 3 will be monitored by Member States, the Commission and the European Audiovisual Observatory, an institution of the Council of Europe.

Member States are obliged by Article 21 of Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty³⁹ to submit annual reports on the application of their schemes. Member States will be systematically reminded of this duty in the State aid decisions addressed to them. An assessment of these reports will take place in the context of the State aid scoreboards regularly produced by DG Competition. DG Competition will continue the ex post monitoring of the application of aid schemes which it has started with regard to the existing schemes of certain Member States.

Furthermore, the European Audiovisual Observatory is constantly collecting relevant data on the film sector, including on subsidies, and is assessing how the sector evolves. These data are available to the Commission. The statistical data provided by the Observatory do not constitute sufficient basis in terms of consistency and scope for informed policy development. There is therefore a need to strengthen this aspect of policy support. The proposed Creative Europe Framework Programme therefore envisages closer collaboration with this institution.

8. CONCLUSION

On the basis of the above, the most effective, efficient and coherent approach would be for the Commission to adopt new rules on State aid for films and other audiovisual works. This should take the form of a Communication, as proposed in the public consultation.

³⁹ OJ 1999 L 83, p. 1.

ANNEX 1: CHRONOLOGY

- 24 March 2011: First meeting of the Impact Assessment Steering group (IASG)
- 20 June 2011: Launch of first round of public consultation by the publication of an issues paper
- 11 July 2011: Meeting with European Film Academy Directors (EFAD)
- 9 August 2011: Meeting with Regional Film funding bodies (CineRegio)
- 7 September 2011: Meeting with Film industry representatives (Producers, Distributors, Directors, Cinemas)
- 14 September 2011: Multilateral Meeting with Member States
- 10 November 2011: Meeting of the Impact Assessment Steering group
10. January 2012: Meeting with CineRegio
13. January 2012: Meeting with EFAD
18. January 2012: Meeting with representatives of the film industry
- 26 January 2012: Meeting of the Impact Assessment Steering group
13. February 2012: Meetings with EFAD and CineRegio
14. March 2012: Launch of public consultation on draft Communication
- 18 April 2012: Meeting with CineRegio
- 26 April 2012: Meeting with EFAD
- 7 May 2012: Meeting with representatives of the film industry
- 8 May 2012: Meeting of the Impact Assessment Steering group
- 5 June 2012: Multilateral Meeting with Member States
- 5 July 2012: Meeting of the Impact Assessment Steering group
- 30 August 2012: Meeting of the Impact Assessment Steering group
- 6 September 2012: Submission of draft Impact Assessment Report to the Impact Assessment Board
- 3 October 2012: Evaluation of the report by the Impact Assessment Board
- 30 April 2013: Launch of public consultation on second draft of Communication
- 14 May 2013: Multilateral Meeting with Member States