



# TELEVISION

IS CHANGING. ARE YOU READY?

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## DIGITAL DEDUCTIONS: DO THEY ADD UP?

### INTRODUCTION

Royalties are paid to performers based on a percentage of the sales price of the programme or film in which they appear. Before any royalty is paid companies are entitled to make deductions from their receipts from sales to cover legitimate costs they incur. For a DVD, for example, the costs may encompass certification fees and the costs of duplication, printing, packaging and distribution of the material.

However, the process is complex and what constitutes a legitimate deduction has been widely interpreted. It remains possible that, either through error or manipulation, artists will not receive their fair reward for their work.

Extending the application of royalty payments to new platforms must in the first instance address the issue of deductions, legitimate or otherwise. It is clear that with new technologies new challenges emerge for negotiators. Equity's approach is to stress three principles: accountability, transparency and compliance.

Deciding what makes up a fair royalty depends on clear definitions, the application of the rules must be open to scrutiny and there must be a means to ensure that all parties abide by those rules. This can all only be achieved with a clear and unequivocal approach and agreement on the issue of deductions.

### INSIDE

This document sets out the current rules regarding what constitutes acceptable deductions from the receipts of a production. It then looks at what deductions might be acceptable in relation to new digital technologies and sets out the key issues identified by Equity as necessary for a robust and reliable system of royalty payments in the future.

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# CURRENT AGREEMENTS AND LEGITIMATE DEDUCTIONS

The Future of Television Agreements document published by Equity in February 2006 identified that the royalty payments system is the best way to ensure a fair share for Equity members from commercial sales – both under current technologies and in the future. All four of Equity's television agreements (with ITV, BBC and the Producers Alliance for Cinema and Television - PACT and Welsh Independent Producers - TAC) contain similar provisions for the application of a 17% royalty. The structure applies to video/DVD sales, sales to UK secondary television market and overseas sales. The provisions as they currently stand contain three central pillars:

- a.** 17% of gross receipts from each production sale (in the case of sales within the UK secondary television market)
- b.** 17% of gross receipts for video/DVD sales with a recognition that some legitimate deductions in certain circumstances can be applied
- c.** In circumstances where a purchasing company controls more than 25% of the selling company or vice versa the sale will be subject to a number of procedures to ensure that any sales price is in line with market prices

In 1992 the Director of Industrial Relations at ITV, circulated a list of the following items of "directly identifiable expenditure" that could be deducted from receipts before the application of the 17% royalty:

- Video registration fees (eg certificate 'PG' or '18')
- Editing
- Re-versioning
- Re-recording and duplicating
- Blank tapes
- Packaging (including printing and packaging)
- Freight and carriage
- Publicity and promotion (including materials and artwork)
- Legal and any other agency fees
- Distribution (including any charges by wholesalers)
- Fees due to collecting societies or other copyright holders

- Returns of unsold stock from wholesalers/retailers

However, the deductions list did not contain any further definition or a value which resulted, specifically in video/DVD sales. This allowed a huge scope for a creative approach to accounting of sales. 1998 the Producers' Industrial Relations Service Ltd circulated to its PACT membership the following guidance: "The royalty is based on gross receipts from sales that is before any deductions e.g. of distribution costs or for example apportionment of income to a financier/broadcaster. The only exception to this is where the production company is effecting its own video distribution in which case there are legitimate deductions for the marketing/manufacturing process."

In 1999 Equity conducted a number of audits which confirmed that the 17% royalty was being applied at different points in the revenue chain and certainly not on gross receipts as it was understood at the time of the agreements. The royalty 'pot' varied from anything between 20%-50% of the sales price. The most creative practices occurred when distribution was carried out by third party distributors rather than the broadcasters own distribution arm.

The issue of how the 17% royalty is applied remains unresolved and will clearly remain so until Equity exercises its right of audit. It is important that an audit is conducted as it will provide the negotiators a snapshot of where we are now which in turn will enable us to 'fix' the provision and ensure that the wording is robust enough to accommodate new platform delivery systems.

# NEW TECHNOLOGIES AND FUTURE DEDUCTIONS

Recent years have seen an explosion of new platforms emerging, which allow artists' performances to be accessed in an enormous variety of formats and across a very wide range of different technologies. The new platforms bring with them numerous new challenges. Not the least of these is the introduction of new – platform providers such as Vodaphone, Orange, Google, Yahoo and Love Films, with whom Equity has no history of working and who bring different expectations from that of our traditional partners in the industry.

These new platforms also bring with them a variety of means of income generation. Business models may for example, be based upon pay-per-view (with viewers charged a fixed price per download) or by subscription (with viewers

paying a fixed price for a defined package) or they may offer free services (to viewers, with income generated by associated advertising).

Equity has sought to ensure that where there is an identifiable revenue stream the broadcaster/producer pays a royalty on the download price. Where the revenue stream is based on a subscription service then payment is either based on the total subscription revenue or a payment is negotiated and distributed on a collective licence basis. Where the service is free at the point of use, but supported by various advertising models, a negotiated sum is agreed and again distribution based on a collective licence.

## LEGITIMATE DIGITAL DEDUCTIONS

The revenue streams identified above may attract deductions before payment to artists are made. Equity wants to agree, where appropriate, identified allowable deductions, the value of such deductions and a mechanism to prevent these deductions being claimed more than once ("double-dipping"). Our early discussions with the broadcasters have confirmed that deductions are ranging from 0%-50% (on all platforms) before royalty payments are made. Where the revenue is based on a pay per view basis we are being informed by producers and broadcasters that there are, in their view, a number of unavoidable deductions.

### Digitisation

Broadly a digital television is defined as system for broadcasting and receiving moving pictures and sound by means of digital signals. It uses digital data, which is compressed and requires decoding by a specially designed television set or a standard receiver with a set top box. In practice for a consumer to receive material via this platform the material will have to be digitised.

Digitalisation is a one-off cost unlikely to occur again. Many broadcasters have commenced a process of digitising their library and current material.

Equity and the producers and broadcasters

need to agree a means of valuing digitisation costs, capping such costs and ensuring there is sufficient protection within any collective agreement to minimise such costs.

### Formatting/Re-formatting

Equity understands formatting/reformatting to be the process by which material is processed to enable delivery via different platforms. Simply put, a product is digitised then re-formatted to enable it to be delivered via DVDs and then re-formatted to appear on mobile devices and then re-formatted to make the product available via video on demand etc.

The challenge for Equity and the producers and broadcasters is to clearly define the work involved in this the process, to agree the cost of reformatting with a maximum level for any production and to ensure we have sufficient protection within our collective agreement to ensure that "double dipping" doesn't occur for formatting/re-formatting cost on the various platforms.

We wish to put in place a tracking process that will flag when the product has been through a reformatting process and for what platform it has been reformatted so that we can ensure that when the independent producers acquires/retains such rights they receive the product from the broadcaster in a digital form and the correct

format. Should this not be the case we need to explore the implications of a further process of re-formatting.

In addition there are a number of other potential costs which Equity is working with broadcasters and producers to identify and quantify and to judge whether they represent justified deductions from the retail cost. Amongst the issues under review are merchant delivery, bandwidth delivery, storage and the manipulation or adjustment of material

## LEGITIMATE DIGITAL DEDUCTIONS

To enable the process of applying a royalty to revenue streams in the digital world Equity will need be certain that we have a robust and reliable system in place to ensure that our members are treated fairly. Such a mechanism will be have to address the following key issues:

- There must be clear definitions of the processes involved and the work necessary to complete the tasks that require deductions. We must have a clear understanding by what is meant by terms such as digitisation, formatting, re-formatting, storage and manipulation or adjustment costs
  - Agreement on identifying which deductions are appropriate before the application of a royalty e.g. technical cost associated with consumer contacts with a VOD service call centre
  - Quantifying the value of deductions
  - Identifying maximum levels of deductions for specific processes
  - Reduction of costs where tasks take place in volume or may be repeated e.g. digitisation costs
  - Flags/triggers when deductions have been made to ensure costs are not deducted more than once
- Clarification as to what happens once material reverts to independent producers both in terms of deductions and revenue share.

# TELEVISION IS CHANGING

This paper is part of Equity's *TV is Changing* campaign. It is intended as a companion to *The Future of Television Agreements* published by Equity in 2006 and the updated *The Future of Television* published in August 2007. Copies of these publications are available from Equity or can be downloaded from [www.tvischanging.com](http://www.tvischanging.com).

Equity has produced a range of briefings designed to update members on recent developments and to provide a deeper insight into the issues at stake as television moves towards its digital future. These briefings illustrate the work Equity has done over the past year and highlight the important issues still to be resolved.

Briefing papers in this range include:

Paying for the Future: Collective Licences

Deductions in a Digital Age: Do they add up?

Broadcasters & Producers: Terms of Trade

Simultaneous Transmissions: TV on Mobile Devices

Working Conditions: Fees and payments

Terms and Definitions: What it all means

Equity has also produced a range of factsheets designed to answer the most frequently asked questions about how all this will affect our members.

This material is available free of charge to any Equity member. If you would like to receive a copy or would like to take part in the debate within Equity regarding the future of television, please do not hesitate to contact us - details are below.



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