

9 December 2002

## **Survey of Exhibition Industry Practices**

U.S. Answers by John Fithian, NATO President

### **1. *Alternative, Non-film Product***

- a) Do your members exhibit any form of entertainment in their cinemas other than motion pictures? For example, do your members show sporting events, music concerts, religious programming, educational programming, or any other form of product other than movies for which a ticket price is charged?

*Answer: For American cinema operators, alternative product is a relatively recent development. In the past several years, our theatre operators have experimented with a variety of new entertainment on their screens. These experiments have included:*

- *Sporting events such as professional wrestling, college football (American-style) games, and “X games”.*
- *Music concerts by popular bands*
- *Corporate seminars*
- *Broadway plays*

*Success with these events has been mixed. We have discovered several challenges, including the ability to obtain the rights to exhibit the new product, marketing the availability of the new entertainment options in cinemas, and finding a consistent schedule of events. Our members hold a variety of views at this juncture. Some believe alternative product can and will produce substantial new revenue streams. Some believe the experiments will never progress to anything meaningful. As we move to digital cinema, however, these experiments will grow and be made much easier.*

### **2. *Cinema Construction, Screen Count, Complex Size***

- a) How many total screens in your country/territory? How many total cinema sites? What is the average number of screens per site?

*Answer: At the end of 2001, there were 35,153 movie screens in the U.S. Of that total, 34,490 were indoor screens and 663 were “drive-in” or outdoor screens. Also at the end of 2001 there were 6,246 total cinema sites in the U.S., consisting of 5,813 indoor sites and 433 outdoor sites. The total average number of screens per site, therefore, was 5.2.*

- b) What type of construction do your cinemas have? In other words, what percentage of your auditoriums has sloped floors, and what percentage has stadium seating?

*Answer: NATO does not maintain data on the type of cinema construction. Generally speaking, all theatres consisted of slope floor construction until the mid 1990s, when exhibitors began to build stadium-style auditoria. Now, virtually all newly constructed cinemas contain stadium seating.*

- c) What percentage of your cinemas has digital sound systems?

*Answer: NATO has no data on this question.*

- d) What is the average number of seats per auditorium?

*Answer: NATO has no data on this question.*

### **3. Cinema Security**

- a) What steps do your members take, typically, to ensure the security of their premises for their patrons? Are security personnel ever hired to be on duty? Are packages prohibited, searched or checked for retrieval after the show?

*Answer: The tragic events of 11 September 2001 have caused our members to revisit the issue of theatre security. Many of our members now use security personnel – some are off-duty police officers, and some are private security forces. Some of our members instituted a policy prohibiting large packages or bags. Others simply search those large bags prior to entry. Some members have hired security consultants (often former FBI agents) to analyze their security policies and make recommendations for changes. NATO has also begun a series of meetings with the U.S. Office of Homeland Security to seek their advice.*

### **4. Concessions**

- a) What average percentage of your members' gross revenues comes from concessions? What average percentage of profits?

*Answer: The London-based publication Screen Digest recently completed a sophisticated report on cinema concessions sales worldwide. They estimate that concessions accounted for 20% of the gross revenues of U.S. exhibitors in the year 2000. They further estimate that those sales accounted for approximately 40% of profits. Those estimates are consistent with our understanding of our industry.*

- b) What type of concessions do your members offer their patrons? Any new innovations that are working?

*Answer: Most of our concession sales come from traditional offerings such as soft drinks, popcorn, nachos and candy. Some of our members have experimented successfully with a more varied menu, including specialty coffees and desserts. In some limited locations, our members operate so-called “luxury cinemas” where patrons can order from a full menu of food choices. Outside the realm of the luxury cinema, however, the traditional items likely will continue to produce most of our sales.*

## **5. Digital Cinema**

- a) Describe the current state of digital cinema in your region. Do you have test sites? Are there plans for more installations?

*Answer: Digital cinema in the U.S. remains in the “testing” phase. Out of more than 35,000 screens in the U.S., fewer than 150 have digital cinema capabilities. Nonetheless, many of our members are investigating the possibility of further installations. The work of the American studios in their digital cinema joint venture (called “Digital Cinema Initiatives” or “DCI”) will help to organize the transition to digital cinema. NATO is working closely with DCI to help them design the technical specifications necessary to promote compatibility and interoperability of equipment. We also seek to ensure that worldwide standards are developed for the technology. NATO and DCI also hope to discuss a business plan for the coming roll out. IF these discussions produce an orderly plan by the end of 2003 as hoped, the true transition to digital cinema in the U.S. will begin shortly thereafter. Nonetheless, it will take many years to complete the transition.*

- b) Describe the attitude of your members relative to digital cinema. Do they believe that digital cinema will be a good thing for theatre owners? What do they believe are the benefits? What are the costs and risks?

*Answer: US cinema operators believe that digital cinema provides more benefits to the studios than to exhibitors. Specifically, we note that the studios stand to save millions of dollars in film print costs and distribution costs. We do not see any similar savings for cinema operators. Secondly, we need technical standards to avoid systems that do not work together and to promote competition in equipment and delivery. Exhibitors also insist that digital cinema provide a picture quality level that exceeds film.*

*Nonetheless, our members believe that the transition to digital cinema is inevitable. We simply hope to obtain business plans where the costs are apportioned to the benefits. That is to say, we believe the studios should pay for the transition. We also believe that digital cinema may offer some marginal benefits by enabling alternative product exhibition. But most importantly, we hope that digital cinema will eventually provide a better movie-going experience for our patrons so that they will come to the movies more often.*

- c) Do your members believe that digital cinema will enable theatre operators to exhibit product other than motion pictures, such as sporting events, music

concerts, business seminars, etc? Do they believe that such “alternative content” can create a profitable income stream for theatre owners?

*Answer: As stated above, digital cinema will enable more product options as a technical matter. Whether alternative product offerings will constitute a substantial business remains to be seen.*

- d) Will digital cinema change the way your government regulates your members’ business? In other words, movies today are distributed in film format. In the future digital cinema world, movies may be distributed over the Internet or other broadband connections, or via satellite. Will these delivery mechanisms trigger any new government regulations?

*Answer: Our lawyers have examined U.S. communications laws to determine if the transition to digital cinema will change the way we are regulated. As currently written, we do not believe that the laws will apply any differently to us in the digital world. We will carefully monitor the development of our communications laws to ensure that this is the case.*

## **6. Disability Laws**

- a) Does your national or local government regulate the cinema business to provide access to people with disabilities? If so, what type of regulations apply? Have your members been engaged in litigation with the government or their patrons regarding this type of regulation?

*Answer: The disabilities laws of our federal and state governments have imposed significant cost burdens on our members. In addition, our members have been subjected to numerous lawsuits from the government and from representatives of the disabled community to force greater access to our theatres. Though our members willingly seek to adapt their theatres to serve all patrons, including those with disabilities, some of the legal issues have imposed an excessive burden on our industry.*

*Under the Americans With Disabilities Act (ADA), our members must provide wheelchair seating for disabled patrons, assistive listening devices for patrons who are hard of hearing, wheelchair ramps, designated parking spaces, accessible bathroom construction, and many other requirements. Presently, the law does not require captioned films for the deaf or descriptive film technology for the blind. Nonetheless, we have faced several lawsuits from the deaf and the blind in an attempt to reinterpret the laws. To date those lawsuits have been unsuccessful.*

*One major area of concern has been wheelchair seating. The federal government and disability rights advocates have brought seven major lawsuits in various states claiming that our wheelchair seating is insufficient. Specifically, the suits claim that wheelchair seating must be placed further up in stadium seating auditoria. Of the suits decided to*

*date, exhibition has won four and lost one. The question raised in these cases is being appealed. We await a resolution of this costly issue.*

## **7. Film Rental**

- a) How is the amount paid to the studio distribution company (i.e., the “film rental”) typically calculated in your region? Is this amount determined by negotiation, by the government, or by some other means? Is there more than one method for determining film rental?

*Answer: As a trade association, NATO does not involve itself directly in any issues relating to film rental charges. Our antitrust laws prohibit any collective activity in this area. I can only respond anecdotally. The amount of film rental is not determined or affected by the government in any way – it is simply negotiated between the studio and the cinema operator. Typically, a percentage of the ticket price is paid to the studio and the cinema operator keeps the remaining percentage. Also typically, the percentage paid to the studio is much higher in the earliest weeks of the movie’s exhibition. The theatre owner’s percentage grows the longer the movie stays in the theatre. These percentages are negotiated before exhibition of the movie, and are sometimes renegotiated during and after the movie’s run in the theatre. (Some studios have moved away from this renegotiation process by requiring “firm terms” – or percentages that can’t be changed.) Sometimes, theatre operators are required to give guarantees of a certain return on the movie for the studio. Sometimes the studio will give a guaranteed amount to the cinema operator, against which are calculated the rental percentages.*

- b) Has the share of ticket price paid to the studios changed over the past few years? If so, how?

*Answer: Though I can’t speak to specific percentages between specific companies, I can relate the general feeling of NATO’s members that the studios are receiving a higher percentage of the ticket price now than in recent past years. One reason for this difference is that the movies do not last as long as the used to. The typical “run” of a film has shortened dramatically. Because the percentage of the ticket price paid to the studio is higher earlier in the run, shorter runs have led to higher overall percentages for the studios.*

## **8. Government Regulation of Movie Content**

- a) Do the governments in your region regulate the content of movies? Is there an aged-based ratings system, either voluntary or legal? (If so, please describe the rating system.)

*Answer: The U.S. Constitution protects the right to “free speech”, which includes entertainment product such as motion pictures. There are a few limits to the protection. For example, pornography that is so graphic and lacks any artistic value can be deemed “obscene” and thus not protected by the constitutional right of free speech. In general,*

*however, the right of free speech protects most movies. As such, the government cannot regulate the content of movies generally.*

*We also believe that a ratings system imposed by the government would violate the constitution. The U.S. House of Representatives considered a governmental movie ratings system in 1999 and rejected the concept by majority vote. NATO lobbied against the legislation, and argued that a law requiring a movie rating system would violate the constitution.*

*NATO and the Motion Picture Association of America (the trade group representing the major U.S. movie studios) do maintain a VOLUNTARY rating system for movies. Most movies exhibited in the United States are submitted voluntarily to the Classification and Ratings Administration, where one of five ratings are applied to the movie (G, PG, PG-13, R, and NC-17).*

*The first three ratings are advisory in nature, and do not impose any restrictions on admission. G is for general audiences and indicates that the movie is appropriate for all ages. PG signifies that some parental guidance is necessary because some material may be inappropriate for young children. PG-13 implies a stronger warning to parents that the movie may be inappropriate for children under the age of 13.*

*Then there are two restricted ratings. R indicates that no one under the age of 17 will be admitted without an accompanying parent or guardian. NC-17 means that no one 17 years of age or younger will be admitted at all. By voluntary agreement, the NATO members enforce the R and NC-17 ratings by checking for age identification at the box office and by taking other steps to ensure that children do not see inappropriate movies.*

- b) Describe the attitude of your members about this government regulation, or voluntary self-regulation.

*Answer: Theatre owners in the United States strongly oppose any attempts by our government to regulate the content or ratings system of our movies. Our members do strongly support the voluntary system, however.*

## **9. Labor Issues**

- a) Are the employees of your members unionized or covered in some other way by collective bargaining laws?

*Answer: Generally speaking, cinema employees in the United States do not belong to any of the voluntary labor unions and therefore are not covered by collective bargaining laws. In some cities, particularly Chicago and New York, some projectionists and other employees belong to a union. However, those unionized employees are the exception to the rule. Collective bargaining generally does not affect NATO members.*

- b) Does your national or local government regulate wages paid to your employees? (e.g., Must you comply with a minimum wage or other wage requirements such as overtime payments?)

*Answer: In the U.S., both the federal and state governments can impose minimum wage rates. The federal rate currently stands at \$5.15 per hour. The federal wage rate serves as a minimum, and the various states can impose higher rates. Roughly 15 of the 50 states do impose higher rates, including some as high as \$6.90 per hour.*

*Federal and state governments can also impose “overtime” requirements. Under federal law, however, movie theatres are exempt from overtime requirements. Nonetheless, most states do impose overtime requirements on cinema operators. Generally speaking, if an employee works more than 40 hours in any week, or 8 hours in any day, those extra hours must be compensated at the rate of one and one-half of the normal hourly rate. Overtime requirements do not apply to managerial employees, however.*

*NATO lobbies regularly to prevent minimum wage rates from being increased.*

- c) Does your government regulate “child labor” by proscribing either the minimum age for workers, or a maximum number of hours that workers of a younger age can work?

*Answer: Again, both the federal and state governments can and do regulate “child labor.” A series of restrictions apply to the maximum number of hours that can be worked for teenagers of specific ages. There are also ages at which children cannot work at all outside of family businesses and farms.*

#### **10. Loyalty Cards, Carte Illimite, etc.**

- a) Do your members use loyalty card programs where frequent patrons earn points for free movies or free concessions?

*Answer: Many of our members do use loyalty card programs where frequent patrons earn points for free movies or free concessions. These programs tend to develop “brand loyalty” for the theatre company. Nonetheless, for the industry as a whole, I believe these programs only serve to decrease our profits. I do not believe that they cause patrons to go to the movies more often. In a highly competitive industry like ours, however, I understand why our members engage in these programs.*

- b) Do your members use unlimited pass programs where patrons pay one price for a fixed period (e.g., one month, or six months) and may attend as many movies as they like? Has the program been accepted by your membership?

*Answer: As a trade association, NATO cannot organize its members for or against any marketing programs like loyalty cards or unlimited pass programs. Nonetheless, I can report that our members do not use unlimited pass programs. A few companies*

*experimented with such programs and stopped them. AMC Theatres, the largest company that is not a member of NATO, is experimenting with an unlimited pass program in two small cities in the Midwest. I assume that the program has not been very successful because AMC has not expanded it beyond those two test cities.*

### **11. *Luxury Cinema, Premium Pricing***

- a) Do your members operate “luxury cinemas” or premium priced cinemas? In other words, do they operate cinemas where patrons pay more than the usual ticket price in order to obtain better amenities, such as special food or drink, or special seats, etc.?

*Answer: The concept of “luxury cinema” is a new and growing part of the exhibition business in the U.S. There are approximately 25 such luxury cinemas in various large cities around the country. With more than 6,000 cinema sites in the country, 25 sites obviously constitutes a small minority of theatres. At these locations, patrons pay more than the usual ticket price, sometimes twice or three times as much. In exchange for that higher price, the patron obtains better amenities like special food or drink, special seats, reserved seating, valet parking, etc. Some of these new luxury cinema locations have been very successful, some have not. I believe that the concept works, but only in certain locations where patrons have significant disposable income and also engage in movie-going frequently.*

### **12. *Motion Picture Product Supply/Windows***

- a) How important are domestic movies to the business of your members? How important are foreign movies? What percentage of your box office receipts is produced by domestic films versus foreign films?

*Answer: The vast majority of movie theatre business in the U.S. comes from films produced and distributed by American studios in English. Though we do not maintain statistics on this issue, I estimate that American movies constitute more than 95% of ticket sales. In recent years, we have had some success with foreign films (such as “Crouching Tiger, Hidden Dragon”), but those successes constitute the exception to the rule. There is a niche market of patrons who enjoy foreign films, and there are a small number of theatres that specialize in foreign product. But this is a small minority of the overall industry.*

- b) Does the government control the percentage of films, or the percentage of movie screens, that must be dedicated to domestic films? If so, what is the attitude of your members about such controls?

*Answer: There are no controls in the U.S. on the origin of films.*

- c) For American films, how long after their release in the United States are they released in your region?

*Answer: Not relevant to movies released in the U.S.*

- d) What about the video/DVD window? How long after theatrical release are videos and DVDs released? Does the government regulate that window?

*Answer: The government does not regulate the window between theatrical release and any of the ancillary movie markets like video or DVD. NATO closely tracks these windows and works to maintain the separation between the primary theatrical run, and the ancillary markets. Nonetheless, the window between theatrical exhibition and video/DVD release has shrunk in recent years. Though we have attempted to maintain a six-month window between the first day of theatrical release and the first day of video/DVD release, the average window now is five months and twelve days.*

- e) Is Video on Demand (VoD) available in your region? In other words, can movies be accessed in real time in the home via cable, broadband, satellite or other distribution mechanisms? If so, how long after theatrical release is VoD available?

*Answer: Video on Demand has begun in the U.S., though the penetration rate is still low. American consumers will need to gain greater access to broadband distribution services before VoD can obtain significant penetration. The major studios have formed two joint ventures to distribute their product through VoD, and have recently launched their services. The VoD window currently comes either slightly after, or consistent with the pay-per-view window. And the pay-per-view window comes after the video/DVD window. Thus, NATO does not currently view the VoD window as a threat to theatrical release.*

### **13. Online Ticketing, Alternative Ticketing**

- a) Do your members sell tickets online? In other words, do your members sell tickets over the Internet to the patron at home? If so, what percentage of total tickets is sold this way?

*Answer: A growing number of our members sell movie tickets online. Most of these sales use credit card transactions online, followed by ticket pick-up at the theatre box office or in a ticket kiosk at the entrance to the theatre complex. Some exhibitors have begun to sell online tickets that can be printed on computer paper at home, eliminating the need to pick up tickets at the theatre. Tickets printed at home include a computer bar code identification system that can be scanned by a hand-held reader by the ticket taker at the entrance to the theatre. Though NATO does not maintain accurate figures on the percentage of tickets sold online, we estimate that approximately 3% of tickets is currently sold this way. (In 2002, approximately \$260 million will be spent on movie tickets on-line.)*

- b) If your members sell tickets online, do they impose a service charge above the normal ticket price?

*Answer: The online ticketing infrastructure can be expensive. Most of our members who sell tickets online impose a small service charge above the normal ticket price to help defray the cost of the infrastructure and the service. American consumers are accustomed to this type of charge for online ticketing for other events.*

- c) Do your members sell tickets in any form other than the box office (e.g., through automated ticket machines, through other remote locations, etc.) If so, what percentage of total tickets is sold this way? If so, do they charge a service charge?

*Answer: Many of our members also sell tickets at kiosks or automated ticketing machines at the theatre location. These machines help to reduce ticket lines and do not necessitate intensive labor demands. Typically, these machines do not impose a service charge. NATO has no data on the percentage of tickets sold this way.*

#### **14. Performance Rights**

- a) Do theatre owners in your country pay licensing fees for the songs in the movies separate from the licensing fees for the movie itself? Do they pay other licensing fees separate from the movie itself?

*Answer: Other than studio film rental, theatre owners in the U.S. do not pay licensing fees for any of the elements of the movie. In other words, when an American exhibitor licenses a film from a studio/distributor, the studio has obtained all rights to all elements of the movie. We do not pay separate fees to actors, writers, musical performers, or anyone else involved in the production of the movie.*

*American cinema operators do pay fees for any copyrighted music played in the theatre lobby or in the auditorium in between show times, however.*

#### **15. Piracy**

- a) Is movie piracy a problem in your region? What are your members doing, if anything, to prevent piracy?

*Answer: Traditionally, movie piracy has not been as big a concern in the U.S. as in other territories. Nonetheless, piracy does occur in our country. Patrons sometimes attempt to record movies off of our screens with camcorders or other devices. Professional pirates also obtain copies of movies from post-production houses. Piracy of American movies does not hurt American exhibitors as much as our colleagues overseas because of the different release schedules. Pirated movies obtained in the U.S. can be used overseas before the movies are even exhibited in theatres.*

*The digital revolution has changed this environment, however. Pirated copies of movies can now be found on the Internet at the same time those movies are released in American theatres. As we move toward digital cinema, this risk will increase.*

*NATO encourages its members to maintain company policies against the use of camcorders in theatres, and to post signage warning patrons of the policy and the fact that they will be asked to leave the premises if they attempt to record the movie. We have also lobbied state legislatures to enact laws to protect our members if they detain suspected pirates and confiscate their equipment. Only a few states have enacted such laws, however. NATO is also working closely with the Motion Picture Association of America to lobby governments overseas to enact more restrictive laws on movie piracy. Finally, we are working to develop public service campaigns in the form of theatrical trailers to educate patrons about the illegality and economic impact of piracy.*

b) Does your national government have any anti-piracy initiatives?

*Answer: U.S. law strictly prohibits piracy of copyrighted materials such as movies. The MPAA has successfully litigated many cases against those who attempt to copy and distribute movies without proper licensing rights. The federal government is supportive of efforts to prosecute piracy. Nonetheless, some new areas of legal and legislative dispute have arisen. For example, the MPAA and NATO have sued the creator and disseminator of technology designed to break the encryption that protects digitized movies. The question is whether the design of the technology is itself violative of American laws.*

## **16. Real Estate**

a) Do your members typically own the land and buildings of their cinemas? Do they lease the land? Do they operate the cinemas under a management contract for someone else who owns the real estate?

*Answer: NATO member theatres are operated in each of the three ways described in this question. That is to say that some of our members own most of the land and buildings where they operate theatres. Other members predominantly lease their facilities, typically for twenty years or longer. Overall, more theatres are operated under lease from other real estate developers than in locations owned outright by the theatre company. Finally, there are a small but growing number of exhibitors who simply operate some cinemas under a management contract for someone else who owns the real estate and assumes the risk of the venture. In the last model, the theatre management company is simply paid a fee to operate the facility.*

b) Does the government own and operate cinemas? Does the government own the land and buildings on which others operate cinemas?

*Answer: In the U.S., the government does not own or operate cinemas that are open to the public. There are a limited number of government operated cinemas on military*

bases but these cinemas are open only to military base personnel and their families, and with one exception, do not show first run films..

### 17. **Screen Advertising**

- a) Do your members sell “rolling stock” (i.e., moving video) screen advertising for non-theatrical products?

*Answer: In the past few years, American exhibitors have discovered a revenue base that our colleagues in Europe have enjoyed for many years – on-screen advertising for consumer products and services other than movies. Traditionally, many American theatres displayed slide advertising in between shows. But full, rolling stock advertisements have recently become prevalent in our theatres.*

- b) If so, how many minutes of screen advertising is typically shown in between shows?

*Answer: Our members must be careful with the amount of on-screen advertising they exhibit. American consumers will not tolerate more than a few minutes of such advertising. Thus, the typical theatre screen advertising for products other than movies only lasts for two to three minutes. We have also found that our patrons enjoy advertisements that are entertaining in their own right, and different from the typical television commercial. We cannot simply play television-like commercials for extended periods of time without alienating our audience.*

- c) Is it customary to show the screen advertising with your house lights up (on) or down (off)?

*Answer: Advertisements in the form of slides are typically exhibited with the house lights up. Rolling stock advertisements are usually shown with the lights down.*

### 18. **Ticket Prices**

- a) Does your association track average ticket prices? If so, what is the current average ticket price? What was the average one year ago, five years ago, and ten years ago?

*Answer: NATO tracks the average movie ticket price on a quarterly basis. First, we ask all exhibitors to submit their pricing information to a third party accounting firm that keeps the individual company data confidential. That firm then compiles industry-wide averages and submits them to NATO. The average includes all types of tickets. Thus, lower-priced matinees and children’s tickets are factored into the average. The last quarterly survey (third quarter 2002) showed an average ticket price of \$5.75. The average ticket price for 2001 was \$5.65. The average in 1997 was \$4.59. And the average in 1992 was \$4.15.*

## 19. Trailers

- a) Are trailers provided to your members for free? Are they delivered for free?

*Answer: Movie trailers are typically provided and delivered to our members by the studios without any charges.*

- b) Can your members request specific trailers?

*Answer: Yes. Trailer allocation is all subject to negotiation and requests are made from both sides.*

- c) Have distributors ever paid your members to play certain trailers?

*Answer: Typically, the studios do not pay exhibitors to play trailers. In several instances over the past few years, however, a few studios paid exhibitors to play trailers that otherwise were obtaining insufficient screen time. It remains to be seen whether this trend will continue and develop. But we know for certain that trailers constitute the most powerful form of movie advertising. We also know that screen time in between movies is very valuable because we know that other consumer product companies will pay handsomely to advertise their products on our screens.*

- d) Do your members feel pressure to play specific trailers? Do distribution companies ever require that certain trailers be played with their feature film?

*Answer: In recent years, negotiations between studios and exhibitors over trailer placement have become complicated and intense. Too many studios seek to play too many trailers before the most popular films. Good marketing strategy suggests that the number of trailers before a feature film be limited. Time demands also dictate this result. Yet the pressure to play more trailers has grown tremendously.*

- e) Are any trailers physically attached to the feature film?

*Answer: By voluntary agreement between the members of the MPAA and the members of NATO, the studio that distributes the feature film may physically attach one or two trailers totaling no more than two and one-half minutes to the film. Beyond those two and one-half minutes, the other trailer time is negotiated between the studios and the individual exhibitors.*