

# Regulatory Impact Statement

## Review of Temporary Ban on the Parallel Importation of Films

### Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Ministry of Business, Innovation and Employment.

It provides an analysis of options regarding the ban on the parallel importation of films for commercial use, for nine months from the date of the film being made available to the public, as provided for by section 35(3) of the Copyright Act 1994. Without further government action, the ban will lapse on 31 October 2013.

The analysis is partly based on data provided by the film industry, and the impacts of the ban raised in public submissions in response to a discussion document.<sup>1</sup> Some information gaps have been encountered:

- a. The current impact on cinema and home video revenue of consumers importing DVDs for personal use and illegally downloading or illegitimately streaming films;
- b. The extent to which consumers would switch to purchasing DVDs from a New Zealand retailer instead of attending the cinema if the ban lapsed; and
- c. The likelihood of retailers parallel importing DVDs.

The Ministry considers that retaining the status quo (letting the ban lapse) will provide a net benefit to New Zealand. The magnitude of any benefits arising from reinstating the ban appear to be small, and are not unlikely to outweigh costs for retailers and consumers that would be created from delayed access to content.

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Date: \_\_\_\_\_

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<sup>1</sup> <http://www.med.govt.nz/business/intellectual-property/pdf-docs-library/parallel-importing/discussion-document-Review-of-parallel-importation-of-films.pdf>

## Status Quo and problem definition

- 2 The ban on the parallel importation of films under section 35(3) of the Copyright Act 1994 (**the Act**) will lapse on 31 October 2013.
- 3 The ban prevents DVDs and Blu-ray (**DVDs**) from being parallel imported for commercial purposes for a period of nine months from the date of the film being made available to the public for the first time in any world market (**the first market**). Parallel importing is where retailers source legitimate goods from overseas authorised distributors rather than local authorised distributors.
- 4 The ban was originally introduced in 2003 and renewed in 2008 as a result of concerns that parallel importing would reduce film distribution and exhibition industry revenues and the impacts that would have on consumer choice and cinema viability. The release of films in New Zealand was often delayed due to the limited availability of cheaper second-hand film prints and distributors waiting to see whether films were successful in overseas markets before bringing films to New Zealand.
- 5 The ban was intended to give sufficient time for cinemas to screen films without competition from DVDs and was implemented for a limited period of five years to encourage cinemas to transition to digital exhibition technology. The pending lapse of the ban is a trigger to assess whether the original rationale for the ban justifies its continuation.

## Description of film video industry in New Zealand

### *Distribution industry*

- 6 The film distribution and exhibition model operates with staggered “**release windows**” to take advantage of the demand for different formats and reduce competition between the different formats. The table below sets out the typical release windows.

Format	Timeframe
New Zealand cinematic release date	0-4 months after first market release
First market DVD, Blu-ray, Pay-Per-View and electronic release dates (collectively the “ <b>first market home video release date</b> ”)	3-6 months after first market release
New Zealand home video release date	4-6 months after first market release

- 7 Around one-third of films are cinematically released in New Zealand within one month of the first market release. Art house and festival films are likely to follow a longer pattern. Similarly, DVDs are generally released between 3-6 months after the first market cinematic release, although many DVDs are released later. Films are screened for around 5-7 weeks. To give films time to screen, authorised distributors release films for home video use after four months from the New Zealand cinematic release dates.

- 8 There are several factors that influence the timing of a film release:
- *Seasonal factors*: family films, which are mostly US films, are generally released during the US school holidays. The US and New Zealand school holidays differ.
  - *Competition with other films*: films of similar genres tend not to screen at the same time. On average four films are released every week.
  - *Screen availability*: small cinemas have a lower number of screens which creates pressure at times.
  - *Availability of advertising*: such as billboards, air time and marketing materials.
  - *Profitability assessment*: for some films, distributors determine the film's success overseas before bringing it to New Zealand. To maximise profitability and increase publicity some films are released in a few cinemas before a wider release.

### ***Exhibition industry***

- 9 There are about 120 cinemas in New Zealand. These include commercial, independent and community cinemas. Community cinemas are generally funded by local councils or trusts and have only one or two screens.
- 10 The majority of cinemas (around 57%) have converted to digital exhibition and it is expected that 100% will convert within the next two years.<sup>2</sup> Regardless of the ban, cinemas are likely to be forced to convert to digital exhibition as 35mm print becomes obsolete. Some cinemas may be faced with a choice to upgrade or close.
- 11 The cinema exhibition industry continues to develop despite impending lapses in the ban in 2008 and 2013, and on-going costs from changes in technology. The number of cinema exhibition businesses has risen from 66 in 2005 to 87 in 2012.

### ***Home video industry***

- 12 The home video industry includes electronic home video businesses, such as online streaming (e.g., Quickflix), pay-per-view (e.g. Sky) and retail services (e.g., iTunes), and physical rental and retail home video businesses. Video rental businesses need to obtain a licence to rent films because the Act provides rights holders with an exclusive rental right. Rental businesses therefore would not be able to parallel import for rental if the ban lapsed. The same applies for online streaming and rental services.
- 13 The timing of home video releases depends on negotiations between the distributors and window participants. It is becoming more common for distributors to release the different types of home video format on the same date. The New Zealand film industry also informed us that they share Australian DVD release dates because DVDs are generally produced in and imported from Australia. New Zealand distributors state that this limits when they can release DVDs and the cost of producing DVDs separately for New Zealand is prohibitive.

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<sup>2</sup> Motion Picture Distributors' Association, press release (23 January 2013): [www.mpda.org.nz](http://www.mpda.org.nz).

- 14 The PwC *New Zealand Entertainment and Media Outlook Report*<sup>3</sup> shows that the home video market significantly contributes to the total film industry revenue. In 2011 the home video industry held about two-thirds of the film entertainment market share. This was made up of around one-third physical DVD sales and two-thirds physical rental and electronic home video. The report forecasts an increase in box office revenue and a decrease for physical home video revenue as electronic video becomes more popular.

### **The retail sector**

- 15 The retail sector includes physical stores such as The Warehouse and JB Hi Fi, and online websites based in New Zealand, such as Mighty Ape and Fishpond. Retailers generally purchase their DVD stock from authorised distributors. This allows them to share marketing resources and costs on DVDs.
- 16 The temporary ban only prohibits New Zealand retailers parallel importing for resale. New Zealand consumers can parallel import DVDs via overseas retailers (such as Amazon) because personal imports are not subject to the ban.

## **Objectives**

- 17 The objectives are:
- a. A viable film distribution and cinema exhibition sector; and
  - b. Effective competition in the market for films in order to incentivise innovation and encourage timely access to a diverse range of affordable films for consumers.

## **Regulatory Impact Analysis**

- 18 There are three options:
- a. Allowing the ban to lapse from 31 October 2013 so that retailers can import film titles as soon as they are released overseas on formats such as DVD; or
  - b. Continue the ban for three years but shorten its period to five months;
  - c. Reinstate the current nine month ban for a further five years.

### **Option 1 (preferred option) - allow the ban to lapse**

#### **Benefits**

- 19 Allowing the ban to lapse would remove a restriction on competition in the film industry, leaving it free to operate and structure itself as it sees fit. This is likely to have a number of benefits for consumers:
- **Earlier access to content:** If it is profitable to do so retailers may parallel import DVDs, including straight to video titles, as soon as they become available overseas. Authorised distributors are likely to bring the cinematic release date for some titles forward to avoid competition with DVDs. Authorised distributors may also bring the release dates forward for physical and electronic videos, to reduce the impact of competition with parallel imported DVDs. If consumers have earlier access to content, particularly electronic content, this may help to reduce piracy.

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<sup>3</sup> PwC, *New Zealand Entertainment and Media Outlook 2012-2016*, August 2012, p 46: <http://www.pwc.co.nz/entertainment-media-outlook/>.

- **More competitive and innovative services:** Distributors would be required to adapt in order to compete with DVDs, other distributors and home video services. This is likely to benefit consumers as distributors may be encouraged to change release dates to meet consumer demands and mitigate the impact of competition. Cinemas may provide innovative services to encourage consumers to attend the cinema.
- **Increased uptake in electronic home video services:** If authorised distributors bring forward electronic home video release dates to avoid competition with DVDs, this may encourage consumers to use such services, increasing the uptake of ultrafast broadband and encouraging further investment into these services.
- **Competition with overseas retailers:** New Zealand retailers could increase DVD sales as they would be able to compete with overseas retailers as soon as the DVD is made available overseas.
- **Some reduced cost of DVDs:** Retailers may offer cheaper parallel imported DVDs. However, there is unlikely to be a significant impact on the cost of DVDs. Overseas prices now generally equate to New Zealand prices.

### Costs

20 In consultation the film industry raised a number of concerns about potential costs:

- **Increased risk for cinema viability:** The film industry is concerned that cinema and distributor revenue could reduce if some consumers purchase DVDs instead of attending cinemas. The industry states that distributors would bring forward release dates for some films which could result in reduced revenue because of increased competition among films or because films would screen during unsuitable viewing periods. This could affect the viability of some cinemas, particularly given the costs of investing in exhibition technology. The industry stated that the closure of a cinema could have a significant impact on some small communities.
- **Less variety of films:** The film industry suggests that distributors may not bring some films to New Zealand if the cinematic earnings are uncertain and this may negatively impact New Zealand's film culture as consumers miss out on a diverse range of films. The industry suggests that there could be a higher risk for home video businesses investing in those films without public awareness created by the cinema release and this could increase the risk of investing in such services and potentially result in less access to content.
- **Reduced home video industry revenue:** The film industry is concerned that consumers may purchase DVDs instead of electronic videos or renting videos if parallel imported DVDs are available earlier. This could make it riskier to invest in electronic services and could reduce the availability of home video content options to New Zealand consumers.

21 The Ministry has evaluated these concerns and does not consider them to be significant because:

### ***Competition with DVDs***

- Retailers are unlikely to import every DVD available overseas. Parallel importing may not be widespread as it may not be profitable to import some films once all the costs of shipping and tax are included.<sup>4</sup> Retailers also generally share marketing costs with the authorised distributors to keep costs low.
- The DVD retail market makes up one-third of the home video market. This indicates that most consumers prefer to rent rather than purchase DVDs. Further, the number of consumers watching movies online has increased 10% since 2009.<sup>5</sup> If this trend continues rental and sales for DVDs are likely to decrease.
- Films are released after the period of the ban with little visible impact. In 2012 (January-October) one-third of films were screened in New Zealand without protection from the ban. Many of these films could have competed with DVDs. The fact that authorised distributors were willing to release these films suggests that the impact of the ban lapsing may not be significant.
- New Zealand consumers can already purchase DVDs online. Despite this, the New Zealand box office takings have increased in the last three years.
- Home video can compete with cinemas on the range of content available, but cannot always provide the same viewing quality or social experience.

### ***Variety of films***

- The number of films affected is likely less than the industry suggests. Only some films are released around specific holiday periods and most family films already compete against each other during the four holiday periods a year.
- The fact that authorised distributors were willing to release films without protection from the ban suggests that distributors would continue to invest in films without the ban in place.
- In 1998-2003 (when parallel importing was allowed) the fluctuation in the number of films released did not correlate with the availability of parallel imported DVDs.<sup>6</sup>

### ***Home video industry***

- The risk to electronic home video services is low given that consumers' appetites for electronic services are increasing. Distributors could also bring forward electronic release dates to mitigate risks to the industry.

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<sup>4</sup> For example, the parallel imported price of the DVD Taken 2 purchased in the US after all additional costs and taxes are included would be higher than the price for retail in New Zealand: HEANZ, Submission Regarding the Parallel Importation of Films and DVDs (April 6, 2013) p 4.

<sup>5</sup> [http://www.stats.govt.nz/browse\\_for\\_stats/industry\\_sectors/information\\_technology\\_and\\_communications/HouseholdUseofICT\\_HOTP2012/Commentary.aspx](http://www.stats.govt.nz/browse_for_stats/industry_sectors/information_technology_and_communications/HouseholdUseofICT_HOTP2012/Commentary.aspx)

<sup>6</sup> Evans and Burgess, Parallel Importation and Service Quality: An Empirical Investigation of Competition Between DVDs and Cinemas in New Zealand, Journal of Competition Law and Economics 1(4) 747-770, p 762 and 767.

- The earlier availability of parallel imported DVDs is unlikely to significantly affect physical rental services because rental and retail markets appear to be largely distinct. People who prefer to rent a DVD may not purchase the DVD instead for more than triple the price. Bringing forward electronic release dates may reduce the profitability of physical DVD rental services by increasing the speed at which consumers switch from physical to electronic services. However, electronic services are naturally increasing in popularity<sup>7</sup> and the physical market is likely to reduce regardless of the ban. Distributors could bring forward DVD release dates. However, this option may be limited due to the costs of producing DVDs for the New Zealand market.
- 22 The Ministry's evaluation that the concerns are not significant is supported by information on the period when parallel importing was allowed (May 1998 to October 2003). During this period the majority of DVDs were parallel imported for rental businesses. One study<sup>8</sup> showed that parallel importing increased in 2000 and 2001 but fell abruptly in 2002 after the High Court ruled in November 2001 that the parallel importing amendment did not extend to rental rights.<sup>9</sup>
- 23 The table below shows that admissions dropped in 2000 and rose again in 2001. There was a similar drop in Australian and Canadian-US admissions in 2000, and these markets would not have been affected by parallel imports. Thus, the availability of video for purchase or rental was not necessarily the cause of the drop.

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<sup>7</sup> PwC, New Zealand entertainment and media outlook 2012-2016, August 2012, p 46.

<sup>8</sup> Burgess and Evans, p 757.

<sup>9</sup> *Video Ezy (New Zealand) Ltd v Roadshow Entertainment (New Zealand) Ltd* [2002] 1 NZLR 855, 7 NZBLC 103, 524.

Cinema admissions New Zealand <sup>10</sup>									
Year	1997	1998	1999	2000	2001	2002	2003	2004	2005
Cinema admissions (millions)	16.1	16.3	16.8	14.9	16.6	17.8	18.4	17.2	15.5
Cinema admissions Australia <sup>11</sup>									
Year	1997	1998	1999	2000	2001	2002	2003	2004	2005
Cinema admissions (millions)	76.0	80.0	88.0	82.2	92.5	92.5	89.3	91.5	82.2
Cinema admissions US and Canada <sup>12</sup>									
Year	1997	1998	1999	2000	2001	2002	2003	2004	2005
Cinema admissions (billions)	1.354	1.438	1.440	1.383	1.438	1.57	1.521	1.484	1.376

24 Even if the drop in admissions was due to parallel importing, a lapse in the ban is unlikely to have the same impact. Parallel importing for rental is no longer allowed and the retail market is still much smaller than the rental market.

### Options 2 and 3 – Retain the ban

25 The Ministry has considered two alternatives for a reinstated ban. Option 2 is to retain the ban for a further three years (until 2016), but shorten it to five months. Option 3 is to repeat previous extensions by retaining the current nine month ban for a further five year period (until 2018).

26 A ban of five months is likely to provide a sufficient period of protection from competition from parallel imports to account for the most at risk films. It is important to note that the **effective length** of the ban is shorter than what is actually provided in the Act because regardless of the ban, DVDs cannot currently be accessed by importers for at least 90 days. For example:

Actual length	Effective length
Four months from the first market cinema release	No risk of parallel imported DVDs for at least a month
Five months from the first market cinema release	No risk of parallel imported DVDs for at least two months
Six months from the first market cinema release	No risk of parallel imported DVDs for at least three months

<sup>10</sup> [http://www.stats.govt.nz/browse\\_for\\_stats/economic\\_indicators/prices\\_indexes/watching-cinema-admission-prices-in-the-cpi.aspx](http://www.stats.govt.nz/browse_for_stats/economic_indicators/prices_indexes/watching-cinema-admission-prices-in-the-cpi.aspx).

<sup>11</sup> <http://www.screenaustralia.gov.au/research/statistics/wcboadmission.aspx>.

<sup>12</sup> <http://www.natoonline.org/statisticsadmissions.htm>.



- 27 The industry has stated that the most at risk films are family films, usually screened around the school holidays to maximise revenue. While the New Zealand cinema screening of most family films is delayed for around one month from its overseas release, distributors occasionally delay the cinematic release of family films from one school holiday to the next to avoid competition with similar family films. The problem is most apparent when family films are released in the US in July, but distributors choose to delay the screening in New Zealand to meet the October school holidays (a three month delay). A five month ban would ensure that such films could be sufficiently delayed in New Zealand cinemas, and still have the usual two month window in which to be screened without competition from parallel imports.
- 28 In addition, Option 2 would involve shortening the length of time the ban would be in force to three years. Changes to the film distribution model and the expansion of online options are occurring rapidly, suggesting that five years is too long a period for the ban to be renewed. A three year period would provide the film industry with time to complete the transition to digital exhibition technology and ensure that ban is not in place for so long that it may protect a film distribution model that does not reflect developments in the market for films, particularly online.

### ***Magnitude of costs and benefits for options two and three***

- 29 The costs and benefits of Options 2 and 3 are due to the same circumstances and have therefore been summarised together. However, the longer the length of the ban, the greater the costs to consumers in delayed access to content and the greater the costs to retailers in potential lost sales.
- 30 However, the benefits of retaining the ban are only likely to increase with its length to a point. Film industry submissions noted that nine months now appears unnecessary due to generally earlier film releases, and consider that six months is an appropriate length. This suggests that no additional benefits would result from Option 3 over Option 2.

### ***Benefits***

- 31 The benefits attributed to the ban by industry are:
- **Continued viability of cinemas:** Cinemas could screen films without competing with DVDs and could delay some film screenings to meet peak screening periods and maximise film revenue. Distributors could also maintain the four month home video release window and maximise the profits from cinematic screenings before DVDs are released in New Zealand.
  - **Diverse range of films:** Distributors may bring more marginal films to New Zealand when compared with the number that might be distributed without a ban in place.
  - **Viability of home video services:** The ban would protect the first to market privilege of rental businesses and electronic streaming services. This may make entry into the market for home video services easier.

### ***Costs***

- 32 The costs of retaining the ban would be the absence of the benefits identified in Option 1:

- **Delayed consumer access to content:** There may be less incentive for authorised distributors to bring home video release dates forward and adapt to an increasingly online market. Consumers who shop in physical retail stores would have to wait longer for DVDs than overseas consumers and consumers who shop online.
- **Less incentive to innovate:** Retaining the ban would allow distributors to continue delaying New Zealand online release dates. Consumers are generally unable to download or stream films via overseas content providers due to regional restrictions. Some consumers may, therefore, be incentivised to use illegal means to access content earlier on overseas streaming services.
- **Competition with overseas retailers:** New Zealand retailers could lose sales during the two month gap where films have finished screening in New Zealand cinemas and are not available on DVD, but are available for personal import from overseas.
- **Less competition for DVDs:** In some instances consumers could be missing out on cheaper DVDs. The ban would mean retailers have to purchase DVD stock from authorised distributors even if it may be more commercially viable to purchase DVDs from overseas distributors. However, this is unlikely to be significant, given that prices for overseas DVDs are generally consistent with overseas prices when taking into account the costs of importing.

33 For reasons outlined paragraphs 21-24, the Ministry does not consider the benefits of retaining the ban to be significant or to outweigh the costs that would be created. This is the case for both Options 2 and 3.

## Conclusions and Recommendations

- 34 The Ministry's preferred option is to retain the status quo and allow the ban to lapse.
- 35 Distributors can reduce any potential competition with DVDs by bringing forward cinematic release dates and the impacts of doing so are only likely to negatively affect a small number of films. Therefore, the overall impact on cinema and distributor revenue is likely to be minor. Some cinemas, distributors and rental businesses may be negatively impacted and would have to adapt their business models in order to remain viable. However, we believe that the overall welfare benefits to the economy and consumers by opening up the market to competition outweigh these costs.
- 36 Allowing the ban to lapse would enable domestic retailers to compete with overseas retailers and would benefit consumer access to content. Distributors may also release films to electronic services earlier and encourage consumers to use such services.
- 37 If the ban was reinstated, distributors and cinemas would benefit from increased revenue when compared with the status quo. This could increase the viability of some cinemas. However, a ban on the importation of all films in order to protect some films screening in cinemas from possible competition with DVDs appears disproportionate to the costs of distorting competition in the physical and electronic home video market and restricting timely consumer access to some films. On balance, there is insufficient justification for reinstating the ban.

## Consultation

38 A six-week public consultation was undertaken, in which 16 submissions were received, including from consumer, retail and film industry representatives. The Ministry also had various discussions with the industry and retailers to further understand the possible impacts of the ban. This RIS was also provided to the Ministry for Culture and Heritage (MCH) and the Ministry of Foreign Affairs and Trade for comment.

### *Ministry for Culture and Heritage (MCH) comment*

- 39 MCH agree with the proposal to allow the ban to lapse but raised two issues:
- Consumers' exposure to non-blockbuster films helps to develop their receptivity to New Zealand films. A loss in film diversity could therefore adversely impact New Zealand film culture.
  - If small and provincial cinemas close, the number of venues that could screen New Zealand films would reduce. This could adversely impact New Zealand film-making.
- 40 As noted above, the Ministry is not convinced that competition between cinemas and DVDs would be significant enough to result in a significant reduction in the variety of films brought to New Zealand or wide cinema closure and therefore consider that there is unlikely to be an impact on New Zealand film culture.

### *Film festival concerns*

- 41 The NZ International Film Festival (**NZIFF**) is concerned about the ban lapsing. However, the Ministry does not think a lapse in the ban would affect the viability of bringing international films to New Zealand during film festivals because:
- Film festivals provide consumers with a unique viewing experience. Many people go to festivals not for a particular film but to attend the festival itself. Often people attend festivals to see films that they would otherwise not know about.
  - It is not clear that there would be a large enough consumer base for retailers to justify parallel importing film festival films.

## Implementation

42 The ban will automatically lapse on 31 October 2013. If the status quo is retained, no further action is required. If a decision is taken to reinstate the ban, a small amendment to section 35 of the Act would be required.

## Monitoring, evaluation and review

43 The Ministry will monitor the number of films released in New Zealand cinemas, cinema admissions and box office revenue to assess the impact of allowing the ban to lapse.