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A Review of the Canada Media Fund's Equity Financing in Television Productions:
Policies, Trends, Stakeholder Perspectives and Options

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Introduction

1. Preamble and Goals of this Study

1.1. Equity Investments and the Federal Government's Policy Priorities

The use of equity investments dates back to 1967 when the *Canadian Film Development Corporation* (the precursor to Telefilm Canada) was first established to support feature films. The CFDC was given a mandate to invest in individual Canadian feature film productions in return for a share in the proceeds from any such production. Over the years, equity investments have continued to be used as a form of financing for films and television productions.

Presently, the Canada Media Fund (CMF), independently-administered private funds and provincial film and television agencies provide funding in the form of equity investments. In exchange, they take an ownership interest in the production. In the case of the CMF, a portion of the Fund's contribution to an eligible project may be in the form of an equity investment.[1] Equity is taken in a project by the CMF to secure the Fund's recoupment rights by providing the CMF with the ability to collect directly any revenues payable to it.[2] In return for the ownership interest assignment in the project, the CMF assigns back to the producer all of the CMF's interest in the distribution and exploitation rights relating to the project. The CMF recoups its investment and participates in profits in accordance with a standard recoupment schedule.

In light of the federal government's policy direction to the CMF to favour projects that demonstrate return on investment and foster lessened reliance on subsidies over time, the CMF is interested in reviewing its approach to equity financing. The CMF also announced in 2009 that it would implement a Pilot Producer Revenue Incentive Program to reward productions that had demonstrated success in terms of return on investment. This Program was to apply to the Convergent stream and be operational mid-year in 2010-2011.[3]

1.2. Goals of this Study

Given the above context, the goals of this study are three-fold:

- To trace the origins of equity financing with a view to understanding the rationale for its use by the Canada Media Fund and other agencies and funds;

1 An equity investment is a cash investment in the production, which results in the CMF acquiring an undivided copyright ownership interest in all versions of the production. Equity investments are recoupable, and subject to a standard and non-negotiable recoupment schedule. Producers receiving equity financing must provide to the CMF the opportunity to recoup its equity participation in a manner no less favourable than pro rata and pari passu with other financial participants·

2 Recoupment defines when and how long it will take before the investors will see their investment back plus any profits and how it will be dispersed between the funder and the investors. Recoupment, if any, can happen some time after the project is completed or it may take a year or more depending on the commercial viability of the project and the aggressiveness of the distribution.

3 Canada Media Fund, Briefing Note, Audience Success and ROI Working Group, December 9, 2009.

- To consider the impact of increasing the level of the CMF's support to television productions in the form of equity financing and other potential changes to current approaches (for example, modifications to the Standard Recoupment Schedule).
- To propose a preliminary design for the Pilot Producer Revenue Incentive Program aimed at providing an incentive to those productions that return revenues on investments or propose alternative approaches that could result in increased recoupment revenues to the CMF.[4]

2. Approach and Methodology

The consultant used a three-pronged approach:

a) a literature review of secondary sources including documents, reports, studies and the Canadian Television Fund's Guidelines on Recoupment between 2003-2004 to 2010-2011 in order to trace changes in policies on equity financing and recoupment;

b) an analysis of recoupment trends of CMF-financed television productions that received equity financing between 1997-1998 to 2009-2010 as well as gross sales of CMF-financed television productions between 1996-1997 and 2008-2009;

c) primary research through consultations with selected key stakeholders including representatives of producer associations, independently-administered private funds, provincial agencies and the Department of Canadian Heritage.

3. Structure of this Report

The report that follows is divided into five sections:

- Section A provides a background on the evolution of policies on equity financing and recoupment;
- Section B outlines key government and industry perspectives on equity financing and recoupment policies relevant to understanding potential changes to be made by the CMF to policies on equity financing;
- Section C then reviews the success of equity financing in generating revenues in television productions between 1996-1997 to 2009-2010;
- Section D summarizes the perspectives of the various stakeholders on both the use of equity financing as well as on considerations for the design of a Pilot Producer Incentive Program by the CMF[5]; and
- Section E provides summary observations for consideration by the CMF including options that could result in increased revenues to the CMF.

4 The consultant has focused on the interview results of this study in addressing this requirement. .

5 The stakeholders interviewed for this study were limited to the independently –administered funds and representatives of provincial funding agencies who use equity financing, the producer industry associations and the Department of Canadian Heritage.

A. History of Policies on Equity Financing and Recoupment

1. Equity Financing and Recoupment

1.1 Equity Financing: the Canadian Film Development Corporation - 1967

In 1967, the *Canadian Film Development Corporation Act* (CFDC) stipulated that the Corporation (Telefilm) could invest in individual Canadian feature film productions in return for a share in the proceeds from any such production. The Act also gave Telefilm the powers to make loans to producers of individual Canadian feature film productions and charge interest, provide grants and guarantee loans.

Section 10 of the CFDC identified the primary tools for industry development as investments in production and loans to producers, which entailed some degree of return. As it has been observed:

"The government's initial vision for the CFDC was for it to operate as a revolving fund for investments in feature films. This model quickly proved inadequate, since the films financed did not make any significant return to replenish the CFDC's funding."[6]

1.2 The 1983 Broadcast Fund: Licence Fees and Equity

When the government created the Broadcast Fund in 1983, it required Telefilm to continue to use equity investments and also to provide support in the form of loans and loan guarantees.

In 1986, the Caplan-Sauvageau Task Force reported on the Broadcast Fund's performance by noting that: "To be an engine of Canadian television production, the Broadcast Fund must not be based on an industrial investment policy predicated on the myth that there is a pot of gold at the end of the American rainbow but based instead on a policy of creating a viable domestic market for Canadian producers."[7]

The Task Force pointed out that due to the realities of the Canadian market, there was little justification for the Fund to be operated as though it were a public venture capital fund following market forces. The Task Force recommended that the Broadcast Fund's involvement in television production favour support in the form of matching the licence fee payments made by Canadian broadcasters and that support be primarily for productions made for Canadians. The expectation was that such productions could recover most of their revenues in the Canadian market.

Support for programs made primarily for sales to foreign markets were to be provided on the basis of profit-motivated investment with the Fund not accounting for a major portion of production expenditures. It was suggested that Telefilm Canada's participation would not be that of a simple equity investor but that the aim would be to achieve the equivalent of increasing the producers' return from the domestic market. This form of aid could be a finan-

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6 Nordicity, *Assessment of the Role of Telefilm Canada in the Development of the Canadian Audio-Visual Sector*, Prepared for the Department of Canadian Heritage, 2003.

7 Report of the Task Force on Broadcasting Policy, Minister of Supply and Services, page 372

cial contribution, a loan forgivable if certain criteria were met, an investment recoverable in last position after other investors or some combination of methods.

1.3 Telefilm Programs Aimed at Generating Revenues in the 1990s: The Production Revenue Sharing Program and the Commercial Production Fund

In the 1990s, Telefilm Canada operated two programs aimed specifically at generating revenues to compensate for declining government appropriations. These programs included the Production Revenue Sharing Program (PRSP) and the Commercial Production Fund.

The PRSP was designed to encourage production companies to maximize production revenues by rewarding those companies that provided an above average rate of return on Telefilm's investments. To the extent that companies achieved a higher than average return on Telefilm's investments, the PRSP provided them with increased resources. The PRSP encouraged Canadian producers to improve their commercial performance, by redistributing a share of the production revenues recouped by Telefilm.[8]

The Commercial Production Fund provided support to Canadian production companies based on an assessment of projects on a financial basis. It provided equity investments to productions with a goal of recovering 65% of the investment value. To be eligible to this Fund, the production company had to be able to guarantee a return of at least 65%. This rate of recoupment represented a minimum since Telefilm's investment in a project was largely determined by the potential for generating revenues above that limit. The Commercial Production Fund had shown that those productions that generated substantial revenues were those sold in foreign countries.

Both of these programs were deemed to represent "Telefilm's aggressive commercial revenue strategy" by the 1996 Juneau Report and were eventually eliminated. The Report noted that Telefilm was a cultural organization and not a venture capital fund and as such increased earned revenue was not necessarily considered a sign of success.[9]

1.4 Recoupment as a Criterion in the Equity Investment Program's Evaluation Grid: 1996-2003

When the Broadcast Fund was replaced by the Equity Investment Program (EIP) in 1996, recoupment became a criterion in the assessment of projects in an evaluation grid. Typically, the EIP was interested in the projected rate of recoupment and contribution in dollar terms that a project was expected to make to Telefilm Canada. The projected rate of recoupment was worth 20% in the assessment of projects in the evaluation grid.

The decision-making process had two stages: in the first stage, applications were analyzed and approved by the EIP for funding; in the second stage, Telefilm negotiated the recoupment rate with each successful applicant.[10]

The EIP examined the estimated revenue projections, taking into consideration the track records of the distributor and producer, potential revenues from projects of a similar nature, as well as the marketing plan. Telefilm then used the recoupment structure proposed by the producer, together with the distribution agreement, to calculate the estimated projected rate of recoupment. This was compared to benchmarks for similar genres and formats.

8 Telefilm Canada, PRSP, Policies:1994-95, page 1.

9 Mandate Review Committee, Canadian Broadcasting and Film for the 21st Century, page 260.

10 Guidelines regarding Telefilm Canada's expectations for recoupment were not published until 1999.

The benchmarks were based on projects that had recouped revenues. Because vast majority of projects did not generate recoupment revenues, the EIP only conducted a full recoupment analysis if there was significant evidence that there would be recoupment. For example, if a project had guaranteed sales or a distributor attached that had had significant success with a similar product in the past.

Telefilm's recoupment policy at the time, while establishing minimum recoupment expectations, also provided incentives for producers of low budget English-language productions and incentives for French-language productions. These incentives inevitably diminished the recoupment rate for the EIP (see Annex 1 for the policy). In addition, Telefilm had a mandate to support developing companies and so consequently Telefilm's recoupment position was less aggressive for new and small companies but more aggressive for larger, more financially sound companies.

1.5 Use of a Standard Recoupment Policy: 2003-2004

In 1999, a review of the EIP found that while one of the benefits of requiring recoupment is that it compels the producer to become more "business-like", at the same time, the limited returns did not necessarily justify the administrative costs associated with having an equity investment program. [11]

In 2003, Telefilm undertook a review of its recoupment policy "intended to minimize negotiations between Telefilm and producers and ensure [the consistent application] of recoupment practices across all of Telefilm's offices."[12] A more standard approach to recoupment would alleviate delays in the contractual process and increase predictability in negotiations between producers and financiers.

A new recoupment policy was introduced in 2004 in order to provide clients predictability, standardization across Telefilm's offices, and reduced time spent in negotiations. As was observed at the time:

"The policy is predicated on the underlying principle that the application should be "no less favourable, (plus or minus 5% on average), to Telefilm, producers or distributors in terms of potential share of revenue relative to historical practice, while eliminating the complexity of recoupment negotiations on a project-by-project basis."

The policy was in part based on a modelling exercise using 46 actual projects, including projects with the highest recoupment levels and projects selected at random. Telefilm undertook a review of all TV distribution contracts for foreign territories dating from 1997 and found that on average distribution fees were 27.75%, and that approximately 20% of the contracts reviewed had distribution fees higher than 30%. A similar exercise was undertaken to determine average distribution expenses. Results revealed that 98% of the time there was a 10% expense cap.

Significantly, the policy also proposed that, "the U.S.A. ...remain an open territory for Telefilm and other financial participants, who will recoup pro rata pari passu in Tier 1."

According to the Canadian Television Fund's Updates, "applicants applying to Broadcaster Performance Envelopes, the English-language Drama Stream or Special Initiatives Stream

11 Arthur Donner, *An Analysis of the Recoupment History and Practices of the Canadian Television Fund's Equity Investment Program and an Assessment of Alternatives*, page 27.

12 Leo Rice-Barker, Telefilm calls for comments on recoupment policy, Playback, July 21, 2003.

for equity financing ...[were required] to provide to the CTF the opportunity to recoup its equity participation in a manner no less favourable than pro rata and pari passu with all Other Financial Participants. Furthermore, the CTF would continue to apply an asymmetrical approach to the standard recoupment models in English and French.[13]

1.6 More Key Changes to the CTF's Recoupment Policy: 2005-2007

In 2005, the federal government's evaluation of the Canadian Television Fund found that the industry was critical of Telefilm Canada's recoupment policies. The study noted that:

"Telefilm's recoupment policies sometimes pose a real barrier to the completion of financing, especially from foreign sources...Negotiating recoupment can cause delays and certainly cuts out a source of payback for the producer... in the more demanding financial environment of the last few years, the typical production company's corporate situation has deteriorated. Telefilm has improved the process by standardizing recoupment policies, although apparently not all projects can meet the standards."[14] (Annex 2 contains extracts from the Report of the Evaluation of the CTF.)

At the time, producers had proposed that Telefilm limit its interest in rights to a finite period, such as five years, but Telefilm was of the view that a considerable part of the overall return to equity results from revenues earned after five years in the completion of a project.

The study also found that despite concerns from producers, public investment in a production merited a return to the CTF if the equity investment was successful.

Also, there were questions about what the benefits would be to production companies should changes be made to recoupment policies to the effect that the CTF would consider lowering returns to Telefilm by perhaps $5 million. The issue was whether producers would use the additional funds to help develop their next projects or to perhaps attract more than the $5 million from foreign sources of financing.[15]

Telefilm Canada changed its recoupment policy in 2006 as follows:

"Beginning in 2006-2007, the CTF will no longer have a different recoupment schedule for English- and French-Language production. The CTF will now allow production companies who invest their provincial tax credits in English-language programming to recoup those amounts in a better position than CTF, in accordance with the same model previously afforded production companies producing French-Language production. The CTF expects that, through this transfer of the CTF's share of future revenues to independent production companies, the CTF will positively contribute to their capitalization. The value of this transfer is estimated to be between $3-4 million per year in future revenues.

The CTF is further amending the standard recoupment policy to improve the potential for production companies to raise international financing, to minimize negotiations between the CTF and producers and to reduce the administrative burden on producers and the Fund. Distribution advances from Eligible Distributors may now be recouped in their entirety prior to the CTF. Furthermore, the producer is no longer required to retain a major open territory from which the CTF may recoup its equity investment. From this change, we estimate the lost revenues to the CTF to be between $2-3 million per year in future years, although these

13 Canadian Television Fund, Guidelines Update, June 23, 2004, page 1.

14 *Summative Evaluation of the Canadian Television Fund Program*, Department of Canadian Heritage, Evaluation Services, Corporate Review Branch, October 15, 2005, page 42.

15 Ibid, page 53

losses are expected to be substantially offset by increased international financing to production budgets and reduced administration costs."[16]

2. Summary Observations

As we can see from a review of historical policies above, Telefilm Canada, the Canadian Television Fund and now the Canada Media Fund's equity investments in television productions have traditionally required a recoupment agreement whereby the producer agrees to pay Telefilm or in this case the CMF its due share of the financial returns on the subsequent exploitation of that production. The principle that has been applied has been that Telefilm, CTF and now the CMF accept to bear a portion of the financial risk of producing Canadian programs in return for a share in the proceeds from any such productions. Such revenues have generally come from foreign sales and/or the sale of second windows in Canada.

Equity investments are an essential part of the financial structure of the productions supported. Our review of the literature shows that while equity investments were intended by the government to be fully recovered in 1967, over the years, this was generally not necessarily the view reflected in government-commissioned reports in subsequent years. However, equity investments were intended to act as a means for the CMF to retain benefit from returns that could then be reinvested into productions.

The Canada Media Fund continues to provide funding in the form of equity investments in television productions in exchange for an ownership interest in the production. In the CMF's television equity financing agreements, the applicants are required to assign to the CMF an undivided ownership interest in the copyright in the production and all subsidiary rights and works, equal to the percentage that the CMF's equity investment forms of the total production budget.[17]

In return for the ownership interest assignment in the project, the CMF assigns back to the applicant all of the CMF's interest in the distribution and exploitation rights relating to the project. The CMF recoups its investment and participates in profits in accordance with a standard recoupment schedule (with some limited exceptions). As a result, the applicant is free to negotiate its own agreements regarding any sales, distribution or licensing of the project,[18] subject to the requirement to report and pay revenues to the CMF in accordance with the standard recoupment schedule.

The CMF participates in revenues realized by the exploitation of the production throughout the world. Exploitation reports for the production, along with CMF's share of revenues, must be submitted to the CMF bi-annually. As a result, any agreements entered into by the applicant for the production must provide for revenue reporting on a per-production basis.

A number of changes brought to the recoupment policy in the last few years have been in response to the industry's desire for the predictability of a standard pre-established recoupment formula. We also observe that certain incentives were put in place to help the capitalization of the industry (incentives for low-budget productions) and to deal with differences in the two linguistic markets (French-language incentive). The incentive that had been applied to the French-language market was then adopted for the English-language market in

16 The Canadian Television Fund, Recoupment Policy 2006-2007, page 1.

17 See Schedule A for an excerpt from the CMF TV equity financing agreement.

18 There are provisions in the Guidelines and business policies, including the Standard Recoupment Policy that prescribe certain business terms regarding distribution and exploitation agreements.

2006 and is currently reflected in the Standard Recoupment Policy. These changes have generally resulted in diminished recoupment revenues for the CMF.

Presently, the Standard Recoupment Policy provides producers with preferential recoupment by allowing them to recoup their provincial tax credits in first tier. The producer recoups the full amount of the provincial tax credit in first tier (100% of his investment) instead of pro rata in terms of what the producer invested. Annex 3 contains a description of the process of recoupment.

B. Selected Government and Industry Perspectives on Policies on Equity Financing and Recoupment

A number of reports and studies provide useful perspectives on policies on equity financing and recoupment. We have outlined them in this section as they continue to be relevant in the context of the goals of this study, particularly as concerns potential changes that the CMF may wish to make in its approach to funding television productions.

1. Perspectives

1.1. Reconciling Cultural and Industrial Objectives

One of the themes that is prevalent in the literature on policies on equity financing and recoupment is that cultural and industrial goals are not necessarily compatible in government support programs for television production.

As early as 1986, the use of equity financing by the Broadcast Fund was seen as creating a "schizophrenic situation" for Telefilm Canada because of having to fulfil both a cultural and industrial mandate. The 1986 Caplan Sauvageau Report, in commenting on the effectiveness of the Broadcast Fund, said: "It was clear from the beginning that owing to the weakness of the Canadian market for independent productions, loans and investments would rarely result in a financial return to Telefilm.[19] The Report makes clear the tension between meeting both cultural and industrial goals:

"If maximizing revenue from foreign sales and maximizing a return to the Fund were perfectly compatible with the expression of Canadian identity and with achieving linguistic and regional balance in production activity, Telefilm would not be faced with the need to choose which goals have priority."[20]

The 1996 Juneau Report advised Telefilm to optimize recoupment wherever possible - but only to the extent consistent with its cultural goals.[21]

In a 1999 study conducted on the recoupment practices of the CTF, it was observed that "foreign sales potential and hence more recoupment require more generic programs [which] may conflict with the Canadian culture objective."[22] This study also stated that regional and industrial development priorities were seen to be inconsistent with the development of a self-

19 Report of the Task Force on Broadcasting Policy, page 363

20 Ibid

21 Juneau Report, page 261

22 Arthur Donner, *An Analysis of the Recoupment History and Practices of the Canadian Television Fund's Equity Investment Program and an Assessment of Alternatives*, page 40.

sustaining industry. For example, the goal of achieving regional balance in funding for television production was considered to run counter to the underlying economics of the industry.

An evaluation conducted of the CTF in 2000 found that "recoupment has the advantage of ensuring that successful projects repay at least some of the investment provided. This in turn ensures more money is available to the Fund to assist a greater number of projects.[23]

The study goes on to note that, "if funding was based on equity investment and recoupability remained an important criterion, it is likely that many culturally relevant programs would not be funded."[24] Also, it was stated that if Telefilm were to be too aggressive on recoupment, this would be a disincentive for other private sector investors who might have invested more if they could have been on an earlier tier of recoupment.

The study concludes that "in the final analysis, the solution that is required is one that provides the CTF with the flexibility to provide grants to programs that are culturally or creatively worthwhile and are not likely to ever generate a profit while supporting mechanisms such as bank loans, equity or lines of credit. This would provide producers with the opportunity to apply for the type of funding they felt was necessary as well –something they have indicated is important...We believe that requiring a repayment of an equity investment is another means by which dependency will and can be reduced. The amount of equity versus grant provided to any given project will vary and will take into consideration the nature of the project and the extent to which the producer is established and can access other sources of funding. Over time, it would be worthwhile considering some equity investment and payback from every project.[25]

The 2003 Lincoln Report of the Standing Committee of Canadian Heritage on broadcasting (*Our Cultural Sovereignty: The Second Century of Broadcasting*) questioned the rationale for the use of an equity investment program: "The idea that there should be equity recoupment is also at odds with other federal government support programs. Support programs for book and magazine publishers are designed, in part, to improve the economic viability of the book and magazine industry. If book or magazine publishers make a profit at the end of the financial year they are not expected to return part of the profit to the government. By extension, given the rate of return for television programming in those categories that need subsidy (e.g., children's, documentaries, drama)..., why is there an equity investment program to recoup money?"[26]

1.2. Recoupment Policies and the Capitalization of Companies

Our review of the literature shows that in earlier recoupment policies administered by Telefilm Canada and later by the Canadian Television Fund, incentives were provided for the French-language market and English-language low-budget productions. These incentives had a long-standing basis in Telefilm Canada's goal to help the capitalization of companies. As early as 997, Telefilm Canada considered small and medium-sized companies (SMBs) the cornerstone of Canada's production and distribution industry.[27]

In a study conducted by Telefilm Canada in 1998, the author observed that,

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23 KPMG, *A Review of the Canadian Television Fund and its Impact on the Industry and Economy*, February 28, 2000, page 27

24 Ibid, page 102.

25 Ibid, page 104.

26 Clifford Lincoln, Our Cultural Sovereignty: The Second Century of Broadcasting, Standing Committee on Canadian Heritage, June 2003, page 184

27 This information is based on a review of Telefilm Canada's Strategic and Action Plans dating to 1997.

"The industry has largely operated on a project basis. Telefilm's programs are mostly project focused. Over the years, Telefilm has concerned itself with the well-being of corporations in the industry but largely in order to ensure that additional investment or loans to the corporation will stand some chance of repayment. In addition, there is ample evidence that Telefilm has been interested in the evolution of the corporation to self-sufficiency."[28]

In a submission by the CFTPA to Telefilm Canada on a review of the recoupment policies in 2003, the CFTPA pointed out that producer deferrals represented the single greatest obstacle to meeting the working capital requirements of a production company."[29]

The CFTPA noted at the time that one of the challenges their members faced was that the financing of television productions required that the producer include both the provincial and federal tax credits in a project's budget. This situation which continues today effectively eliminates a production's company's ability to use the tax credit to capitalize corporate growth or reinvest these sums in better developing future projects.

1.3. The Grind Factor

In briefing notes prepared by the CMF in 2009, it was stated that any consideration by the CMF to increasing its level of equity investment in a production would require that the federal government address the issue of the "grind." An equity investment is considered government "assistance" for the purposes of the Canadian Film or Video Production Tax Credit (CPTC), and as such reduces ("grinds") the amount available to applicants to the CPTC.[30]

As the note pointed out: "If the CMF were to consider changing its funding formula so as to make more or all of its funding contributions in the form of equity investments, this would grind down the federal tax credit such that a reduction in the percentage of tax credits included in the financial structure would require additional sources of financing to fill that gap."[31]

Presently, about 70% of the CMF's funding is in the form of license fee top-ups. Generally, the first CMF contribution to an eligible project is in the form of a license fee top-up to a maximum of 20% of the project's eligible costs, with amounts in excess of 20% in the form of an equity investment. About 30% of production funding overall is provided as equity investment.

The CMF's briefing note went on to point out that: "Within this context, the CMF will need to consider carefully the impact of changing its funding formula towards equity investments so as to ensure that the potential loss to the system as a result of the grind factor does not outweigh the benefits of a producer incentive program."[32]

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28 IPMA, *A Study for Telefilm Canada Program Support for Small and Medium Sized Film and Television Production and Distribution Companies*, April 1998, page 24.

29 CFTPA, *Telefilm Canada's Recoupment Policy Review*, July 25, 2003.

30 It is instructive to understand the reason for the grind. A 1983 study explained the reason as follows: "Since labour expenditures are defined only in respect of a property of the corporation, a corporation can include labour expenditures only to the extent of a film or video production. If a corporation receives funding in the form of equity participation of 20%, for example, the total production spending and labour expenditures in respect of which the corporation can claim the CPTC are reduced to 80% of the amounts determined. This is commonly referred to as the equity grind."

31 The Canada Media Fund, Audience Success and ROI Working Group, December 9, 2010.

32 Ibid

A study conducted by the Department of Canadian Heritage in 2008 on the Economic Analysis of the Canadian Film or Video Production Tax Credit found that other Department of Canadian Heritage programs for the cultural industries, such as the book publishing grant program, do not reduce the size of the grant if other government funding sources have been accessed.

An evaluation of the Canadian Film or Video Production Tax Credit conducted by the Department of Canadian Heritage found that generally provincial programs do not deduct assistance received from other government programs and thus it was not clear why federal and provincial revenue agencies have different policies.[33]

2. Summary Observations

Our review of the literature allows us to make the following observations:

- Cultural and industrial goals were not necessarily seen as being compatible in government support programs for television production making it a challenge for Telefilm Canada and the CTF to adopt aggressive policies in terms of recoupment;

- Favourable recoupment policies were developed to assist the capitalization of production companies;

- The benefits cited of the use of equity investments as a form of public support by Telefilm and the CTF included compelling the producer to become more "business-like" and using recoupment revenues to support new productions;

- The reasons for not using equity financing have included the administration costs associated with the negotiation of deals and the "equity grind";

- Alternatives to the use of equity financing by Telefilm and the CTF were mentioned as early as 1999 and included grants, and conditional advances.

33 Department of Canadian Heritage, Summative Evaluation of the Canadian Film or Video Production Tax Credit, 2008.

C. An Analysis of Recoupment and Sales of CMF-Supported Television Productions: 1996-1997 to 2009-2010

In Sections A and B, we traced the history and evolution of policies on equity financing and recoupment which provides a context in which to understand the role and rationale for the use of equity financing and recoupment by the CMF and other agencies.

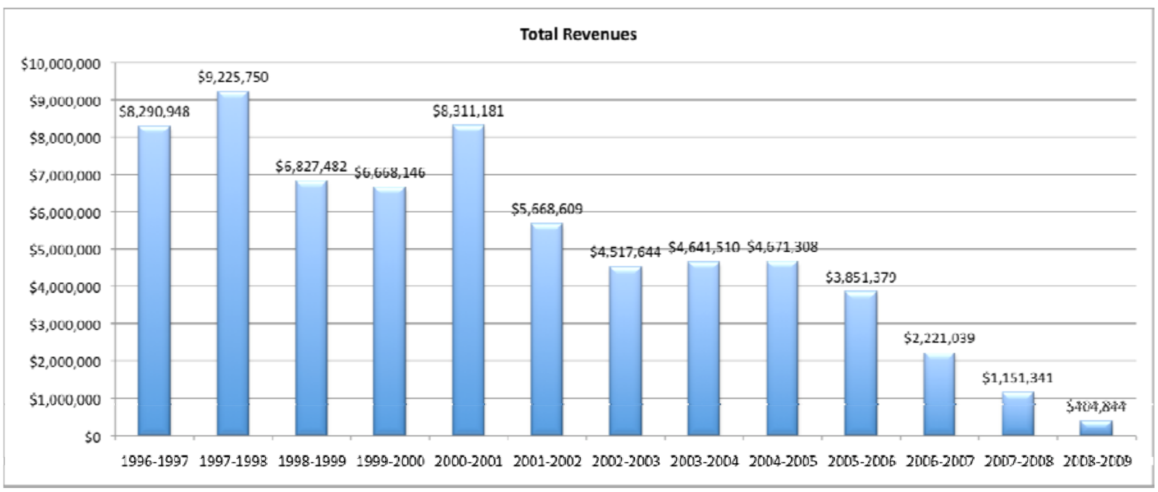
In this section, we examine the extent to which CMF-supported television productions have recouped revenues and generated gross sales. [34]

1. General Trends

An analysis of the recoupment of CMF-supported television productions between 1996-1997 (the year the EIP was created) and 2009-2010 shows that projects contracted between these fiscal years earned the CTF recoupment revenues of more than $66.4 million and a profit of $1.4 million. On investments made by the CMF of more than $1.2 billion for this period, revenues recouped represent a 5.5% rate of recoupment and profits represent 0.3%.

Table 1 shows amounts recouped by year in which projects were signed, between 1996-1997 and 2009-2010. Revenues recouped on older projects are greater than on more recent productions as it takes years before revenues are generated. Revenues on projects for the last few years should be seen within this context.

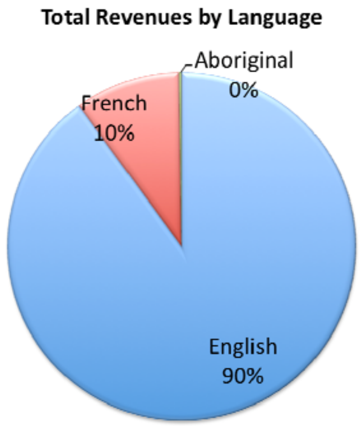
Table 1: Revenues Recouped by Year: 1996-1997 to 2009-2010



In tables 2 and 3, we see that of the total $66.4 million recouped since 1996-1997, more than 90% has come from productions in the English-language market and 10% from the French-language market.

34 We should note that the databases used for an analysis of recouped revenue and gross sales are not the same. The database for gross sales does not represent all television productions financed by the CMF and are those sales generated outside the financial structure. Feature films have not been included in these databses.

Table 2: Revenues Recouped by Language-Market



Language	Revenues	%
English	$59,788,644	90%
French	$6,514,368	10%
Aboriginal	$148,168	0%
Total Revenues	$66,451,180	

Table 3: Revenues Recouped by Year and Language

Signature Year	Aboriginal	English	French	Grand Total
1996-1997		$7,720,428	$570,520	$8,290,948
1997-1998	$11,216	$7,618,134	$1,596,400	$9,225,750
1998-1999	$4,580	$6,359,187	$463,715	$6,827,482
1999-2000	$26,182	$6,204,082	$437,882	$6,668,146
2000-2001	$14,984	$7,789,044	$507,153	$8,311,181
2001-2002	$30,354	$5,109,649	$528,605	$5,668,609
2002-2003	$12,584	$4,080,235	$424,825	$4,517,644
2003-2004	$7,109	$4,274,497	$359,905	$4,641,510
2004-2005	$9,758	$4,220,843	$440,707	$4,671,308
2005-2006	$5,714	$3,431,517	$414,149	$3,851,379
2006-2007	$16,779	$1,770,024	$434,235	$2,221,039
2007-2008	$8,909	$855,815	$286,618	$1,151,341
2008-2009	$0	$355,190	$49,654	$404,844
2009-2010	$0	$0	$0	$0
Grand Total	$148,168	$59,788,644	$6,514,368	$66,451,180

In tables 4, 5 and 6, we observe that almost all the profits generated since 1996 on television productions has come from the English-language market and essentially from the drama genre.

Table 4: Total Profits by Genre From CMF-Supported Television Productions

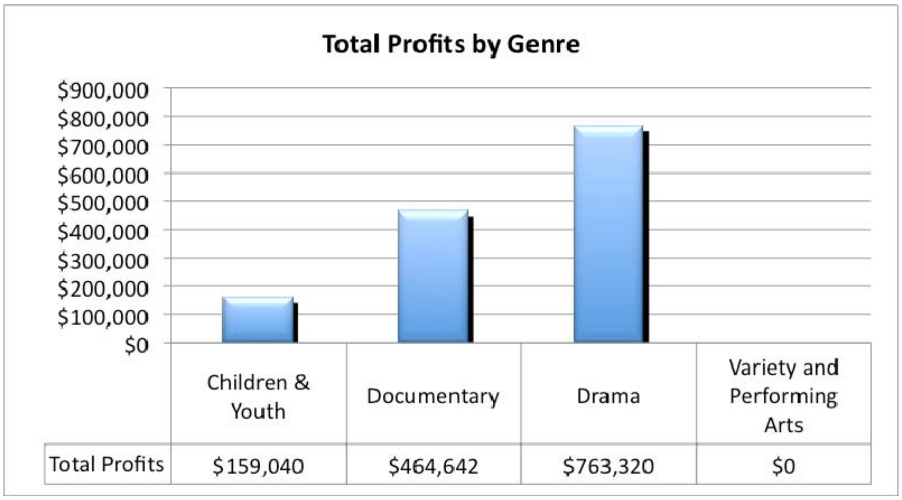


Table 5: Profit Generated from CMF-Supported Television Productions

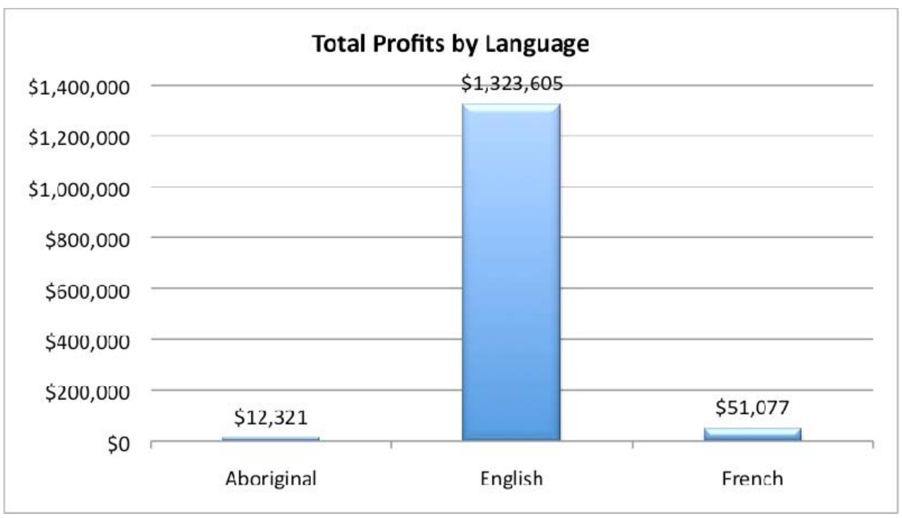
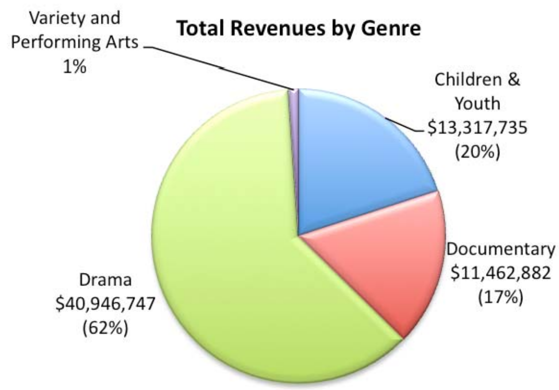


Table 6: Profit Generated from CMF-Supported Television Productions

Language	Aboriginal	English	French	Grand Total
Children & Youth	$7,963	$100,000	$51,077	$159,040
Documentary	$4,358	$460,285	$0	$464,642
Drama	$0	$763,320	$0	$763,320
Variety and Perfor	$0	$0	$0	$0
Total Profits	$12,321	$1,323,605	$51,077	$1,387,003

When we examine revenues recouped by genre, as is shown in table 7 below, we can see that 62% of all revenues recouped came from drama productions followed by children and youth at 20% and documentary at 17%. It is important to note that not all productions receive equity financing from the Canada Media Fund. This may help to partially explain the results in variety and documentary for example. We should note that films included as part of the drama genre are those that aired on television which had eligible licence fees and met minimum thresholds.

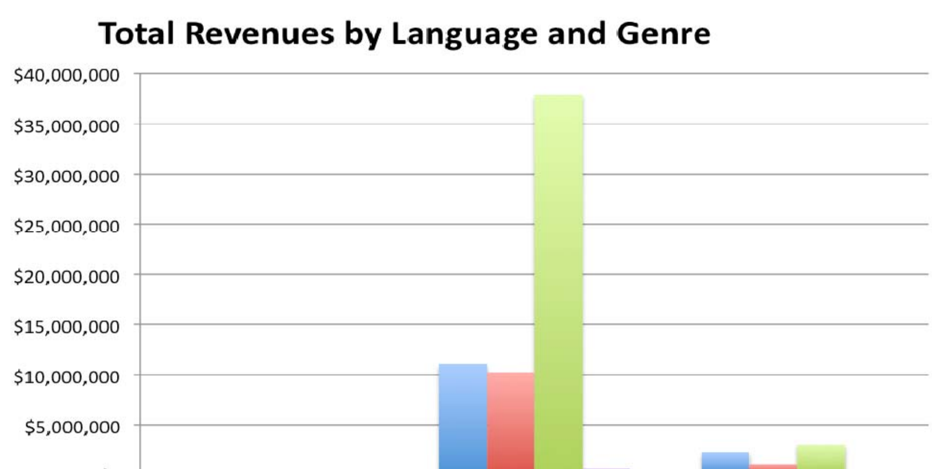
Table 7: Revenues Recouped by Genre



Genre	Amount Recouped	Percentage
Children and Youth	$13,317,736	20%
Documentary	$11,462,882	17%
Drama	$40,949,024	62%
Variety and Performi	$721,537	1%
Total	$66,451,180	100%

A look at revenues by language market and genre as in shown table 8 shows that revenues have primarily come from the English-language market and from drama productions.

Table 8: Revenues Recouped by Language Market and Genre



	Aboriginal	English	French
Children & Youth	$18,776	$11,057,309	$2,241,650
Documentary	$121,305	$10,235,903	$1,105,675
Drama	$3,602	$37,891,040	$3,054,382
Variety and Performing Arts	$4,485	$604,392	$112,661

In table 9, we note that out of the top 50 earners of CMF-supported television productions between 1996-1997 to 2009-2010, there were 4 documentaries, 9 children and youth programs and 37 dramas. All but 2 of the top 50 earners were English- language productions and the two French-language titles among the top 50 earners were children and youth productions.

Out of the 50 top earners, only 5 had revenues of more than $1,000,000; 20 had revenues of between $1,000,000 and $500,000; and 25 had revenues of less than $500,000. The greatest number of top 50 earners were signed in 1996-1997 and 1997-1998, with 8 and 11 projects, respectively.

Table 9: Summary of Top 50 Earners by Genre– CMF Supported Television Productions (1996/97 – 2009/10)

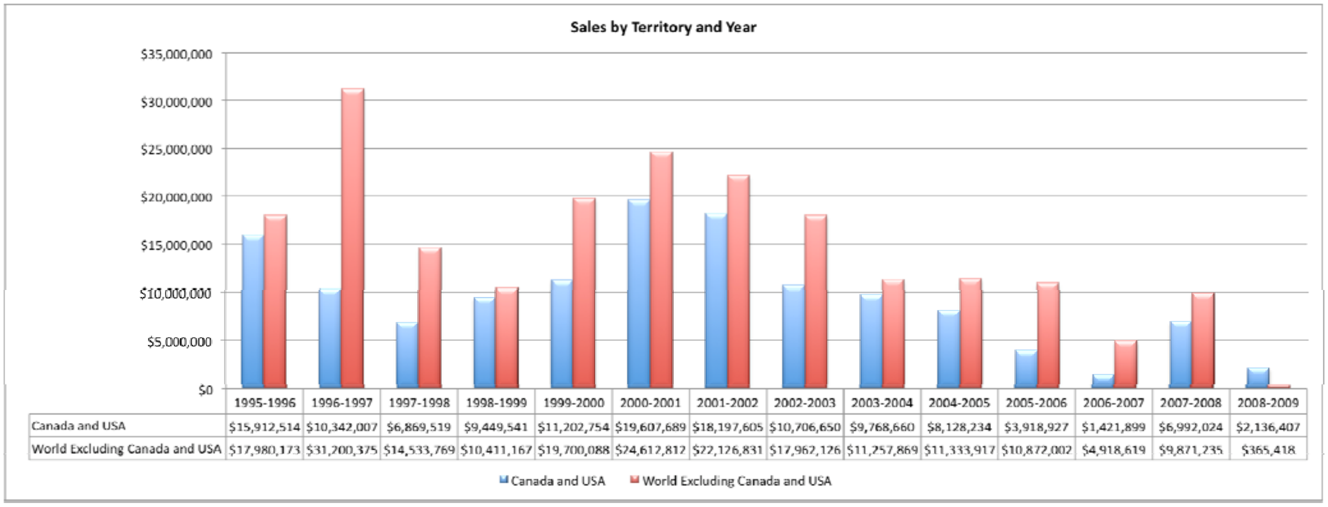
Signature Year	Children & Youth	Documentary	Drama	Grand Total
1996-1997	$2,236,249	$805,903	$2,973,129	$6,015,281
1997-1998	$922,110		$6,028,157	$6,950,267
1998-1999			$2,483,447	$2,483,447
1999-2000	$426,398		$1,892,739	$2,319,137
2000-2001	$978,074	$710,970	$2,091,717	$3,780,761
2001-2002	$320,495		$1,364,811	$1,685,306
2002-2003	$318,718		$1,025,569	$1,344,287
2003-2004	$733,886		$1,023,584	$1,757,470
2004-2005		$452,510	$904,078	$1,356,588
2005-2006			$1,471,193	$1,471,193
2006-2007			$563,838	$563,838
Grand Total	$5,935,930	$1,969,383	$21,822,262	$29,727,575

As shown in tables 10 and 11, total gross sales of CMF-supported television productions from 1996-1997 to 2008-2009 were about $341 million of which 60% came from foreign markets (excluding Canada and the US).

Table 10: Total Sales: Canada, USA, and the World

Applicable year	Canada	United States	World Excluding C	World Excluding U	Grand Total
1995-1996	$3,693,137.83	$12,219,376.56		$17,980,172.70	$33,892,687.09
1996-1997	$4,673,889.70	$5,668,117.05		$31,200,374.67	$41,542,381.42
1997-1998	$3,722,228.56	$3,147,290.91		$14,533,769.00	$21,403,288.47
1998-1999	$5,427,888.84	$4,021,651.96		$10,411,167.39	$19,860,708.19
1999-2000	$6,313,703.19	$4,889,050.41	$264,608.86	$19,435,478.80	$30,902,841.26
2000-2001	$11,240,291.46	$8,367,397.80	$215,836.76	$24,396,975.48	$44,220,501.50
2001-2002	$10,017,687.82	$8,179,916.90	$546,761.97	$21,580,069.35	$40,324,436.04
2002-2003	$6,364,570.07	$4,342,079.81	$771,610.80	$17,190,514.94	$28,668,775.62
2003-2004	$5,939,852.26	$3,828,807.25	$106,221.04	$11,151,648.43	$21,026,528.98
2004-2005	$5,509,601.04	$2,618,632.66	$1,042,852.00	$10,291,065.28	$19,462,150.98
2005-2006	$1,908,188.38	$2,010,738.23	$166,400.62	$10,705,601.79	$14,790,929.02
2006-2007	$1,033,828.61	$388,070.40	$66,000.00	$4,852,619.01	$6,340,518.02
2007-2008	$925,867.00	$6,066,157.00		$9,871,235.25	$16,863,259.25
2008-2009		$2,136,407.00		$365,418.00	$2,501,825.00
Grand Total	$66,770,734.76	$67,883,693.94	$3,180,292.05	$203,966,110.09	$341,800,830.84

Table 11: Total Gross Sales Canada and USA, and Other



	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009
Canada and USA	$15,912,514	$10,342,007	$6,869,519	$9,449,541	$11,202,754	$19,607,689	$18,197,605	$10,706,650	$9,768,660	$8,128,234	$3,918,927	$1,421,899	$6,992,024	$2,136,407
World Excluding Canada and USA	$17,980,173	$31,200,375	$14,533,769	$10,411,167	$19,700,088	$24,612,812	$22,126,831	$17,962,126	$11,257,869	$11,333,917	$10,872,002	$4,918,619	$9,871,235	$365,418

Table 12: Total Gross Sales by Genre

Genre	Canada	United States	World Excluding Canada	World Excluding USA and Canada	Grand Total
Children	$5,687,987	$9,492,338	$750,226	$37,389,648	$53,318,201
Documentary	$6,734,518	$6,265,513	$397,011	$15,545,999	$28,943,041
Drama	$53,673,246	$51,175,686	$2,033,055	$148,477,647	$255,359,633
Variety and Performing Arts	$643,016	$137,970		$1,686,683	$2,467,669
Grand Total	$66,770,735	$67,883,694	$3,180,292	$203,966,110	$341,800,831

Table 13: Total Gross Sales by Genre

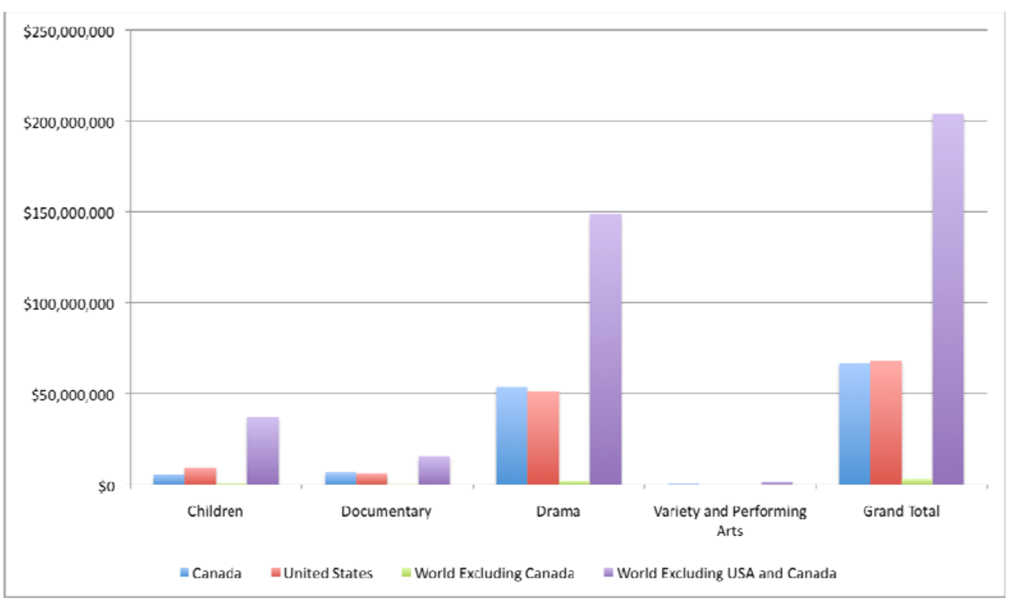
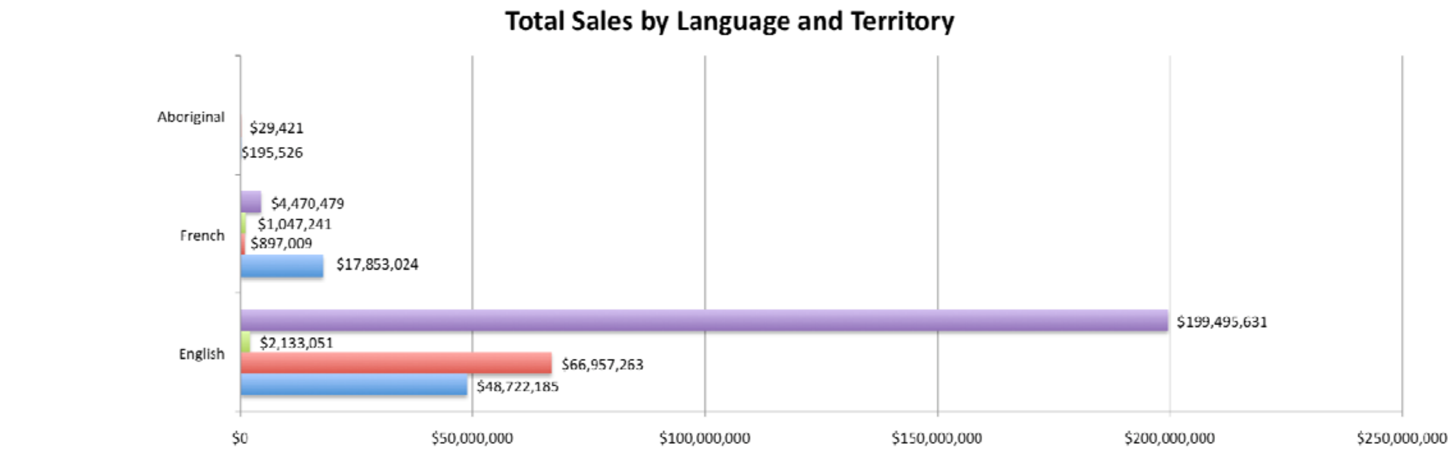


Table 14: Total Gross Sales by Language

Language	Canada	United States	World Excluding Canada	World Excluding USA and Canada	Grand Total
Aboriginal	$195,526	$29,421			$224,948
English	$48,722,185	$66,957,263	$2,133,051	$199,495,631	$317,308,130
French	$17,853,024	$897,009	$1,047,241	$4,470,479	$24,267,753
Grand Total	$66,770,735	$67,883,694	$3,180,292	$203,966,110	$341,800,831

Table 15: Total Gross Sales by Language



	English	French	Aboriginal
World Excluding USA and Canada	$199,495,631	$4,470,479	
World Excluding Canada	$2,133,051	$1,047,241	
United States	$66,957,263	$897,009	$29,421
Canada	$48,722,185	$17,853,024	$195,526

Tables 12, 13, 14 and 15 show that gross sales of CMF-supported productions come overwhelmingly from the English-language market and from drama productions representing more than 74% of all sales between 1996-1997 and 2008-2009. Children's productions follow in gross sales after drama representing 15% of all sales in the same time period.

2. Summary Observations

Generally, CMF-financed television productions between 1997-1998 and 2009-2010 show that revenues recouped represent a 5.5% rate of recoupment. Most of the revenues recouped have come from the English-language market and from drama programs. Most of the sales of these television productions came from foreign markets outside Canada and the US.

D. Stakeholder Perspectives

The consultant conducted seven interviews with stakeholders to solicit their views on the CMF's use of equity financing and the design of a Pilot Producer Incentive Program.

The goal of these interviews was to seek out perspectives on the CMF's current policies on equity financing and recoupment and on the design of a Pilot Producer Incentive Program. (Annex 4 contains the interview guide used in these interviews and Annex 5 provides a list of stakeholders interviewed.) The following section provides an overview of the themes that emerged from the interviews.

1. Views on Policies on Equity Financing and Recoupment

1.1. The CMF's Standard Recoupment Policy Versus Policies of Other Equity Investors

Representatives from the privately administered funds (Bell Broadcast and Shaw Rocket Fund) and Nova Scotia Film expressed the view that their recoupment policies generally differ from the CMF's Standard Recoupment Policy in the treatment of the producer's provincial tax credits. They note that this treatment provides a very attractive incentive to producers.

As equity investors, they would support the CMF becoming more of an equity investor but they point out that should this happen, the CMF's current Standard Recoupment Policy would need to be reviewed, particularly as concerns the treatment of provincial tax credits. Some stakeholders interviewed questioned the rationale for the CMF, a federal organization having adopted a recoupment policy that provides preferential treatment of the producer's tax credits whereas provincial agencies have not adopted such an approach.

They explained that while this approach may have been appropriate many years ago when the provincial tax credits generally represented 15% of a production budget, it is no longer appropriate as provincial tax credits generally represent a more significant portion of the budget, approximately between 35% to 40% of a budget.

One stakeholder pointed out that the CMF's Standard Recoupment Policy which allows distribution advances to be recouped by the distributor first (before any other investment) is one factor that helps explain the reason for the CMF's low recoupment revenues. She noted that this has impacted on all equity investors because in some cases, they have had to adopt the same policy in the treatment of distribution advances in their policies.

Stakeholders that are equity investors would support the CMF becoming more of an equity investor but they note that the CMF would have to change its Standard Recoupment Policy to be in line with their respective policies. One stakeholder wondered whether a change in the CMF's funding, whereby the Fund became more of an equity financier would lead to a decrease in the number of television productions being supported.

Generally, the view expressed was that having the CMF play a greater role as an equity investors would provide "a stronger voice and position to negotiate fairer agreements with the broadcasters."

Those stakeholders that are equity investors state that recoupment is an indicator of success for their respective organizations and should the CMF become a more significant equity investor, the Fund, too, would have to be involved in the negotiation of deals on a project-to-project-basis. This approach, which is different from the current use by the CMF of a standard recoupment schedule, has generally resulted in a higher rate of recoupment.

In contrast to the views of the above stakeholders, the Canadian Media Production Association (CMPA) points out that production companies are in a precarious financial state due to "broadcasters taking more for less" (domestic rights), and the decline in foreign sales. The CMPA states that producers are finding it difficult to build equity in their companies and that whatever equity they presently have is being used for the development of projects.

The APFTQ notes that producers should be assisted in the exploitation of intellectual property rights internationally through the creation of a new initiative to facilitate the international sales of formats by French-language producers.

1.2. Ownership of Rights and Revenues

Another issue that has been raised by stakeholders as having an important impact on recoupment revenues is ownership of rights and broadcaster agreements. It is being observed that broadcasters have increasingly over the years taken more rights as part of their agreements, and that generally, "there is [now] no money to be made in the domestic market."

Stakeholders consider that a healthy production community is important and that the most important asset for a producer is his ability to exploit that asset, but if his rights to the domestic market are eroded, international rights are the only asset left.

According to the CMPA and the APFTQ, producers are not likely to see any stream of revenues from the domestic market in the future.

1.3. Broadcasters as Equity Investors

Representatives from the independently administered private funds point out that it is rare that broadcasters make equity investments in television productions, especially in children's productions. They express the view that there is no incentive for a broadcaster to invest in a production as an equity investor.

One stakeholder pointed out, one of the ways for the CMF to increase recoupment revenues is to provide the broadcaster with an incentive and not the producer, who is already receiving a significant incentive through the CMF's recoupment policy. One example cited was to consider having broadcasters play a role in generating international sales and then having them share in the revenues generated from foreign markets.

The CMPA expressed the view that the broadcaster envelopes have "skewed all the power into the hands of the broadcasters, giving them the ability to dictate terms which has led to a decline in domestic revenues for producers. Both the CMPA and the APFTQ are interested in "rebalancing the system" so that there is a more "fair and equitable" share of resources, some of which should be under the control of the producers.

1.4. The Equity Grind

Stakeholders generally agree that if there were "no equity grind", there would be a benefit to the system as a whole in that the value of the tax credit would increase.

It was explained that historically (in 1998), even licence fee top ups were to be considered government assistance and thus would have reduced government assistance but that after some lobbying from the industry, the Department of Finance made the decision to treat licence fee top ups as non- government assistance. They amended the *Income Tax Act* to the effect that licence fee tops ups were not to be considered government assistance. Equity investments on the other hand are considered government assistance.

2. Views on a Pilot Producer Incentive Program and Alternative Options

Almost all of the stakeholders interviewed including the CMPA and the APFTQ expressed concerns about the creation of a Pilot Producer Incentive Program by the CMF.

2.1. Limited CMF Funds, the Benchmark of Success and Declining Foreign Sales

While some of the stakeholders support the concept of producers being encouraged to place more emphasis on selling their productions to foreign markets, they do not support reallocating funds to this program, particularly as it is not clear what the benchmark of success would be in light of the CMF's low rate of recoupment.

One stakeholder wondered how the creation of a Pilot Producer Incentive Program will lead to higher recoupment revenues by the producer and the CMF when recoupment trends show that revenues are not likely to increase unless the CMF modifies its Standard Recoupment Policy.

While the CMPA would like to have an incentive that "rebalances the power" between broadcasters and producers, they do not support the creation of a Pilot Producer Incentive Program that measures success based on revenues generated. From their perspective, it is difficult to reconcile the decline in recoupment revenues with continuing use of equity as a form of public assistance and a Pilot Producer Incentive Program. They consider that if the CMF uses foreign sales as an indicator to develop producer envelopes, "it would take too long to build up those revenues" because of the decline in foreign sales.

According to the CMPA, the decline in international sales is partly explained by the fact that the CMF has placed a more domestic focus on television productions and thus, the producer can do very little to make television productions more marketable.

They recommend perhaps using audience success or other measures to deem a television production successful. They note that the CMF could create a new stream of funding to encourage producers to develop productions targeted at the international market. This stream would not necessitate the use of a broadcaster trigger but instead international sales could be used as the trigger. The CMPA explained that situations have arisen in which, a foreign broadcaster was interested in a sequel to a production but because the domestic broadcaster was not interested, the producer was not able to develop the project which would have earned international sales.

The APFTQ considers that sales of formats represents an opportunity for French-language producers. They note that other countries are exploring this avenue and would be interested in the CMF undertaking research to assess what the opportunities would be for French-language producers.

2.2. Eligibility of Companies and Regional Access

Some stakeholders are concerned that production companies in the regions will not be eligible to a Pilot Producer Incentive Program. They point out that while larger companies have the resources to make sales, small companies are focused on development, and getting their productions financed as opposed to having the resources and skills to exploit their existing catalogues. One stakeholder was concerned that the beneficiaries of the Pilot Program will probably be the larger companies who are located in Montreal or Toronto.

Other stakeholders noted that not all of CMF's television productions have received equity investments, so that the pool of companies that would be considered to be eligible for the Program would not represent "a true picture."

E. Summary Concluding Observations and Potential Options for Consideration by the CMF

1. The CMF as an Equity Investor

Our review of the policies on equity investments and recoupment shows that over the years, there have been modifications brought to policies in response to industry concerns about the need for transparency (one-on-one negotiation of projects versus a Standard Recoupment Policy) 0r the need for more preferential terms by the industry. These changes have generally resulted in diminished recoupment revenues for the CMF.

Government-commissioned reports have reported on the difficulty of agencies such as Telefilm Canada reconciling cultural policy objectives with industrial ones as concerns equity investments and recoupment. These studies have generally adopted the position that cultural objectives should have primacy over industrial ones.

In addition, because of the grind factor associated with equity investments, for the CMF to increase equity investments in television productions, this would result in generally less resources for the industry.

Our analysis of recoupment revenues generated by CMF-supported television productions between 1996-1997 to 2009-2010 shows that revenues being returned to the CMF have decreased in the last few years.

Both the grind and the decrease in recouped revenues raise implications for the CMF in its potential consideration to increase the level of equity investments in television productions or to create a Pilot Producer Incentive Program to encourage greater revenues to be returned to the CMF. The stakeholders interviewed for this study generally do not support either increasing the level of equity investments in television productions or the creation of Pilot Producer Incentive Program primarily because of these factors. Those that do support increasing equity investments in television productions recognize that the CMF would need to make modifications to its present Standard Recoupment Policy.

2. Options

There are other options that CMF could consider that were proposed by some of the stakeholders interviewed for this study.

2.1 Direct Measures

The CMF could adopt direct measures that could result in increased revenues for the CMF. These include either introducing a new program using equity investments or modifying current policies.

For example, the current Performance Envelope Program could be replaced by a Selective Program in which the CMF could make the decisions on the choice of projects financed based on an assessment of recouped revenues. This would obviously represent a dramatic change for the CMF and would be less efficient and less predictable than the current Performance Envelope Program. It would also lead to higher administrative costs and there would be no guarantee that the CMF would select the projects that would generate the highest returns to the Fund.

The CMF could also modify its Standard Recoupment Policy, particularly its treatment of provincial tax credits and distributor advances as suggested by some stakeholders interviewed for this study. Alternatively, the CMF could also set- up enforcement activities to increase project audits. These modifications could lead to increases revenues either for the producer and the CMF. In the case of eliminating or reducing the preferential recoupment position for provincial tax credits, this would also lead to a delay in producers's recoupment of these credits.

Other avenues opened to the CMF could include increasing its level of equity investment per project (and decreasing its level of licence fee top-up) or perhaps negotiating recoupment on a per-project basis with producers. As the representatives of independently-administered funds explained in our interviews, higher revenues generated by these funds are a direct result of the negotiation of recoupment agreements on a one-to-one basis with producers.

As we have seen in this study, one of the reasons for the adoption of a Standard Recoupment Policy by the CTF in 2003-2004 was to ensure transparency in the process of decision-making and also to reduce administration costs. These issues will need to be addressed by the CMF should the Fund return to a one-on-one negotiation of recoupment arrangements with producers.

Finally, the CMF could also modify its rules on the treatment of non-broadcast rights in such a way that would ensure the maximum exploitation of television content with increased potential for revenues either for the producer or the Fund or both. Representatives of producer associations believe that producers would benefit from the exploitation of rights to their productions domestically if the treatment of rights by the CMF were to be revisited.

At the same time, the involvement of the CMF in negotiation of rights could represent an administrative challenge in light of a complex and evolving rights marketplace.

2.2. Indirect Measures

The CMF could also consider indirect measures to increase revenues to the Fund. As most revenue potential for most programming comes from non-Canadian markets, in which visibly Canadian elements may make programming less appealing, the CMF could consider modifications to the requirement that television productions achieve ten out of ten in Canadian content. This could lead to the sale of television productions which have more international commercial appeal. However, the CMF would need to consider that there is no solid evidence that supports the contention that television productions that have less than ten out of ten Canadian content are likely to generate more sales. It is also possible that by funding productions of less than ten out of ten, the CMF's mandate to support content for Canadian audiences could be questioned.

Finally, the CMF could introduce a marketing assistance program that would help producers, broadcasters and distributors increase international sales. Currently, the CMF does not fund marketing and promotion costs for the television component of funded projects but it could support marketing activities with the goal of generating additional international or non-TV platform sales.

However, the CMF would need to consider the impact of diverting production funding to a new program as well as the possibility that such a program could merely displace existing marketing and promotion spending by broadcasters and/or distributors, rather than generating new marketing activity.

Annex 1: The CTF's Recoupment Policy: 2003-2004

Minimum Recoupment Practices

The EIP will recoup its investments no less favourably than pro rata and pari passu with all other financial contributions (except as noted below) including:

broadcaster investment, producer investment or deferral, private fund and provincial agency investment, craft and creative deferrals (whether or not by related parties) and any form of producer-related financial participation which is directly or indirectly supported by producer fees, corporate overhead or federal or provincial tax credits.

For projects whose financing structures include distribution advances, minimum guarantees, pre-sales for non-Canadian territories or other similar forms of participation including gap financing, the producer must offer the EIP a deal which will not unfairly limit the EIP's ability to recoup its investment, and which will permit a reasonable expectation of recoupment.

Although a producer may sell world-wide distribution rights in return for an advance or minimum guarantee to be included in the project's financial structure, the advance or guarantee may not recoup from world-wide revenues ahead of the EIP's investment. The following are the two most typical kinds of recoupment arrangements that can satisfy the requirement:

• Open territory: A major territory or territories is or are excluded from the recoupment of the advance/guarantee to allow for the EIP's investment to recoup in first position (shared with other investors entitled to recoup in the same position as the EIP) from net revenue generated from these territories, without being subject to prior recoupment of the advance/guarantee. The open territory must be a territory or territories that represents reasonable revenue potential to the EIP. An open territory arrangement does not mean that the provider (usually a distributor) of the advance/guarantee cannot be granted the right to sell in the open territory, simply that the advance/guarantee does not recoup from the open territory.

• Revenue corridor: The producer negotiates a deal with the provider of the advance/guarantee (usually the distributor) such that the advance/guarantee is recoupable, not from 100% of revenue but from some lesser share of the revenue. The remaining portion of revenue flows to the EIP (and other investors entitled to the same position as the EIP).

When an advance or guarantee is provided by a company related to or affiliated with the producer, the EIP may require a recoupment position for the advance or guarantee that is more consistent with that of other financial contributions (i.e. pro rata and pari passu) in consideration of the benefit derived by the related company from the production budget and projected revenues.

Since financing structures, distribution arrangements, marketability and most other elements of projects vary considerably from project to project, the EIP considers different deals acceptable on a case-by-case basis. In every case, the EIP is seeking a reasonable expectation of recoupment in light of its objectives above.

Approved budget over-runs and service deferrals (deferred payments to commercial laboratories, equipment rental companies and post-production facilities) may be recouped only after the EIP has recouped.

For productions where the EIP deems certain budget items to be excessive (including producer's fees and corporate overhead), the EIP requires a recoupment position that ensures that such items do not negatively affect the EIP's recoupment.

Incentive for Producers of Low Budget English-Language Productions

To encourage wider distribution of projects produced by non-integrated SMEs producing low budget English language productions (thereby improving their capitalization through recoupment), the EIP provides the following incentives:

• Where the production budget of an English-language project produced by a non-integrated SME does not exceed $1 million, the EIP will forego recoupment of 25% of its investment in favour of the producer.

Producers will be allowed to recoup this amount as their own, in addition to whatever other investment they may have in the project, pro rata and pari passu with all other investments.

• Documentaries: An exception to the minimum requirement of an open territory(s) or revenue corridor will be made for documentary one-offs whose financing structures include a world-wide distribution advance or guarantee of no more than $35,000 from an arm's length distribution company such that EIP will accept that such advance or guarantee recoups ahead of the EIP from world-wide revenues.

Incentive to Encourage Private Investment

In order to encourage producers seeking non-traditional sources of private financing for their projects, the EIP will offer the following incentive to productions benefiting from such funding:

• Until full recoupment of eligible private investment, eligible private investors may receive 50% of revenues pro rata and pari passu. The other 50% will be shared pro rata and pari passu with the remaining first tier investors.

Such a preferred position will not apply to: foreign investors, suppliers deferring payments, broadcasters and other CRTC licencees, funds established as a requirement of the CRTC, and Canadian investors eligible to receive accompanying benefit from their participation, such as distribution or licensing rights, payment for services provided to the production or the fulfillment of regulatory requirements.

Applicants should note that, by and large, financing provided by private investors who may be granted this preferential recoupment position will render a project ineligible for tax credits.

Incentive for Producers of French-Language Productions

In recognition of the difficulties faced by producers of French-language productions in gaining access to the global marketplace, and therefore in contributing to the capitalization of their companies through recoupment, the EIP provides the following incentive:

• Until full recoupment by the producer of a provincial tax credit used towards financing a French-language production, the producer will receive 50% of net production revenues. The other 50% will be shared pro rata and pari passu among the remaining investors.

Standard Distribution Terms and Conditions

The EIP may impose caps or limitations on deductible distribution fees and expenses.

The EIP is exploring ways to standardize its recoupment policy and distribution contract terms and has planned consultations with the industry in this regard.

Annex 2: Extracts from the 2005 Summative Evaluation of the Canadian Television Fund

2.3.2.4 Recoupment (page 42)

Telefilm's equity investments through the EIP have always had recoupment privileges; that is, if the project succeeds financially, Telefilm recovers some of its investment. The amount recouped is plowed back into production and totals around $9 million a year.

While this is certainly a significant sum, some key informants among broadcasters and producers were highly critical of recoupment policies.

According to critics, Telefilm's recoupment policies sometimes pose a real barrier to the completion of financing, especially from foreign sources (which are said not to understand why the "natural" financial positioning does not apply). Negotiating recoupment can cause delays and certainly cuts out a source of payback for the producer. As indicated earlier, in the more demanding financial environment of the last few years, the typical production company's corporate situation has deteriorated. Telefilm has improved the process by standardizing recoupment policies, although apparently not all projects can meet the standards.

Producers believe that tracking projects over several years, along with other aspects of administration, remains very costly for Telefilm. Some producers suggest that Telefilm should at least limit its interest in rights to a finite period, such as five years. The agency counters that tracking efficiency is now quite high, and that a considerable part of the overall return to equity results from revenue earned after five years.

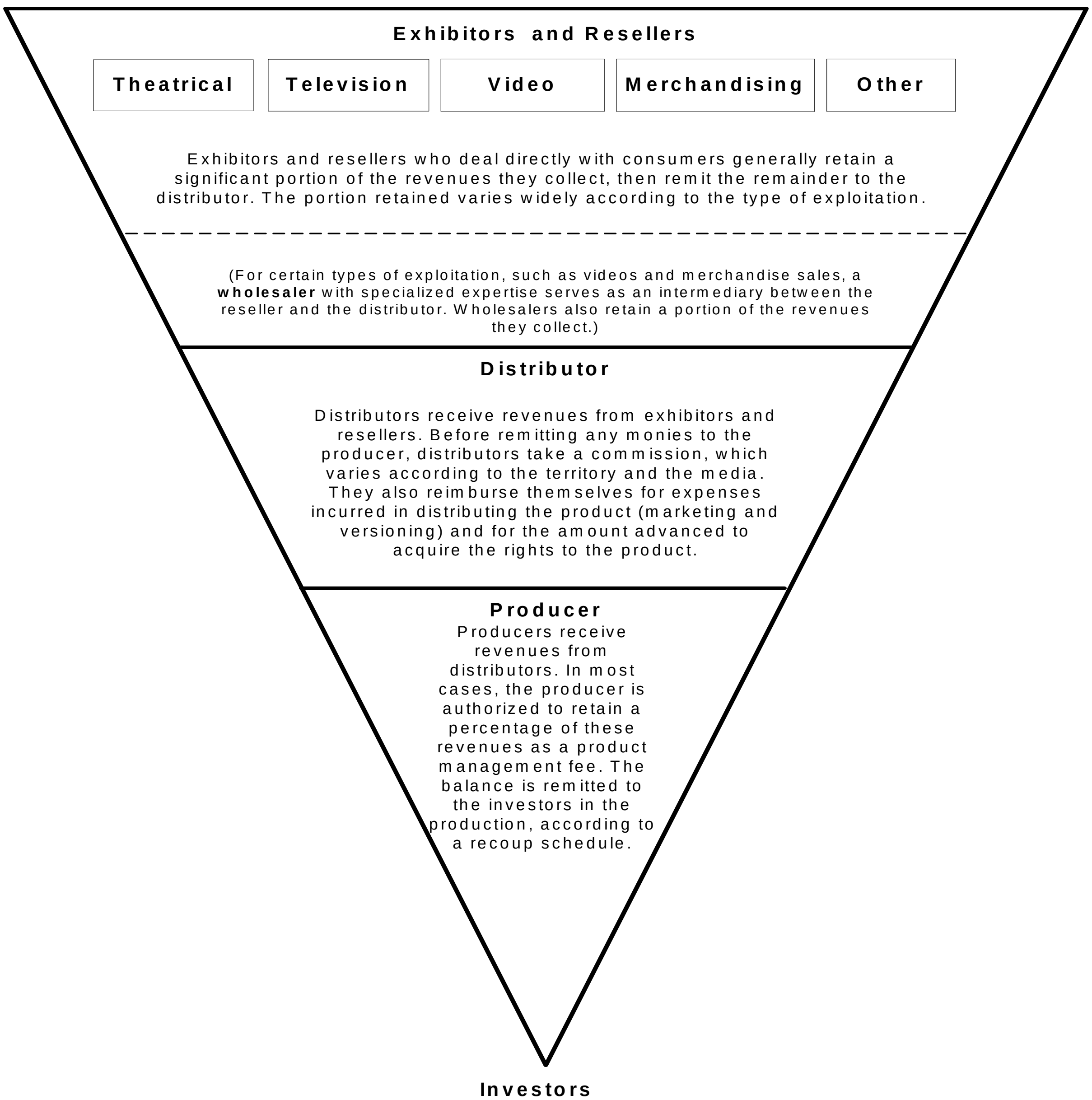
The rationale for recoupment on equity investments is certainly understood: that the public investment merits a return if the equity investment is successful. Although recoupment is recognized as a long-standing condition of Telefilm's funding, it averages only a few percentage points of the total equity advanced. In fact, when the Canadian Film Development Corporation (the forerunner to Telefilm) was first established, it was supposed to replenish its fund from the proceeds of its equity investments in films. At issue is whether that approach remains sound.

Supposing that changes in recoupment policies lowered returns to Telefilm by $5 million, the question is how much production companies would benefit. Would they use the extra funds to help develop their next projects? Would they attract more than the $5 million from foreign sources of financing? Clearly, further examination is needed of recoupment policies and their net impact on the financing of targeted Canadian television programming.

Recoupment (page 59)

Among producers and broadcasters, some key informants questioned the cost effectiveness of recoupment on equity investments by Telefilm. There is still a sound rationale for Telefilm to share in returns on the equity investments it makes for the purpose of reinvestment in Canadian productions. However, in an era when project financing is increasingly complex, Telefilm's recoupment policies may deter foreign financing and, indirectly harm the corporate health of production companies. It remains uncertain whether further changes in recoupment policies would benefit the development of Canadian television programming more than current practices.

Annex 3: Equity Financing and Revenues Recouped



Annex 4: Interview Questions

Equity Financing: Levels, the Equity Grind and the Current Recoupment Policy

1. The CMF's equity in a television production is not established at any set percentage. Licence fee top-up is limited to 20% of the budget, but equity investment has many different caps by genre. Most funding does not hit the cap and in the children and youth genre, many projects do not receive any equity at all.

   Should the level of equity financing in television productions be increased?

   What impact would there be or should there be if the CMF were to modify its funding formula of television productions such that equity investments would increase?

   In a context in which the equity grind could be removed or addressed, what benefit would accrue directly to the producer?

2. In an effort to provide the producer with more incentives to generate revenues, are there changes that can be brought to the current CMF Current Recoupment Schedule that would act an incentive for producers to exploit markets and platforms in an effort to increase revenues? If there were changes, could these changes act as an incentive and thus, not require the introduction of a Pilot Producer Revenue Program?

   In an effort to ensure that the CMF continues to have streamlined processes in place, what factors should the CMF keep in mind with either modifications being made to the current Standard Recoupment Schedule or in the context of introducing the Pilot Producer Revenue Program?

3. Broadcasters currently green light television projects and not producers. Is this a consideration that the CMF should take into account in making changes to increasing equity investments in a television production?

4. The CRTC will be eliminating licence fee top-ups as an eligible Canadian program expense for all specialty services with Canadian Programming Expenditure requirements. What impact will this have on broadcasters's equity investments in television productions?

A Pilot Producer Incentive Revenue Program

1. In the CMF's briefing note on Audience Success and ROI Working Group, the CMF said that it "supports an approach that will reward the individual project which meets a revenue threshold regardless of genre and company. This would seem to be a more fair and equitable approach. " In your view, how should the CMF arrive at the threshold? What should the reference period be? Three years? Five Years?

2. What are your views on what the incentive should be? An envelope for use on future productions?

3. Are there other considerations in the design of the Initiative that should be taken into account?

Annex 5: Stakeholders Interviewed and Others Consulted

1. Agnes Augustin, President and Board Treasurer, Shaw Rocket Fund
2. William Barron, Business Affairs Analyst, Ontario and Nunavut Region, Telefilm Canada
3. Harold Boies, Manager, Private Broadcasting, Broadcasting and Digital Communications Branch, Department of Canadian Heritage
4. Norm Bolen, President and CEO, CMPA
5. Antonietta Coppola, Financial Analyst, Compliance and Collection, Telefilm Canada
6. Helen Kennedy, Deputy Director General, Broadcasting and Digital Communications Branch, Department of Canadian Heritage
7. Ann MacKenzie, President and CEO, Film Nova Scotia and Chair of the Association of Provincial Film Agencies (APFA)
8. Reynolds Mastin, Counsel, CMPA
9. Shannon Nix, Director, Programming Services and Content Policy, Broadcasting and Digital Communications Branch
10. Hélène Pépin, Manager, Compliance and Collection, Telefilm Canada
11. André Provencher, President, APFTQ
12. Marc Séguin, Senior Vice-President, Policy, CMPA
13. Andra Sheffer, Executive Director, Bell Broadcast and New Media Fund/Independent Production Fund/Cogeco Program Development Fund
14. Robert Soucy, Director, Canadian Audio-Visual Certification Office (CAVCO) Department of Canadian Heritage
15. Linda Wood, Director, Business and Legal Affairs, Film Nova Scotia