

## What China's Trade Deal Means

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**New rules could give studios greater entry to the world's fastest-growing movie market, but the fine print reveals a still-fuzzy complexity.**



When it comes to doing business with China, the devil is always in the details. The recent announcement that the Chinese government finally will comply with a World Trade Organization order to treat U.S. films more fairly is no exception. On paper, it sounds great: China, ever concerned about outside cultural influences, will ease its 20-picture annual import quota by granting entry to 14 more 3D or Imax titles. Also, Hollywood studios

will get 25 percent of box-office proceeds (a far cry from the 50-50 split studios enjoy in most foreign markets).

Publicly, studio executives lauded the deal when it was announced by Vice President Joe Biden and his Chinese counterpart, Xi Jinping, on Feb. 17 in Los Angeles. But privately, they wonder how it will shake out -- and when -- because the Chinese government has yet to sign a WTO Memorandum of Understanding (and no one knows when it will). "How is it actually going to work? When you are talking about China, you just never know," says one Hollywood insider. "If anyone says this is etched in stone, they are kidding themselves." The U.S. film industry had wanted the import quota lifted altogether, but it was clear that wasn't going to happen when China ignored a March 2011 deadline imposed by the WTO. After Hollywood heavyweights including Jeffrey Katzenberg reached out to the White House, talks began between the Obama administration and the Chinese about some sort of compromise.

Hollywood signaled it was willing to live with the resulting agreement because it can be revisited in five years. According to one insider, a final sticking point was revenue-sharing: The studios wanted 30 percent but had to settle for 25 (previously, it was 13 to 17 percent). Says a veteran studio distributor, "This was a get-out-of-jail-free card for China," on which pressure to respond had been mounting.

Dan Mintz, CEO of Beijing-based DMG Entertainment, adds, "Obviously, from the top-line level, all of this is good," but he agrees the fundamentals of doing business in China haven't changed simply because one key barrier has been partially lifted. "It's important

to remember that the quota is just one layer that is used by the powers that be to control things," says Mintz. "They have censorship, they control all the screens, and they hold control over when a film comes on, against which competition and how long it stays in theaters."

Still, the Chinese market is too hot for Hollywood studios not to keep trying. In 2008, the local box-office take hit \$630 million; in 2011, it reached a massive \$2.1 billion. Theater construction also is exploding, spurring a proliferation of state-of-the-art 3D screens. And that is one area in which Hollywood has the upper hand as its proliferation of 3D tentpoles deliver much-needed content. Five of China's 10 top-grossing movies in 2011 were 3D studio releases, all of them American.

"The chief beneficiaries of the extended quota will be the U.S. studios," says IM Global CEO Stuart Ford. "But it's a move in the right direction for the industry as a whole insofar as it's a step toward a more balanced, partner-driven distribution framework in a territory with such vast revenue potential for all kinds of movies and related content." Large-format exhibitor Imax also is poised to benefit because it has a major foothold in China, with 217 theaters set to open by the end of 2015.

The potential windfall for Hollywood is staggering. In 2011, *Transformers: Dark of the Moon* was China's top-grossing title, earning \$172 million -- far and away its largest gross outside of North America, where the film took in \$352.4 million. Interestingly, had the new revenue-sharing deal been in effect, Paramount would have seen a return of \$43 million, compared with \$26 million. As it was, the studio probably received less than \$20 million.

The first 3D release set to open in China this year is *Titanic 3D*, in early April. No one -- not even the film's overseas distributor, Fox -- knows whether the new rules will be in place by then, but most studios believe they will by summer, which is primetime for 3D blockbusters. There's also no word on which 3D titles China will accept this year, but the choices include *The Amazing Spider-Man*, *The Dark Knight Rises*, *Brave*, *The Avengers*, *Men in Black III* and *Madagascar 3*. (One note: China still bans movies that depict ghosts.)

Whatever happens, Mintz warns Hollywood not to expect China's business practices to change overnight: "The potential downside of this is that Hollywood will get over-enthusiastic and assume everything is all good now -- and we can just copy and paste what we do everywhere else, and it's business as usual. That will never work."

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## **CHINA BY THE NUMBERS**

### **Box Office**

**2008:** \$630 million

**2009:** \$908 million

**2010:** \$1.47 billion

**2011:** \$2.1 billion

### **Number of Screens**

**2010:** 6,200

**2011:** 10,000

**2012:** 16,000 (projected)

**Locally Produced Films**

**2011:** 588 (fewer than half will see a theatrical release)

**Top Three 3D Releases in 2011**

*Transformers: Dark of the Moon:* \$172 million

*Kung Fu Panda 2:* \$94.5 million

*Pirates of the Caribbean: On Stranger Tide:* \$73 million