

Entertainment Industry

Competition, Foreign Investment
and Regulatory Issues in Canada

Blakes

What's Inside

1 / Canada's Growing Digital Economy

2 / Four Things You Need to Know

3 / Recent Trends and Development in the Entertainment Industry

6 / Foreign Direct Investment

8 / Merger Review and Collaborations in the Entertainment Industry

9 / Marketing Practices

10 / Big Data

12 / Contact Us

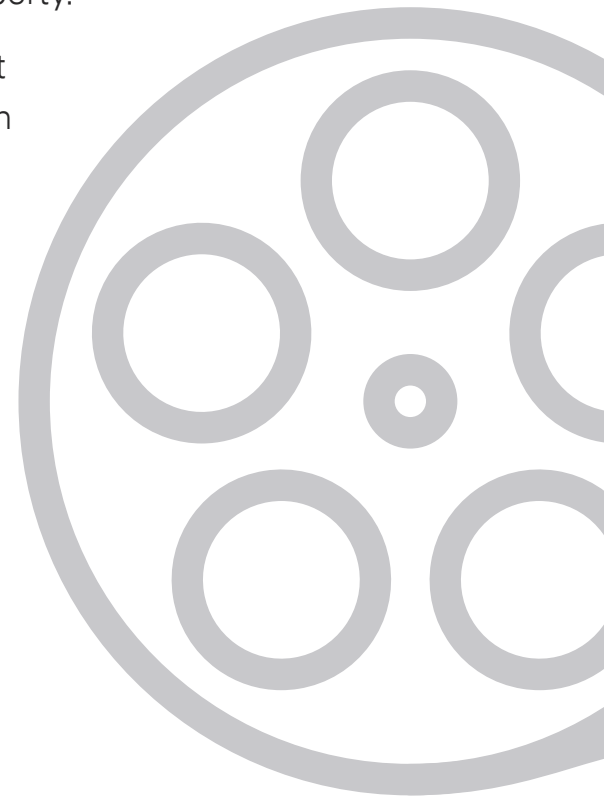


Canada's Growing Digital Economy

Canada's growing digital economy is anchored by a C\$15-billion entertainment industry. Over 57,000 businesses involved in movies/cinema, music, publishing, radio, internet and gaming make up this vibrant and dynamic sector of the economy, which is expected to grow at an annual rate of 3.7 per cent through 2022.

Seeing opportunities for growth in Canada, mergers and acquisitions activity in the industry increased in the second half of 2018, driven by mid-market transactions involving technology providers. This trend is expected to continue as investors see opportunities for growth and strong returns from businesses rich in talent and intellectual property.

Companies operating in the industry should be aware that Canadian government agencies, including the Competition Bureau, the Department of Canadian Heritage, and the Canadian Radio-television and Telecommunications Commission (CRTC) could impact their businesses. Companies operating in, or planning to enter, Canada should be familiar with the special rules that apply in this space, as well as the tax benefits that are available for Canadian-controlled companies.



Four Things You Need to Know

- 1 M&A transactions** in the entertainment industry can require multiple regulatory approvals, including from the Competition Bureau, the CRTC and the Department of Canadian Heritage. Each agency has different review thresholds and approval requirements.
- 2** Importantly, **non-Canadian investors** that are looking to acquire (or even establish) a company operating in this industry may require approval from the Department of Canadian Heritage, even where the target company is a start-up.
- 3** The **Competition Bureau** and consumer protection agencies enforce rules around deceptive marketing practices. Terms and conditions must be clear, pricing needs to be transparent, and any performance claims must be validated in advance.
- 4 Structuring considerations** are important not only for foreign investment reviews, but also in order to benefit from substantial tax credits.



Recent Trends and Developments in the Entertainment Industry

The Canadian entertainment industry has seen noteworthy changes, driven by the changing media consumption practices of consumers.

Film and Television

Canada has traditionally been a hub for audio-visual production in both the film and television markets. National Canadian production has been driven by public funding from bodies such as Telefilm, the Société de développement des entreprises culturelles in Quebec (SODEC) and the Canadian Media Fund, and the need to fill legislatively required quotas of Canadian content. The decline of the traditional broadcasting system has decreased the revenues flowing to Canadian content, putting in question the traditional funding systems for such production and the economic viability of the system going forward. In June 2018, the Canadian government announced a legislative review of the *Telecommunications Act* and the *Broadcasting Act*, the framework laws that underpin Canada's domestic content creation regime.

As consumers increasingly choose to view content over the internet, the over-the-top video market continues to develop, with an expected market growth in Canada of 5.2 per cent through to 2022. In 2017, Canada represented the fifth-largest over-the-top market globally. As further discussed below, Canada is an important market for large over-the-top players such as Netflix.

Total yearly volume of production budgets of film and television production in Canada increased by 5.9 per cent to an all-time high of nearly C\$9-billion in 2018. This continual growth can be attributed to an increase in volume of foreign productions shooting in Canada. Foreign productions (often called "service productions") comprised 53 per cent of the total film and television production budgets in Canada. Tax incentives, the diverse architectural and natural landscapes available in Canada, and the existence of studio infrastructure and specialized labour make Canada attractive as a filming location to foreign producers. As further described below, both Canadian and foreign producers can benefit from beneficial tax treatment.

A number of television shows are currently filmed in Canada, such as *Star Trek: Discovery*, *The Handmaid's Tale*, *The Flash* and the new Netflix series *The Umbrella Academy*. Television production in Canada has been particularly vibrant in British Columbia. The growing global demand for content, as well as Vancouver's proximity to Los Angeles, have been suggested as reasons behind British Columbia's surge.

Large production studios exist to accommodate the local and foreign production in Canada, for example, the Pinewood Toronto Studios, which is currently undergoing a 200,000-square-foot expansion following its acquisition in 2018 by Bell Media, making it the largest production studio in Canada with 525,000 square feet overall.

Video Games and e-Sports

The video game segment of Canada's entertainment industry is a significant economic contributor and is rapidly growing. According to the Entertainment Software Association (ESA) of Canada, video games contribute approximately C\$3.7-billion annually to Canada's GDP. ESA also estimates that the segment includes 596 active video game studios (a 21 per cent increase since 2015) and 21,700 full-time jobs (a six per cent increase). Large Canadian cities are attractive headquarters for gaming companies, due to federal and provincial tax incentives, an abundance of skilled labour and the large gaming communities active in those cities.


E-gambling and e-sports are expected to see strong growth. On average, individuals aged 18 to 25 worldwide spend more time watching others play video games than watching traditional sports. Prize pools for betting on gaming tournaments are increasing in size, demonstrated by the multi-million dollar prize pool for the 2018 Dota 2 competition in Vancouver. The e-sports sector is anticipated to experience a 22 per cent market growth in Canada over the next five years.

Canadian video game companies are frequent targets for foreign direct investment, and potential investors must be aware that video game companies are considered cultural businesses under Canada's foreign investment laws, a distinction which, as described below, lowers the applicable financial threshold for triggering a pre-closing review.





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Social Media

Social media has dramatically changed the entertainment industry. Audiences that previously watched TV or films or read books are now increasingly being entertained through social media. YouTube viewership is now much higher than that for a traditional TV channel. Furthermore, social media is an interactive form of entertainment – users become active real-time participants, as opposed to simply watching. For example, 79 per cent of viewers visit Facebook at the same time as watching TV or movies, and 83 per cent tweet about shows or movies they are watching while viewing. As a result, viewers of media are active instantaneous influencers of the industry - they can review online at the same time they watch.

Social media platforms allow users to share stories in several languages, and collaborate through comments and messages. These platforms have created an Internet community that makes storytelling a social, on-the-go experience. Social media companies are also making inroads into licensing and production of original content, and are partnering with film and production companies to co-produce stories for film, TV and digital platforms.

Social media has transformed marketing and promotion within the entertainment industry. The potential audience reach with sharing a movie trailer or TV clip on social media is enormous. The average Facebook user is connected with over 300 friends and entertainment celebrities having tens of millions of followers on Twitter. Via social media, the industry has captive instant worldwide audience. Even major sporting events and industry award shows such as the Super Bowl, the Grammy Awards or Academy Awards generate huge amounts of online buzz. The forum allows users to participate in the success of celebrities who often post behind-the-scenes posts, photo tweets or commentaries to increase fan interaction.



Foreign Direct Investment

The Canadian entertainment industry continues to attract significant foreign direct investment, including from major U.S. studios and entertainment companies. Notable recent investments by American companies in the Canadian entertainment industry include the following:

Production by Netflix in Canada

In 2017, Netflix promised to spend a minimum of C\$500-million on original production in Canada over five years. The investment is expected to benefit Canadian producers, directors, writers, actors and film crews. Netflix also promised an additional C\$25-million to further develop the market for diverse content in Canada, including French-language and Indigenous content.

Canadian Base for CBS

In 2018, CBS Corporation leased 24,000 square metres outside of Toronto to serve as its Canadian base in film and television production. The space includes six sound stages, offices and other facilities to support its growing production output, including *Star Trek: Discovery*, which is a television series currently filmed at various sound stages around Toronto.

Just for Laughs

In 2018, ICM Partners joined with Bell Media, Groupe CH and Howie Mandel to acquire the *Just for Laughs* festival and various television and live productions both in and outside of Quebec.





Foreign Investment

Cultural Businesses: Notification and Review

While all investments that result in an acquisition of control by a non-Canadian of a Canadian business are subject to possible pre-closing review under Canada's foreign investment laws, the financial thresholds that trigger such a review are far lower for investments in a Canadian cultural business (including a threshold of just C\$5-million for direct acquisitions). Even where the threshold is not met, the government can order a review of the investment within 21 days of receiving notice of the transaction. Many businesses in the entertainment industry can be considered cultural businesses, including video-game and software companies, as companies that offer certain telecommunications services.

The Canadian government has also issued detailed guidance on when certain investments in certain sectors, such as book and magazine publishing, will be subject to an enhanced review.

Tax Considerations

Foreign investment in Canadian companies in the entertainment industry may also impact their tax treatment. The Canadian Film or Video Production Tax Credit Program, at the federal level, and equivalent tax incentives at the provincial level of many provinces (including Quebec, Ontario and British Columbia) have been designed to encourage Canadian programming, stimulate the development of an active domestic independent production sector and give a tax credit to qualified corporations producing Canadian film or video. While both federal and provincial tax incentives are also available to foreign productions for work undertaken in Canada, the tax incentives available to Canadian-controlled companies are higher than those available to companies that are not Canadian-controlled.

Merger Review and Collaborations in the Entertainment Industry

Merger Notification

Canada's *Competition Act* establishes various thresholds that, if exceeded, require that merging parties notify the Competition Bureau of their transaction before closing. The financial thresholds assess the book value of the merging parties' assets and revenues in Canada. Although the Canadian businesses of the parties to a global merger may be relatively small, a Canadian notification will be required if the relevant thresholds are exceeded. For example, both AT&T's recent acquisition of Time Warner and Disney's proposed acquisition of 21st Century Fox were subject to notification in Canada, despite much larger presences in other countries.

Companies in the entertainment industry should note that regardless of whether a merger meets the notification thresholds, the Competition Bureau has the authority to assess whether any merger is likely to prevent or lessen competition substantially.

Choice for Consumers

The Competition Bureau has tended to focus on the extent to which mergers between firms in the entertainment industry may decrease competition in the market through reduced choice of options for consumers.

Partnerships and Joint Ventures

As with any industry, partnerships or joint ventures between competitors in the entertainment industry may have the potential to cause anti-competitive effects. For that reason, the Competition Bureau has scrutinized close collaborations between competitors.

Investments in Radiocommunications, Telecommunications and Broadcasting Companies

Canadian companies active in the radiocommunications, telecommunications and broadcasting industries often require licences and registrations granted by the CRTC. Depending on the type of licences and registrations held, transactions involving the transfer or change of control of such businesses and their assets may be subject to notification and approval requirements with the CRTC, and investors in the space should be aware of the possibility of such regulatory oversight.

Marketing Practices

Marketing practices in the entertainment industry have recently been subject to a significant amount of attention from the Competition Bureau.

Influencers

The Competition Bureau has issued specific guidance regarding best practices that social media influencers can adopt to comply with the deceptive marketing laws. Examples of the Competition Bureau's guidance include ensuring appropriate disclosures regarding material connections between the influencer and the supplier of the products that the influencer is promoting and basing all reviews and opinions on actual experience.

Ticket Pricing

The Competition Bureau has been actively pursuing companies that do not include all related fees in their upfront pricing (sometimes referred to as "drip pricing"). A lawsuit followed an earlier public statement by the Bureau in which it called on certain ticket vendors to review their marketing practices and display the final price of tickets upfront.

Video Streaming

The Competition Bureau recently issued letters to operators of online video-streaming services in Canada advising them to review their marketing practices and related terms and conditions to follow best practices and comply with law. The letters advised operators to ensure they review their terms and conditions for clarity and transparency.

Astroturfing

The Competition Bureau has warned that "astroturfing," which means the practice of creating commercial representations that pretend to be authentic experiences and opinions of impartial consumers, may be contrary to the deceptive marketing practices provisions of the *Competition Act*. The Bureau has challenged companies engaged in astroturfing to ensure that Canadians can have confidence that consumer user reviews are authentic and to prevent competitors from gaining an illegitimate advantage over each other.



Big Data

The digital economy has been a major focus of the Canadian government over the last several years. Recent initiatives include the creation of the Digital Charter and the issuance of a mandate letter to the Commissioner of Competition by the Federal Minister of Innovation emphasizing the importance of ensuring competitiveness in the digital economy, including by preventing the abuse of big data. Businesses in the entertainment industry should be aware that their digital activities may be the subject of regulation and possible enforcement.

Mergers and Marketing Practices

The Competition Bureau recognizes that big data can have positive effects. For example, platforms with search features can provide more accurate results where those platforms have access to large amounts of data. Conversely, the Bureau also considers big data to be a potential barrier to entry into a market.

Misleading consumers about data collection and use is another form of competitive conduct that the Bureau has flagged as raising the potential for enforcement action. To reduce the risk of enforcement, firms in the entertainment industry should ensure that customers are not misled about the type of data collected, the purposes for which the data is collected, and how the data will be used, maintained and erased.



Privacy

The Canadian Privacy Commissioner is responsible for enforcing federal law regarding businesses' use of personal information in the context of a commercial activity. The Privacy Commissioner's recent activity has included issuing guidelines on the importance of obtaining meaningful consent from consumers for the use of their data and conducting several high-profile investigations into how certain organizations manage users' personal data.

Privacy concerns may also arise in the enforcement of competition law. The Competition Bureau recognizes privacy as an important element of competition in the digital economy, which means the Bureau may consider reductions in consumer privacy as a potential anti-competitive effect in analyzing mergers or competitive practices.

Cybersecurity

The event of a breach of a user's personal information, Canada's federal privacy law requires that businesses provide notice to affected individuals where there is a "real risk of significant harm" and file a report with the Privacy Commissioner. Businesses must also keep a record of any privacy breach within their organization for a period of 24 months after its discovery.

Digital Charter

As part of the Canadian government's strategy for regulating the digital economy, the recently-announced *Digital Charter* lays out the government's basic principles for online governance. Those principles include, among others, the portability and interoperability of user data.



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