

Changing the rules in exhibition and distribution :  
the private-sector approach

# Revitalizing Canadian pay-TV

## Fred Klinkhammer and the First Choice challenge

by Tom Perlmutter

Six months after its September 1984 restructuring and re-launch, Canadian pay-television is enjoying a second life. If there is wide agreement among all concerned that the pre-September '84 Canadian pay-TV experience was a disaster, are things different today? Are the different levels of pay-TV viable propositions in Canada? Have the tensions between pay-television and the cable companies – that is, between the proponents of Canadian movie channels and cable-supported, largely American specialty programming – been resolved satisfactorily? Finally, can the Canadian Radio-television and Telecommunications Commission regulate an orderly marketplace subjected to the destabilizing pressures of rapidly changing communications technology?

In the following Cinema Canada interview, First Choice Communications Corp. president and CEO Frederic Klinkhammer answers an emphatic yes to all of the above. In predicting that within the next decade First Choice could produce more Canadian production than the Canadian Broadcasting Corp. does today, Klinkhammer outlines a novel – and rather different – approach to the familiar dilemmas of Canadian independent production. The changes Klinkhammer would like to introduce are considerable; whether they would be welcomed either by the CRTC or the Canadian production community remains to be seen.

Ontario born and educated, Klinkhammer became First Choice president and CEO on March 1, 1984, and since then has proceeded to redirect, restructure and revitalize the pay network with great effectiveness. A graduate of Ryerson Polytechnical Institute in Business Administration Computer Systems, Klinkhammer has worked in the radio, television and cable industries. A former vice-president, general manager and corporate director of Toronto's Channel Seventynine Ltd., Klinkhammer was also president and CEO of Cablenet Ltd. Canada, U.S. Cablenet Inc., Cablenet Inc. and Cablenet Development Corp. in four Canadian provinces and the U.S. midwest.



**Cinema Canada:** Perhaps we could start with a broad outlook of the state of pay-TV now, some four months after the September relaunch.

**Fred Klinkhammer:** Let's go back to September 1 and follow it through. On September 1 the division of the Canadian marketplace into two distinct segments – one east and one west – was implemented with the Canadian Radio-television and Telecommunications Commission's (CRTC) blessing. Coincidental with that, in the majority of markets a different approach to the consumer was taken by the cable companies, ourselves and the specialty chan-

nels. We introduced the Satisfaction Three-Pack which consisted of the Canadian Sports Network, MuchMusic and First Choice \*Superchannel. So you had a situation where the subscriber ideally was going to get the combined benefit of what had been First Choice and Superchannel from a programming point of view – although our schedules were similar there were some properties we had that they didn't and vice-versa – plus two new services. Based on any research that's ever been done about television viewing habits, movies, news, sports are the predominant things that people need and are also predominantly where viewing falls. So this package

comes together at what had been the previous retail price of \$15.95 in the vast majority of the markets in the country. There are some exceptions to that, but 80% of the cable systems are offering that package at that price. In my view, that changed the offering to the public. We billed it at the time as finally real value. I know that sounds like a cliché but I think it's proven to be the case. What's happened since then is we have experienced about 4,700 net gain per week. We were some 230,000 subscribers at the time. We are some 312,000 subscribers today (early Jan.).

**Cinema Canada:** You're talking about adding 350,000 subscribers in six months.

**Fred Klinkhammer:** We're probably talking about 350,000 before June. That's our cash break-even point. It means we then have positive cash-flow coming from the operations month-to-month without having to put cash into the operation. One caution I have to give you here is that we are talking only of the east now. First Choice operates only in the east and all numbers I give you relate only to eastern operations. Subscriber numbers for the west would have to be added to those.

**Cinema Canada:** Beyond break-even can you give me a sense of what kind of return on investment the company is looking at?

**Fred Klinkhammer:** To be honest, we've not made those determinations because there are a number of things that have to happen first. The first thing is Canadian production and therefore Canadian content must improve. The health of the Canadian production industry is in part dependent upon our health. Our health is in part dependent upon the kind of Canadian content regulations that we have.

**Cinema Canada:** Are you advocating changes to those regulations?

**Fred Klinkhammer:** Significant changes. Not significant philosophically, but significant how-to changes. Right now there is both a time and a budget quota. That might have worked had the monopoly environments proposed at the time been established. All of the applicants, some 13 for the national license, had suggested that those kinds of quotas

and regulations were possible assuming that there was only one licensee in the country and one licensee for a considerable number of years. We did not have that situation. The licensee did not have the negotiating clout south of the border and so costs were considerably higher than they otherwise would have been, and also subscriber bases had not grown because the retail prices had been too high. The biggest stumbling block to pricing at this time is our spending obligations on Canadian content.

**Cinema Canada:** *What changes would you like to see?*

**Fred Klinkhammer:** We're about to file a brief with the CRTC very shortly where we deal with the issue of Canadian content. We propose an entirely new model as to how to meet the original objectives of stimulating a Canadian production industry and insuring that there is quality in Canadian production produced in this country. We have had serious discussions with the cable community about it and with many producers. This will only work if producers, craft unions, and the cable industry all believe in it.

**Cinema Canada:** *What are you going to say in the brief?*

**Fred Klinkhammer:** I can't say. It's still in the draft stages at this point in time and we're still talking with producers about how to best achieve the end. Just to spend a couple of minutes on this: First of all, you have to decide whether those rules are designed primarily as a stimulant to the production industry or whether they are essentially cultural rules. There are some producers who believe they are essentially cultural rules, and some who believe they are essentially a way of stimulating their industry. What everybody agrees on is unless the stream of production is consistent, they can't afford as a production community to have the required overheads for an on-going production operation. Each time they've got a significant project, they've got start-up costs and therefore their overheads are high. If it can be predictable and a fairly steady stream, I think they're better off and I think we're better off and, therefore, the country's better off.

**Cinema Canada:** *Were these issues raised when you applied for revisions to your license last summer?*

**Fred Klinkhammer:** No, they were not.

**Cinema Canada:** *Why not? You were aware of the fact that you were going to be hurt by these continuing Canadian content regulations yet you accepted the regulatory régime.*

**Fred Klinkhammer:** If you go back and look at the press and various hearings that took place at the time prior to our east-west split, the Commission had made it very clear that it felt that the program supplier - us - and the cable operators had not worked together to market the product properly. They had publicly said, 'We think you've failed as marketers and until you can demonstrate to us that you can work together and properly market the product, don't talk to us about any changes. If changes are then subsequently necessary we will keep an open mind.' That was said at the Canadian Cable Television Association (CCTA) convention. It was said at any number of public hearings and any number of conversations that various members of the Commission had with

both the press and individuals.

**Cinema Canada:** *You now feel you've proved your marketing skills and can go back for changes?*

**Fred Klinkhammer:** No question about that.

**Cinema Canada:** *How likely is it that the CRTC will look favourably on changes and how dependent is First Choice on a favourable regulatory outcome?*

**Fred Klinkhammer:** I think providing that the proposal meets the requirements of the Broadcast Act and the objectives of the act, the Commission will be very flexible in its thinking. I think they see themselves as a sort of third party in this - the cable company, ourselves and the regulator - in terms of

**Fred Klinkhammer:** Yes, that much I'm pleased to tell you. The current Broadcast Fund is generated from a six per cent tax on cable revenues, all cable revenues - hardware, plus software, plus us. It is bizarre to say the least that we don't have access to that fund. And yet us and our partner, the cable operator, are the generators of the fund.

**Cinema Canada:** *Do you feel that, given the CBC cutbacks and the danger they represent to the Fund, it makes it imperative for Telefilm to find other broadcast outlets such as pay-TV?*

**Fred Klinkhammer:** I don't think that any changes that have taken place at the CBC impact the level of draw on the Broadcast Fund one bit. I think the Broadcast Fund was originally envisaged

**Cinema Canada:** *Does that mean the CBC will be willing to talk to you about ties?*

**Fred Klinkhammer:** I never predict what somebody else is going to do. I think in some parts of the CBC there's been some movement in their attitude. I think Variety is much more flexible in their thinking than Drama is right now. I think that as time passes the orderly marketplace will indeed evolve. CTV has access to that Fund and frequently is involved in productions that we are also involved in.

**Cinema Canada:** *Is there a particular reason why CBC would want to isolate you?*

**Fred Klinkhammer:** CBC insisted on having first window. How can you be a premium service and take second window?

**Cinema Canada:** *Let me go back to the September relaunch. Why did you go for a split? Why didn't First Choice and Superchannel amalgamate and reap the benefits of economies of scale, elimination of duplication and so on?*

**Fred Klinkhammer:** I guess it was philosophically impossible. I think the principals of both companies wanted to retain their independence. I don't think there was a mutual ground to agree as to who would control. Ideally, it would have been better to amalgamate.

**Cinema Canada:** *Were there discussions at the time about possible amalgamation? What were some of the basic disagreements?*

**Fred Klinkhammer:** Sure, we had discussions. We couldn't agree on who would be the controlling circle and of how the service would be marketed and the approach to the market place.

**Cinema Canada:** *Presumably both companies wanted to achieve maximum penetration.*

**Fred Klinkhammer:** There are stylistic differences in terms of approach. Do we approach the market with a heavy image-oriented campaign or as a merchandiser/retailer with less glitz and more at the street level asking the buying question? There were also philosophical questions as to how to program. Do you use a burst model, a modified burst model or an entirely different one? We could agree on the kind of programming but not how to program it. We couldn't agree on how the product should be marketed. We couldn't agree on who should control the company. I would say there were the three stumbling blocks that prevented an amalgamation.

**Cinema Canada:** *What is the burst model?*

**Fred Klinkhammer:** If you look at a majority of the operators, say the lead operators, HBO and Showtime, they both use what is referred to as a burst model. They run 40 to 42 titles a month - we run double the number. They release all of those titles during the first calendar week of the month and repeat them throughout the month. That's a burst. Bang - here's our month. It's much the same as a commercial broadcaster bursting his new program schedule in the fall and again in the spring. We run double the number of titles and believe in our environment we're better off to release those titles progressively throughout the month so there is at least one new item on air every day.

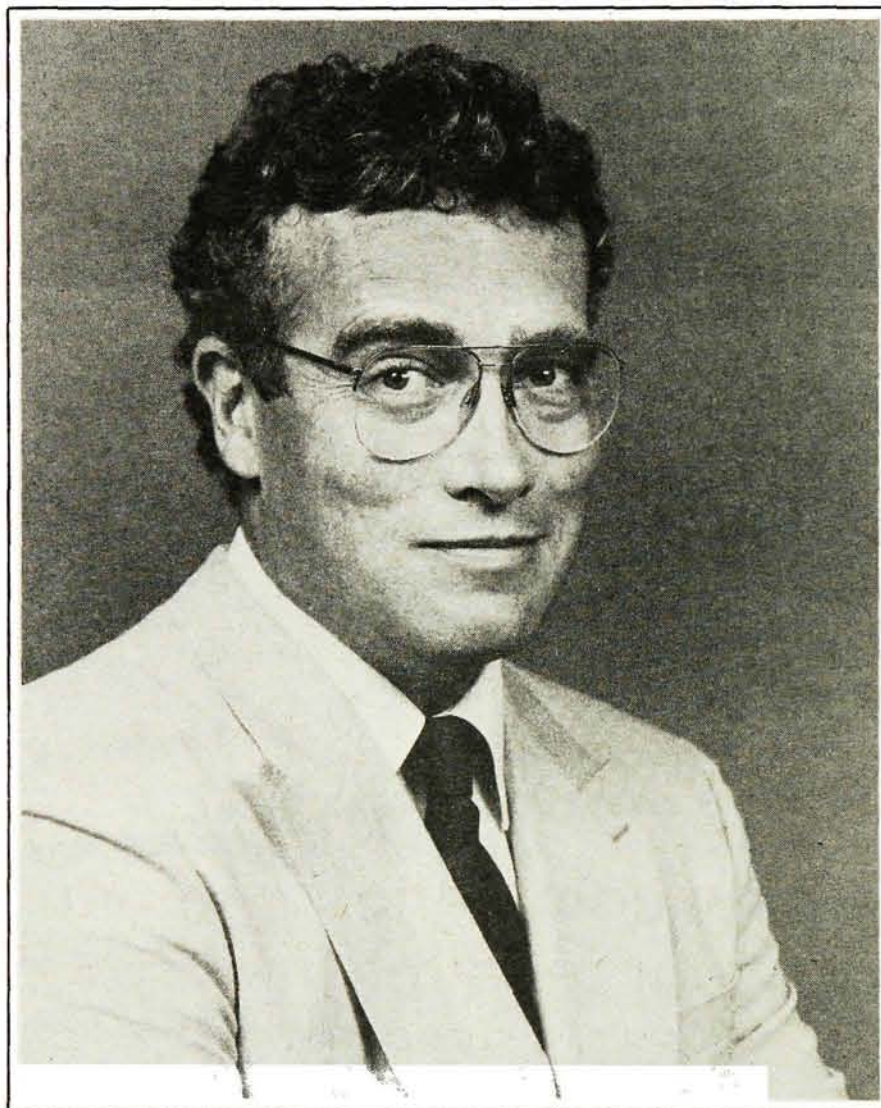


Photo: Patrick Harbron

establishing a mechanism to meet the needs of the Broadcast Act. Otherwise, why not just license HBO?

**Cinema Canada:** *Does First Choice have contingency plans should the CRTC uphold current Canadian content regulations?*

**Fred Klinkhammer:** I think the short answer to that is no. There are no contingency plans. There may well be contingency plans that the cable operator has. As chief executive officer of First Choice, I am so convinced that our proposal is rational and will appeal to the production community, the craft unions and the regulator that a significant and radical change will take place that eases the burden on us but at the same time ends up with more dollars flowing to Canadian production and a higher quality of Canadian production with international appeal.

**Cinema Canada:** *Would part of the proposal involve having access to the Broadcast Fund?*

as stimulating independent productions, not CBC productions. The fact that the CBC has gone through some cutbacks doesn't impact the capacity of the Fund to function.

**Cinema Canada:** *CBC was Telefilm's major matching partner last year.*

**Fred Klinkhammer:** That's not surprising because their drama department also had a rule that said they would not participate in a project if we would participate. In effect, they used their clout to isolate us from the Fund even on a shared basis. We can technically get access to the Fund providing there's a broadcaster - a subsequent window.

**Cinema Canada:** *You've had difficulties there which you now think will be resolved?*

**Fred Klinkhammer:** I predict that we will have direct access to the Fund through a producer, an independent producer, without having to have a tie to a commercial broadcaster.

**Cinema Canada:** You mentioned marketing differences. Can you elaborate?

**Fred Klinkhammer:** We changed from having spent a great number of dollars on image and identity to a marketing method that is very sales-oriented, that always asks the buying question. It is far more retail-oriented. We highlight the product itself rather than the company that offers the product. And we do a great deal of price-point advertising. If you review any of our media you'll find that there's nothing that runs that doesn't mention Three Pack. There's nothing that runs that doesn't say call your cable company now.

**Cinema Canada:** Given the new packaging at relaunch, why didn't you go for a completely revamped image with a new name?

**Fred Klinkhammer:** We intend to in the long run and it will probably change this year. The reason we didn't change it at the time is that we had a look at previous amalgamation of systems, including service operators. Most of this had taken place in the States. Companies had gotten together completely or in joint-ventures or mergers or entered into partnerships or been subject to takeover. Just about any economic model. In every case they lost a proportion of their subscriber base when they changed the name. If they didn't change the name they lost fewer subscribers. Our objective was to retain as much of the subscriber base as possible.

**Cinema Canada:** Weren't you afraid that First Choice had lost a lot of public

credibility the first time round?

**Fred Klinkhammer:** One of the things we know was that people frequently changed from First Choice to Superchannel and back. There was constant movement in the marketplace. So we felt that despite some of the negatives associated with both the names in the initial stages, the common use of both the names would provide the maximum subscriber potential. That certainly appears to be true. It doesn't appear that we've lost any subscribers.

**Cinema Canada:** Do you keep tabs on your subscribers: who they are, what they like to see, and so on?

**Fred Klinkhammer:** One of the beauties we have is that we get constant feedback from the cable companies who are constantly in touch with their subscriber base. We also have a phone room for subscribers and we document every call. We also use Primetime, our viewing guide mailed to all subscribers, as a survey vehicle. We do four surveys a year. We just got the results of one two weeks ago. We asked the people a little bit about themselves demographically. We asked a great deal about what they watch in our survey, how they watch it, when they watch it. We ask them to rate us on a satisfaction level and to make suggestions as to what they'd like to see - from specific title suggestions to types of programming. One of the startling things about the survey is that these people are having to go out and buy stamps, sit down and spend one half-hour to fill out the form and go and mail it. I think we got some 4500 responses to the last one. The next one will go out in March or April.

**Cinema Canada:** What were the results of this survey? What kind of conclusions can you draw from it?

**Fred Klinkhammer:** A great deal of it we've been told before. I guess some of the new information that we learned is that our average subscriber has now been with us much longer than he used to be. That's not surprising based on the cable companies' reporting reduced churn. Over half our subscriber base has now been with us a year without a change.

**Cinema Canada:** What is the demographic profile?

**Fred Klinkhammer:** For a long time it appeared to skew towards blue collar, towards people with middle levels of education, mid-economic strata, quite young in age - early 20s. We've now found that more and more of our subscribers are typical family households: 3.2 children, own their homes, better than high-school education, university or college, in the 25-49 age-bracket. The new subscriber base we acquired this fall is skewing toward more white-collar, more family units than individuals living alone.

**Cinema Canada:** What's the churn rate at the moment?

**Fred Klinkhammer:** That's the one answer I can't give you. I can tell you what I'm told it is. Cable operators tell us that it's running at about five to six percent which is about the same level as it runs on HBO in the States. Keep in mind that we have two to three percent for a gas company or for hydro because

of move rates which are particularly high in urban centres. The cable operators only report their weekly net gain so we don't know how many connections and disconnects they have. There are also a large number of cable operators who can't tell you whether or not they have churn because what they count as a connection is any change to service to a house. They might have added a second outlet, e.g. Arts & Entertainment, to the package and they show that as a disconnect and a churn. But those that can report and are actually able to track (did I lose the subscriber? did I gain the subscriber?) claim that it's a five to six percent. We would expect it would run on average just over six percent. That's our target.

**Cinema Canada:** What do you see as your total potential market? What kind of penetration levels can you expect? Will it go as high as 50 or 60 percent?

**Fred Klinkhammer:** There are 3.2 million raw cable homes in eastern Canada. The reason I say 'raw' is that a large portion of those speak only in French, particularly in the province of Quebec, and therefore are not our target. They are our sister operation's, SuperEcran's, target. Our base is probably 2.5 million. I don't think you'll ever see 50 or 60 percent penetration. We're talking about a premium service that is not for everyone. I think that it's been reasonably demonstrated that any cable operator offering the Three Pack at this time, who is also actively merchandising with us, can get 20% of his market. That's immediate. He can be there today. Some get there quicker, some get there slower. I think that, overall, there's a potential to

A new completion company,  
qualifying your fees for the 75% category  
under the Canadian content regulations

## Film Finances Canada Finances-Films Canada

Pour tous renseignements:  
Michael Spencer, President

1001 DE MAISONNEUVE BLVD. WEST, SUITE 910  
MONTREAL, QUEBEC H3A 3C8  
TELEPHONE: (514) 288-6763

get 40 percent of the overall cabled homes.

**Cinema Canada:** *Over what time-period?*

**Fred Klinkhammer:** That's the interesting question. Over about four additional years. Four years from today we should be about 40%. I want you to understand that that's contingent upon some assumptions. It's contingent upon the fact that there is no competing service licensed or allowed to be imported. It's contingent upon the fact that we are committed to spend substantial dollars on individual Canadian productions so the the quality of the Canadian product comes first.

**Cinema Canada:** *Let's turn to some of the competing services. There has been some speculation that direct broadcast satellites, where the consumer will receive signals directly via a miniaturized dish, pose a threat to pay-TV. There has been concern expressed about pay-per-view, superstations and home video. Can you comment? Let's start with direct broadcast satellites (DBS).*

**Fred Klinkhammer:** The few DBS experiments that have been conducted have failed because you're back to some form of antenna installed in the subscribers' homes and which has to be maintained. You're involved with a high capital cost. You're also involved with reduced availability of channel selection in almost all cases. Because Canada is so heavily cabled and because we've been importing signals not only from south of the border but east and west in this country for a long time, our selection level is higher. A typical DBS system is only capable of carrying four or five channels. It's unlikely that DBS represents a new threat to us. On the contrary, in the long term it presents a new market for us which is the non-cabled rural home.

**Cinema Canada:** *What happens if the CRTC approves distant stations?*

**Fred Klinkhammer:** All of those stations are buying programming coincidental with one of the Toronto operators. So all it is is another viewing opportunity for the same program list.

**Cinema Canada:** *Home video is presumably much more of a threat.*

**Fred Klinkhammer:** Home video did a lot of damage to us initially because it was just coming into its maximum growth period at the same time that we were beginning to market our product. It is now beginning to mature as an industry. It had a big growth last year. It's going to have tremendous growth this year. And it's starting to adopt a very complementary pattern to us. One of the things that our research shows - a piece of research that HBO did - is that if you first acquire your VCR machine you are unlikely to become a premium subscriber in the six-month period following purchase. After that you're highly likely to, because we represent an opportunity for you to create your own library and to time-shift programs so that you can watch them at more convenient times. Statistically if you look at VCR penetration in the country, you are twice as likely to be a subscriber of ours if you have a VCR machine than if you don't because the two are directly complementary. That's the pattern that's now starting to appear in the States. So during the initial period of VCR ownership, home video represents a threat.

After the six-month period it doubles the chances, the probability that you'll become a premium TV subscriber.

**Cinema Canada:** *You're saying VCRs are going to boost premium TV?*

**Fred Klinkhammer:** We, in fact, have a promotion with one of the large VCR manufacturers, which I can't name at this point in time, where their product and ours will be promoted in a complementary and common way very shortly. Next fall.

**Cinema Canada:** *Are you going to run into problems with the people you're purchasing programs from if you do this promotion?*

**Fred Klinkhammer:** We cannot and will not encourage people to record programs.

**Cinema Canada:** *But implicitly you are.*

**Fred Klinkhammer:** No, we're not. In the States there's been a copyright rule that you are free to record a program for your own use. Our copyright provisions have recently been tabled in the House of Commons. We'll see some clarification.

**Cinema Canada:** *Isn't the likelihood of copying going to lead to higher prices for First Choice for programs? And won't there be competition for programs with video?*

**Fred Klinkhammer:** There will always be some form of video marketplace. There's an orderly market: theatres, home video and us. It's controlled by the studios. The pattern is almost 100 percent predictable. It goes to the theatres. After the theatrical release; in fact towards the end of the theatrical release, it goes to home video. Six months following that it comes to pay-TV. There are always exceptions to this. The odd exception will be where - *Raiders* is a good example - a film does not go to video or pay because the intention is to re-release it. *Raiders* was re-released this past summer, then it went to home video and three months later it came to us.

**Cinema Canada:** *Have you been able to renegotiate for better prices for programs since the split into regional monopolies? Are you being squeezed on pricing?*

**Fred Klinkhammer:** We haven't had an impact there yet because most of the contracts we and Superchannel had were offered separately and competitively. They were five-year deals with all of the studios. The split will have an impact when renewal time comes along because First Choice and Superchannel will be able to negotiate together. For the core of our product, ourselves and Superchannel, we have an output deal with each of the major studios for virtually all of their product.

**Cinema Canada:** *Is that onerous given the fact that the contracts were negotiated on a competitive basis?*

**Fred Klinkhammer:** They are onerous in terms of cost, not in terms of product. They give us a guaranteed stream of top-quality product.

**Cinema Canada:** *How heavy a burden are those costs for First Choice?*

**Fred Klinkhammer:** Virtually all ongoing costs are a product of the negotiations that occurred in the early days

of the competitive model and are higher than they otherwise would be and they're higher than they will be in the future. Perhaps it's not onerous, but it's an unnecessary burden. It means that our costs today are higher than they will be in the future.

**Cinema Canada:** *Let me raise the question of relations with the cable companies. In the past we've had a lot of quarrelling between pay-TV and the cable operators. Is the tension still there?*

**Fred Klinkhammer:** I don't think there's the acrimony there may have been at one time. I still don't feel that the relationship is as close as it could be. I see it as a partnership relationship with them being the merchandiser and us the promoter of the product. I think there are still a number of individuals in the cable community that see the program-supply business and therefore the licensing of a premium service in this country as rightfully their domain. Only time will cause that to change.

**Cinema Canada:** *My sense is that there is a certain ambiguity on the part of the cable companies with respect to the movie channel. There's talk about the possibility that the specialty channels forming part of the basic cable package. That would threaten the whole basis of your present marketing of pay-TV.*

**Fred Klinkhammer:** The cable community has made itself very clear at any number of public hearings that it sees the specialty channels supporting and supplementary to the movie channel. They've made specific on-the-record commitments to use the importation of the American specialty channels as value-enhancement to the Canadian specialties and the Canadian movie service. I spent a long time with the cable industry and leaders in the industry have made some very specific commitments. I never found them to be people who don't keep their commitments.

**Cinema Canada:** *Cable is also looking into the possibility of introducing pay-per-view which they say should be controlled by them. A pay-per-view service would have access to movies simultaneously with theatrical release. It will also broadcast special sporting and other events. This seems to pose a direct threat to the movie channel.*

**Fred Klinkhammer:** Pay-per-view is an area where the cable operators and ourselves have to agree to disagree. Our view is going to be that pay-per-view rightfully falls into our domain, not theirs. They are the carriers, not the originators of the product. The fact of the matter is that pay-per-view is an impractical event in this country. It makes it virtually impossible for the government to use broadcast licensing as a cultural tool because it's like a theatre. How do you have Canadian content rules on pay-per-view? In addition to that, the technology is so complex. Ted Rogers leads the way. He will tell you that he has a pay-per-view capable box and it is, to a degree. I've had first-hand experience with it in Chicago. But it's not pay-per-view the way it needs to be done. This one needs a phone conversation or at least a phone-call to be made to initiate computer contact with the box. Any pay-per-view experiment that's been done shows over 50 percent of orders are placed within the last two hours before the pay-per-view event. Over 90 percent are placed within the last four days. Until

the order mechanism can be done on a real-time basis without human interference by touching a key pad on the box, you don't have a viable pay-per-view system. The capital cost of that key pad-or extra-box is so prohibitively high that, although you can demonstrate pay-per-view here and do it for very special items that are planned well in advance, you can't do it as an ongoing, day-to-day business. The easiest interim step would be to do it from a telephone touch-tone which will drive the box.

**Cinema Canada:** *Given technological advances and the probability of significant reductions in capital cost, it will be up to the CRTC to decide who will actually control it.*

**Fred Klinkhammer:** I'm sure that we will compete for that license aggressively and I'm sure that the cable operator will compete for that license aggressively. Maybe by the time the technological advances come along to make it realistically possible, relationships between the cable companies and ourselves will be so good that we'll be able to do it as a partnership, a true partnership.

**Cinema Canada:** *Are there any difficulties with the cable companies over revenue split?*

**Fred Klinkhammer:** At the moment we get about 55 percent of the retail price and 45 percent for the cable operator. In the States the split is about 50-50. I don't believe it should be a split in revenue expressed as a percentage. I think the cable company has certain costs involved in providing service and they should be compensated for their costs plus a reasonable return on investment. They are the retailers of the product.

**Cinema Canada:** *Are you saying that they should be operating on a cost-plus basis?*

**Fred Klinkhammer:** I'm saying that their portion of the revenue should be fixed by the marketplace in terms of what the retailer's prepared to pay and that they should be chasing aggregate income from subscriptions rather than per subscriber income. My whole argument to them is that they have to think of themselves as a retailer and that therefore they have to think in terms of volume. They can't think in terms of, say, at 10 percent penetration I should be making a significant sum of money. They should be saying at 40 percent I could be making a lot of money.

**Cinema Canada:** *Where's the difference between your thinking and theirs?*

**Fred Klinkhammer:** I think that because most of the cable operators in Canada have had experience in the States, they are not aware there is a third partner, the third partner being the Canadian people. Most HBO contracts say we are entitled to such-and-such a rate or 50% of your retail price, whichever is greater. That's a typical arrangement in the States which generally works out to about a 50/50 split. In Canada there's a third party, the Canadian public as represented by the CRTC, that says a portion of the gross subscriber fee must be reinvested in the Canadian production industry. I think the cable industry and ourselves should share on about a 50/50 basis after the third partner has had his.

**Cinema Canada:** *The CRTC requires you to pay for programming that you*

may not want, but a portion of that programming you would have purchased anyways and is part of your ordinary cost of operations. Aren't you in effect suggesting that the cable companies carry the burden of some of your operating costs?

**Fred Klinkhammer:** No, I'm not. In the States when he has a deal with HBO, he's getting roughly 42 movies a month. Canada is getting 83. Before we even introduce Canadian programs on our schedule, we carry more than HBO and Showtime combined. Canadian product is introduced on top of that. That makes for a higher wholesale cost to us and therefore a higher wholesale cost from us to the cable operators and a higher retail price to the end-consumer, because there is a third party.

**Cinema Canada:** Are you suggesting that, without the third party, you wouldn't be carrying Canadian programming because you'd have your schedules filled with the 82/83 shows you mentioned?

**Fred Klinkhammer:** Well, I wouldn't personally because I'm an intense nationalist. But I would say that if there had been no regulation you probably would have ended up with an HBO model in this country and that kind of pricing, \$10.95 retail.

**Cinema Canada:** Why are you carrying double the product of the American pay networks?

**Fred Klinkhammer:** The market place in Canada is different. We've always had more choice and more programs available in Canada than they have south of the border.

**Cinema Canada:** So without the 80-odd shows you wouldn't achieve your targeted penetration?

**Fred Klinkhammer:** That's right. Also you must remember that cable and premium services were sold coincidentally and in the States the multi-pay home is very high. A subscriber will frequently have HBO and Showtime. We provide those two services as a single service. That's what it amounts to.

**Cinema Canada:** The cable companies don't accept your notion of the third party and the way revenues should be split. What does that do for your relationship?

**Fred Klinkhammer:** The relationship was very difficult at the beginning because the cable operator had been a competitive bidder for a license. It then became even more difficult as time passed because there were obviously acrimonious negotiations that took place where the cable operator was the only source of outlet for the product and he could play one of the premium service-suppliers against the other. That aggravated the situation. Then when things did not turn out as everyone had anticipated, blame had to be attributed. It's the natural environment. And everybody tends to blame the other guy. What's changing is that we now have a successful product on the market place and so we're sharing with the cable operators the laurels that come with that success. That has brought us closer together.

**Cinema Canada:** Is the revenue question going to be a continuing source of contention?

**Fred Klinkhammer:** No, because I think it has been essentially resolved at this point. We're at 54/46. That's close to 50/50. I don't think it's so far away that they're particularly distressed about it.

**Cinema Canada:** But you still would like them to see things in a different way?

**Fred Klinkhammer:** I think I'd like them to have, and I really think the onus falls on us to demonstrate this to them, an understanding that they are the only broadcast licensee in the country that does not have direct obligations to Canadian culture and Canadian identity—direct economic obligations.

**Cinema Canada:** There is the six percent levy.

**Fred Klinkhammer:** That levy is not on them. That levy is on the subscribers. That's not an indirect tax. That's a direct tax that's added onto the bill after their fee. That levy is on the Canadian public. It's not on us and it's not on them.

**Cinema Canada:** So you're saying they have no direct economic burden and you have which you would like them to share?

**Fred Klinkhammer:** I think I may have gotten you a little confused here. As a cable operator, a Canadian cable operator, which I was, you look and you say, gee, if I could sell this product at \$10.95 which I can sell HBO and if I imported it into this country, I'd have 30% penetration. Why can't your price be that? That's how I would think when I was a cable operator. That's how the majority of my friends and colleagues in

the business think because they don't understand the impact of the spending rules. They don't understand that there really is a third party involved here. There is someone else taking a piece of the action.

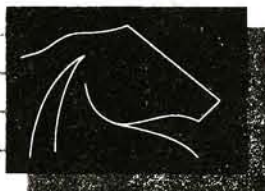
**Cinema Canada:** Will you become involved in production?

**Fred Klinkhammer:** We will not be involved in the licensing of new production until we have positive cash-flow and we cannot be involved until it can be placed properly. We don't want to be involved in low-budget efforts. There is a change in the whole environment. Imagine a producer comes to us with a project we're excited about. It's a higher level of product. We can come to the table as an investor, as accessor to the Broadcast Fund, and, because of our clout south of the border, can bring HBO to the table. The whole way productions take place in this country will change in less than two years.

**Cinema Canada:** What are your goals for the company?

**Fred Klinkhammer:** We all want to make a lot of money. I also want to make a Canadian contribution. I left a multinational specifically to go to a Canadian company. The day will come when First Choice is a larger contributor to Canadian production than the CBC. The day will come when it will be recognized that Canadian production must have international appeal. If we have steady production, then the cultural mandate automatically follows. It's going to take 10 years. The coming 10 years are going to be very dramatic. I'm very excited about it.

Alberta Motion Picture



Development Corporation

## A CORPORATION FUNDED BY THE GOVERNMENT OF ALBERTA, CANADA TO STIMULATE THE GROWTH OF AN INDUSTRY

### 33 MOTION PICTURES NOW IN DEVELOPMENT

Established just two years ago to assist the promotion of the Alberta commercial Film and Video Industry, the AMPDC, through a loan fund, is assisting in the development of 20 features, 8 television series and movies, and 5 docu-dramas with production budgets totalling \$75 million. Five such projects are completed and in distribution with four to six more slated for 1985.

The industry is responding! Producers, talent, craft, and technicians are set for successful film and video production here. Solidifying more links with financial and marketing sources is now the goal. If that's you, be it in sales, licenses, distribution guarantees, co-productions or investments, we think you would be interested in hearing more about these developing projects, the industry otherwise in Alberta, and the Alberta Motion Picture Development Corporation.

FOR MORE INFORMATION, PLEASE CONTACT LORNE W. MacPHERSON, PRESIDENT.  
P.O. BOX 1740, CANMORE, ALBERTA T0L 0M0 (403) 678-2525