

Can Legendary Entertainment Bypass China's Film Quota System?

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Getty Images

Wanda's billionaire chairman, Wang Jialin

In the wake of Dalian Wanda Group's \$3.5 billion acquisition of Thomas Tull's studio, the high-stakes political maneuvering in Beijing is gathering steam.

When Chinese real estate and investment conglomerate Dalian Wanda Group acquired Thomas Tull's Legendary Entertainment for \$3.5 billion in January, many thorny questions came to the fore.

For the first time ever, a Chinese company — one headed by China's richest man, Wang Jianlin, no less — had come to own a U.S. film company that has backed several international blockbusters, with a track record that included such hits as *Godzilla*, *Pacific Rim* and *Jurassic World*.

Sizing up ensued: Was Wanda the latest dumb money to airdrop cash into Tinseltown, or was it up to something far more sophisticated? (The latter, it turns out: Wanda managed to offset most of the cost of Legendary in a matter

of weeks, flipping the studio to Chinese investors in a share offering that raised \$2.4 billion).

Meanwhile, Wanda continued expanding its already sprawling global movie theater network, merging U.S.-based Carmike Cinemas with AMC Entertainment in a \$1.1 billion all-cash deal (which still needs FTC approval) that will create the largest cinema chain on the planet, spanning North America, China and Oceania. No company has ever held so many screens in so many places. Again, what was Wanda's strategy?

Above all, many wondered whether these watershed moments signaled that 2016 would finally be the year when the deals between Hollywood and China begin to flow in earnest, after so many false starts in the past. (Thus far, that has indeed been the case: Weeks later, China's Perfect World Pictures invested \$250 million into Universal's film slate, Hangzhou-based Film Carnival poured \$500 million into former Disney chairman Dick Cook's startup studio; and Joe and Anthony Russo, the directing duo behind Marvel's *Captain America* franchise, launched boutique studio Anthem & Song with an estimated \$200 million to \$300 million in Chinese financing.)

Still, despite all of the speculation and cross-border hubbub, sources in Beijing tell *The Hollywood Reporter* that one crucial question has yet to be addressed: Now that Legendary is nominally a Chinese company, how will the Chinese government treat the studio's movies? Is Legendary now American or Chinese?

"Wanda is going to try to make a strong case that Legendary's movies should be classified as Chinese from now on," one senior Chinese film executive told *THR* in Beijing, asking not to be named due to the sensitivity of discussing policy matters.

If China's film regulators are unwilling to go so far, Wanda probably will try to negotiate other concessions on behalf of Legendary, the exec suggested.

"That's how I would play it — open strong, then work towards the middle, maybe better treatment for some movies but not all," he added.

Both Wanda and Legendary declined to comment.

While wonky on the surface, the question of classification could have game-changing implications for both Hollywood and the Chinese industry, insiders say.

The Chinese box office grew 50 percent in the first quarter of 2016, and it is expected to surpass North America as the world's largest film market sometime next year.

In an effort to nurture its domestic industry while dampening Western cultural influence, China limits Hollywood's market access with a notoriously strict quota system, which allows just 34 foreign films into Chinese theaters on revenue-sharing terms each year. The authorities also institute blackouts on foreign imports during the most lucrative moviegoing weeks of the year, over the summer, fall and winter holidays, giving local pictures an uncontested run at cinemas. Local movies also take close to 50 percent of box office, whereas Hollywood's share is limited to 25 percent under the quota system.

"Wanda, like any studio in a similar position would, will of course attempt to get this better treatment [for Legendary]," said Peter Schloss, CEO of CastleHill Partners, a Beijing-based specialist merchant bank focusing on media, sports and entertainment.

"It will be especially fascinating to see what the Chinese government response would be," added Lindsay Conner, a partner at Manatt, Phelps & Phillips, LLP Entertainment, who represented Beijing-based Perfect World Pictures in its \$250 million slate deal with Universal. "This is the first time a significant Western film production company has had Chinese ownership and that has the potential to be a game changer," he said.

The situation presents China with an unprecedented dilemma, pitching two of its key policy goals in conflict.

On the one hand, granting Chinese status to Legendary's movies would provide a strong incentive within the local industry for the Chinese takeover of film companies abroad. But it would also create a de facto expansion of the quota on Western movies allowed into the country, given that most of the movies Legendary has in the pipeline — with one notable exception (more on this below) — are Hollywood through and through.

"How the government responds will provide some indication of what it regards as the greater priority," Conner explained. "Is it more important to build China as a force in the global film industry, or is it more important to limit and regulate the number of Western films that are allowed into the country each year?"

"It's the classic double-edged sword, but in this case it's wielded by a powerful Chinese media company," he added.

Increasing Chinese soft power abroad is one of Beijing's highest-level policy priorities, and the failure of Chinese films internationally has been a disappointment to both the leadership and the local industry. Since its release in February, Stephen Chow's fantasy blockbuster *The Mermaid* has grossed a record-smashing \$525.8 million in China, while earning just \$3.2 million in North America. Other Chinese hits have fared considerably worse overseas. Last

month, Chinese officials announced a scheme to offer any local film that can make more than 1 million yuan (\$150,000) abroad a cash rebate of 1 percent of total foreign box office.

Legendary's upcoming films, even if they flop spectacularly by Hollywood standards, are all but certain to make vastly more money in the international marketplace than Chinese films have in recent years. But classifying Legendary movies as Chinese only adds yet another layer of complication to the macro policy picture.

"On paper, this may allow them to say that 'Chinese' films are doing well overseas, but it's not clear how a movie like *Jurassic World* or *Godzilla* actually helps Chinese soft power," said Stanley Rosen, a professor of political science at the University of Southern California who studies China's film industry. "It will seem like they are making a concession to Western culture, when their goals are to do just the opposite."

"The temptation would be to put more Chinese elements into the films, and get them approved as co-productions," Rosen explained. "The danger there," he added, "is whether they will still be successful globally — how much Chinese content can you put in there and still get the international market?"

Long before Wanda came calling, Legendary was already exploring the China co-production angles under its Asia-focused Legendary East shingle, set up in 2011 and headed by Peter Loehr, former managing director of CAA China.

The studio's long-gestating debut China co-prod, *The Great Wall*, is finally set for worldwide release on Feb. 17, 2017 (it was originally slated for release on Nov. 23). Financed and produced by Legendary, Beijing-based LeVision Pictures and the state-backed film colossus, China Film Group, the big-budget fantasy action feature is directed by Zhang Yimou and stars Matt Damon, Willem Dafoe, Hong Kong's Andy Lau, Jing Tian, Luhan, Pedro Pascal and others. Set in the Northern Song Dynasty, the story explores a set of mysteries surrounding the Great Wall of China.

"*The Great Wall* will be a very important test case," Rosen said, "because it does have a lot of Chinese content — it features the Great Wall, a cherished symbol of China around the world — and it also has Hollywood actors, English dialogue and the potential to be an international hit."

Come 2017, you can bet that both the international film community and the Chinese government will be carefully weighing the film's credibility and performance — albeit according to very different metrics.

In recent years, Chinese regulators have been strict about ensuring that co-productions meet the full criteria of the official classification, which requires substantial Chinese content and story elements, along with a cast and crew that is at least 30 percent Chinese — including in lead roles. With the official co-production stamp of approval come all of the benefits extended to local Chinese films, including a 43 percent share of Chinese box office instead of the usual 25 percent Hollywood takes.

Most of the industry sources *THR* consulted, both in China and Hollywood, said they think it is unlikely that Wanda will succeed in getting regulators to treat Legendary films as fully "Chinese" for import purposes.

With the opening gambit closed, Wanda is expected to pursue middle ground concessions, as the Beijing executive suggested.

"China may be willing to bend the rules on co-production status, if [Wanda and Legendary] move partway towards some of the guidelines," agreed Rosen.

And even if Legendary deems that adding too much China content to its tentpoles will hurt them globally — at least for now — there are plenty of additional ways in which Wanda will wield its heft and local savvy to the benefit of Legendary in the booming Chinese home market. For one, the conglomerate owns China's largest movie theater network, guaranteeing a big splash on a huge number of screens for any Legendary release. Wanda also owns one of China's largest distributors, Wuzhou Film Distribution, which will presumably work its relationships with China Film Group to secure desirable release dates and plenty of lead time for marketing Legendary's movies online and on the ground in China — something the Hollywood studios have long craved.

"There's also the issue of the highly competitive and political process of securing one of only 34 revenue sharing slots for the calendar year," noted Rance Pow, president of the Shanghai-based cinema consulting firm Artisan Gateway.

Regardless of whether Legendary remains a Western company in the eyes of the authorities, with Wanda at the negotiating table, there's a good chance the studio will be able to snag an extra quota slot each year in China's bruising, zero-sum film import sweepstakes.

"That would certainly be a benefit that could not have been achieved otherwise," said Conner.