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The Future of Film Distribution and Exhibition

Janet Wasko

The Internet is revolutionizing TV and motion pictures.

Mayra Langdon Fleisman, Film Scouts¹

You have to open your eyes, and your vision has to encompass the whole picture. You really have to feel it ... movies, television, DVD, Internet. It's all the same thing, just different configurations ... It's an incredible landscape.

Quincy Jones, musician and film producer²

E-cinema is possibly the greatest revolution since Al Jolson opened his mouth on screen.

Patrick von Sychowski, *Screen Digest*³

Even though there is much ado over the Internet and digital media, models of distribution and exhibition for new media forms are still somewhat unclear. Although the future is 'blurred and murky', and the risks of speculating are well known, that does not stop many media observers from engaging in rampant crystal-ball gazing and exuberant predictions.

Rather than being swept into what Vincent Mosco has called 'the near religious transcendence' of cyberspace,⁴ it is important to look at what is actually changing, what may change in the future and what may also remain the same because of the political economic context in which these changes are taking place. While predicting new models of distribution for the wide range of new media is a formidable and somewhat perilous task, this chapter will be limited to speculation about future distribution and exhibition models for films. More specifically, it will focus on the commercial film industry in the US, otherwise known as Hollywood. In addition, the focus is mostly on the US market, even though Hollywood companies are all part of transnational conglomerates for which the global entertainment market is increasingly important.

While it is tricky to sort out the various technologies that may be involved and how they may evolve, the following sections will explore unfolding developments in film distribution via video-on-demand (VOD), utilising the Internet, cable, and telephone lines or digital

subscriber line (DSL), followed by an overview of digital cinemas or e-cinema. As the evolution of these developments is guided not only by the technology itself, but also by more general economic and political tendencies, some of this discussion may well provide clues as to how the distribution of other forms of new media may evolve.

It also should be noted that some of the projects or systems discussed might be gone by the time this chapter appears in print. Some of the claims should also be considered 'forward-looking statements', a term that US regulatory agencies require corporations to use when speculating about expected future business.⁵

VIDEO-ON-DEMAND: INTERNET

Some of the excitement over the Internet has been prompted by the possibilities for distributing new and interesting entertainment forms. Currently, short films and some independent feature films are distributed via the Internet at sites such as *Atomfilms*, *iFilm.com*, *CinemaNow*, *CinemaPop* and *Hypnotic*. Of course, Hollywood has always looked to such independent and experimental alternatives for innovative ideas, and, these days, everyone seems to be looking for the next *Blair Witch Project* (1999). Nevertheless, the major Hollywood companies mostly have been unsuccessful in developing Internet sites with new content.⁶

Another possibility is the direct release of feature films via the Internet. On 5 May 2000, *SightSound.com* released *The Quantum Project*, billed as the 'first direct-to-Internet movie', with a \$3 million budget which allowed for known actors and relatively high production values. Still, major Hollywood films continue to be released first in cinemas, with little discussion of changing this release pattern.

Hollywood seems mostly concerned with the Internet as an additional outlet for the distribution of films some time after they have appeared in cinemas. In March 2001, Motion Picture Association of America (MPAA) head Jack Valenti announced that, within a year, Hollywood features would be available to download from the Internet. 'The studios have a history of watching, waiting and studying. They would have preferred to be able to do that, but the experience with Napster has told them that option is not available,' says Skip Paul, a former Universal executive who is now chairman of *iFilm.com*.⁷

Even though the studios are reported to be formulating serious Internet strategies as of Summer 2003, it is still unclear how the online distribution of Hollywood films will unfold. Several scenarios were possible: independent sites or middlemen, each major with its own site, one site for all majors, or several jointly owned sites.

The only option that does not seem likely is one jointly owned channel, because of obvious antitrust violations.⁸ While many may consider the distributors' ownership of any exhibition outlets to be problematic, it seems likely that the majors will gather more additional revenues from distribution to a number of different sites after issues of control are settled, as will be discussed below. A few examples of existing services or plans for future sites will be discussed briefly in the next sections.

EXAMPLE: INDEPENDENT SITE

SightSound Technologies is a six-year-old company that claims to have rented the first full-length film downloaded over the Internet in 1999. In January 2001, the service also offered Miramax's 1999 feature film *Guinevere* to be downloaded (not streamed) for a 24-hour viewing licence at \$3.49. The claim is that it was the first Hollywood film offered online in a legal, non-pirated way.⁹ The Disney-owned Miramax also made a deal to offer 12 full-length features on *SightSound.com*, which offers other films (mostly pornography and cheap independent films) for downloading.

During the summer of 2001, the company appeared to be struggling to stay afloat, cutting its workforce and complaining that: 'For the last ten years, the major motion picture studios and the major record labels have maintained an unnatural prohibition with their content on the Internet. And it is their unwillingness to utilise this new and useful way to distribute movies and music that has forced *SightSound Technologies* to where it is today.'¹⁰

EXAMPLE: MAJOR STUDIO-OWNED SITE

In August 2001, five of the major studios announced plans for a joint on-demand service that would offer old and new releases for broadband Internet users in the US. The participants included MGM, Paramount, Universal, Warner Bros. and Sony. The site was likely to be a version of Sony's *Moviefly* (but using another name), and planned to allow viewers to browse a 'virtual' video store, look at the front and back of the 'box', and view film stills. Anti-piracy software, or Digital Rights Management (DRM), was to employ codes to prevent unauthorised copying.¹¹ Significantly, Disney and Fox were not part of the alliance, but were said to be considering a joint project offering their films to Internet customers.

Beyond the antitrust implications of such arrangements, other complications involve the major studios' corporate connections with cable and video companies. For example, Paramount's online activities could run into conflict with sister company, Blockbuster, as would Warner Bros. with Time Warner's cable operations and AOL's online and television ventures.

EXAMPLE: MINOR STUDIO-OWNED SITE

CinemaNow started streaming independent films both for free and for a fee in November 1999. The site is partly owned by Lions Gate Entertainment, but also has received funding from Microsoft and Blockbuster. *CinemaNow* offers fee-based films in their traditional pay-per-view window and a subscription service. In June 2001, *hollywood.com* joined *CinemaNow*, which offers pay-per-view films for \$2.99 each, available for streaming at any time during a 48-hour window from the time of purchase. *CinemaNow's* library includes more than 1000 films, mostly from independent companies (see plate 09).

INTERNET ISSUES

While the Internet continues to attract a good deal of attention, technological and economic questions remain. The technology has developed rapidly, with broadband

Internet connections and compression technology making it possible to transmit large amounts of data relatively quickly. According to the US General Accounting Office, more than 100 million Americans are online in some way; however, only about 12 per cent have high-speed or broadband access. Thus, for most people, receiving feature films via computers is still a relatively slow and cumbersome option and will remain so for the near future. For example, several reporters reported numerous obstacles before managing to download *Guinevere* when it became available in early 2001. One writer reported that, even at optimum speed, it took approximately 24 hours for the actual download to take place. Another noted that, 'Watching a film ... while leaning forward staring at a computer isn't exactly a bring-out-the-popcorn kind of experience. Fifteen minutes into the film I gave up and took my dog for a walk.'¹²

Besides the gnawing question of whether there are enough people who will pay to watch movies on computers, the other pressing issue, of course, is piracy. In a world where digital copies of films do not deteriorate with each copy, Hollywood is obviously concerned that digital pirates can easily produce huge quantities of copies, quickly, inexpensively and from anywhere. With the industry already claiming a \$2 billion loss from the piracy of audiovisual products, digitised versions of Hollywood films present serious problems.

One estimate is that Hollywood films are traded online nearly 500,000 times each day from hundreds of sites. MediaForce, an online company that tracks pirated digital content, claimed that a million pirated downloads occurred during the month of June 2001, including box-office hits such as *Lara Croft: Tomb Raider*, *Shrek* and *Pearl Harbor*.

The industry's anti-piracy efforts are led by the MPAA, which is working on political solutions, trying to convince governments to enact strong legal protections, such as the Digital Millennium Copyright Act of 1998. Like the music labels, the studios have chosen to challenge piracy first in court. The industry took on CraveTV, an online re-broadcaster based in Canada, and RecordTV, an online video recorder made available to the public by a company based in Agoura Hills, California. It then crippled Scour Exchange, which went bankrupt within months of a suit being served.

In January 2000, the major Hollywood studios won an important battle when a US District Court found in their favour in a case that challenged the public posting of programming code that makes it easy to copy DVD movies. Most Hollywood movies on DVD include CSS (Content Scramble System), which has been used since 1996. With the code breaking system, called DeCSS (Decrypt the Content Scramble System), DVDs can be played on any system. The code was published in 2600: *The Hacker Quarterly*, considered the bible of hacker publications, and posted on its Web site (www.2600.com). One report summarised up the court's decision on the case, noting that, 'The trial was a rout. The US District Court judge ruled in favor of the eight studios on every point.'¹³

While technological issues ultimately may be sorted out, with some obvious help from the government, there are still economic questions to be answered. A major concern is how to profit from this new form of distribution. While other distribution outlets have provided additional profits with little added costs (for example, television, cable, videocassettes,

DVD, and so on), Internet distribution may be different. Content providers, such as the major film studios, may have to pay per-stream licensing costs to software companies such as RealNetworks or QuickTime so that customers can view videos, as well as per-stream charges to Internet service providers such as AT&T. As one analyst recently explained, 'The early model for broadband has been TV. But broadband is exactly the opposite of the broadcast world. Your costs go up as your audience grows.'¹⁴

This also explains why advertising may not be included. The size of audience needed to support advertising may not be possible without prohibitive costs.¹⁵ However, other analysts assume that the major film studios will solve these issues by distributing their films from their own servers, with relatively low distribution costs.¹⁶

If revenues are forthcoming from some kind of Internet distribution, other questions remain about the timing, or 'window', of a film's Internet release, and whether ultimately it will replace video and/or pay-TV. Rights to Internet distribution will have to be negotiated, especially for past films where such rights have not been imagined, much less specified. These include issues relating to territory, as well as payments to talent and licensors.¹⁷ Certainly, Internet distribution rights will have to become an essential part of Hollywood deals, if they are not already.

OTHER INTERNET USES

While the Hollywood majors are fighting digital pirates and sorting out ways to officially distribute their wares via the Internet, they also are using the technology in other ways. In addition to sites that offer industry news and information, all of the majors have Web sites that promote their various businesses, as well as sites for individual films. Currently, the Internet could be thought of as 'just another medium to market in, like print, radio, theater and television'.¹⁸

After all, the technology offers new possibilities for 'one-to-one marketing', using databases of moviegoers with preferences and profiles, and targeted e-mail promotions. The sites also can be used to 'build communities'. An example: Sony TriStar's *Starship Troopers* site featured 'Mobile Infantry' that users could employ to join the battle against the giant alien bugs, while Trooper ID screens provided links to other users' sites. The *Starship* site had attracted over 30,000 users by Summer 2000, thus providing free promotion for the film. By 1997, 40 per cent of the movie sites online had interactive attributes, such as games or quizzes, and 30 per cent had community features.¹⁹

VIDEO-ON-DEMAND (VOD): CABLE

Some commentators believe that the majors would prefer an Internet/television combination, moving from a personal computer platform to a television-like platform. In other words, they would prefer getting the potatoes back to the couch for 'lean back' rather than 'lean forward' technologies. A television setting, with more sophisticated remote control devices and interactive electronic television programme guides, will allow not only films to be delivered on demand, but pizza and other merchandise as well.

VOD revenue is predicted to be \$192 million for 2001 and to increase to \$4.75 billion by 2005. Enthusiasts predict that VOD households will reach 27.8 million by 2005. However, these estimates are made with the assumption that these services will be able to offer Hollywood films.²⁰ If 44 million homes are using VOD by 2010, the market may be worth anywhere from \$2 billion to \$6 billion a year. One report estimates that at least \$1 billion in additional revenues may be forthcoming for the studios, which generally get about 50 per cent of pay-per-view revenues from cable and satellite companies.²¹

But VOD delivered by cable is also dependent on the huge multiple-system operators (MSOs), such as Time Warner Cable, Insight Communications, Cox and Comcast. Also involved are the companies producing the technology that will aggregate and store the content, companies such as Concurrent, Demand Video, DVA, nCUBE and SeaChange. When VOD on cable finally takes off, sales for such equipment is expected to reach \$1-2 billion per year within the next five years.

One of the services that could become a major player is iN Demand, the industry pay-per-view consortium owned by AT&T, Time Warner and Comcast, the three largest cable operators in the US. However, cable systems are also developing their own VOD services.

Another version of film distribution via cable is subscription VOD (or SVOD). For a single monthly fee, usually between \$6 and \$10 above basic subscription fees, subscribers have access to a list of titles that change every month. The movies are available during the usual pay-TV window. Early efforts to implement a version of SVOD included HBO and Time Warner's Full Service Network (FSN) trial in Orlando, Florida, in the early 1990s, and Viacom's Showtime Anytime, tested in Castro Valley, California, in 1993. The services experienced technical and economic challenges, but have contributed important consumer research and business modelling for these companies' current plans.

HBO is testing an SVOD service called HBO On Demand, in Columbia, South Carolina, which allows subscribers to watch original HBO programming, including *The Sopranos* and *Sex and the City*, as well as films from Warner Bros., DreamWorks and Fox. The service is set up like pay-per-view, although subscribers can watch films whenever they want. Showtime planned to begin trials sometime in 2001 with a service that would offer films from Paramount and MGM, plus original programming.

A similar service is already offered by Starz Encore, a subsidiary of Liberty Media, which claims that it is the largest provider of cable and satellite-delivered premium movie channels in the US. Starz Encore owns 15 domestic channels and offers various themed film packages, including films from Disney, Sony and Universal.

VIDEO-ON-DEMAND: DSL

Another VOD option is delivery by way of high-speed telephone lines. An example is iNtertainr, a service that sends its signals over private computer networks, connecting to homes either by DSL or digital cable. Consumers buy a device that switches the signal from their computer to their television set. Most customers receive the service via DSL,

which involves going to the iNtertainr icon on the DSL provider's home Web page that gets them into the computer network. After typing in a password, customers choose a film and are billed either through their credit card or their DSL provider. iNtertainr may eventually be available as an added feature of digital cable, available through a set-top box with remote control.

Originally formed in 1996, the project includes a range of investors, including Comcast, Intel, Microsoft, NBC, Sony and Qwest. The service offers recent motion pictures from a number of major studios (Universal, Warner Bros., DreamWorks, Fox, New Line Cinema, Columbia TriStar) and pricing options that include pay-per-view and package options. While iNtertainr currently offers films after their home video release like other VOD services, it is unclear how much of its programme fees go to content providers. Also, Comcast is the only cable operator that is testing the service, so it will probably have to continue to rely mostly on telephone companies' DSL services.

It is unclear how successful iNtertainr will become, as much depends on relationships with both the Hollywood content providers and, eventually, cable operators. A similar service was planned between Blockbuster, the video store giant, and Enron, a telecommunications company. EBEntertainment was to be a 'high-speed, closed phone line VOD service'. However, only MGM agreed to offer its film archives, and, without much support from the major Hollywood studios, the project folded in mid-2001. While Hollywood's lack of co-operation may have represented a wait-and-see attitude, it also seems likely that the studios intended to prevent Blockbuster from gaining an advantage in yet another lucrative outlet for their products.

VOD ISSUES

Even though many feel that VOD, in one form or another, is inevitable, there are still some unresolved issues. It seems clear that cable companies want VOD to better compete with satellite services, and they feel that they need Hollywood films. However, one of their big problems is the reluctance of Hollywood companies to supply content. As the head of Viacom explained recently at a cable industry convention: 'Paramount wants to make money with its films, and video-on-demand could end up displacing existing revenue from video rentals and sales'.²² Of course, home video is the single largest revenue source for Hollywood films, attracting over \$15 billion in 2000. Thus, any form of VOD will need to supplement, but not detract from, home video revenues, or else completely replace those revenues.

The timing of VOD releases and the licensing arrangements between the studios and VOD companies are key issues. According to some sources, the studios are demanding around 70 per cent of the revenue from VOD, although Universal's deal with iN Demand is said to be a 60 per cent deal.²³ Until some of these technical and economic wrinkles are ironed out, video-on-demand may continue to be, as many observers have already noted, 'video on delay'.

ELECTRONIC OR DIGITAL CINEMAS

People won't stay away from the theater. They like to be in a crowd, get out of the house, go on dates – they like the whole movie-going experience. I do see online and theaters as different release patterns. The online films will not be considered as good as what's in the theaters. Today, if a movie is released directly to video, or on cable, it is seen to be subtly inferior. That's not always the case, but that's the way people see it. If you made a really good movie, you wouldn't release it online. Theatrical releases will still be the way filmmakers want to get their films out.

Roger Ebert*

After years of speculation, the technology and support for electronic or digital distribution of films to cinemas is developing rapidly. E-cinema or digital cinema involves film prints converted to electronic form, digitised and encrypted, then transmitted from a central server to cinemas via DVD, satellite or fibre-optic link, and projected on electronic projectors.

Over the past few years, various demonstrations have shown that the quality is improving and may finally be acceptable to the film industry. Digital versions of major films have been demonstrated at trade shows, including a screening of *Star Wars Episode 1: The Phantom Menace* at Showest '99. (Around that time, George Lucas vowed to release the next *Star Wars* instalment only in a digital format.) In addition, a few digital cinemas have screened digital versions of Disney's *Mission to Mars*, *Dinosaur* and *Joy Story II*, as well as *Final Fantasy*, during the summer of 2001.

The industry is making progress in establishing technical standards through organizations such as the Society of Motion Picture and Television Engineers (SMPTE) and the Motion Picture Experts Group (MPEG), as well as the National Association of Theater Owners (NATO) and the MPAA.²⁸ Several e-cinema systems seem to be emerging. The one most often mentioned is Texas Instruments' Digital Light Processing (DLP) system, which uses a digital micro-mirror device. The company has three major licensees, Barco, Christie Digital and Digital Projection, and is seen by some as the industry leader. Meanwhile, Hughes-JVC, a company owned by the Victor Company of Japan, is developing a system based on Direct Drive Image Light Amplifier (D-ILA), using liquid crystals on a microchip. Another contender is Technicolor's Digital Cinema, developed in conjunction with Qualcomm. By mid-2001, 31 sites were participating in a demonstration programme that included Technicolor, Texas Instruments and Disney.

As noted above, distribution of digital films is possible by DVD, satellite or fibre-optic link. Ultimately, satellite distribution may be the most efficient method and has been demonstrated with technology developed by the Boeing Company. The system is supported by the company's military satellite experience, presenting interesting potential alliances. Again, Miramax has participated in early tests, offering its feature film *Bounce* for a trial run of the system in March 2000 and *Spy Kids* for another demonstration in March 2001.

Both Disney and Sony, as well as other industry sources, have shown enthusiasm for e-cinema. According to a *Screen Digest* report, there are likely to be an estimated 10,000 digital screens worldwide by 2005 and a complete transition within 20 years. The enthusiastic report also predicts that almost 100 per cent of the major Hollywood studios' films will be available both in digital and conventional 35mm format by the end of 2004.²⁹

Many of the advantages cited by e-cinema's supporters are apparent. The most obvious is the elimination of film prints, which cost on average \$3 million for a major film, or around \$1500 per print. Often 3000 to 4000 prints are produced for each film, with the total global cost of prints estimated at \$5 billion each year.³⁰ Digital versions of films also eliminate the wear and tear that is common with film prints, with fewer scratches and less dust. In addition, multi-language audio tracks become possible, as well as simultaneous worldwide release dates. Distributors would be able to move poorly performing films more easily or possibly alter or re-edit films during their theatrical runs.

E-cinemas are envisioned as multi-format outlets featuring films, live concerts and other special events, corporate meetings, and so on, which could help some cinemas earn desperately needed extra revenues. This type of activity is already happening in Canada at Viacom's Famous Players cinemas, which feature live pay-per-view wrestling from the World Wrestling Federation, employing Bell ExpressVu satellite operations. Another additional source of income might be advertising from local sources, which may be enthusiastically welcomed by some, while dreaded by others. With digital projection, individual cinemas might also be able to schedule screenings more easily to accommodate public demand, as well as saving on less labour-intensive projection. Although cinema projection is already often automated, further reductions in labour costs may be possible.

While there are clear advantages and most believe that digital cinema is an inevitability, there are some formidable questions that will need to be answered before widespread digital exhibition is a reality. Again, security and control are key issues. Even with encryption systems, the potential for pirating cinema-quality versions of new films is far more ominous than with current pirated prints, which often are copies of tapes shot from projected films in cinemas.

With a number of companies developing digital cinema technology, there are likely to be compatibility issues. It is still unclear whether there will be one standard or 'open architecture' allowing more than one system to be used. In addition, questions prevail regarding the compatibility of encryption and compression equipment.

Another issue that e-cinema enthusiasts seem to overlook has to do with the advantages of film projectors that are not only less expensive, but more rugged and universally adaptable as well. Even if the costs come down for electronic systems, the e-cinema equipment may rapidly become obsolete, with constant new developments in digital technology.

Moreover, there is the critical issue of cost. Although prices for digital projectors are dropping (from \$220,000–\$240,000 to \$160,000 in just one year), they still are major investments compared to a 35mm projection system that is currently priced at around \$30,000–40,000. Most analysts agree that digital systems must be around \$100,000 to be

viable. With the total cost of converting 100,000 screens around the world at an estimated \$25 billion,²² the big question is: who will pay?

In a recent trade paper article, one exhibitor expressed the sentiments of many other cinema owners, explaining: 'We know exactly what we are prepared to pay to move to digital: nothing.'²³ Many of the major US cinema chains will be hard-pressed to make such substantial investments, as recent cinema upgrading has left a number of them in or near bankruptcy. One proposal has suggested that a consortium of the major studios fund the new projection systems, but it is unlikely that the majors will agree. More than one studio executive has explained that it is up to the exhibitors to fund the new technology as one of the costs of doing business. Another option is from Technicolor Digital: the company will install systems at no cost to exhibitors or distributors, but charge exhibitors 12.5 cents per customer and charge fees to studios to distribute films electronically. Clearly, this is a crucial issue that will need to be resolved before e-cinemas become the norm.

Furthermore, even though the distributors seem to be the most obvious benefactors of the new systems, it is unclear whether they will be willing to give cinema owners any advantages in new exhibition licensing arrangements, where many would argue that the distributors now have the upper hand.

Nonetheless, the enthusiasm over e-cinema is growing, with glowing reports and claims by industry spokespeople, who anticipate major changes and increased opportunities. Patrick von Sychowski, author of the previously mentioned *Screen Digest* report, comments: 'Electronic cinema is an entirely new medium and as yet the industry hasn't had the opportunity to grasp its full impact.'²⁴ E-cinemas may be commonplace sometime in the future; however, it is unlikely that these thorny issues will be sorted out in time for an all-digital first run of *Star Wars Episode III* when it is scheduled to open in 2005.

THE UNCERTAIN BUT PREDICTABLE FUTURE

From this brief and speculative overview, it seems certain that there will be changes in film distribution and exhibition in the future. In addition, these developments will continue to be accompanied by a series of familiar promises and hopes. As with the introduction of cable and video technologies, new forms of digital distribution and exhibition have been associated with the prospect of more consumer choice and content diversity, as well as more independent production and expanded competition. Some have again predicted a 'shift of power' from the studios to independent film-makers. Others have suggested that, when all is said and done, major films will still appear in cinemas with electronic equipment, and Web-enabled television will feature different tiers of content: mass market fare, 'edgy' pay-cable channels, and independent and experimental fare for niche audiences.²⁵

However, as this discussion suggests, it may be safe to predict that the major Hollywood studios, as part of well-heeled transnational conglomerate organisations, will continue to be the dominant forces in guiding whatever models prevail, at least in the US market. They have the desired content, they already dominate other distribution outlets and they will continue to receive whatever help is necessary from a political system that mostly supports their

success. In other words, it is clear to at least some observers that video-on-demand and e-cinema promise to maintain and extend the studios control over distribution.

Thus, despite the uncertainty about the future, it is safe to predict that some things will remain the same. Again, there is continuity as well as change in store for the entertainment industry. Moreover, it is certain that profit will continue to be the major motivation for change. Despite the rhetoric of providing choices and access for consumers, the self-stated aim of the studios is to make money. More money. Lots of money. Decisions will be made with that goal in mind.

MPPA head Jack Valenti, has observed that the future is 'blurred and murky', and the only thing that is certain is that the studios will not distribute films in the same way any more. What also seems certain is that the entertainment and media transnational corporations will continue to dominate whatever new distribution and exhibition models evolve, operating under the same overall strategies as in the past.

Notes

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