Trans Atlantic Consumer Dialogue

DOC No. IP 13-11 DATE ISSUED: JUNE 2011

Resolution on Competition and Copyright

Introduction and Motivation

Creative individuals, communities and industries increasingly depend on innovation in the digital technology industry. Creative and digital technology industries are both characterised by dominant players, network effects and use of copyright. Copyright law and licensing should support innovative and competitive markets, driving and financially rewarding technological and creative innovation. However, copyright systems cannot always be assumed to do this, and the practices of copyright owners do not always support innovative and competitive markets. Therefore competition law and policy has a key role to play in maintaining competitive creative and digital technology markets as they seek to prevent abuse of dominant position and anti-competitive agreements.

The Transatlantic Consumer Dialogue (TACD) wants to see a digital economy characterised by competitive, dynamic and innovative markets to which consumers have meaningful access to a wide range of knowledge, information and cultural products on fair terms. We want to see a copyright culture that supports this by striking a fair balance between the rights of creators, investors and consumers. Consumers are also creators, such as when they use copyrighted works as part of their own political or cultural expression. Unfortunately the reality is that there are many barriers to innovation and competition in these markets including:

- Market dominance by a few very large companies with large market shares
- Lock-ins and high switching costs for consumers through proprietary standards, Digital Rights Management (DRM) and onerous contract terms
- Excessively restrictive copyright law provisions and excessively expansive enforcement provisions
- Restrictive and excessively costly copyright licensing processes by collecting societies

These barriers raise prices, reduce consumer choice, hinder market entry by small new innovative companies offering new business models and hamper the development of a competitive and innovative digital economy.

TACD calls upon the US and EU governments to:

- Actively enforce and ensure compliance with competition law in creative and digital technology markets
- Encourage the use of open standards through public procurement, standards development and regulation
- Ensure adequate and workable fair use exceptions and immunise them from DRM and contractual over-rides
- Create sufficient disincentives to the misuse of copyright enforcement procedures
- Introduce competition impact assessments for all proposed amendments to copyright law

- Require efficient licensing models including extended collective licensing and cross-border licensing
- Introduce effective supervision, governance, transparency and accountability of collecting societies

Background

Market structure and characteristics

The creative and the digital technology industries are characterised by dominant companies with large market shares and monopolies, and a complex ecosystem of entrepreneurs, micro-businesses and small and medium sized enterprises (SMEs). Markets for digital products and services demonstrate network effects where a single standard emerges as dominant once sufficient numbers of consumers have adopted it. As a result, one producer tends to dominate the market and their products become the "standard" or the "gatekeeper" for complementary products. Despite the dominance of some players, such markets can experience a high degree of competition if there is rapid innovation and paradigm shift. Competition is on innovation, not price, and companies will invest in innovation and development to dislodge the incumbent with new technology.

However, the ability to dislodge the incumbent is reduced if the dominant company can prevent network effects by, for example, constraining consumer choice through lock-ins and high switching costs, such as proprietary standards, DRMs and onerous contract terms, or by preventing other companies from producing complementary interoperable products. For example, while most digital music is sold in MP3 format, a common format for hardware and software, some companies sell digital music in proprietary formats. Proprietary formats are commonly only supported by the hardware and software of the relevant company, for example Amazon's e-books and Kindle hardware. This effectively prevents consumers switching hardware and software which stifles competition and the ability of companies to challenge the dominance of incumbents.

Failure by competition authorities to rigorously enforce competition law in the creative and digital technology industries will be to the detriment of SMEs who want to develop new innovative products, consumers who will face higher prices and restricted choice, and the development of the digital economy.

Copyright law and enforcement

Copyright law confers exclusive rights, such as the right to copy, adapt and distribute a work. These temporary monopoly rights effectively regulate the markets in knowledge goods and facilitate the financial reward of creativity and innovation. However, like any monopoly copyright risks stifling economic development and innovation as creators and innovators, including consumers, are prevented from building on past innovation. The exclusive rights conferred by copyright should be no more than is necessary to ensure a fair return to investors and creators, sufficient to reward and therefore incentivise creativity and innovation. Over the last few decades there has been an extension of both the scope and term of copyright, while fair access through copyright exceptions has been eroded. This over-extension of the monopoly rights has frequently been based on economic evidence provided by the industries seeking increased protection rather than a thorough independent assessment of the cost and benefits of such extensions to society as a whole. A recent proposal by the European Commission to extend the period of protection for sound recordings from 50 to 95 years has been heavily criticised and its passage through the legislative process delayed by the Council.

Copyright exceptions have an important role to play in allowing fair access to copyrighted work and encouraging social and commercial innovation. For example, the exceptions for

fair use in the US and private copying in the EU make it possible for consumer electronics companies to develop technologies such as DVR. The fair dealing/fair use provisions and other exceptions in national laws as regards to criticism, review and news reporting are central to the functioning of the news and publishing media in a democratic society. The exceptions for the benefit of visually impaired people allow for the creation of assessable formats which would otherwise not be provided by the market. Copyright exceptions that allow consumers to format-shift the digital content they have purchased allow them to overcome lock-ins through propriety formats.

In the EU law copyrights are mandatory for Member States whereas most exceptions are merely permitted and Member States have implemented them in different, and sometimes very limited, ways. The US has a broad fair use defence which has provided welcome flexibility if a little uncertainty about what is permissible in practice. In addition, the exceptions designed to benefit consumers, public institutions and businesses can be denied through contract law and restricted through licensing provisions and DRMs. DRMs are protected through anti-circumvention provisions in most copyright laws regardless of their intention and effect. Copyright enforcement procedures can also have a significant impact. Expedited enforcement procedures and enhanced remedies, particularly when directed at internet intermediaries instead of the actual alleged infringer, can encourage the premature cut-off of fair or authorised uses.

Limited exceptions, which have not kept pace with technological development, and legal uncertainty cause a chilling effect discouraging innovation as companies seek to develop new products and services for consumers within the limits of existing copyright law. The role of exceptions in encouraging competition and innovation deserves recognition and support from policy makers.

Copyright licensing

Innovation and mass use of copyrighted content in the digital market requires appropriate licensing solutions by collecting societies. Consumer access to copyrighted content is in most cases not directly provided for by the copyright owner, but by licensees, such as leisure and hospitality businesses, radio and TV broadcasters, online retailers and platforms. While the internet has opened up a global market, allowing the cost effective sale and consumption of copyrighted content across national borders, collecting societies and copyright owners still insist that the exclusive rights conferred by copyright, and related rights, are licensed on a country-by-country basis.

When potential licensees are unreasonably refused a licence, or have unreasonable licence terms or rates imposed on them, it stifles competition and prevents the development of new products and services. Similarly, the high costs associated with obtaining licenses, including negotiating time, act as a barrier to the development of new digital business models. In 2005, the European Commission, quoting the European Digital Media Association (Edima) which represents online music providers, said that "the direct cost of negotiating one single licence amounts to €9,500 ..... As mechanical rights and public performance rights in most Member States require separate clearance, the overall cost of the two requisite licences per Member State would amount to almost €19,000."[1] Licensing complexities are also a problem for audiovisual content. In the absence of functioning copyright licensing solutions consumers are denied access to their cultural heritage and innovative new products, while creators miss out on financial rewards resulting from the continuous use of their works.

[1] Commission staff working document: Study on a Community Initiative on the Cross-Border Collective Management of Copyright, Commission of the European Communities, Brussels, 7 July 2005 p47-48

Extended collective licensing provides access to creative works, ensuring that creators and copyright owners receive remuneration and allows licences to respond quickly to consumer demand. It facilitates smooth rights clearance and reduces instances where the licensing transaction costs make the use of works financially unviable. Such licensing schemes were designed to facilitate the cost effective mass use of copyrighted content in Nordic countries in the 1960s as market based alternatives to compulsory licensing. In the past 40 years extended collective licensing has been successfully implemented for radio and TV broadcast, and a number of education and research uses. Collecting societies, which are deemed sufficiently representative, can represent all copyright and related rights owners in a specific category of works on a non-exclusive basis. It allows collecting societies to issue "extended licences" covering the works of creators who are not members and ensures that non-members have the right to be remunerated by the collecting society, just as members are. Creators and copyright owners can opt-out of the extended collective licence.

There may be areas where innovative licensing solutions such as extended collective licensing allow collecting societies to overcome market failure and offer a viable alternative to compulsory licensing. Including in particular, markets for works where transaction costs for negotiating individual licences constitute a barrier to the development of new business models, services, and uses, particularly with regards to multi-media content and mass use of works in the online and broadcast environment.

The international **cross-border licensing** of copyrighted content has continuously been frustrated by collecting societies. Reciprocal representation agreements, negotiated by national collecting societies to facilitate cross border licensing, have repeatedly been found to be anti-competitive by competition authorities because they seek to maintain the territorial monopoly of collecting societies by imposing un-competitive terms on members and licenses. Yet International Confederation of Societies of Authors and Composers (CISAC) members have refused to amend their model contract, the Santiago Agreement. The European Commission has identified a number of anti-competitive practices by collecting societies which prevent cross-border licensing of music including territorial restrictions, discrimination in cross-border distribution of royalties, and membership rules which restrict cross-border licensing. In 2005 the European Commission concluded that "if left entirely to the market, innovative and dynamic structures at EU level for cross-border collective management of legitimate online music services would not emerge. This applies to cross-border licensing and cross-border distribution of royalties."[2]

The internet provides consumers and businesses with a global platform to exchange knowledge, goods and services. But by not offering the creative and digital technology industries the appropriate licences, collecting societies are limiting the emergence of new products, markets and technical development to the prejudice of consumers. Yet reciprocal representation agreements and cross border licensing are rarely within the scope of existing collecting society supervision arrangements.

Supervision of collecting societies

Typically creators cannot choose which collecting society should administer their rights, and potential licensees cannot choose which collecting society to buy a licence from. Because collecting societies are monopolies they are subject to some regulation and supervision in most countries to ensure they comply with competition law. The majority of EU Member States impose transparency and accountability requirements on collecting societies though supervision by a designated body or the competition authorities. Countries such as Germany require prior authorisation for collective rights management and once established collecting societies are under permanent supervision. In the US the Department of Justice has

[2] As above p23

imposed anti-trust consent decrees to target anti-competitive licensing practices by collecting societies which harm creator members and licensees.

Ongoing issues in relation to the way collecting societies operate and treat both their creator members and licensees who provide products and services to consumers demonstrate that more robust supervision of collecting societies is needed. The European Commission intends to bring forward a framework Directive to enhance governance, transparency and multi-territory licensing for online rights management in 2011. The recent Hargreaves review in the UK has recommended that collecting societies should be required by law to adopt codes of practice, approved by the Intellectual Property Office and the UK competition authorities, to ensure that they operate in a way that is consistent with the further development of efficient, open markets. [3]

All collecting societies should meet minimum standards on transparency, accounting, the publication of tariffs, distribution keys, annual accounts and management costs. To ensure that they effectively serve the interest of their members and licensees, and support competitive and innovative markets for copyrighted content, minimum standards on the treatment of licensees, members and reciprocal representation agreements with other collecting societies should be set and actively enforced.

[3] http://www.ipo.gov.uk/ipreview.htm