

9 Views of interested organizations and members of the public

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9.1. During the inquiry the MMC received letters from a number of organizations representing consumers and others not directly involved in the supply of recorded music. The views of these organizations and a number of members of the public who wrote to the MMC are summarized below.

Consumers' Association

9.2. The Consumers' Association (CA) submitted to the MMC a copy of the evidence which it had presented to the NHC, and attended a hearing.

9.3. CA, the publisher of *Which?* magazine, said that it had taken a close interest in the CD prices issue for some years, ever since it had first produced a report in *Which?* on the subject, in January 1990, together with an accompanying policy report which set out the arguments in detail. In that report CA had, in particular, drawn attention to:

- (a) the continuing high prices of CDs since their introduction to the UK market in the early part of 1983: the failure of CD prices to fall had stood in marked contrast to the price of CD players, which had more than halved since their introduction;
- (b) the falling cost of producing CDs, by then little more than the cost of producing LPs which nevertheless were selling for far less in the shops; and
- (c) the CA survey of the general public in August 1989 which had shown widespread dissatisfaction with CD prices, and remarkably low levels of CD ownership among people who had bought music systems which included a CD facility.

9.4. Since publishing the 1990 report CA said that there had been widespread interest in the subject and a number of organizations had carried out reviews. CA said that perhaps the most interesting development in the last couple of years had been the PSA's report on record pricing, published on 13 December 1990. That report recommended some important changes to the market protection afforded to the recording industry by Australian copyright legislation (see paragraphs 3.46 to 3.49.)

9.5. CA noted that a full-price CD in UK shops now cost up to £15. CA gave some examples from a recent survey it had carried out, which showed substantial variations from shop to shop, and that some special offers had pushed the price down to below the £10 mark. There had also been a substantial increase in the number of budget and mid-priced recordings at around £5 to £7 and £8 to £10 respectively. But the absolute level of full-price recordings was extremely high, and indeed had risen considerably, in the two years since the January 1990 *Which?* report.

9.6. CA said that what was instructive about these figures was no longer how they compared with vinyl LPs-which had now been discontinued by some record companies and retailers-but how they compared with the price of the same CDs bought through retailers in the USA. CA gave comparative prices for the USA in respect of the sample recordings which it had looked at in the UK. Thus, the Welsh National Opera recording of *The Mikado*, retailing in W H Smith at £14.49, could be obtained at prices ranging from \$13.99 to \$14.99 in the USA. Similarly, Pink Floyd's *Dark Side of the Moon* on sale at £13.99 or £14.99 in the UK ranged from \$10.99 to \$15.99 in the USA. CA argued that it was possible to conclude from these prices that CDs broadly cost the same number of dollars in the USA as they did pounds in the UK; and, even with the pound's relatively weak exchange rate of around \$1.45 (as at early February 1993), this implied that US prices-for exactly the same product-were only around 70 per cent of those in the UK.

9.7. CA gave us a summary of a survey which had been carried out in June and July 1992 by the Bureau of European Consumer Unions (BEUC). CA said that this was a little more difficult to interpret, because it had been carried out before 'Black Wednesday' on 16 September 1992, since when the value of sterling had fallen by some 20 per cent. The figures broadly suggested that, prior to 'Black Wednesday', UK shop prices, including VAT, were around 18 to 20 per cent higher than those in Germany, the cheapest country in the survey; excluding VAT, the margin was around 13 to 15 per cent. Although CA did not have any more recent figures readily available, it was fair to assume that the price differential between the UK and Germany had more or less disappeared since 'Black Wednesday' and that UK CD prices were now more or less equal to, if not cheaper than, those elsewhere in the EC. CA said that in many respects this approximate equalization of CD prices across the EC ought not to be particularly surprising, given that trade barriers had been removed within the EC, and parallel imports were allowed. Any retailer who could see bargains to be struck in another EC country could get supplies sourced from that country, and pass any savings on to consumers. Far more disturbing, however, was the persistent gap between prices in the EC and in the USA, given that these prices related to an identical product.

9.8. CA said that it was very hard to pinpoint the underlying reasons for the discrepancy between EC and US prices. Given its persistency over the years, and the fact that it continued even at very weak sterling exchange rates, it could not possibly be due to exchange rate changes alone.

9.9. Equally, CA did not think that the price differential could be attributed to differences in production costs or levels of royalties, given that these applied to exactly the same product, produced by the same artists, for the same recording company. The most likely explanation was quite simply that the record companies saw the EC as a relatively low-volume but high-profitability market as compared with the low-profitability mass market that existed in the USA. CA thought that this interpretation was to some extent borne out by the continuing low level of CD player ownership in the UK: the most recent figures available showed that 27 per cent of households had CD players, up from 21 per cent in 1990; broadly comparable figures suggested that the UK was roughly in line with Germany (24 per cent), France (23 per cent) and Denmark (20 per cent) in this respect, though well below the position in the Netherlands (43 per cent) and Switzerland (39 per cent), and well above the position in Italy (9 per cent).

9.10. CA said that, in theory, it would be possible for EC consumers to take advantage of at least some of the lower prices in North America. A number of US companies offered mail order. However, there were obvious limitations to this; in addition to postage and packaging, where charged, import duty was payable at EC borders at a rate of 4.9 per cent of total costs, and 17.5 per cent VAT had to be added to that. In addition, many consumers would need to take account of the (not insignificant) cost of a telephone call or fax across the Atlantic. CA believed that considerations of this kind, together with the inconvenience and risk of ordering from another country, ruled this option out for all but the most enthusiastic, and more or less eradicated the prospect of EC retail prices being forced down by competition from personal imports from the USA.

9.11. Nevertheless, CA considered that if import agents, UK distributors and retail chains were allowed to import direct from wholesalers in the USA they could circumvent the obvious practical problems faced by private buyers. This was effectively barred, however, by UK copyright law-the 1988 Copyright Act-which provided that copyright owners or their licensees had the right to prevent the importation of records from another country, even where those records had been reproduced with the permission of the copyright owner in that particular country. In other words, the right of the copyright holder to prohibit imports extended to what would otherwise have been legitimate parallel imports, as well as to pirate recordings. Imports were sometimes permitted under licence, although they would normally be labelled as such, and were often sold in a special section of the shop concerned. CA said it understood that such specially licensed imported recordings were normally of material for which there was a very limited domestic market.

9.12. CA considered that the net result of import restrictions was the ability of copyright owners to segment the world market according to what price they thought different sections would bear. Arbitrage was impossible and competition from non-EC imports non-existent.

9.13. CA set out its response to each of the main arguments which might be put in favour of the current restrictions:

- (a) *Copyright restrictions were needed to prevent piracy.* CA said that this was true. However, it was not a justification for preventing parallel imports from countries that had signed up to the various intellectual property conventions and enforced them properly. CA said that these conventions were specifically designed to ensure that copyright holders, among other rights- holders, would get a fair reward for their creative effort, and be well protected from counterfeiting and piracy. Provided copyright was being respected in the country of origin, it ought not to be any concern of the copyright holder if recordings were being exported and sold in another country. CA observed that international intellectual property conventions did not explicitly require member states to control parallel imports of recordings that had been legitimately produced and sold. Such restrictions would, after all, be incompatible with the freedom for parallel imports now enjoyed within the EC; moreover, Sweden had no restriction on parallel imports in its copyright legislation. It might even be argued that the lower prices that would result from a removal of controls over parallel imports would reduce the incentive to import pirated recordings.
- (b) *Freedom of parallel imports would damage the UK music industry.* CA said that the argument could be made that high CD prices in the UK helped to keep our own music industry profitable so that profits could be invested in recordings by UK artists. However, that argument was in CA's view misconceived. It was wrong to think of the prices paid by UK consumers as a kind of local subsidy for artists whose works would otherwise be unprofitable: if they were unprofitable, the artistic works concerned should either be subsidized by the state on clear public interest grounds, or they should not be produced. CA said that record companies invested in UK artists with the expectation that they could make a profit out of that investment which was, in this sense, simply risk capital. Inevitably there were considerable risks, since many works failed, but the rewards from success were great, especially if recordings sold well in overseas markets, including the USA with its low retail prices.
- (c) *Imports would be 'free riders' on domestic investment in advertising and promotion.* CA argued that this could in theory be a problem for a UK producer without any overseas affiliates which had licensed the sale of its recordings to an overseas company, say in the USA, with which it had no direct links. In such circumstances, the UK company would probably be forced to charge a higher licence fee to the US company to cover its UK promotional efforts (the US company should have a sufficient incentive to accept this because of the prospect of UK exports). Otherwise, however, international music companies or companies that had major overseas affiliates should face no real problem: freedom of parallel importing would not reduce overall sales, merely sales through the UK arms of the companies.

9.14. CA noted that arguments of this kind had been considered in great detail by the Australian PSA (see paragraphs 3.46 to 3.49); CA said that the PSA report deserved careful study, as many of its conclusions applied directly to the UK.

9.15. CA said it was clear that copyright restrictions lay at the heart of the extreme and unfavourable price comparisons between the USA and the UK (and, for that matter, the rest of the EC). Such restrictions gave the record industry a degree of control over prices charged in different sections of the world market which very few other sectors of industry enjoyed. CA said that reform of these controls over parallel imports offered by far the best way of removing artificial barriers to genuine price competition in the UK market for sound recordings, thereby helping to secure a fairer deal for the public. CDs suffered from a 'market failure' which kept prices unjustifiably high, and that was due to a lack of clarity about what the copyright restrictions were for. Copyright was supposed to give artists an incentive to compose and perform their works without fear that others could copy them and take the gain. This should be entirely a matter for the production phase of the industry. Once a recording was put on the market there was no such market failure to be corrected and no reason to put obstacles in the way of international trade.

9.16. During the inquiry we invited CA to comment on the surveys conducted for the MMC by BMRB and Management Horizons Europe. In its comments, CA said that to a considerable extent these surveys underlined what it and many other critics of the record industry had alleged for some time, namely that prices were far higher in the UK and the rest of the EC than in the USA, and for no good reason. The precise percentage differences were slightly lower than in previous comparative exercises of this kind, but this was by no means unexpected given the recent substantial decline in the sterling/\$ exchange rate. CA said that in assessing these developments, it was important that the MMC should take a long-term view-much as it had done with its comparisons of new car prices across the EC-before reaching a final verdict on the public detriment arising from the current situation. CA, however, did not consider that the BMRB survey on its own was sufficiently wide-ranging; the sample of titles assessed was far too small, particularly on the classical side.

9.17. In relation to the Management Horizons Survey, CA said that it was essential for the MMC to deal firmly and decisively with the arguments that adverse price differentials for other products justified adverse price differentials for recorded music; and that open parallel importing regimes had not eliminated price differences between other markets. CA considered that both of these arguments were spurious; they had nothing to do with the fundamental question of whether copyright holders should have a right to restrain parallel imports in the interests of market segmentation. CA remained strongly of the view that they should not.

British Copyright Council

9.18. The British Copyright Council (BCC) explained that it represented the interests of the copyright owners of virtually all the categories of works and products eligible for protection under the copyright law of the UK, save for sound recordings (represented by the BPI), films (represented by the British Film and Television Producers' Association) and the rights of broadcasters. The members of the BCC are the individual organizations which represent the various sectors of the copyright industry; currently there are 30 members.

9.19. The main points made by the BCC were:

- (a) It was in the public interest for a copyright owner to be able to control the importation of all copies of his works or products made in another country without his authorization, including copies made in a country where there was no protection and hence no need for authorization; and the need for copyright owners to have this protection was recognized, and required, by the Berne Convention.
- (b) Potential 'parallel imports' were copies of a protected work made with the direct or indirect authorization of the person who was the copyright owner in the country of manufacture. It was also in the public interest that a copyright owner should be able to control the importation of such copies.
- (c) Copyright depended entirely upon statute; national laws did not have extra-territorial effect, and hence the copyright system internationally comprised a set of national systems defining and regulating national markets; and within each national intellectual property market the economic, commercial and legal characteristics were separate and distinct.

- (d) Intellectual property had therefore been marketed on an individual market basis; copyright owners of national works and products needed to protect their investment from unfair competition by importations of copies of those works and products.
- (e) Those who sought to bring in parallel imports made no contribution to the development of national production, nor to the publishing, printing and production industries, nor to the earning power of authors.
- (f) Those who sought to bring in parallel imports were engaging, in effect, in unfair competition by capitalizing on the expenditure of the national copyright owners in developing the public demand for the works whose copies they sought to import; they did not stimulate competition or develop markets, but simply distorted legitimate trade.
- (g) Those who sought to bring in parallel imports did not usually pass on the benefit of any cost differential between the imported copies and the copyright owner's supplies.
- (h) Because of the availability of today's high technology to pirates, pirated copies were often almost indistinguishable from other copies. This meant that a power to control only the import of pirated copies would be unworkable in practice.
- (i) There was no evidence that the existence of the power to control parallel imports, for example in the USA or Germany, had resulted in excessively high prices. There was also no evidence that in a country which had withdrawn the power prices had fallen; for example, prices of books in Australia.

9.20. The BCC noted that the EC Rental Directive required member states to make legislative provision for the power to control the importation of copies of protected works into the EC (ie not moving from one Community state to another, but into the EC). That Directive had to be implemented by 1 July 1994. The BCC said that similar discussions were being pursued in the WIPO meetings.

Trademarks Patents and Designs Federation

9.21. The Trademarks Patents and Designs Federation (TMPDF) explained that it represented the interests of owners of intellectual property (patents, trade marks, designs and copyright) over a wide spectrum, and included members who were owners of copyright sound recordings, computer programs¹ and video recordings.

9.22. The TMPDF considered that the protection afforded by intellectual property rights had allowed important and creative segments of the market to develop without being undermined by piracy. The right to control the licensing of intellectual property rights was fundamental to the ownership of those rights. Licence rights must include the ability to control the distribution of the protected goods, including the right to license importation of goods into a territory. The reason for this was the straightforward need to ensure an orderly supply of goods on to the market, thereby avoiding sporadic local supply or unsatisfactory supply from a single source at a remote location. Any recommendation on the pricing of recorded music should allow for a continuation of the right to license the distribution of goods. This was a right which the TMPDF considered to be critical to success in a number of industries, not just that of sound recording.

9.23. The TMPDF noted that WIPO had held meetings of Government experts in June and July 1993 to discuss a possible protocol to the Berne Copyright Convention. The question of distribution rights was on the agenda of that meeting with an endorsement from WIPO in support of the right of copyright owners to control importation and distribution of copyright works. The TMPDF had supported the WIPO endorsement and had advised the UK Government representative of its support.

9.24. During the MMC inquiry the Uruguay round of the GATT agreement was completed. The TMPDF noted that a part of that agreement concerned intellectual property in what was referred to as the agreement on Trade Related Intellectual Properties (TRIPS). Within the TRIPS agreement there was a Part II which addressed copyright and specifically provided in Article 14 that producers of records should enjoy the right to authorize or prohibit the direct or indirect reproduction of their records. The TMPDF hoped that any MMC recommendations on the pricing of recorded music would accord with the fundamental principles of intellectual property law, including TRIPS.

National Music Council of Great Britain

9.25. The National Music Council of Great Britain (NMC) submitted written evidence. It is a member of the International Music Council, and has 37 member organizations in Great Britain, including the BPI, the MPA, the MCPS, and the Musicians' Union (MU). The NMC said that its submission had been prepared independently of any member organization and was submitted on behalf of its constituent members.

9.26. The NMC said it recognized that the reference related to whether or not a monopoly existed, and that it had been made against the background of the NHC's inquiry into CD prices. That inquiry had led to press and other comment that CD pricing in the UK could be dealt with by amendments to the 1988 Copyright Act, by removing from a copyright owner the ability to prevent parallel imports. The NMC said that such amendments to copyright legislation could have unforeseen adverse results.

9.27. The music industry relied on the legal rights which existed at different levels. These levels interacted, and any action to restrict the operation of any one element might adversely affect other rights. If imports were allowed from the USA, and volume became significant, three consequences would follow. First, the UK publisher of the musical work would not receive royalties on the imported product; secondly, a British composer of works contained on such records would ultimately receive a royalty from the USA, but only after some time, and at the US rate, which was lower than the UK or European rate; and thirdly, such product, once imported into the UK, would be able to circulate freely within the EC, influencing price levels, and hence the profitability of record companies and publishers, as well as the income of composers.

9.28. A significant inflow of product from the USA, resulting from a lifting of the import restrictions, could have a serious effect on the royalty earnings of composers and publishers per unit shipped. Composers and publishers would have no say in the price of a record, and in the UK they were not protected by a minimum royalty which would take effect when the price dropped below a certain level.

9.29. The NMC did not represent record retailers, but noted that if import restrictions were lifted, the most likely beneficiaries would be the large retail chains such as W H Smith and HMV. It said that these operations already controlled a large percentage of the market, and retail competition was unlikely to increase if import restrictions were lifted. Indeed any such move would probably have an adverse effect on independent record retailers, who tended to stock a wider range of product.

9.30. The NMC considered that protection against parallel imports was covered in the EC Rental Directive, and noted that one country, Norway, had recently passed an amendment to its Copyright Act effectively outlawing parallel imports. The USA already did so under section 602 of the US Copyright Act. It was unlikely to change its policy, and would no doubt welcome any relaxation by the UK.

Department of Trade and Industry

9.31. The Textiles and Retailing Division of the Department of Trade and Industry (DTI) submitted written evidence. The DTI stressed that its note was limited to certain economic issues and had not been seen by any DTI Ministers involved in competition matters.

9.32. The DTI observed that the record industry made an important contribution to the national economy; that its performance had compared favourably with that of the whole of UK manufacturing in recent years; that it was a sector in which the UK had absolute and comparative competitive strengths which should be exploited for the maximum advantage of the national economy; and that these competitive strengths should be allowed due scope for their expression. The DTI submitted some comparative statistics which highlighted the main facets of the record industry's recent performance.

9.33. The industry needed to earn sufficient revenues to enable it to invest not only in the most up-to-date plant and equipment, but also, and of particular significance, in the finding and development of new artistic talent. This multifaceted nature of 'investment' in the record industry meant that comparisons with other sectors required particular care; nevertheless, the DTI observed that the 20 per cent or so of turnover devoted to expenditure on A&R, together with expenditure on fixed capital formation, compared well with the 2.2 per cent of the value of sales spent on R&D in manufacturing industry generally and the 10.2 per cent in the electronics sector.

9.34. The DTI noted that the UK domestic market accounted for some 7 per cent of world record sales. The UK had one of the largest and best developed music industries in the world. Domestic product accounted for some 49 per cent of the UK record industry's sales value in 1992, against 39 per cent home production in France and 24 per cent in Germany. A buoyant, competitive and appropriately profitable domestic market was likely to remain a major factor in the UK record industry's ability to invest in the development of new artistic resources and in the growth, whether through direct export or royalty earnings, of its external business.

Media Research Publishing Ltd

9.35. *Mr Cliff Dane*, the author of the 1993 annual survey of the UK record industry for *Media Research Publishing Ltd*, a research and publishing company concerned primarily with the UK media sector, gave the MMC an overview of his general conclusions about the UK record industry which he had reached in the course of that survey. Mr Dane explained how his general approach had been to look in detail at the published accounts of all significant UK record companies, drawing on his personal knowledge of the industry.

9.36. Mr Dane said that, in analyzing the accounts of the largest record companies, there did not appear to be significant *prima facie* evidence of 'super-profits' either in absolute terms or by comparison with the recent past. This, he said, was certainly the case with PolyGram, BMG, Sony, Virgin, Warner and EMI.

9.37. However, the overall profitability of these companies might not give a true representation of their results from music products alone. The majors' UK subsidiaries often included video interests and distribution and manufacturing activities, which might or might not benefit from overseas income from direct sales or royalty income from licensing. Mr Dane believed that the MMC might be in a position to separate out the results of such different activities.

9.38. One of the keys to analyzing the underlying profitability of the majors was to look at their treatment of A&R costs, ie all those costs involved in the production and exploitation of new recordings. Theoretically, if there was a 'conspiracy' to remove super-profits from the main UK limited companies, this could be effected by paying onerous royalty rates on recordings originating outside the UK, and licensing out to other territories at a rate which subsidized the real costs. However, Mr Dane had no information in this area, and in view of the present UK tax regime, multi-nationals would be likely to want to increase rather than reduce their UK profits.

9.39. Nor did smaller, independent companies which had been considered 'successful' in the industry, such as Mute Records, Creation Records and Go! Discs, appear to have been making significant profits, or indeed yielding excessive management remuneration.

9.40. Two factors which Mr Dane considered had been significant in stopping what appeared to be high CD prices from generating excess profits had been the much higher returns enjoyed by artists than in the past, and the increasing costs of artist development such as promotional videos, recording costs and tour support. Moreover, the industry appeared to be taking a much more stringent approach to costs and overheads than hitherto, becoming increasingly dominated by accountants.

9.41. One area where the industry certainly did spend substantial sums was in investing in bands which were never successful. Mr Dane said that the majors could give numerous examples of this. He said that a low 'hit' rate was a key factor in high overall prices, and although the record companies obviously would not go out of their way to lose money on new artists, they in fact often did so.

9.42. Mr Dane considered that the exploitation of back catalogue and the success of a few major artists probably subsidized a large amount of unsuccessful A&R activity. Where companies were able to avoid originating new material, and instead to license in recordings from primary sources, they were often able to generate some of the more impressive profit figures in the industry, particularly in the mid- and budget-price markets. For example, the survey had included Tring, the super-budget specialist, and Music Collection International.

9.43. Mr Dane said that a feature of the industry in the last 20 years had been the growth of secondary marketing companies such as Pickwick, Castle, Demon, Ace and See for Miles.

9.44. Another factor in the debate over excessive profit, which Mr Dane believed could be overlooked, was the number of companies that had failed over the last decade. It was generally possible to salvage a company containing substantial copyrights, but there were many examples of failed companies which had relied on licensed rights, such as Stylus, K-Tel and Ronco (all of these in the television advertised market).

9.45. Mr Dane considered that other significant factors were:

- (a) *Ease of, and barriers to, entry.* The music industry was relatively easy to enter and historically, small new companies had often developed major new talent, even if their artists subsequently moved on to the majors. In the last 20 years there had been significant new independents such as Chrysalis and Virgin; more recently Telstar, Castle and Mute had emerged in different sectors of the market, while in distribution Pinnacle had become a significant threat to the majors.
- (b) *The relationship of the independents and majors.* Mr Dane thought that the NHC had appeared to adopt an 'independents are good' and 'majors are bad' stance. However, he noted that a feature of the industry was the multi-faceted links between majors and independents which included:
 - (i) majors linking with A&R-based independents (PWL, Big Life, ZTT, Go! Discs) in jointly-owned companies;
 - (ii) independents licensing acts or labels to majors (Food);
 - (iii) majors distributing independents' records (Beggars Banquet, Castle, Telstar);
 - (iv) independents developing bands which then moved on to majors; and
 - (v) independents linking with majors for international sales.

Simkins Partnership of Solicitors

9.46. The Simkins Partnership of Solicitors (Simkins), a legal practice specializing in the media and entertainment sector, submitted written evidence. It said that the UK music industry in its present form operated in the public interest, generating a significant level of employment and export earnings, sustaining cultural dynamism, and producing a large number of internationally respected British cultural ambassadors at a corporate and individual level. Any amendment to legislation which was likely to have a harmful effect on such an important sector of UK industry should be considered as contrary to the public interest. Simkins considered that the removal of the current restriction on parallel imports would have such an effect.

9.47. Simkins said that the current system was designed to remunerate the UK artist, composer, record company and publisher on the basis that record manufacture took place within the UK or EC. The result of allowing into the UK market records manufactured outside the EC would be a massive distortion and inequitable distribution of reward, in which the creative contributors to the industry, the artists, composers and individual producers, would be likely to suffer most.

9.48. Simkins said that, notwithstanding the market share held between the majors, the independent record companies were responsible for a significant proportion of the market. Established artists often tended to gravitate to majors after starting their careers with independents. The independents ranged from one person with sufficient capital to press 1,000 records, up to sophisticated operations such as Beggar's Banquet and Mute Records which sold millions of records each year. The independents were also very important in the classical music field, where companies such as Conifer, Hyperion, Chandos and ASV supplied much innovative material.

9.49. If import restrictions were lifted, the effects would be as follows:

- (a) First, a significant part of a UK music publisher's income was currently generated by the levying of a mechanical royalty in relation to each CD manufactured in the EC and sold in the UK. This was collected locally by the UK publisher and then divided between it and the UK composer. Simkins considered that it would be very harmful to UK publishers if that mechanical royalty were paid to the local sub-publisher in a country outside the EC and remitted to the UK publisher by its local sub-publisher for the following reasons:
 - (i) The UK publisher's receipts would be reduced by its sub-publisher's retention, which could be between 10 and 50 per cent. Thus UK publishers would earn significantly less. Where the UK publisher was a major, overseas retentions would benefit the multinational but not its UK operating company. Thus, even in the case of a major, the UK operating company would have its margins reduced.
 - (ii) The rate of mechanical royalties payable by record companies to publishers outside the EC was significantly lower than in the UK, and elsewhere in the EC it was higher than in the UK. In the USA, for instance, royalties were calculated at a rate which was effectively 30 to 50 per cent lower than in the UK. The US rate was greatly reduced by the operation of what were termed 'controlled composition' clauses in the recording contracts entered into with artists. These typically provided for a ceiling on the level of mechanical royalties payable to publishers. That ceiling was usually set at 75 per cent of the rate recommended by the US Copyright Royalty Tribunal.
 - (iii) The UK publisher would have to rely on the efficiency and accuracy of the accounting practices of its sub-publisher. This was probably not such a concern for the majors, but for independent publishers, relying on the veracity of accounts submitted from distant parts of the world with cheap labour costs (and therefore cheap CD manufacturing costs), there was bound to be a significant loss of revenue.

Simkins argued that the combined effect of these three factors could well reduce the margin of UK publishers by 25 per cent and possibly by more than double that figure. This would seriously damage the UK publishing business which made a major contribution to the success of the industry.

- (b) Secondly, Simkins said that the margins that UK record companies earned on UK CDs which they had manufactured in the UK or the EC were significantly higher than the margins earned from royalties paid in respect of sales of CDs manufactured outside the EC. Simkins estimated that the return would be between four and six times as great on domestically manufactured CDs as on royalties paid by licensees outside the EC in respect of locally manufactured CDs. Again, problems regarding the ineffectiveness of audit rights and the veracity of accounts would apply. Simkins considered that if the proposed copyright changes were implemented, UK record companies would undoubtedly suffer from a significant level of 'leakage' of product from overseas into the domestic market. This would reduce the sales of their own domestically manufactured CDs upon which they received the margins which underpinned their investment in new talent, promotion and marketing costs. The majors would suffer less than the independents because any profits foregone in the UK would be made by the multinational through its overseas affiliates and thus kept within the organization. But the importance and influence of the majors' UK operating companies would be significantly reduced.
- (c) Thirdly, UK recording artists generally received their remuneration in the form of royalties and advances from UK record companies. Simkins said that the UK record companies' profits would be significantly reduced by the lifting of import controls under the 1988 Copyright Act, and inevitably the artist would suffer. Fewer artists would be engaged by record companies and those who were would receive lower royalties and advances.
- (d) Fourthly, in the case of much contemporary popular music, the recording artist was often also the composer of the musical works he or she recorded. Simkins said that in the early stages of his or her career, it was frequently the advance received from a publishing company that provided the means by which the artist or composer could develop his or her talent. Without such support from the publisher, creative talent would be deprived of a vital source of support at a critical stage of its development. Simkins argued that the specific disadvantages that would occur for a composer if import restrictions were lifted were as follows:
 - (i) The composer typically received a share of the publisher's income from the exploitation of publishing rights. This would range from 50 to 80 per cent of the publisher's receipts. Accordingly, if the UK publisher's return from mechanical royalties was reduced by 25 per cent to 50 per cent in the case of imported CDs, then there would be the same diminution in the composer's remuneration from this important source.
 - (ii) The problems regarding royalty collection supervision and audit rights that had been mentioned above would apply equally to UK composers.
- (e) Finally, any manufacturing or duplication outside the UK that would previously have taken place within the UK would detrimentally affect this area of the business. The lifting of import restrictions would inevitably have such an effect. The result would be lay-offs and ultimately a reduction in capacity. This would diminish the service that the manufacturing sector of the industry could supply to the record companies, which required speed and flexibility of response in a fast moving retail market.

9.50. Simkins noted that WIPO was proposing a Protocol to the Berne Convention on authors' rights which would improve copyright protection, rather than reduce it. It said that one of the four proposals which had been included for discussion was the introduction of a general right to control the import of sound carriers. Sections 22 and 27 of the 1988 Copyright Act already did that for the UK, and Simkins considered that it was illogical to remove a level of protection at national level that was being proposed at the international level.

9.51. Furthermore, the unilateral removal of a level of protection that was enjoyed by music industries in other advanced countries would inevitably put the UK industry at a competitive disadvantage. Such changes had to be made on a world-wide basis to have an equitable effect.

9.52. Simkins said that, in any case, it was not at all sure that allowing parallel imports would result in generally lower UK prices. If allowing parallel imports did bring down prices, such reductions would only apply to the most popular recordings. It doubted that there would be sufficient volume to justify wholesalers in the UK importing records for artists who were not in, say, the top 10 or 20 positions in the *Music Week* albums chart. Damage to the industry would be caused because of the narrowing of margins in relation to the most commercially successful material. This would have the knock-on effect of reducing the funds available for investment in less commercially successful sectors or in nurturing new talent.

9.53. Simkins said that if the Norwegian experience (prior to the change in Norwegian law) was relevant, then imports were likely to remain at a high level. 20 per cent of the CD market in Norway consisted of parallel imports, mostly from the USA; furthermore, the emphasis was on best-selling albums.

9.54. Nor was Simkins convinced that any lowering of prices would lead to increased sales. Many UK record companies had demonstrated a level of success that would be the envy of large sections of British industry. If those record companies thought they could increase the number of units sold and thereby their return by lowering prices then Simkins was sure that one or other of them would have done so. It therefore doubted very much whether any increase in sales would outweigh the reduction in income per unit.

9.55. Simkins considered that the effect of parallel imports on independent record companies would be particularly damaging. Independents might well be able to command premium prices for some of their releases, but they would have great difficulty doing so in relation to their best-selling albums if these were competing with parallel imports. For example, a group which released their records through an independent in the UK and through a major in the USA would find that the UK dealer price applied by the independent would be significantly undercut by parallel imports from the USA.

9.56. Independents lived off their most successful albums. If they were unable to retain their margins on those very successful acts, they would be in no position to release many of their less commercial records. The question whether those less commercial records could command premium prices or not would therefore be academic since the independents would be unable to sustain the cost of recording and releasing the numbers of records that currently made their way into the market.

9.57. Simkins said that the irony of the proposed change was that arguably the least harmful effects would be felt by the major multinational companies who would be able to take their profits through overseas affiliates. It was the independents who would be put out of business first by the change. Ownership and control of the industry would be concentrated into fewer, increasingly foreign hands, often interested more in short-term profits than in nurturing indigenous talent. Thus, far from serving the public interest, the lifting of import restrictions would strengthen the monopolistic position of the small number of multinational record companies that controlled the global market.

Members of the public

9.58. The main points made in the letters from members of the public were that prices were higher in the UK than the USA, Hong Kong, or Europe; that the larger retail chains such as W H Smith and HMV charged higher prices than some smaller retailers even though they must be obtaining larger discounts; that record companies were charging 'full price' on 'back catalogue' CDs; that small retailers experienced difficulties in obtaining supplies from the large record companies and were forced to purchase through distributors; that the public was being forced to purchase CDs because vinyl records were being eliminated (and cassettes did not offer comparable quality); that availability of some CD recordings was a problem; that there should be some relationship between price and playing time rather than an arbitrary divide between mid-price and full-price-many CDs ran only for 50 to 60 minutes although they had been promoted as offering up to 80 minutes' playing time. The view was also expressed that since the inquiry had been announced, CD prices had fallen, but no doubt they would rise again if the MMC made no pricing recommendations. Other comments are summarized in the following paragraphs.

9.59. One member of the public submitted a petition. One hundred and two people had signed it, also stating at what price 'they would buy more than twice as many CDs'. The prices cited ranged from £4.99 up to £9.99.

9.60. A *songwriter* and music fan, who had been a performer and had worked in artist management and record production, made a submission.

9.61. He said that since the mid-1960s, British popular music had enjoyed great success throughout the world. Overseas sales of British music had contributed greatly to the country's economy as markets such as the USA, Japan and Germany have looked to the UK as a major talent source. The British record chart was a shop window and UK chart success was often a springboard to international sales. However, in recent years Britain's position had weakened, as its music industry had failed to sustain the launch and development of world-beating musical talent. Whilst many music industry executives chose to regard this problem as short-lived, it was hard to imagine Britain regaining its former pre-eminence by the end of the decade. There were two main reasons for this: first, the nature of music broadcasting, and secondly, the high price of CDs.

9.62. He observed that in the UK there existed a massive audience for song-based rock music; this sold albums, filled concert halls, created worthwhile music copyrights, built careers and, unlike 'dance', 'novelty' and 'lightweight pop' music, was capable of making an impression in the international market. In his view both the BBC and independent radio (and television) had failed to cater properly for this audience and had therefore lessened the incentive for record companies to sign and develop the sort of acts that might otherwise have achieved international success.

9.63. On the pricing question, he argued that the music industry's only consideration seemed to be the short-term goal of satisfying corporate demands, ie as unit sales declined, profits could only be maintained by increasing prices. The short-sighted policy of pushing the retail price of CDs beyond £14, when there was clearly justification for a significant price reduction, was seriously damaging the domestic market and the future for British music around the world. He observed that in defending this policy, record companies had stated that the signing of new talent would be compromised by lowering prices, but this did not ring true. How could the record labels be taken seriously in this respect when CDs of new acts were selling for the same high prices as CDs by established names? What was the point of signing new talent and pricing it beyond the reach of the average record buyer?

9.64. He said that in order to maintain the illusion that CDs were fairly priced at £12 to £13, the record companies had artificially inflated the price of other formats to flatter CDs. In the case of vinyl, the format was slowly being killed off. At the same time, there was gross wastage of money in A&R, promotion and marketing.

9.65. By gradually raising dealer prices, the record companies had put the onus to sell units more and more on to the retail sector. But there was also a degree of hypocrisy from the high street. The biggest retailers' profiteering could not have gone unnoticed by the record companies' account managers and had perhaps added to the atmosphere of mistrust between the two factions.

9.66. There had, however, been one significant development since the NHC inquiry and that was the proliferation of CD special offers in the high street. Whilst record companies would have preferred to maintain the illusion that CDs were fairly priced at £14 (and therefore an absolute bargain at £9.99), they were clearly being forced to offer them at considerably less than that. As each month passed, the major companies, co-operating with the retail chains, took turns in offering 'selected releases' at £9.99. The following month they 'all swapped places'. Retailers and record companies were unlikely to publish the results of these price-cutting campaigns, but it was understood in the industry that sales often increased dramatically.

9.67. Finally, he said that any proposal to change copyright law, which was extremely complex, would be an inappropriate response, but if that were to happen, the industry would be responsible.

9.68. *Mr C E Barrans* said that one of the advantages of CDs was the available playing time of up to about 78 minutes, more than the equivalent of two whole 12-track LPs, yet there very few CDs which featured the contents of two complete LPs. He noted that some CDs had less than 30 minutes of music on them. He considered that there should be some relationship between price and playing time.

9.69. Another unfair practice adopted by recorded music manufacturers and retailers was their use of the manufacturers' 'special price' stickers. Often the customer would in fact be charged full-price at the counter. Mr Barrans said that his queries about this practice had met with rather feeble excuses from the manufacturers and retailers concerned. Mr Barrans also queried why some productions were sold at mid-price and others at full-price, whereas there had been no price difference when these productions had been available in LP and cassette formats. He also did not understand why megastores charged between 50p and £1 more for CDs than the usual price in other stores such as W H Smith. Finally, Mr Barrans said that there had been further price increases in recent months with mid-price CDs costing nearly £10 and full-price CDs costing nearly £15.

9.70. *Mr M Hodgson* said that in comparing the various retail prices within the UK it should be borne in mind that the megastores and chains had much more buying power than an independent retailer such as his employer, Covent Garden Records (CGR). He said that there seemed little justification for the megastores' higher prices. Overheads might be high in the central London megastores, but the provincial branches of the same shops generally charged the same prices.

9.71. Mr Hodgson also considered that average retail margins in the UK were higher than in the USA, but said that US record shops had much of their stock on a sale-or-return basis, which meant they did not have to pay for it until sold, and could return any 'over-buys'. He pointed out that small companies such as CGR generally had to reduce prices to clear stock. Furthermore, he understood that UK mail order companies generally carried little or no stock and obtained discs only to meet specific customer orders, thereby avoiding the retailers' heavy investment in stocks. He said that US stores were also used to having the record companies' representatives coming in and counting the stock for them prior to taking an order, with considerable savings for them in staff time and salaries.

9.72. He considered that the economies of scale in a market the size of the USA were considerable compared with the UK. Both because of this discrepancy, and the greater productivity of US workers, most consumer goods were cheaper in the USA. He therefore wondered why CDs were being investigated. They were after all a luxury, whereas food was a necessity. Mr Hodgson observed in any case that CDs in the UK were around £5 cheaper than in France or Germany, which he considered a more relevant comparison than the USA with its very different economies of scale.

9.73. He nevertheless concluded that there was one aspect of the record companies' pricing policy which did warrant investigation. There were two rival systems ready to replace the analogue cassette—the DCC and the MiniDisc. Both offered recordability, and both were digital, but the specification was not as high as for CD. Yet the pre-recorded software cost the same as a top price CD. There seemed to be no justification for this, and even less for the policy of bringing out new titles on DCC and MiniDisc (for which there was hardly any market yet) but not on analogue cassette. It seemed to him to be a cynical attempt to force the consumer to invest in yet another format.

9.74. Finally, Mr Hodgson said that he hoped the MMC would bear in mind that any attempt to force UK retailers to reduce prices generally would force some out of business and would certainly have a detrimental effect on their staff in the present recession—none of the staff at CGR, for example, had had a pay rise for nearly two years, despite there having been redundancies.

9.75. *Mr P Howat* said that like many people who had commented on the high price of CDs, he had seen and bought CDs in the USA, and had wondered why they were relatively so much cheaper there than here. Similarly, he had observed that they were even more expensive in other European countries, albeit that the sterling equivalent price of CDs bought in other countries depended on prevailing exchange rates. However, as a *Gramophone* reader he was aware that many discounts were available on CDs sold in the UK. Indeed he said that it was extremely rare for him to pay the full price. He argued that presumably the advertisers in *Gramophone* (and other magazines) were able to support the smaller mark-up over the wholesale price by the greater volume of sales that their lower prices achieved. This suggested that the price elasticity significantly exceeded minus one. On the other hand he assumed that these mail order companies might not have the high cost of retail premises.

9.76. He was aware of the argument that it was necessary for the wholesale price of CDs to be high to enable the manufacturers to cross-subsidize, ie pay for losses on poor sellers, with the profits from good sellers. He was prepared to accept this. He said that on scanning *Gramophone* he was always surprised at the number of new CDs that were issued each month. He noted that some of these issues were of music that was very rarely heard, and the existence of such recordings was a boon. He believed that the industry could and should regulate itself; a company whose product failed to satisfy its market would, after all, go out of business.

9.77. He concluded that, while he would welcome cheaper CDs, he himself rarely paid more than 80 per cent of the full price. He was prepared to accept that the present wholesale price structure supported the recording industry well, enabling it to be innovative. Record buyers had the choice of high shop prices or lower mail order prices. On balance he considered that the price of CDs was satisfactory and a wide choice was available to the consumer.

9.78. *Mr R A Kempster* hoped that the inquiry would obtain satisfactory answers to the following questions:

- (a) Why was it apparently essential that all full-priced CDs cost virtually the same price? The production costs for an opera must be appreciably more than those for a solo piano recital.
- (b) Why was it invariably the case that a two, three, or four CD set cost two, three, or four times the single CD price? Surely the production, packaging and retailing costs were not in this proportion?
- (c) Why were cassettes and LPs sold at appreciably lower prices than CDs, when the actual manufacturing costs had now become similar?
- (d) Why did recordings from small specialist labels have to cost the same as those from major international companies? In other branches of publishing this was not the case—the stock of a major bookshop would reflect a diversity of prices as well as subject matter.

9.79. *Mr Kempster* did not consider that prices of CDs were necessarily too high, but did believe that some of the manufacturers' practices needed investigation and explanation, and that the behaviour of the major retailers, who had an apparent stranglehold on the market, should also be reviewed. He concluded that there was a suspicion of a monopoly which partially worked to the benefit of the consumer, but which mainly benefited the large manufacturers and retailers, and that it should be investigated.

9.80. *Mr J R A Lilley* raised the following points for consideration by the MMC:

- (a) Should a small number of companies, one of which had developed the CD format at great cost at a time when the technology was already dated, be allowed to force out other formats by simply using their dominant position and by not issuing recordings in those formats? He noted that one often heard or saw 'CD only' or 'no cassettes'. Thus it seemed that people were being forced to buy the high profit margin CDs to the benefit of the record companies and retailers.
- (b) Why limit comparison of the sales price of CDs in the UK with that of CDs in other countries? Why not make a comparison of the recording, manufacturing and distribution costs of CDs, LPs and cassettes, as well as their sales price? In this respect *Mr Lilley* noted that in quality terms it was difficult to distinguish between CDs and digitally recorded LPs.

9.81. *Mr G O'Neill* said that he had built up a collection of some 800 CDs covering a range of music from opera to rock and pop over the past four years. They were largely replacements for his existing vinyl record collection. A number of these recordings had been imported from the USA, Europe and Japan.

9.82. Mr O'Neill had observed that prices in the retail chains such as Woolworths or Boots tended to be near the top of the range. Those in the specialist chains such as Our Price, HMV and Tower varied; many records were at full price, but sales were held on a regular basis in these outlets and typically £2 or £3 might be deducted from the nominal price. It was in the independent record shops that prices were often lower, as such outlets had to compete with the chains. Here, price reductions might be made in niche repertoire as an inducement to regular customers; these stores also typically competed on the specialist knowledge of their staff and their willingness to order records either from within the UK or from abroad.

9.83. Mr O'Neill said that imported CDs were available, but at a higher price than UK product and in much smaller quantities. It was sometimes possible to obtain such imports before the release date in the UK but the major record companies tended to use their oligopolistic position to prevent the importation of such parallel product. Often, customers who had been willing to pay a premium for imported records found that the record companies reissued these at mid-price at a later date; this tactic tended to act as a disincentive to collectors purchasing imported CDs and enabled the major record companies to control the CD market. Mr O'Neill considered that the import licensing rules should be relaxed in order to encourage importers to bring product into the UK and increase competition.

9.84. In Mr O'Neill's view, the major record companies constituted an oligopoly in the international music industry. Their multinational operations allowed them to achieve economies of scale, for example in marketing, and to segment the market, thus enabling discriminatory pricing to occur. Their relationship with the independents was parasitic; while the latter discovered new talent, the longer-term gains from its exploitation were enjoyed by the majors. The latter also benefited from their long-term contractual relationships with artists. The majors had also effectively killed off the vinyl record, forcing consumers to purchase the more profitable CD.

9.85. Dr M C Steele said that, as recent contributors to the *Gramophone* magazine had pointed out, a blanket assertion that CDs were being overpriced by the companies that produced them considerably oversimplified the issue. He considered that there certainly was overpricing, but that the case had to be established fully, with examples.

9.86. Dr Steele said that the present full price for a CD of £14 to £15 was certainly too high-even allowing for inflation-and was inhibiting the type of expansion in sales that had occurred with the LP in the 1950s and 1960s. He hoped that a long-term study of production costs, clearly distinguishing technical costs (which one would expect to fall) and labour costs (which one would expect to rise in line with the RPI), would be made. He observed that the record collector would need to be satisfied that the second category was now the chief determinant-ie that the increasing price of the CD was not simply going into the pockets of the record industry at whatever level.

9.87. Dr Steele said that with a few minor exceptions, the industry had served the classical collector reasonably well so far as mid-price CDs were concerned. However:

- (a) The current high street price of £9.99 for EMI and PolyGram CDs-ie over 65 per cent of the full price-could not be termed 'mid-price'. This niche was filled by Classics for Pleasure and IMP, termed 'budget' price. He believed that the spirit, if not the letter, of trades description legislation should be applied to ensure the correct nomenclature.
- (b) Even allowing for VAT increases last year (very smartly passed on to the consumer by most high street retailers!), the mid-price CD had increased in price from £7.99 to £9.99 over the past two years-an increase proportionately higher than that of full-price CDs over the same period.
- (c) Regular perusal of *Gramophone* suggested that the listings of mid-price releases by the major companies had declined in number over the past two to three years. If these impressions were correct, he suggested that any inquiry into CD pricing would need to take this into account.

9.88. Dr Steele welcomed the arrival of the budget-priced Naxos recordings to the UK market and noted similarly that collectors had benefited from other, smaller producers such as IMP, which used British as well as Croatian and Hungarian orchestras, and had managed to maintain reasonable price levels, although he noted that such recordings were often poorly represented on the shelves of larger retailers.

9.89. He noted that in the late 1980s some companies-notably Olympia, Hyperion and Bis-had maintained price levels some £1.50 to £3.00 below those of the majors. Such price differences seemed to have narrowed since then. He said that while retailers might be responsible, CD purchasers needed to be reassured that it was not the result of a trend towards price setting at a uniformly high rate, and the end of free competition between independents and majors.

9.90. However, Dr Steele considered that the industry should be congratulated for giving the classical consumer value for money most of the time-ie providing over 65 minutes of music on each CD. Nevertheless, it still occasionally tried to sell CDs with 37 minutes of music on them at full price. Similarly, he noted that the industry had profited on works just over 80 minutes in length, usually spreading them over two full-price CDs-eg the *Nutcracker* ballet and *Salome*-although recently there had been signs that the industry had responded to criticism of this practice.

9.91. Dr Steele said he was surprised that the high street retailing arm of EMI (HMV) sold full-price EMI CDs at prices not greatly different from its competitors. He said that he knew the argument was that EMI did not want to compete unfairly with its high street rivals by exploiting its role of record producer and retailer: on the other hand he considered that this really amounted to a price-fixing understanding at the expense of the customer. In any case, it was commercially anomalous that a major recording company should also be a retailer.

9.92. In his view the recording industry had not helped itself by investing in new vehicles such as DCC and MiniDisc. The collector was having to subsidize technical developments that he or she might not want, and which were commercially inappropriate in the present climate of economic recession. Dr Steele argued that it made more sense to cut costs for existing well-established delivery systems (the cassette and the CD), rather than to spend vast amounts on research and development to devise yet more systems for which there was no mass market.

9.93. *Mr R Westcott* made representations on behalf of Analogue Addicts (Analogue), a national voluntary organization of which he was a member. Analogue had been formed in 1988 with the aim of saving vinyl LPs from disappearing.

9.94. *Mr Westcott* said that he appreciated that pricing might be the principal concern of the inquiry, but he hoped that the MMC would not fail to address the matter of the unfair treatment of the vinyl LP format. He considered that the media had failed to recognize the minority concern about the record companies' deliberate policy to eliminate vinyl LPs, in the interests of greater profits, and against public demand, by the 'forced' substitution of CDs. In *Mr Westcott's* view, LPs were good value for money (costing no more than £10.00 an album); they were the most collectable format with the best packaging; and most importantly, they offered musical superiority. The British specialist hi-fi industry had recognized vinyl LPs as having the best sound quality of any format.

9.95. Analogue considered that recent consumer surveys had indicated sufficient demand for vinyl LPs to warrant a renewal of sales from high street stores. However, it was clear that the record companies, which formed a cartel, wanted to control format supply to maximize profitability irrespective of the public's wishes. Analogue said that this was wrong. People deserved the freedom to choose, and vinyl deserved fair treatment.