

# **GOWERS REVIEW OF INTELLECTUAL PROPERTY IFPI SUBMISSION**

## **Introduction**

The recording industry is a dynamic, successful, innovation-driven and risk-taking business whose achievements and future success depend critically on adequate intellectual property protection. We are an industry that entertains, innovates, employs, invests, drives economic growth, contributes to cultural diversity and pioneers the knowledge economy.

This submission is written by IFPI on behalf of our membership comprising over 1,400 major and independent record companies operating in more than 70 countries.

We welcome the Gowers Review on Intellectual Property. This is an opportunity to ensure that the right intellectual property framework and the proper investment conditions are in place to fully unlock the economic and consumer benefits offered by the music and creative industries in the digital environment.

Intellectual property is central to the future development of the UK and global economy. It is the basis for rewarding creators for their work and is the spur to innovation and creativity. These are assets that are key to the future economic and cultural health of our society and to the post-manufacturing economy.

Intellectual property remains one of the few areas where Britain, and its European partners, can still be genuinely competitive on a global scale. At a time when Europe is losing jobs to outsourcing in Asia, where manufacturing costs are low, creative industries based on intellectual property generate an increasing percentage of GDP in Europe.

Europe's creative sector is also competing with the US. Creative industries are looking for EU policies that nurture Europe's creative community. The US is actively promoting and protecting its interest in the knowledge economy. It is vital that Europe keeps pace.

## **Intellectual property and unlocking economic value**

Creative industries based on the value of intangible services and rights – industries including music, film, entertainment, design, software and others – are today widely acknowledged as the key to future economic growth and employment. The global value of creative industries now accounts for over 7% of global GDP, a sector worth £720 million in 2005 and forecast to grow to £1 trillion by 2009 (source: PWC Global Entertainment and Media Outlook). This is a fast-growing, dynamic sector, one of the most successful globally, providing millions of jobs and bringing huge benefits in particular to the UK economy.

Creative industries, and the intellectual property rights that give value to their work, are also driving the digital era. They are the source of the commercial content demanded by consumers, without which the most exciting digital distribution technologies are

redundant. Intellectual property is the key to getting this content to the market, benefiting the consumer and unlocking economic value.

### **The UK music industry – a driver of the economy**

The UK, home of the world's first copyright law, has always set an excellent example to the rest of world in the priority that it has attributed to intellectual property rights. Britain played a major role promoting copyright legislation in the European Union and shaping the 1996 WIPO Internet Treaties. Britain's commitment to promoting innovation and creativity has helped bring huge economic and cultural rewards: the UK has the world's second most successful music industry, worth £5 billion to the UK economy; more recently, it has the fastest-growing *digital* music business in Europe.

The UK music industry is a driver of the British economy, responsible for 126,000 jobs and generating £300 million in VAT plus income and corporation tax. The industry is a net exporter with annual earnings in excess of £435 million.

British music's success has been achieved with no help from government other than via good intellectual property laws. Were it not as successful, it is possible that the UK government would set up committees, tax credits, and subsidies in the same way as it has helped the film industry. It does not need to do that. The UK music industry is only looking for the right intellectual property framework and proper investment conditions to allow it to deal with the many challenges it faces.

### **Copyright underpins the music industry and diversity of choice for consumers**

Intellectual property protection underpins the business of the music industry globally. Copyright is the means by which creators and innovators can be rewarded for their works, and thereby provides the incentive for creative business. Record companies' business model is based on what is best known as a "virtuous circle of investment" by which the revenues from a small number of successful recordings finance the substantial costs of developing, promoting and marketing new talent. The recording industry worldwide spends about 15% of its turnover on artists and repertoire (in the UK the percentage is usually higher) – more than almost any other industry.

The role of the record company as an *investor* in music cannot be overstated. Some £1.7 billion is invested in developing new artists each year, £207 million of that in the UK. No other sector in the music industry, from publisher to retailer, invests on any similar scale nor shoulders the substantial risks involved. No other sector is as dependent on having its content properly protected and its investments properly rewarded. None of this would be possible without effective copyright protection.

### **Dispelling copyright myths**

Copyright today is sometimes both misunderstood and misrepresented. Copyright is not a "monopoly"—it is a property right granted by law, which does not prevent independent creation or restrict competition among providers of similar services, but rather increases the choices available to consumers.

Copyright holders do not seek to "lock up content" from consumers. In fact the opposite is true. The music industry prospers only by making its music available. In the digital era, record companies have demonstrated a commitment to making music available as ubiquitously as possible – as long as it is properly licensed and paid for.

Strong copyright protection furthers the advance of technology, with copyright itself an enabler of new digital services. The record industry is committed to embracing the technologies of the digital era, while stopping their abuse in ways that harm copyright holders.

### **The transition to a digital music business is working**

The recording industry is today successfully transforming itself into a digital business. It is developing multiple revenue streams and flexible distribution, and is proactively licensing music in as many legitimate formats and channels as possible. Digital technologies have opened up diverse new ways of reaching consumers. There are at least ten revenue channels for record companies today, compared to a decade ago when recorded music was available only on CD or radio. Today's music distribution channels range from a track downloaded from iTunes to a master ringtone and an online subscription. There are well over two million tracks available from more than 300 online services, at an average cost of around 79p or less than a euro – less than the price of a cup of coffee or a London bus fare. More than any other industry selling creative content in the digital marketplace, the music industry is meeting the demands of consumers for flexibility and convenience in their experience of acquiring music.

The digital music market has grown quickly in the last three years. Digital revenues to record companies internationally in 2005 totalled US\$1.1 billion, over 5% of the industry revenues, and are widely forecast to rise to 25% by 2010.

The existing intellectual property regime is key to this emerging market. Existing copyright laws largely provide the appropriate legal protection, allowing record companies to use technological measures to distribute and protect their creative works. They make possible the use of digital rights management (DRM) systems which help flexibly tailor music offerings to consumer demand. DRM is an essential building block of the digital music economy – and it is working, via services like iTunes and Napster, in the market *today*.

The copyright regime is also helping the recording industry protect its creative content and tackle piracy. Adapting its business model to the digital era has been an extraordinarily complex and difficult exercise for the music sector, and one in which copyright protection has played a vital role. Between 1999 and 2003 an explosion of free unauthorised music saw the number of unlicensed music files on the internet jump from less than one million to more than one billion.

At the same time a series of network operators have built businesses based on copyright infringement. Actions against illegal file-sharing have played an important role in educating consumers and creating the space for new legitimate services. Even more important, a series of important legal judgments in 2005, including against Grokster and Kazaa, has significantly improved the legal and commercial environment for the emerging legitimate digital market internationally.

Education has played a key role too. Over the last three years record companies have rolled out an internationally-coordinated programme of education initiatives aimed at young people, parents, businesses and internet users. This is an area with a great deal of undeveloped potential for partnership with government, particularly in incorporating copyright education into the school curriculum.

Just as the role of copyright can be misunderstood, the music industry has sometimes been criticised for not turning to digital distribution sooner than it did. Such criticism is unfair and uninformed. It ignores many factors, including the complexities of digitising

and protecting repertoire; the absence – until the arrival of the revolutionary iPod in 2001 – of a credible intermediary between the record company and the consumer; and the speed with which record companies have licensed the vast bulk of their repertoire the last three years. Moreover, none of the critics has offered a coherent statement of what the music industry should have done differently to adapt to the new conditions of the digital market.

The music industry was the first to deal with these challenges, confronting problems that are now being faced by other sectors such as the film and newspaper industries. And in today's digital environment, it is the *music business* which is pointing the way forward for those other creative industries. Three years after record companies turned to digital distribution, the film industry is offering consumers the first movie downloads, while newspapers in the UK and elsewhere are grappling, as yet rarely profitably, with the challenge of monetising the internet.

## IFPI'S SUBMISSION IN SUMMARY

**The UK's copyright regime provides a good framework but requires certain updates.**

The UK government has long understood the importance of copyright, including in the digital era. It has also understood the importance of letting market forces, and not the state, determine the future of the music business.

UK copyright law was written in a balanced way that has helped creative industries adapt to technological and market change over many years. It has successfully stood the test of time and has been repeatedly reviewed to accommodate the challenges of digital technologies - most recently in the context of implementation of the EU Directives on Copyright and E-Commerce.

Today UK copyright law is broadly appropriate to the digital era, but needs updating in certain significant areas - particularly in the area of term of protection for sound recordings, and where the abuse of new technology has shifted the policy balance and undermined copyright holders' ability to enforce their rights meaningfully.

***IFPI seeks the assistance of the UK government in improving the copyright law and environment in the following important respects:***

1. *Extend the term of protection for sound recordings.* Recommend to the EU that the term of protection for sound recordings be extended from 50 years to match the 95 years protection provided by the US. This is needed to promote UK and European economic interests, end discrimination with our trading partners and bring performers and record companies' rights closer into line with other groups of rights holders.
2. *Address the problem of stream ripping.* Help ensure that the law does not sanction the use of new stream ripping capabilities to selectively copy individual sound recordings from streamed programmes, making time-based transmissions into a substitute for purchasing permanent copies.
3. *Assist in obtaining improved cooperation from ISPs.* Provide support for the record industry's efforts to obtain meaningful cooperation from ISPs in the fight to control P2P piracy, including commitments to terminate the accounts of serious infringers.
4. *Clarify authorisation liability.* Clarify the law to ensure that unauthorised P2P services and others that induce or encourage the use of their services to infringe copyright can be held liable for authorisation of infringement.
5. *Secure more effective enforcement.* Take steps to secure more effective enforcement of rights of UK right holders, including ensuring the availability of adequate civil and criminal sanctions at both UK and EU level as well as government commitments to improved enforcement abroad (with a focus on the problem countries of China and Russia).
6. *Secure full performance rights abroad.* Help to secure an adequate range of rights for UK record producers abroad, particularly a full public performance right in the US, China and Japan.
7. *Avoid undermining copyright rights.* Refrain from changing the law in ways that would undermine the value of copyright rights or the ability to enforce them, in particular by adding or expanding exceptions in such a way that legitimate markets are harmed, by

*stepping in to regulate the ongoing marketplace development of DRM, by interfering with well-functioning licensing mechanisms, or by removing control over parallel imports from outside the EU that undercut European markets.*

8. *Increase public awareness of copyright. Assist in increasing public awareness of the meaning and value of copyright, including the scope of rights, the nature of exceptions and the beneficial functions of digital rights management. This should include incorporating copyright into the school curriculum.*

Each of these points is explained more fully below in our responses to the questions posed in the Call for Evidence and our list of "Other Issues", and/or in the submission to this Review by the British Phonographic Industry (BPI).

## GENERAL QUESTIONS

### 1. How IP is awarded

- (a) Are there barriers to obtaining IP rights due to system complexity? What could be done to improve this situation?
- (b) How easy is it to find out about obtaining IP rights? What could be done to improve awareness for businesses and innovators? Is there sufficient awareness of the need to protect IP internationally?
- (c) Are there barriers to obtaining UK IP rights on grounds of cost? What drives these costs?
- (d) How do these costs compare internationally in your organisation's experience?
- (e) Do you have any comments on the UK Patent Office fees structure for obtaining and renewing IP protection?
- (f) Is lack of trust in the system a barrier? To what extent do you rely on other tools to bring innovation to the marketplace, such as being first to market, maintaining trade secrets, or using an open innovation model to generate value through reputation or network effects?
- (g) Are there specific barriers to obtaining IP rights in your sector?
- (h) Are there specific barriers to obtaining IP rights for small businesses or individuals?
- (i) How well does the national system for awarding IP, administered by the Patent Office perform? How well do the international and European systems work?

On this question, IFPI refers to the response in the submission of the British Phonographic Industry (BPI), our counterpart in the UK.

## 2. How IP is used

- (a) What types of IP does your organisation use and why?
- (b) To what extent do you seek multiple overlapping forms of IP protection?
- (c) To what extent are these decisions influenced by sector-specific considerations?
- (d) How does your company value its IP? Are there problems with raising finance against intangible assets based on IP? What improvements could be made in this area?
- (e) To what extent does the term of IP rights at the margin affect investment decisions?
- (f) How well does the UK IP system promote innovation?
- (g) To what extent does your organisation make use of other methods used by Government to encourage innovation, such as public funding?
- (h) Are data on the use of patents and other forms of IP useful as a means of measuring innovation?
- (i) Do you have any evidence as to the static or dynamic costs that IP rights (as statutory monopolies) impose on the economy?
- (j) Have you encountered patents or other IP rights being used defensively, i.e. obtained not to develop products, but only to prevent others from doing so? Under what circumstances do you consider this acceptable?

The record industry relies on copyright to protect the value of its creative products. Copyright is the lifeblood of all segments of the music industry. Record companies also use trademarks to distinguish their products from those of their competitors, and to inform consumers of the source of the music they are buying. While some record companies own patents, patents are generally not a major component of the company's business. On the other hand, record companies are often licensees of patents belonging to others, particularly those relating to technologies used in different formats in which recordings are embodied or disseminated.

The term of copyright in sound recordings can and does affect investment decisions. The catalogue of a company owning recordings that are likely to appeal to the tastes of consumers in a country with a longer term of protection will be worth more than the catalogue of a company owning recordings with greater appeal in a country with a shorter term. Moreover, as shown in the Liebowitz report attached to this submission as Annex A, there is a commercially significant greater incentive to invest in creating recordings that enjoy a substantially longer term.

We believe that the IP system in the UK does a good job of promoting innovation creativity. The law is generally quite effective in granting adequate rights and facilitating licensing and efficient business models. Increased creative output could additionally be fostered by extending the term of protection for sound recordings to match that of the UK's chief competitors. In addition, there are several areas where the law needs to be updated in order to stop the abuse of technology eroding the incentives to create. These areas are described in more detail in other sections of this submission.

The record industry does not make use of public funding, but relies on the market mechanism of copyright to fund its creative efforts. Over the years, copyright has proved to be the most effective model to incentivise a wide variety of creative activity.

There is a substantial body of literature attempting to measure the use of intellectual property. Although much of it relates specifically to patents rather than copyrights, most of the literature supports the economic benefits provided by IP protection. See the bibliography of relevant sources, attached as Annex B to this submission.

It is inaccurate to consider copyright a monopoly in a negative sense. It must be recognised that copyrights are quite different from patents in many relevant respects. Most importantly, they do not confer an ability to block the creativity of others. If a work is independently created, even if absolutely identical, it does not infringe copyright.

In addition, copyright does not protect ideas or facts — it leaves subsequent authors entirely free to build on concepts or even general styles contained in the works of their predecessors. Moreover, copyright law incorporates a balance in defining the scope of rights, with a set of exceptions permitting a variety of reasonable uses without permission or even payment. Given all of these differences, copyright protection itself does not prevent others from developing competing products.

Multiple sound recordings compete for consumer attention in the market. Copyright, with its low barriers to entry, provides an incentive to produce these works and engage in such competition.

### 3. How IP is licensed and exchanged

- (a) How easy is it to negotiate licences to use others' IP for commercial or non-profit purposes?
- (b) What mechanisms do you use for finding potential licensing partners?
- (c) How easy is it to use others' IP for research purposes? Have you experienced difficulty around research exemptions?
- (d) Are there specific barriers to licensing in the main forms of IP currently used: patents, copyright, trade marks, and designs?
- (e) Are there barriers to licensing IP on grounds of cost? What drives these costs?
- (f) Are there specific barriers to licensing IP in your sector?
- (g) Does your organisation use methods to facilitate exchange of IP - such as crosslicensing or pooling IP rights with other firms or organisations?
- (h) Are there specific barriers to licensing IP rights for small businesses or individuals - for example barriers to entry to patent pools?
- (i) Are there barriers to trade and exchange of IP internationally?
- (j) Does your organisation consider renewing patents using "licence of right" provisions in patent law (which entitle any person to a licence under your patent and reduce your renewal fees by half)?
- (k) What could be done to improve "licence of right" provisions and business awareness of them?
- (l) Do you have any experience of the compulsory licence provisions within current patent law? Are they effective? How could they be improved?

See response to this question in the submission of BPI.

#### Licensing models

In the copyright field, there are many different licensing models in use. They include blanket and collective licensing models, as well as recent alternatives such as those offered by Creative Commons. These models are voluntarily agreed and they function against the backdrop of the basic rights established by law. The goal should be to maximize choice and flexibility for both rightholders and users - and the current law in the UK makes this possible.

#### Barriers to trade

As to question (i), IFPI's members experience direct and indirect barriers to international trade and to the international transfer and exercise of IP in a number of countries. The biggest barriers are high piracy rates - in many countries exceeding 90% - and direct market access barriers.

At this point in time, the priority country in terms of market access problems is China. This is the world's potentially most exciting music market for UK exporters, and is already the largest market in Asia after Japan. However, censorship, ownership and investment restrictions and a piracy rate of nearly 90% are a substantial barrier to the Chinese market.

One important obstacle to international trade and international exercise of IP is censorship. In China, all audio and audio-visual products are subject to strict scrutiny by the Ministry of Culture before they are allowed to be imported, published or reproduced in China. All song lyrics require approval (and record companies have to submit translations). The Chinese government also polices and filters Internet traffic into China.

China also applies direct restrictions for international companies to enter the Chinese market and exercise their IP, e.g. the Chinese government limits the quota of non-Chinese

content in the market. Record companies setting up a business in China require a government approved joint-venture with local companies. And the holding of foreign companies is capped at 49%.

We urge the UK government to continue its efforts to eliminate barriers to international trade, in particular in using its influence in the European Commission to make market access to China a high priority.

#### **4. How IP is challenged and enforced**

- (a) Are there specific problems with enforcing the main different forms of IP: patents, copyright, trade marks, and designs?**
- (b) Are there barriers to challenging infringement and enforcing your IP rights on grounds of cost? What drives these costs?**
- (c) To what extent does your organisation make use of other methods than litigation to resolve IP infringement cases, for example the Patent Office opinion service, mediation services, Alternative Dispute Resolution, or the Copyright Tribunal?**
- (d) To what extent do you use IP litigation insurance? How effective is it?**
- (e) Are there barriers to using such methods to settle IP disputes without recourse to litigation? How might they be removed?**
- (f) Are there specific barriers to challenging and enforcement of IP rights for small businesses or individuals?**
- (g) To what extent is the risk of litigation a factor in your organisation's investment in innovation?**
- (h) What are the principal barriers to efficient and successful challenge and enforcement internationally?**

IFPI coordinates the enforcement of its members' rights internationally. IFPI's enforcement department works with copyright holders and law enforcement agencies worldwide through a structure of regional anti-piracy coordinators and in cooperation with IFPI's regional offices and national industry bodies. IFPI's litigation department coordinates litigation for record companies in countries around the world. We work closely with international intergovernmental bodies such as WIPO, UNESCO, OECD, WCO, WTO and The Hague Conference, as well as the European Commission to enhance the efficiency of enforcement through international cooperation and commitments, legislation, training and improved infrastructure.

Improved international enforcement requires changes in other countries and at international level. The UK government plays an important role in the work with G8 countries, as well as in influencing European priorities and initiatives and contributing to the work of international organisations, and should use these avenues to tackle obstacles to international enforcement. We urge the UK government to work towards this end through the DTI, within the G8 context, in its work with the European Commission and DG Trade, and through input to international organisations such as the WTO, WIPO, the OECD, WCO and UNESCO, taking into account the problems and priorities listed in this section.

#### ***International framework - background***

As a starting point, the WTO TRIPS Agreement provides important enforcement obligations governing both specific enforcement mechanisms (Art 42-60) and required standards of meaningful application to ensure effective action, expeditious remedies and deterrent sanctions to prevent infringements and deter further infringements (Art 41 and 61). But poor adherence in many countries is a major obstacle. The WTO offers a useful review mechanism in the form of the TRIPs Council, which reviews the relevant law and regulation in WTO member states and keeps track of the operation of the TRIPs Agreement in WTO member states. The WTO also offers a dispute resolution mechanism, but cases based on the enforcement of intellectual property are rarely brought. Other international intergovernmental organisations and primarily the OECD, UNESCO, WCO and WIPO engage in useful supporting work examining enforcement strategies, but have no review or sanction mechanism.

At national level, only the US through the Special 301 annual review process imposes sanctions on countries with inadequate enforcement. The UK DTI maintains a close working relationship with rights holder groups and gives consideration to their priorities in its work program, but does not exert direct pressure on third countries.

At EU level DG Trade works with third world countries to improve enforcement, recognising the importance of IP and the detriment to the EU stemming from poor enforcement by major EU trading partners. Again, however, it suggests measures and offers advice, rather than imposing sanctions. Also at EU level, the Enforcement Directive on civil enforcement of IP was an important step to ensure the availability of essential measures in all EU member states. The Commission is also looking into an initiative on sanctions for criminal infringements of IP (see 'Specific Issues: Legal Sanctions on IP infringements').

### ***Priorities in legislation***

IFPI has developed a catalogue of legislative priorities from its enforcement and litigation experience, and through its work with the European Commission on the EU Enforcement Directive and with WIPO's Enforcement Division. The list below sets out a number of points that we urge should be included in the UK governments' work with third countries through the DTI directly, through DG Trade, and through work with WIPO and the WTO.

- ***Right to information***

International enforcement of IP relies heavily on access to information about the source of infringing products and services, the distribution or dissemination network, and information making it possible to assess the size of the problem and to substantiate claims for damages. The UK system of disclosure recognises this need and adequately addresses it, but similar provisions do not exist in many other countries. The need for a right to obtain infringement-related information (including from third parties) is recognised in Art 8 of the EU Enforcement Directive, but many countries in the EU and elsewhere do not provide a sufficient legal basis.

- ***Presumptions of ownership***

Many countries still permit frivolous and unnecessary challenges to ownership of copyright even when there is an obvious infringement. In particular in cases involving repertoire and contractual relations from a multitude of countries it is neither economical nor proportionate to prove initial ownership and the chain of title, and can tie up limited judicial resources. This can and should be easily avoided by providing a legal presumption of ownership (based on the name appearing in the context of the work). This is recognised in the Berne Convention for authors and more recently in the Enforcement Directive for phonogram producers, as well. Presumptions of ownership as well as presumption of the subsistence of protection for the benefit of authors and phonogram producers alike should be recognised in all countries.

- ***Statutory damages***

Providing merely compensatory damages is not a sufficiently deterrent remedy and makes IP violation a lucrative 'business'. The difficulties of substantiating damages discourage the assertion of valid claims. International enforcement of rights through multi-territory litigation is very costly and the damages and costs

awarded by courts to the successful plaintiff in many countries do not even cover a meaningful portion of the actual loss. All countries including the UK should provide courts with the ability to award statutory damages at their discretion.

- *Freezing of assets*

Many infringers have set up systems to hide assets, to avoid personal liability, and to move any gains between countries. All countries should provide meaningful claims and procedures to freeze personal and corporate assets of alleged IP infringers in a meaningful and timely manner.

- *Export control*

For customs, to control exports (as well as imports) is an important tool in international enforcement, in particular in countries with a high capacity for the production of creative content on physical carriers, i.e. optical discs. As a priority, the Russian Federation, which is the second biggest pirate market worldwide, should introduce export controls to avoid high volumes of infringing and counterfeit content entering the European market.

### ***Obstacles resulting from infrastructure and resource allocation***

IFPI also seeks the government's assistance in removing existing practical obstacles to effective enforcement in other countries. The most serious of these obstacles are as follows:

- *Lengthy and inefficient proceedings in other countries:*

In many countries it is uneconomical even to start proceedings, given that court delays mean they will continue for years to the first instance judgement on the merits.

- *Securities required for border seizures, preliminary injunctions, or asset freezing.*

For many rights holders it is difficult to fund legal action because the most essential measures, e.g. preliminary injunctions, asset freezing orders and border seizures, are granted subject to the payment of high levels of bonds or securities.

- *Legal standing, documentation and formalities*

In many countries, requirements on legal standing or evidentiary rules are cumbersome and may require rights holder representatives from other countries to appear in court in person. Other obstacles include the need to present documents issued in countries other than the forum in a certain form or in official translations.

- *Inaccurate WHOIS data*

The public WHOIS service providing information about domain name holders is a standard feature of domain name systems around the world. IFPI as well as other rights holders seeking to stop and prevent infringements of their rights online rely heavily on the public WHOIS databases maintained by registry operators.

This information is essential to address online infringements of IP quickly in direct contact with those who can remedy the problem. WHOIS information supplied by domain name holders (registrants) who intend to violate rights is frequently – and not surprisingly – incomplete or inaccurate. Overall, WHOIS directories are a long way away from being the reliable source of information that they need to be.

### ***Free zones***

One problem experienced by IP rights holders and recognised by the World Customs Organisation (WCO) is the development of Free Zones, i.e. zones that are placed ‘outside’ the application of customs rules, with the intention of creating an environment exempt from duties and taxes, but also subject to simplified administrative procedures. While the creation of Free Zones is not meant to cut into customs’ control and interception of infringing and counterfeit goods, Free Zones are in practice used to hide the true origin of goods, and have been used to produce and dispatch counterfeit and pirate products. This issue in particular should be addressed by support for the WCO’s work in this area.

## SPECIFIC ISSUES

### Current term of protection on sound recordings and performers' rights

**Background:** The Review will fulfil the Government's commitment to examine whether the current 50 year term of protection on sound recordings and performers' rights in sound recordings is appropriate, in the light of its extension to 95 years in a number of other jurisdictions.

- (a) What are your views on this issue?
- (b) Is there evidence to show the impact that a change in term would have on investment, creativity, and consumer interests?
- (c) Are you aware of the impact that different lengths of term have had on investment, creativity, and consumer interests in other countries?
- (d) Are there alternative arrangements that could accompany an extension of term (e.g. licence of right for any extended term)?
- (e) If term were to be extended, should it be extended retrospectively (for existing works) or solely for new creations?

The current term of protection for sound recordings and performers' rights in the UK is too short in the broader context of term of protection in other countries outside the EU and for other types of works within the EU. This is to the detriment of the music industry, performers, investment in music and the UK economy as a whole.

The term of protection for sound recordings in the UK, set by the EU Term Directive, is now 50 years from the date of publication. This term is significantly shorter than the evolving international trend. In the US in particular, sound recordings are entitled to 95 years of protection (or life plus 70 for those that are not works for hire). Many other countries have extended the sound recording term to 70 or 75 years, including Australia, Brazil, Chile, Mexico, Morocco, Singapore and Turkey.

The implications for the UK are clear: UK record companies have assets that are less valuable, because less long-lasting, than those of record companies in many other countries, including the United States. They have less incentive to invest in R&D, to invest in creating new recordings, to invest in digitizing and restoring old ones, or to take chances on innovative and untested acts. None of this is good for consumers, or for the competitive position of the UK economy.

Even looking at the issue solely within the EU, the term of protection for right holders in other types of works is life plus 70—the approximate equivalent of 95 years, nearly twice the length of the term for sound recordings. This disparity is neither rational nor equitable. Two creators creating in the same year, one a composer and the other a performer, will enjoy very different rewards. If both are fortunate enough to live 50 more years, the composer will continue to reap benefits from his composition, while the performer will no longer receive any royalties for his performance. If they do not survive that long, the family of the composer will collect royalties while the performer's will not. In fact, many performers these days outlive their royalties and if they are not famous, highly successful artists, may lose their only livelihood. It is for these reasons that several thousand performers have signed petitions seeking term extension for sound recordings in the EU.

IFPI has commissioned research examining the economic impact of term extension in the EU. The study, by Professor Stan Liebowitz, is attached to this submission (along with a short summary). It provides important evidence for the economic benefits from extending the term of copyright for sound recordings. Among its conclusions:

- “Increasing the copyright term of sound recordings from 50 to 95 years would likely increase nominal revenues by almost 70%. Discounting these future nominal revenues, as is proper, lowers their present value to a range from 3% to 10% depending on the discount rate chosen. The discounted value is of sufficient size to allow an economically consequential increase in the production of new works.” Liebowitz study at ii.
- “Because the proposed extension of copyright is likely to have measurable impacts on revenues, the existence of a copyright length differential across markets will lead to production being focused more heavily on the market with the longer copyright term than would otherwise have been the case. . . . This difference in copyright duration works to the detriment of European producers and will almost certainly lead to inefficient production because the playing field is uneven.” *Id.*
- “Ownership provides valuable social function with regard to the efficient stewardship of valuable resources. This is equally true for copyright ownership. Similarly, reinvestments in copyrighted works are required from time to time. The potential benefits of both of these factors remain in effect forever and thus argue for a longer copyright term.” *Id.*

As to the question about possible “alternative arrangements that could accompany an extension of term,” presumably this focuses on how best to ensure wide public access to works in which term has been extended.

The fundamental value of term extension itself lies in the enhanced availability of works to the public. Extending copyright term provides an economic incentive for greater investment and dissemination of older works in different formats and through different delivery mechanisms. It also provides a continuing stream of revenue to performers at a later stage in their lives (or to their heirs).

Concerns have been expressed about whether copyright owners will provide access to these older works during the extended term. This is an area where business motives coincide with the public interest, as profits from a longer term of copyright can only be enjoyed if the works are actually made available. At the same time, however, it is natural for policy makers to want to ensure that efforts to make works available to the public are not unduly frustrated for any reason – whether it be inertia or lack of funding.

There are many possible mechanisms for dealing with these concerns during an extended term—i.e., to ensure that if a record company is not ready or willing to make such a work available to the public, others are able to do so. All of them, however, require careful consideration and further discussion in order to arrive at a solution that will be equitable and feasible. The record industry is committed to working with all interested parties to achieve such a result.

Some parameters can already be established. As a preliminary matter, any solution must be workable throughout the European Union. In the context of this review, it therefore will be more constructive to outline policy goals rather than specific legislative proposals. For example, the conclusions could be that the term of protection for sound recordings should be extended; that a legislative mechanism should be built in to promote the public availability of works during the extended term, particularly where there is no commercial

exploitation taking place; and that the law should address the situation where the copyright owner(s) of such older works cannot be located. (See discussion of orphan works below).

Equally important, there are a number of pitfalls to avoid. Any solution must avoid establishing negative precedents that will cause problems in other areas of copyright. For example, formalities such as registration requirements are inconsistent with international treaties (Berne Convention Art 5; WIPO Performances and Phonograms Treaty Art 20), and it would be dangerous to suggest that treaty obligations can be ignored with impunity during the period of the extended term. (Such obligations include minimum rights for authors and the 3-step test for permissible exceptions.) Similarly, one should avoid overly burdensome, restrictive or impractical rules. The imposition of a statutory or compulsory license in particular would replace the flexible, efficient market mechanisms on which the copyright system is based with a broad governmentally-administered scheme, without a showing of the need to do so. A preferable approach would establish some type of fall-back alternative for only those situations where copyright owners are unwilling to exercise their rights under reasonable conditions.

Finally, any term extension should apply to all works still protected by copyright, not just works to be created in the future. Many economic arguments support the benefits of this approach. As the Liebowitz study demonstrates (pp. 19-21), an extended copyright in already-created works will place the copyright owner in the best position to avoid overuse, misuse, and consumer deception, and to invest in the expense of efficiently resuscitating old works as new technologies come along. Ultimately the benefit to consumers should outweigh any detriment. In addition, this is the only practical approach—otherwise we would end up with a system of unacceptable complexity, where each work has a different term of protection depending on what the law was on the date it was first created or published. For all of these reasons, every past term extension we are aware of in the UK and elsewhere has been applied to all works currently under copyright (see discussion in *Eldred v. Ashcroft*, 123 S. Ct. 769, 785 (2003)).

## Copyright exceptions - fair use / fair dealing

**Background:** There are a number of exceptions to copyright that allow limited use of copyright works without the permission of the copyright holder.

- (a) What are your views on the current exceptions in copyright law?
- (b) Could more be done to clarify the various exceptions?
- (c) Are there other areas where copyright exceptions should apply?
- (d) Are the current exceptions adequate or in need of updating to reflect technological change? For example copyright law in the UK does not currently have a private “fair use” exception. Such an exception might allow individuals to copy music CDs onto their PC and MP3 player for their personal use. Should UK law include a statutory exception for “fair use”?
- (e) How would you see content owners being compensated for such use?
- (f) To what extent has technological change presented difficulties in use of copyrighted material in the field of education?
- (g) Are there issues concerning the archiving of material covered by copyright?

U.K. copyright law contains an extensive list of exceptions and limitations to the rights of copyright owners, which have been carefully crafted to implement specific policy goals while avoiding too great an intrusion into the nature and value of the rights. It is this careful crafting that generally ensures compliance with the standard 3-step test for exceptions in international treaties and the EU Copyright Directive, which permits exceptions to be applied only (1) in certain special cases which (2) do not conflict with a normal exploitation of the work and (3) do not unreasonably prejudice the legitimate interests of the rightholder (EU Copyright Directive, Art 5(5)). The list of exceptions in the UK has been regularly adapted to respond to developments in technology and markets. It was most recently updated to deal with the challenges of digital technology in 2003, in the context of implementation of the EU Copyright Directive (Copyright and Related Rights Regulations 2003). At that time, the UK chose not to adopt a private copying exception.

In 2006, there have been no new developments with respect to sound recordings that warrant reopening this list or amending the existing exceptions. To the extent any new or expanded exceptions are considered for all types of works, such as exceptions for educational or library use, care must be taken not to allow non-profit intermediaries to serve as functional competitors to commercial distribution. For example, recent amendments to US law allowed libraries to digitize works in their collections for preservation purposes, and permitted digital transmissions of works to be used in the course of distance education—but subject to requirements of technological safeguards against unauthorized access and unrestricted distribution, including a limitation to on-premises use of libraries’ digital copies (see sections 108 and 110(2) of US Copyright Act). Such limitations are essential if the exception is to avoid significant damage to the value of the market for the work, and if it is to satisfy the 3-step test.

In particular, adoption of a broad US-style “fair use” exception would not be advisable. First, it is not one of the exceptions permitted under the EU Copyright Directive (Art 5 (2)(b)). In any event, such an exception would not fit well within the UK copyright structure, which differs from the US in important respects. Most fundamentally, it is inconsistent with the approach of specific, detailed exceptions on which the balance struck by the Copyright Act is based. If a “fair use” provision were enacted, its relationship to the existing exceptions would be ambiguous and unclear. This is particularly true with respect to the “fair dealing” exception that has been a cornerstone of UK copyright law for many decades. Fair dealing addresses much of the core of what

might be called “classic” fair use, and the overlap would be difficult for right holders and users to interpret and courts to apply. It must be borne in mind that the generality of the US fair use provision works in the context of a century of judicial decisions giving it content. The fair use doctrine was first developed by the courts, and was much later codified in very general terms so that its meaning could continue to be developed by the courts. It is therefore not easy to import into a very different legal context. In the absence of such a well-established interpretive backdrop, the doctrine’s vagueness would cause significant confusion.

One specific example raised in the Call for Evidence relates to the advisability of enacting a new exception that explicitly allows individuals to copy CDs onto PCs and MP3 players for their personal use. While this idea at first glance may seem unobjectionable, adding such a “personal use” exception to UK legislation would be unnecessary and dangerous. To begin with, there is no real-world problem here that needs a legislative solution. Today’s technological capabilities empower individuals to copy all types of copyright works in many formats. Much of this activity is technically infringing, but copyright owners choose not to assert their rights against individual users who engage in acts of de minimis personal copying. This has been true since the invention of the photocopier, and the current generation of devices that can copy digital entertainment products are simply the latest iteration. No one has ever been sued or threatened with legal action for copying a lawfully purchased CD onto a digital recording device for personal use. Any concern about this issue is purely theoretical.

At the same time, seeking to address this theoretical issue through legislation is likely to have damaging practical consequences. The overriding message to the public would be that all copying for personal use is permitted without limitation. Consumers, who will not study the exact terms of the statute, may well assume a free pass for copying music at home, from any source, in any amount, and for any purpose—including to share with an unlimited community of friends or even anonymous mutual interest groups. Moreover, unless such legislation were carefully and narrowly circumscribed, and adequate remuneration to rightholders assured, it would run a serious risk of violating the 3-step test of international treaties and the EU Copyright Directive. See recent decision of the French Cour de Cassation in *Universal Pictures v Que Choisir*, 28 February 2006 (explaining how private copying can be inconsistent with the the 3-step test).

There are many ways in which a new law on this subject could be misconstrued, all of which would have a substantial negative impact on right holders’ legitimate markets. The law may be seen to authorise illegal downloading from the Internet, or copying a CD purchased by a friend—both of which would substitute for a sale. It may be seen as permission to make a copy of one’s own CD to give to friends, to post it online in a shared folder, to make unlimited numbers of copies in each of multiple formats, or to ignore agreed-upon terms as to the extent of permissible copying. Any of these overbroad interpretations would result in a significant incursion into the core ability of right holders to determine how best to monetise in the most appealing way the public’s enjoyment of their creations. And the damage would be magnified by providing incentives for the development of services set up to make “personal copies” at consumers’ requests, or providing a defence to authorisation liability for such services (see authorisation and stream ripping discussions in “Other Issues” below).

Such a change in the law would be particularly inappropriate at this point in time, when markets and technologies are rapidly evolving to give consumers the ability to choose among offerings with different prices based in large part on how many copies can be made, in which formats and for what purposes. This is an area where market mechanisms are working—providing consumers with the freedom to do exactly what they want, in more flexible ways than any legislation can provide. This issue is therefore becoming a

relic of the past, with implications only for legacy formats. It would not make sense for the government to act so as to interfere with positive market developments or create risks that are accompanied by only diminishing benefits.

There are more productive and less intrusive ways to address such concerns. Greater clarity about what is permitted as a matter of both law and practice could be provided through education and public awareness campaigns. The record industry can contribute by confirming that record companies will not pursue private copying that is innocuous in nature—i.e., an individual copying a CD that he or she has purchased onto his or her iPod or similar device, without further distribution, where there is no agreement as to the terms of copying.

## Copyright – digital rights management

**Background:** Increasingly digital media content is distributed with digital rights management (DRM) technologies that can enable rights-holders to track usage and prevent unlicensed copying by technological means. However concerns have been raised about interoperability and that such technologies may impair the content consumer's legal rights. For example they may be unable to take into account exceptions to copyright, the ultimate expiry of copyright term, or the future evolution of technology. They may therefore undermine legitimate rights to access digital content, now and in the future. (NB: We are aware of all formal submissions that have been made to the All Party Parliamentary Internet Group on this issue)

(a) Do you have a view on how the use of digital rights management technologies should be regulated?

In responding to this question, we would like to start by clarifying what exactly is meant by digital rights management (DRM), given the misleading and incomplete ways in which that term is often used.

Technological measures used in connection with the distribution of music and other copyright works are an essential tool enabling the development of a flourishing digital music market. These measures, broadly known as DRM, may also encompass the narrower concepts of technological protection measures (TPMs), copy control technologies (CCTs), and rights management information (RMI).

In their totality, DRM technologies implement the varying terms and conditions on which copyright content is made available. In many ways, they are analogous to rules of retail establishments and performance venues in the bricks-and-mortar world, but permit much greater flexibility. It is no longer necessary to be limited to a single price for the viewing of a performance or the retention of a permanent copy. With DRM, consumers can be offered a wide range of options, involving different levels and durations of use for different prices. They may choose to purchase a disc, burn a copy, subscribe to a monthly service, listen to streamed music, or download singles or albums. Payments can be tailored to usage, benefiting consumers and right holders alike.

DRM technologies perform several beneficial functions. Most important, they allow works to be enjoyed at different prices for different levels of use. They streamline processes for agreeing on terms and conditions of use, and for licensing, billing and royalty payment. And they prevent indiscriminate dissemination of copyright works in today's world, where digital technology makes it possible to make and distribute multiple perfect copies with the press of a key. DRM provides the means for keeping a subscription as a subscription, a rental as a rental, and a download to one customer from becoming an upload to the rest of the world. In essence, DRM enhances the consumer experience while safeguarding the continued economic viability of copyright.

It is important to note that DRM is not a new development. It has already been widely accepted in the marketplace in connection with legal online music services as well as many forms of physical carriers. Consumers understand that when they purchase music online, their chosen form of enjoyment comes with certain functionalities and certain restrictions, reflecting the bargain they have struck. Thus, they may pay one price to experience the music by listening to streams, another to retain copies temporarily, and another to burn up to three permanent copies. The DRM is part of the background, designed to be transparent and not distract from the user experience.

DRM is working in the market. Digital music services have flourished, due to the appeal of their flexible offerings. Hundreds of legitimate online services are now available globally; record companies have licensed more than 2 million tracks for consumers to enjoy; and the number of tracks downloaded has more than doubled in the past year (reaching 420 million). iTunes, the most successful online service today, would not have been an attractive proposition for most right holders without DRM. As to physical carriers, DVDs and videogames have always been protected by copy controls, and consumers are accustomed to that fact. More permissive technologies for managing the copying of CDs have also been extensively deployed by some record companies in some regions.

As with all technology, DRM is neutral in that it can be designed and implemented in different ways—some more permissive and some more restrictive. But real-world market pressures lead to reasonable implementations. The business imperative for record companies is to maximize the sale of music. If any particular DRM gives the consumer a bad bargain, the consumer will walk away—and that DRM will quickly become a thing of the past. Flawed or draconian DRM will not survive.

The use of DRM is and should remain a matter of choice, which will vary among right holders depending on their goals and business models. Some may choose to refrain from any use of DRM, and some may use it only for tracking of purchases and royalty payments.

It should also be recognised that DRM, as a neutral technology, poses no inherent threat to consumer security or privacy. DRM technologies are no more insecure than other software products, all of which can be developed and tested sufficiently so as to avoid unacceptable risks. The record industry is also committed to respecting user privacy, and does not use DRM to inappropriately gather personally identifying information.

In terms of legal regulation, DRM is already subject to a number of different regimes. These range from the prohibition on circumvention under copyright law, to broadly applicable rules on consumer protection and privacy. Many of the concerns noted in the Call for Evidence were thoroughly examined and considered in developing the anti-circumvention provisions in the EU Copyright Directive and in UK law. They have been adequately addressed and there is no reason to re-open the same exhaustively debated ground.

In particular, achieving interoperability is a key goal of the record industry. Consumers should be able to enjoy the music they buy on a wide variety of devices and services. But this is not inconsistent with the use of DRM, and can be addressed by market forces rather than a change in the law. The goal can be achieved even when proprietary DRM systems are used, as long as providers of DRM technology agree to allow their systems to interoperate. In the meantime, we are working to improve the situation by licensing content onto all secure platforms and by contributing to cross-industry standards development. Work is already progressing in such cross-industry discussions, and the record industry is an active participant.<sup>1</sup> We believe that such voluntary market solutions are preferable to government intervention, which would inevitably be less flexible.

---

<sup>1</sup> An example of cross-industry standards development is being undertaken within the Coral Consortium, an open membership body which brings together content providers (including record companies and movie studios), service providers, consumer electronics manufacturers, and other technology companies. Coral's aim is to create specifications for an open, voluntary framework to address DRM and format interoperability issues. Rather than attempt to standardise DRM itself, the Coral Consortium has created an interoperability framework, using, where possible, existing open standards. Within this framework, content can move between systems that use different DRMs, but in a secure fashion. The aim is to allow proprietary DRMs to compete and evolve, while shielding consumers from the effects of incompatibility. See [www.coral-interop.org](http://www.coral-interop.org).

As to the other specific concern mentioned in the Call for Evidence, that DRM technologies “may impair the content consumer’s legal rights . . . to access digital content,” as a preliminary matter it must be made clear that consumers do not have legal “rights” to such access. There has never been any obligation for copyright owners to make their works available to consumers without the consumers’ agreement to the terms and conditions for use set by the copyright owners. Nor is there a legal right to exercise any of the exceptions to copyright—these are defences to a claim of infringement, not independently granted rights that the law protects against interference. Accordingly, European law confirms that right holders are entitled to use DRM in ways that may vary copyright exceptions. See EU Copyright Directive Art 5, 6 and recital 39.

Nevertheless, the EU legal structure protecting DRM technologies against circumvention has been intentionally constructed so as to address such concerns. Thus, there is no prohibition on circumventing technologies used to protect public domain materials, for example those in which term has expired. Similarly, there is a complex scheme for ensuring that exceptions are appropriately accommodated. Right holders are given the opportunity to make possible the exercise of lawful uses, and if they do not do so adequately, Member States have the power or even obligation to intervene (depending on the nature of the exception). The UK version of this mechanism provides (Copyright, Designs and Patents Act 1988, section 296ZE) that a user should first apply to a copyright owner for the means to make a permitted use. If this voluntary approach does not work, there is provision for the user to submit a complaint to the Secretary of State, if a permitted use is prevented by DRM. The Secretary of State may then, if necessary, direct copyright owners to take measures to enable access.

In fact, DRM can and should allow consumers to enjoy the experience of music in diverse and flexible ways. DRM is used today not just to restrict copying and distribution, but also to enable many uses that go well beyond the technical limits of copyright exceptions. These expanded uses may include making multiple copies in different formats for personal use, or appropriate sharing with friends and family. In some circumstances, use without any payment is accommodated—for example, sampling a recording for a period of time to decide whether to buy.

As to the concern about DRM failing to take into account the future evolution of technology, it is not entirely clear what this means. In general, DRM is more likely to be able to adapt to the evolution of technology than legislation possibly could. To the extent that this refers to the concerns library groups have expressed about archaic DRM and lost keys, and a consequent inability to preserve archival material in accessible form, we agree that these concerns should be addressed. This is a very specific problem for which effective solutions can be found without questioning the use of DRM or undermining its effectiveness for the core purposes for which it is intended.

In sum, there is no need for new regulation in this area. DRM is complex and evolving, with considerable market experimentation taking place. Occasional glitches have been experienced and quickly addressed in the marketplace, but overall this has been a positive story. Additional regulation at this point would be premature, and is likely to cause more problems than it solves. The fears that have been expressed by certain consumer and user groups need not and should not be realized, given the reality of consumer power in marketplace.

## **Copyright – orphan works**

- (a) Have you experienced any difficulties in identifying the owners of copyright content when seeking permission to use that content?**
- (b) Do you have any suggestions on how this problem could be overcome?**

Sound recordings generally provide clear indications of the name and location of the copyright owner, so that they are less likely to become orphan works than other types of creation. But companies may go out of business or transfer rights without a public record, so it is not impossible that sound recordings may seem to have lost their parentage.

Record companies are users as well as owners of copyrighted works. They record musical and literary works written by others, and may issue parodies or other new versions of others' sound recordings. Particularly when the works they wish to use were created many years ago, so that records of transfer and ownership may be unclear, it can sometimes be difficult to locate the actual right holder. Whether the work at issue is a sound recording, or other type of work, record companies and other would-be users may therefore not be able to secure a license.

Such problems could be overcome by a mechanism that permits those who have made a good faith, reasonably diligent effort to locate the right holder to proceed with the proposed use without fear of unreasonable liability. The key should be to remedy the block caused by the inability to negotiate, rather than to provide anyone with a windfall. In other words, any solution should ensure that on the one hand, the right holder who learns of the use has the opportunity to be compensated, but on the other hand, the user will not be subject to monetary exposure above and beyond an appropriate license fee.

The US Copyright Office recently proposed amending US copyright law to incorporate such a mechanism, based on extensive consultation and analysis (see US Copyright Office, Report on Orphan Works: A report of the Register of Copyrights, January 2006, available from: <http://www.copyright.gov/orphan/orphan-report-full.pdf>). The Copyright Office's recommendation is currently under consideration in the Congress. IFPI believes that this recommendation is balanced and reasonable, and could support a similar approach in the UK.

## **Copyright - licensing of public performances**

- (a) Have you encountered problems with the system of licensing and paying royalties to collecting societies for public performance of music and/or sound recordings?**
- (b) Could the system be clarified or simplified, and if so how do you see this working?**

Recorded music is increasingly used in commercial contexts in clubs, bars, shops, etc, to drive the business and to attract customers. The reason for the use of recorded music is simply to add value directly or indirectly to the services these businesses are offering to their customers. It is fair and reasonable that record companies and artists are paid when their music is used for public performance. Indeed, this is also recognised at the European level in the EU Rental and Lending Directive and its interpretation. It is essential that the UK complies with this obligation in full. Problematic in the UK are two overly broad carve outs from the public performance right in Sections 67 and 72 UK CDPA that should be deleted or further limited.

The sheer volume of the use means that the public performance market has become an increasingly important market for the record companies in the UK and internationally. For instance, the number of licensed premises in Holland alone is over 180,000, and in Spain over 95,000.

The volume of the users and uses also makes public performance licensing particularly suitable for collective licensing. The industry is therefore working actively with its collecting societies, including the PPL, to develop efficient collective licensing operations to meet the market demand.

While the industry is striving to facilitate the public performance of sound recordings, we expect that users also behave in a business-like manner. For instance users should:

1. Accept that music has value and be prepared to pay a fair market price for the rights. The current license fees are in many areas significantly below the real value of the rights to users.
2. Acknowledge the value of the collecting societies' services in facilitating licensing and reducing transaction costs. Users should see collecting societies as valuable business partners and providers of services and treat them accordingly.
3. Assume a more responsible and business-like attitude to music licensing by voluntarily seeking licenses and by accurately reporting music usage. Many collecting societies are still forced to spend most of their time and resources on the enforcement of rights -- in tracking down unlicensed users and auditing existing licensees.

We also note that there are serious deficiencies in these rights in other countries that are major markets for UK right holders. In particular, the public performance right is non-existent or unacceptably narrow in the US, China and Japan. We ask that the UK government assist in industry's efforts to remedy these problems.

## **Legal sanctions on IP infringement**

- (a) Are you aware of any inconsistencies or inadequacies in the way the law applies legal sanctions to infringement of different forms of IP or to different circumstances?**
- (b) For example, should criminal sanctions on online infringement be the same as those relating to physical infringement?**

As far as the levels of sanctions are concerned, judges are too often reluctant to use the full scope of sanctions available under the law. Severe sanctions have to be available and should apply to those copyright infringements that cause the most serious harm. We do not believe however that IPs have to always be treated the same, in particular in terms of the criteria applied in defining the criminal offence. Rights in trademarks for example require in their nature and exercise an element of a commercial context. This is not the case for copyright which covers all creative works. It follows that it would be wrong to require for all criminal IP offences a commercial purpose or scale, only because this is inherent to trademark protection.

The question of horizontal treatment of all IP alike has also been raised in the context of the recent discussion of a possible EU Directive on Criminal Sanctions for criminal infringements of IP. In consultations regarding the possible new EU Directive on Criminal Sanctions for criminal IP violations, IFPI and BPI, along with other copyright holder organisations, made the point that it is was not feasible to apply the same rules to patent infringements that are applied to trademark and copyright. This is essentially because the treatment of patent infringements – often claimed by another legitimate business acting at the same level in the distribution chain in the same market segment – do not lend themselves in the same manner to a harmonized broad brush approach at European level. We believe that in the context of a European Directive the rules on criminal offences and sanctions should not be determined for patent law along with other IP. We hope that the UK government uses the discussion on criminal sanctions for IP infringement at EU level to work towards a meaningful framework for copyright and trademark violations, adding to and improving the efficiency of criminal prosecution, facilitating EU-wide cooperation, allowing public prosecutors and courts to take into account previous convictions in other countries, and bringing in useful elements already adopted for civil enforcement from the EU Enforcement Directive.

The availability and level of criminal sanctions should depend on the general factors relevant to criminal prosecution, such as the extent of harm caused by the infringement. It should not depend on whether or not the infringement was committed online or in connection with a physical carrier. The TRIPS Agreement in Art 61 requires that as a minimum criminal procedures have to apply to wilful infringements on a commercial scale, which should cover all deliberate infringements that cause serious market harm. In most countries, the definition of what constitutes a criminal copyright violation is broader than the minimum standard required by TRIPS and it is left to public prosecutors to decide whether or not to initiate criminal prosecution taking into account the character, purpose, or effect of the infringement. This applies to online and offline infringements alike. We believe this is appropriate and submit that it would be impossible to make a clear-cut distinction between offline and online infringements, in particular given the particular need for legal certainty in criminal law. At the same time, we are aware that digital communication networks are used for infringements causing harm at an unprecedented scale. We propose that the UK works at EU level towards effective criminal procedures and sanctions without distinction between online and offline, taking into account the usual factors such as the harm caused.

## **Coherence between competition policy and IP policy**

- (a) Has your organisation experienced any activity linked to IP rights that you regarded as unfair competition?**
- (b) How did you deal with this problem?**
- (c) Was competition law effective at controlling this behaviour?**
- (d) Should competition law have a greater role to play in regulating IP?**
- (e) How would you see the system working?**

IFPI believes that competition policy and IP policy in the UK are coherent and that by and large they interact appropriately.

This is particularly true with respect to copyright. It is important to note that exclusive copyrights are not monopolies in the competition law sense, since exclusivity relates to individual works or recordings which form a small part of large and complex relevant markets. Moreover, copyrights differ from patents in important respects. As described above, copyrights are limited in scope, do not prevent subsequent independent creation, leave others free to utilize ideas and facts, and are subject to numerous statutory exceptions such as fair dealing.

A fundamental principle recognised in both EU & UK competition law is that competition law should not interfere with the essential subject matter of an intellectual property right. This is of great importance. If competition law is misused so as to effectively reduce the scope of rights granted under intellectual property law, then the incentive to make investments in creating intellectual property will be substantially undermined and the resulting uncertainty will further disincentivise investment. Investors in intellectual property need certainty that the scope of rights granted to them by the IP framework will not be effectively removed by overzealous application of competition law.

On the other hand, the exercise of intellectual property rights may properly be the subject of competition law action, where such exercise has an anti-competitive object or effect (something which is judged according to an established body of law at both the European and UK level). As an example, IFPI has supported action by the European Commission against customer allocation clauses contained in reciprocal agreements between authors' national collecting societies (see for example case COMP/C-2/38.126 – the "Santiago Agreement").

To conclude, IFPI does not see any need for change in the relationship between IP law and competition law in the UK. Competition law principles have been established and developed over a period of time, including in circumstances where copyright is implicated. Competition law doctrines are available where needed to redress anti-competitive conduct involving the exercise of IP rights, and the scope of copyright protection itself should not raise monopoly concerns.

## Parallel Imports / International Exhaustion

**Background:** European law does not allow firms to use trade mark or copyright law to prevent their goods sold in one EEA Member State from being imported and resold in another Member State – i.e. they are not able to segment the EU market. However European law does allow the use of trade mark and copyright law to restrict the imports to EU Member States of goods sold outside the EEA. It also specifically inhibits EU Member States from legislating to remove such import restrictions at the national level – so called “international exhaustion” of trade marks or copyright. There has been a good deal of debate, both here in the UK and at EU level, about the costs and benefits of removing restrictions on parallel imports. There is a further issue of firms taking advantage of variations in prices on pharmaceutical products across the EU and repackaging drugs bought cheaply elsewhere within the EEA to resell within the UK.

(a) Has your company been affected by parallel trade?

(b) What would be the impact on your organisation of a change in the current rules?

(c) What evidence is there of the costs and benefits, both for consumers and firms of the current rules?

The UK government and the European Commission have considered the issue of parallel imports recently in 1999 and in 2001, respectively. When the issue was addressed in the UK in 1999, the Trade & Industry Select Committee concluded that it was not in the UK’s interests to lift parallel import restrictions for music copyright or trade marks. The European Commission reviewed the issues in great detail in the run up to the EC opinion on exhaustion of trademark rights (2001/C 123/05, OJ 25.04.2001), attached as Annex C to this submission, which confirmed the rule of regional exhaustion and listed the arguments against international exhaustion. This decision was based in large parts on the extensive research conducted by NERA, S J Berwin and IFF Research (Final Report for DG XV of the European Commission, 8 February 1999, the ‘NERA study’) as well as the arguments presented in the public hearing. We refer to the NERA study and the European Commission opinion for a comprehensive collection of arguments, analysis and conclusions.

The main arguments considered by the Commission in its opinion in favour of regional exhaustion were (a) the recognition of the benefit of the comparatively higher economic value of IP rights in Europe, (b) the need to take into account that European businesses offer high quality post-sales services and face higher production costs than those benefiting from PI, (c) the fact that businesses will only serve developing markets for the benefit of developing countries using marginal prices if they are confident that the same goods are not re-imported onto primary markets and undercut prices, (d) the need for effective border control against counterfeits that would be compromised by parallel imports, and (e) the benefit to businesses and consumers alike in maintaining consumer confidence in the quality and safety of products. At the same time, the NERA study showed that price reductions expected to follow from PI would be negligible (between 0 and 2%). The Commission also recognised that – while the opinion focused on the exhaustion of trademarks – the same arguments applied to other IP and that many products carried a number of different types of IP that should all be subject to the same system of exhaustion.

Now even more than before the balance in the area of copyright - as far as the European interest is concerned - clearly favours regional rather than international exhaustion of rights. The pressure of low quality and counterfeit products onto the European market in particular from Asia and the Russian Federation has increased rather than decreased. At the same time, Europe has been faster than most other parts of the world in the take up of electronic commerce, increasing the choice available to consumers. In particular for

entertainment products that can be delivered digitally, the move from physical products to digital products has already shown a bigger impact in Europe than in other countries. Looking just at music alone, the UK, France, Italy, Germany, and the Netherlands are among the top ten digital markets worldwide.

We believe that the rule of regional exhaustion is best suited to promote the EU knowledge economy for the benefit of consumers and firms alike.

## OTHER ISSUES

### 1. Authorisation liability and P2P services

Another issue on which targeted government assistance is needed is to clarify the liability of online services, particularly peer-to-peer (P2P) services that induce or promote the use of their services for purposes of infringement. IFPI adopts and refers to the submission of BPI for a full explanation of this issue. We join in its request that the government should enact legislation, consistent with the emerging international consensus in cases such as *Grokster* and *Kazaa* that would establish clear liability for businesses that induce and feed off the unlicensed copying and making available of sound recordings.

### 2. ISP cooperation

Another issue of major importance to the future of the record industry is the role of internet service providers (ISPs) in the fight against Internet piracy. The cooperation of ISPs is critical to copyright owners' ability to address such piracy, both to remove infringing material quickly from the Internet and to bring legal action against infringers. ISPs are in a unique position with respect to both control over access to content and relationships with its providers, and are usually best placed to act promptly and effectively against infringement over their networks or services.

In seeking such cooperation, record companies are building on an existing legal framework: the EU E-Commerce Directive as implemented in the UK (in the Electronic Commerce (EC Directive) Regulations 2002). This framework was intended to provide incentives for ISPs to cooperate through conditional safe harbours for specified activities. It operates against the backdrop of potential direct or secondary liability for their role in disseminating infringing content, ensuring that if they behave responsibly, they will be protected against any monetary remedies.

What does this mean in the real world? First, ISPs are only eligible for safe harbours if their role fits within a defined narrow scope—i.e., if they act as true intermediaries, without becoming active or knowing participants in making infringing content available, or profiting from the infringement. Second, they must promptly remove or block access to infringing material they host upon being notified or otherwise learning of the infringement. Finally, they remain subject to potential injunctive relief in all cases, as both the E-Commerce Directive and the Copyright Directive make clear (see Copyright Directive article 8(3), as implemented in section 97A of the UK Copyright, Designs and Patents Act 1988, and the E-Commerce Directive article 12(3)).

In addition, generally applicable laws in most jurisdictions require ISPs to provide information about the identity of infringing subscribers, for purposes of enforcing legal rights. In the UK, record companies have successfully relied upon existing principles of English common law (in particular the decision of the *House of Lords in Norwich Pharmacal Co and Others v Customs and Excise Commissioners* [1974] AC 133) to obtain orders requiring ISPs to provide information necessary to identify infringing users. The courts, in considering applications for such orders, have recognised that there is no source for obtaining the information other than the ISP (for example, the decision of Mr Justice Blackburne in *Universal Island Records v NTL Group*, High Court, Chancery Division, 14 October 2005). ISPs have complied with these orders and provided

identifying information which has been used by UK record companies to take legal steps against the infringing end users.

Against this backdrop, the record industry worldwide has asked for reasonable and needed assistance from ISPs to contain the epidemic of online piracy we are currently facing. The key forms of cooperation we have sought are:

- **Assistance in quickly stopping the dissemination of infringing content.** Prompt removal of infringing material from the internet, or termination of the accounts of customers engaged in egregious infringing activity, upon receipt of notices from right owners.
- **Assistance in identifying infringers.** Retention of the necessary data, and cooperation with right owners and relevant authorities.

The recording industry has pursued various different paths to secure such cooperation, including through IFPI's internet anti-piracy program, through attempts to obtain voluntary agreements and industry codes of conduct, and where necessary, through litigation.

#### *Internet anti-piracy program*

IFPI and its network of national groups invest substantial resources each year in internet anti-piracy. ISPs in the UK regularly cooperate by removing or blocking access to ("taking down") content they are hosting upon receipt of a notice informing them that content is infringing and requesting that it be taken down (as they must in order to preserve their safe harbour from monetary damages). Through the cooperation of ISPs under the "notice and take down" system, IFPI and its national groups removed 75,515 www/ftp sites and 31.6 million files from the internet in 2005.

By contrast, infringing content stored on a user's computer and shared through a P2P network presents greater enforcement challenges. In this area, ISPs have been less willing to cooperate. There are a number of steps an ISP could take to stop such infringements – the most effective of which is to terminate service to an infringing user. While such termination is not required by the E-Commerce Directive or UK law as a prerequisite to safe harbour protection, it is feasible and not burdensome. In fact, it is part of the legislative structure in the United States, where an ISP providing Internet connectivity to a P2P user is entitled to the safe harbour only if it has adopted and reasonably implemented a policy that provides for the termination in appropriate circumstances of subscribers who are repeat infringers (US Copyright Act, section 512(i)).

We note also that ISPs clearly have the legal right to do so, since virtually all provide terms of service that prohibit the use of the service to violate the law, including copyright infringement, and reserve the right to terminate accounts if the prohibition is not respected. If all ISPs implemented these terms on an industry-wide basis, whether pursuant to a code of conduct or a legislative mandate, none would suffer any competitive disadvantage. They should enforce their terms of service and terminate service to subscribers who they are aware are abusing it to make infringing content available.

#### *Voluntary arrangements and industry Codes of Conduct*

The E-Commerce Directive also indicated that member states should encourage the drawing up of codes of conduct to contribute to the proper implementation of the ISP safe harbours (article 16(1)).

The recording industry is pursuing voluntary industry-wide codes of conduct in various countries as a possible route to improving ISP cooperation. At EU level, we have participated in discussions regarding the Reding Charter for audiovisual content online. Unfortunately, such voluntary codes have had limited meaningful results to date. The Reding Charter does not extend to music, and does not provide any meaningful obligation for ISPs to take steps to address P2P piracy.

Importantly, if ISPs were to cooperate in terminating the accounts of those infringing copyrights, it would reduce the need to continue suing individuals. Litigation against individuals (described further in the submission of BPI) has proved a successful and necessary deterrent. However, termination of user accounts would be a much more efficient course of action and similar to the consequences for a subscriber not paying his or her internet bill.

#### *Litigation against ISPs*

As described further in BPI's submission, BPI has coordinated legal action taken by record companies in the English courts against certain ISPs that are providing services to infringing P2P users, to obtain the identifying information needed to bring lawsuits against those users.

Although such ISPs are protected from monetary liability, as noted above copyright owners still have the ability to sue for an injunction. In the UK, the ability to apply for an injunction is preserved in section 97A of the Copyright, Designs and Patents Act 1988, which provides that a court has power to grant an injunction against a service provider where that service provider has actual knowledge of another person using their service to infringe copyright.

Record companies in the UK have not so far sought such injunctions against ISPs, but courts in other European countries have issued them. In Belgium, a court held that an ISP providing internet services to infringing P2P users was required to take steps to prevent users using its system to infringe copyright, and ordered the preparation of a technical report to outline the ways in which this could be done, including by filtering of content (*SABAM v Tiscali*, Court of First Instance of Brussels, 28 October 2004). In France, the record industry has obtained 130 orders requiring ISPs to terminate the accounts of infringing users, and in Denmark, a court recently ordered an ISP to take similar action (Supreme Court Order, 10 February 2006, in case no. 49/2005).

We believe that an English court would also grant an injunction against an ISP in similar circumstances. The equitable principles applying to the grant of injunctions are sufficiently flexible to permit a range of possible forms of relief, including an order requiring an ISP to cease providing internet services to a known infringing user, and an order requiring an ISP to block access to a known infringing service.

#### *Improving cooperation*

While the record industry continues in the UK a multi-faceted strategy to attempt to improve ISP cooperation, progress remains slow. The evolution of internet piracy has distorted the balance struck in the E-Commerce Directive. P2P infringement, which was not envisioned at the time the Directive was adopted, has become the predominant source of damage to copyright markets, and yet ISPs in Europe are not subject to any obligation to take meaningful action in return for their enjoyment of safe harbours.

So far ISPs have been unwilling to do so voluntarily. If reasonable assistance is not forthcoming, the record industry will need to take further steps, either through the courts or through seeking the government's help in obtaining greater cooperation and enabling meaningful action.

### 3. Stream ripping

IFPI joins in BPI's request for the Government's attention to and assistance with the pressing problem of stream ripping, which represents a significant threat to markets for copies of sound recordings. Advances in technology now allow consumers to selectively copy individual sound recordings from a digital broadcast or webcast and create massive libraries that substitute for legitimately purchased digital downloads. A detailed description of the problem and stream ripping tools available to consumers is part of the BPI submission.

At a minimum, the time-shifting exception in UK law should be amended to ensure that it does not cover stream ripping, or offer unintended protection against liability to the providers of stream ripping tools.

### 4. Copyright awareness and education

Education and public awareness on copyright have a vital role to play in the future success of the music and creative industries in the digital era. The recording industry has been extremely proactive in this area internationally in recent years. In some countries it has enjoyed significant support from government, in forms ranging from ministerial endorsement of industry initiatives to financial sponsorship.

Music sector education to date has focused heavily on people engaged in illegal file-sharing. IFPI surveys have consistently shown that due to a combination of education and deterrence actions, seven out of 10 people in Europe are aware of the illegality of unauthorised file-sharing.

As the digital market takes shape, however, a more long term and structural approach to copyright education is needed. The creative industries are forecast to see 46 per cent employment growth 1995 and 2015 (source: KPMG). Britain is preparing a generation of young people for employment in the creative and knowledge based economy - yet ironically, millions of young people from that same generation are leaving Britain's schools without the basic understanding of the copyright and intellectual property issues on which their future livelihoods may depend.

Copyright education in schools is one key to the long term future health of the UK's creative industries. It must become a higher priority for government. IFPI is calling for educational programmes on copyright, intellectual property and the value of creativity to be incorporated into the core curriculum of UK primary and secondary schools.

The recording industry looks to the UK government to match the considerable efforts already made in this area. IFPI has launched a series of multi-country educational projects in the last three years, each aimed at enhancing public awareness of copyright and of the issues surrounding music on the internet among specific audiences. These have variously been cited as best practice by the European Commission, endorsed by the International Chamber of Commerce, and jointly launched by the governments of Austria, Italy, Ireland, Hong Kong and Netherlands. They include:

- The cross-sector [www.pro-music.org](http://www.pro-music.org) campaign branded “Everything you need to know about music online”. The website, launched in six languages, is the most comprehensive international education resource on legitimate digital services and copyright issues. It is supported by an international alliance of musicians, performers, artists, major and independent record companies and retailers across the music industry.
- A guide produced with children’s welfare charity Childnet International and the music sector’s “pro-music” alliance - “**Young People, Music and the Internet**” – which has been distributed widely in 11 countries. The guide is cited in the EU Commission’s proposed “Charter of Commendable Practices” needed to stimulate the growth of film online. Available at [www.pro-music.org](http://www.pro-music.org)
- A publicly-available software programme, **Digital File Check**, which helps to remove or block any of the unwanted “file-sharing” programmes commonly used to distribute copyrighted files illegally. It also allows the user to delete copyrighted music and video files from the “shared folders” of the computer from where they are commonly swapped illegally on the internet. The system is available in Belgium, Denmark, Finland, Germany, Greece, Ireland, Italy, the Netherlands, Poland, Portugal, Sweden and the United Kingdom. Available at [www.pro-music.org](http://www.pro-music.org)
- A **Copyright and Security Guide** for companies produced jointly by the music, film and video industries and endorsed by the International Chamber of Commerce. The Guide has been distributed to companies in the UK and seven other countries.

## Annex A

### EXCERPTS FROM LIEBOWITZ REPORT ON EU COPYRIGHT EXTENSION\*

#### SUMMARY (PAGE iii)

**“There are numerous economic grounds that can be adduced to support a request for extending the copyright on sound recordings. There are clear benefits that will arise from an increase in new creations and the proposed increase in copyright are large enough to lead to measurable increases in new production.**

“While it is also true that there are increased costs, in the sense that copyright allows price to stay above the cost of reproduction, no one has measured the size of these costs to determine how large they are. Nor is there evidence that these costs lead to prices being above a competitive “zero profit” level since the costs of production need to be recouped in some manner. Even if there were some monopoly power, the removal of this inefficiency in the sound recording market would entail treating the creators of the sound recordings, whose talent would be the cause of the monopoly power, more harshly than the treatment given to the many owners of other unique assets with similar efficiency characteristics elsewhere in the economy”

#### KEY EXCERPTS FROM THE REPORT

- **The proposed change in the sound recording copyright is likely to have considerably larger financial implications for artists and record companies than has previously been assumed.** Increasing the copyright term of sound recordings from 50 to 95 years would likely increase annual revenues for artists and record companies by between 5% and 6% in present value terms. (This estimate takes into account the present value of revenues that would occur far in the future, and patterns of recording sales over time) Sales of original recordings continue at essentially a constant level many decades after their release. Market data in the UK shows that sound recordings from prior decades generated sales in 2004 that were approximately 25% of the level of sales in an average year from the prior decades.
- **The difference between copyright duration in Europe and the US works to the detriment of European producers and will almost certainly lead to inefficient production because the playing field is uneven.** The existence of a copyright length differential across markets will lead to production being focused more heavily on the market with the longer copyright term than would have otherwise been the case even if that were the less efficient market for such production. European creators will tend to focus more on the US market if the US has a lengthier copyright life than in the EU and production might move to the US for this reason.
- **The increased revenues accruing from extending the term of protection in the EU to match the level existing in the US would lead to an economically consequential increase in the production of new works.** The benefits to consumers from copyright extension will begin to occur almost immediately. The producers of sound recordings can be expected to go ahead with some projects that would not have been considered sufficiently profitable under the old copyright regime. Consumers very quickly begin to benefit from these additional works brought forth by copyright extension

- **For the large majority of works without inherent monopoly power from a powerfully talented individual, the only cost advantage that would accrue to consumers of non-copyrighted works would be the savings in not having to pay the creator of the work.**
- **There are benefits of copyright that are due merely to the fact that it provides ownership, and encourages efficient stewardship, of valuable resources. The potential benefits remain in effect forever and thus argue for a longer copyright term.** Copyright ownership helps protect against poor quality recordings and deception of the consumer, as well as overuse and misuse for offensive or malicious purposes. Copyright ownership similarly ensures that there will be reinvestments in copyrighted works that are required from time to time, such as the costs of digitising and converting recordings for sale on the internet.

\*This summary of excerpts from the report is prepared by IFPI with the consent of the author

**WHAT ARE THE CONSEQUENCES OF THE EUROPEAN UNION EXTENDING  
COPYRIGHT LENGTH FOR SOUND RECORDINGS?**

Dr. Stan J. Liebowitz

Professor of Economics  
Director of the Center for the Analysis of Property Rights and Innovation  
University of Texas at Dallas.

Prepared for the IFPI

February 2006

## TABLE OF CONTENTS

Table of Contents.....	i
Executive Summary.....	ii
I. Introduction.....	1
II. The Sound Recording Market.....	1
III. The Sound Recording Copyright.....	2
A. <i>The Copyright Monopoly?</i> .....	3
IV. The Economic Basis of Copyright.....	4
A. <i>The Consumption-Production Tradeoff</i> .....	5
V. The Gains and Losses from Extending Copyright for sound recordings.....	7
A. <i>Present Values</i> .....	8
B. <i>Payment versus creation</i> .....	8
C. <i>The Impact of Unauthorized Copying on Optimal Copyright Length</i> .....	9
VI. The Importance of Sales Decades After Creation.....	9
A. <i>Present Values of Future Payments</i> .....	10
B. <i>The Pattern of Sound Recording Sales</i> .....	12
C. <i>Using Current Data to Infer the Past and Future</i> .....	14
VII. The Impact on Domestic Production When International Terms Differ.....	18
VIII. The Efficiency of Ownership.....	19
A. <i>The Benefits of Stewardship</i> .....	19
B. <i>Other “Quasi-Creation” Costs</i> .....	20
IX. Conclusions.....	21
BIBLIOGRAPHY.....	23

## EXECUTIVE SUMMARY

This report examines the economic consequences of increasing the EU sound recording copyright from 50 to 95 years, effectively matching the length of the sound recording copyright in the US. The analysis is based upon economic methodology and relies upon current economic thinking on topics related to copyright length. This analysis also provides some new empirical data to help inform discussion of these issues. It does not, and indeed it cannot, prove whether increasing the copyright length is good or bad. Nor is the function of this report to advocate a position on this topic. We do know that copyright imposes some tradeoffs between production of new works and consumption of old works. It is possible that the optimal copyright length is infinite or that it is much shorter than infinite.

The conclusions of this report are as follows:

- I. It has sometimes been claimed that the impact of a copyright law extension is likely to have a trivial impact on production. An empirical analysis in this report, based on a unique data set, indicates that the proposed change in the sound recording copyright is likely to have considerably larger financial implications than has previously been assumed. Increasing the copyright term of sound recordings from 50 to 95 years would likely increase nominal revenues by almost 70%. Discounting these future nominal revenues, as is proper, lowers their present value to a range from 3% to 10%, depending on the discount rate chosen. The discounted value is of sufficient size to allow an economically consequential increase in the production of new works.
- II. Because the proposed extension of copyright is likely to have measurable impacts on revenues, the existence of a copyright length differential across markets will lead to production being focused more heavily on the market with the longer copyright term than would have otherwise been the case. In other words, European creators will tend to focus more on the US market if the US has a lengthier copyright life than in the EU and production might move to the US for this reason. This difference in copyright duration works to the detriment of European producers and will almost certainly lead to inefficient production because the playing field is uneven.
- III. Ownership provides valuable social function with regard to the efficient stewardship of valuable resources. This is equally true for copyright ownership. Similarly, reinvestments in copyrighted works are required from time to time. The potential benefits of both of these factors remain in effect forever and thus argue for a longer copyright term.
- IV. The onset of unauthorized copying over the last few decades reduces the ability of producers to appropriate revenues from a given amount of sound recording usage while at the same time increasing consumer usage for a given amount of consumer payment. This tilts the balance of copyright away from the production of new works, threatening to reduce production below efficient levels. Therefore, the optimal copyright length becomes longer in the fact of such activity.

- V. In the vast majority of instances, copyright provides no monopoly power to the copyright owner. The type of monopoly power that can be exercised through copyright is associated with unique individual abilities. In those instances where such monopoly power exists, irrespective of the fact that economic efficiency would be improved if such monopoly power were reduced, such reduction would be at variance with the treatment of this type of monopoly power elsewhere in the economy. It is also the case, given the large fraction of new works that lose money, that a small number of winners would need to earn very high returns if the industry as a whole were to be able to generate normal competitive returns.

In summary, there are numerous economic grounds that can be adduced to support a request for extending the copyright on sound recordings. There are clear benefits that will arise from an increase in new creations and the proposed increase in copyright are large enough to lead to measurable increases in new production. While it is also true that there are increased costs, in the sense that copyright allows price to stay above the cost of reproduction, no one has measured the size of these costs to determine how large they are. Nor is there evidence that these costs lead to prices being above a competitive “zero profit” level since the costs of production need to be recouped in some manner. Even if there were some monopoly power, the removal of this inefficiency in the sound recording market would entail treating the creators of the sound recordings, whose talent would be the cause of the monopoly power, more harshly than the treatment given to the many owners of other unique assets with similar efficiency characteristics elsewhere in the economy.

## I. INTRODUCTION

The current copyright length on sound recordings in the EU is fifty years. I have been asked by the IFPI to examine the likely consequences of changing this copyright length to ninety five years, which would in effect match that of the United States.

I have been involved with analyzing the economic issues surrounding copyright since 1979, when the Canadian government asked me to examine the economic issues surrounding the impacts of new technologies, such as photocopying and cable television, on the then current copyright regime. Since then I have continued to work on topics related to copyright (as well as other topics unrelated to copyright).

My approach in this report is based upon my training as an economist. As such, I cannot make claims as to whether any particular result is better than another—economics does not allow findings of good or bad—but can only lay out the consequences of particular actions. In particular, economics frequently focuses on the efficiency of particular policies, and on the changes brought about by various policies, whether in terms of overall efficiency or wealth transfers from one group to another.

It is probably worthwhile to define the term “efficiency” as used by economists since it plays an important role in any economic analysis. Economic efficiency in production means that output is produced at the lowest cost, that the output of each product occurs up to the point where producing one more unit would generate less consumer value than the cost of producing it, and that all products which have consumer values greater than the cost of production be produced. Efficiency in consumption requires that consumers achieve the greatest value from the products they purchase given the money that they have available to spend. In other words, overall efficiency implies that the total quantity and variety of production will maximize the value received by consumers given the resources available. If the economy can be thought of as producing a giant pie, economic efficiency means that the pie is made as large as possible so that consumers have more to consume no matter how the pie is sliced up.

Copyright is the tool used by society in order to achieve some degree of efficiency in the production of creative works, and the sound recording copyright is the key factor in helping to achieve efficiency in the production and consumption of sound recordings. The analysis that follows examines in some detail the likely economic consequences if the current EU sound recording copyright of fifty years were increased to ninety five years. We begin with some background history.

## II. THE SOUND RECORDING MARKET

Thomas Edison invented a tinfoil recording process in 1877 which he soon improved by replacing the tinfoil with wax cylinders. To avoid Edison’s patents, Emile Berliner developed in the late 1880s a competing recording technology based on discs, which came to be known as the gramophone. A battle between the cylinder and the disc took place over several decades but discs had won the day by 1920. Edison’s company introduced its own disc, known as the ‘Diamond Disc’ with great fanfare and in a precursor to the ubiquitous “is it live or is it Memorex” commercials, embarked on demonstrations asking the public to guess whether they were hearing live performers or a disc. It is reported that millions took this test between 1915 and 1925.

At that time the recording industry was still engaged in acoustic recording. There were no microphones and no amplifiers. Singers, for example, shouted into a recording horn and the sound energy was converted into a mechanical signal on the disc. In the mid 1920s engineers at Western Electric devised a new method for performers to sing into microphones, which converted the sound into electric currents controlling an electromagnetic record cutter, producing a recording. These discs were identical in playback format to the old discs and could be played on the older equipment. Most phonographs of the time still reproduced the sound acoustically, without electrical amplifiers.

Early recordings were of low sonic quality and a single record had a very short capacity in terms of playing time. It was not until the 1950s that high quality recordings with longer playing times appeared. The original long playing record, introduced in 1948, rotated 45 times per minute and could play 12 minutes of music per side; this was soon replaced by the more standard LP record which rotated 33 times per minute and played for over 20 minutes per side.

Although improvements in the quality of master recordings preceded improvements in the home retail market by several years, the quality of the master recordings was considerably lower in these early time periods than it was to become in the 1950s and beyond.

The quality differential in sound recordings that occurred in the 1950s has implications for some of the empirical analysis below. The sound quality after that period was such that, after the introduction of stereo in the early 1960s, limitations in human hearing have made further sonic improvements very difficult. Recordings made from the late 1950s and beyond, therefore, are of higher quality than recordings before this period. That means that we would expect current sales of recordings made before the late 1950s to be less popular than recordings made after this period for the simple reason of their inferior sound quality.

This implies that information prior to the late 1950s will possibly underestimate the future sales of records that we can expect in the post stereo/LP era. As we will see below, the sales of records from the 1960s and 1970s, thirty and forty years after their introduction, continues at a somewhat higher level than was the case for recordings from the 1950s. Although this might be due to their more recent issue, some portion of this difference is probably due to the sound quality issues.

### III. THE SOUND RECORDING COPYRIGHT

Copyright covers the expression of ideas (e.g., through words or music). Copyright provides the copyright owner the sole right to reproduce an artistic work (although there are defenses to infringement such as fair dealing which allow others to make reproduction under certain circumstances).

But copyright protection is very narrow—for example, if someone else should, by a remarkable coincidence, write exactly the same song or story as you, without ever coming into contact with your work, your prior copyright does not prevent him from selling his work. If I tell largely the same story as a prior author (young lovers dealing with the anguish of having families that hate each other) writing it in my own words and providing my own detail, I am free to do so. Any author can produce a product that is very similar in style and substance to a prior copyrighted work, as long as they have made their own creation and not copied someone else's work.

A copyright on a sound recording is generally even narrower. Once a song is recorded, any other performer is allowed to make a recording of the same song (usually with a compulsory payment to the creator of the song, although not to the creator of the original performance). Follow-on performers do not even need to put their own creative spin on their sound recording. If I can make a recording that sounds exactly like the Beatles rendition of forty years ago copyright would not prevent it. Sometimes these sound-alike recordings are used in movies, television programs, or advertisements since the rights to these imitation recordings are usually far less expensive.

#### *A. The Copyright Monopoly?*

It is sometimes said that copyright provides a monopoly to the copyright owner. Although copyright provides the copyright owner a monopoly on making copies, this does not mean that copyright provides an economically meaningful monopoly.<sup>1</sup>

All property rights provide a monopoly of sorts. You have a monopoly on the use of your house, since by law you can prevent others from using it. For similar reasons, you have a monopoly on the use of your car. Neither of these monopolies is an economic monopoly since your car and house are (presumably) just like many others and allows you no special advantage in the marketplace.

You also have a monopoly on your effort. In general, that is not an economic monopoly either. Yet, if you could serve a tennis ball with inordinate skill you might become a top money-winner on the tennis circuit. This skill would be a form of monopoly power since only a very few can make it to the top. Similarly, if you were amazingly funny you might make a fortune as a comedian. Again, this rare talent is a form of economic monopoly. As a comedian you might not go on tour at every possible opportunity. The less frequently you go on tour, the more you might be able to charge for your appearances. This restriction of effort, if it is done to increase overall profits, might properly be called an exercise of monopoly power.

Economics textbooks often talk about how the incomes of such ‘stars’ consists of ‘economic rent’ that could be taxed with no ill effect to efficiency, although there is no real attempt in tax laws to identify and remove ‘monopoly’ earnings of these individuals as opposed to ordinary high earnings that might have no monopoly element. If, for example, a surgeon earns 200,000 euros, but in his next best career (which has no non-monetary advantages or disadvantages) he could have only earned 110,000 euros, then 90,000 euros would be known as economic rent, and it could be taxed with no ill effect since the surgeon would remain a surgeon even at a salary of 110,000 euros. If the surgeon faced a downward sloping demand for his services, he would provide too few surgeries, relative to the efficient ideal. Economic efficiency would be served if the surgeon were forced to perform more surgeries. Yet there is no free society that would attempt to bring about this extra efficiency by forcing the surgeon to work longer hours, or to remove all income that is rent. Nor is there any attempt to force leading comedians or tennis stars to perform more often, even though it might make their market closer to the competitive ‘ideal’ by reducing a monopoly restriction on production.

---

<sup>1</sup> Although copyright provides a monopoly over the particular title, there might be many close substitute titles available. Every firm has a monopoly over the products that bear its name. Kia and Mitsubishi have a monopoly over automobiles with their names, although few would argue that they have monopoly power in the automobile market. See Edmund W. Kitch (2000).

Similarly, if I create sound recordings of much higher quality than other people I might be able to earn the high income that is associated with the small number of top sound recording artists. In reality, the “monopoly” conferred by copyright is no different than the ‘monopoly’ that everyone is given over their own efforts. This putative monopoly only creates an economic monopoly for unusually talented individuals. In those few cases it provides monopoly power, but most of the time it does not. The monopoly, if there is one, is really due to the underlying talent of the artist, not to copyright per se. The copyright merely allows the creator to tap the monopoly power that is inherently there.

Government prohibitions on monopoly, through competition law, tend to focus on attempts by monopolists to artificially and unfairly restrict competition. In general, a high market share (monopoly) that is achieved entirely through the production of a superior product is admired and is not the focus of competition law. Copyright does not confer any ability to restrict the behavior of competitors. Once the Beatles recorded the Sergeant Pepper’s Album, those songs were available for anyone else to put on a record. Any real economic monopoly achieved by a copyright owner is due to the greater talent of the creator relative to competitors. Such monopolies are not the type of monopoly that modern competition policy tries to restrict.

In a perfectly efficient copyright system, which I describe below, authors would merely receive the minimum payment required to provide them sufficient incentive to produce their works. This result holds even if the payment were only ten thousand euros per year. Yet this would treat individuals who make their living creating copyrighted products differently and in an inferior manner compared to other workers, even though it would be economically efficient.<sup>2</sup>

#### IV. THE ECONOMIC BASIS OF COPYRIGHT

Artistic expressions and performances cannot be ‘used up.’ There is no limit to the number of copies that can be made from a master recording. Economists have a term for goods that cannot be used up—nonrivalrous goods (sometimes known as public goods)—and the production of these goods has different efficiency characteristics than is the case for more typical goods. Whereas competitive markets are normally expected to produce the theoretically ideal quantity of apples or shoes, that is not the case for non-rivalrous goods. This has important implications for understanding the difficulty in setting the optimal copyright length.

Neither competitive markets nor any other practicable mechanism exists for the ideal production of nonrivalrous goods. This point was made by Nobel Prize winner Kenneth Arrow in a classic 1962 article.<sup>3</sup> Under fairly simple and general conditions it can be shown that less than the *ideal* quantity of nonrivalrous goods will be produced in competitive markets. Nevertheless, as Harold Demsetz properly noted in a classic 1969 critique of Arrow, *efficiency* does not require production of a theoretically *ideal* output, but instead is related to the method of producing the best *achievable* output.<sup>4</sup> In other words, even if competitive markets could not produce an ideal

---

<sup>2</sup> By way of analogy, there is a concept known as perfect price discrimination, in which the seller charges each consumer the absolute maximum that the consumer would be willing to pay. This is considered perfectly efficient since it leads to the same output as perfect competition. Yet consumers would be indifferent between such a system and scrapping the entire market since they get no net benefit from this market. Economic efficiency, in this case, leads to a result that non-economists would almost certainly reject.

<sup>3</sup> See Kenneth J. Arrow (1962).

<sup>4</sup> See Harold Demsetz (1969).

quantity of some nonrivalrous good, they would still produce these goods efficiently if there were no feasible alternative methods of producing these goods at an output closer to the ideal level.

The difficulty in producing nonrivalrous goods ideally is due to the tradeoff between efficient production and efficient consumption. Understanding this tradeoff is essential for grasping how economists would go about measuring the ideal length of copyright, and that is the issue to which we now turn.

#### A. *The Consumption-Production Tradeoff*

The fact that ideas and expressions do not get used up allows for an unusual result in terms of the ‘efficient’ or ideal level of *consumption*. Since my listening to a song doesn’t reduce your ability to also listen to the same song, the efficient consumption of that song, once it has been produced, is to allow everyone who has a value of the song that is greater than the cost of transmitting or reproducing the song (often assumed to be zero) to consume the song.

This is a quite remarkable result. Typical goods, such as apples, are scarce, meaning that there are fewer apples in existence than the quantity that potential consumers would wish to eat if apples were freely available; thus, some rationing mechanism, such as price, must be used to determine who gets the apples.

The ability of one unit of a nonrivalrous good to be reproduced without limit turns usual rules of consumption efficiency on their head. Everyone, today and in every future generation to come, can listen to Beethoven’s Ode to Joy or enjoy Debussy’s Prelude to the Afternoon of a Faun. The concept of scarcity returns if we contemplate attending any given performance (where seats are not infinite), or listening to any given sound recording (which uses resources in its production), but the piece itself, the one that was in the mind of the composer, has no scarcity attributes, *once it is conceived*. Thus, efficient consumption of a nonrivalrous work, such as Beethoven’s Ninth, assuming that transmittal costs were zero, would require that everyone who placed a positive value on hearing the symphony be allowed to listen to it.

This would seem to imply that everyone who might derive value from consuming an intellectual product should be allowed to consume it, if we are interested in achieving economic efficiency. But there is a fly in this ointment, which is why the term “tradeoff” exists in this section’s heading.

The requirement that all potential consumers be allowed to consume the intellectual products puts a serious restriction on the price(s) that can be charged for the product. If consumers have differing values for the good and the producer is only able to charge one price in the market, then no matter what price the producer picks, some potential consumers will be priced out of the market—unless the producer picks a price of zero.<sup>5</sup>

A price of zero would lead to the efficient consumption of the product. But a price of zero would also leave the producer with no revenue. Zero revenue would obviously be an untenable position for a producer.

---

<sup>5</sup> There is a possibility known as ‘perfect price discrimination’ whereby the producer gets to charge each consumer a price just below the price the consumer is willing to pay. This is unrealistic but is the only market mechanism that can, in theory, lead to the efficient production of nonrivalrous goods.

Economists normally assume that producers require remuneration to produce. Not only is it usual to make this assumption, but there is overwhelming evidence that this assumption is correct. Although there are a large number of amateur meteorologists, cooks, and basketball players, it seems highly unrealistic to believe that there is no need to pay individuals to perform these services at a professional level. Similarly, for the creation of artistic works, such as sound recordings, it is difficult to imagine full-time professional production without pecuniary reward.

Thus if producers of nonrivalrous goods, such as the performances found on sound recordings, were to receive no revenue, then there is little reason to believe that production will occur at a rate anywhere near the efficient, to say nothing of ideal, level. This, then, is the problem brought about if one attempts to achieve efficient consumption—there will be nothing for potential consumers to consume since a price of zero fails to provide efficient incentive to create. Failing to achieve ideal consumptive efficiency is the cost involved in providing conditions to promote reasonable quantities of artistic works of the quality demanded by consumers.

Therefore, if markets are to be used to provide producers with a pecuniary incentive to create intellectual products, creators must be given some degree of control over the use of their products, prohibiting others from copying their ideas or expressions. This is the role of copyright.

Intellectual property protection, then, can be seen to create two countervailing results. First, it provides authors of compositions and performances the wherewithal to receive remuneration for their activities, which has the beneficial impact of increasing the production of expressions and ideas. On the other hand, copyright laws allow the owners of the intellectual properties to charge positive prices for their use, restricting the usage and consumption of these ideas below their ideal levels.

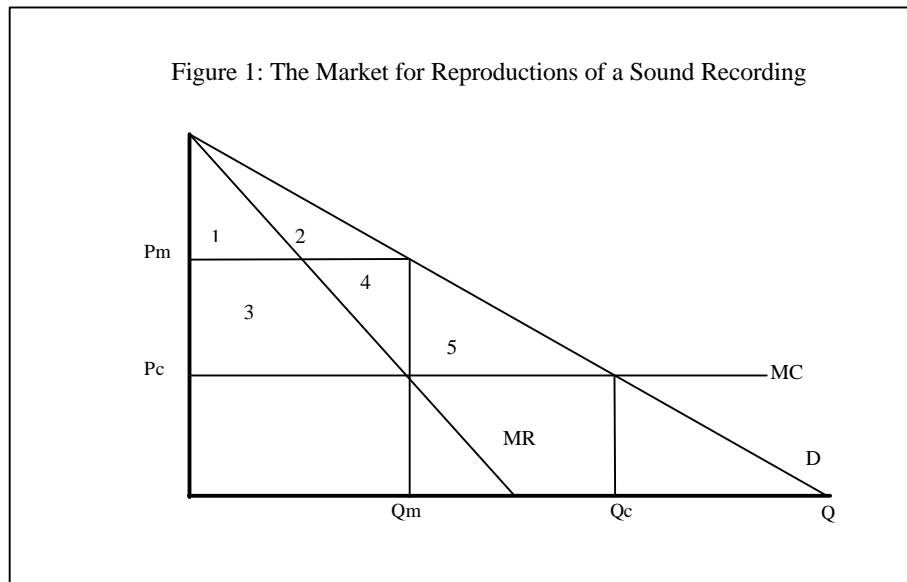


Figure 1 is the standard textbook treatment of these issues using basic supply and demand. Assume it represents the market for reproductions of a particular sound recording title for some period of time. The demand for this title lasts for multiple time periods, each identical to the first.

The perfectly competitive solution would be a price of  $P_c$  and quantity  $Q_c$ , which also yields consumption efficiency (the sum of areas 1–5). The problem is that this result yields no profit in the reproduction market with which to pay for the creation of the title which implies that no consumption at all will occur without some copyright protection.

Copyright provision results in a ‘monopoly’ output level  $Q_m$  and price  $P_m$  and most importantly revenues above the reproduction costs (areas 3 plus 4 are these net revenues) with which to pay for the creation of the sound recording. If these revenues are sufficient to cover the costs of creating the sound recording society benefits from the production of copies of this title in the amount of  $1+2+3+4$  (for as long as the copyright last), less the fixed costs of creation. Area 5, the benefit to society from increasing output from  $Q_m$  to  $Q_c$  does not exist under copyright since output stops at  $Q_m$ . However, being able to imagine an improvement (area 5) is not the same as being able to bring it about, as Demsetz pointed out. Once a copyright regime is adopted as the mechanism to stimulate production of creative works, area 5 is no longer feasible during the life of the copyright. The loss of area 5 can be thought of a cost of copyright, since it is required in order to generate any titles, and thus value, at all.

Of course if the sound recording continues to sell it is likely after some point in time that more than enough revenues will be generated to cover the cost of creating the sound recording. According to economics, once a creator has received sufficient payment to generate creation, any further payment is unnecessary and even wasteful. Therefore, in any years of copyright beyond that required to cover the costs of creation, area 5 would represent an opportunity lost due to the overlong length of copyright. Of course, because of uncertainty in the music business, there are many sound recordings, probably the vast majority, which never sell enough to recoup their costs. For this reason the returns on those recordings that are successful need to return more than the bare minimum that would allow the specific successful recording to break even.

In theory it is possible that the optimal length of copyright could be anything. The factors that influence this length are discussed next.

## V. THE GAINS AND LOSSES FROM EXTENDING COPYRIGHT FOR SOUND RECORDINGS

The optimal length for copyright is not something that anyone can define with certainty. To make a full determination of the costs and benefits of copyright extension, economists need to know more about these markets than they currently do; the information requirements are severe. The data that are required for such an examination would include (1) the increase in revenue that extending copyright would provide to creators; (2) the number and value of new works created as a result of this additional revenue due to extending the copyright duration (i.e., the elasticity of supply of creative works; (3) the reduction of surplus for reproductions of copyrighted materials under extended copyright, relative to the surplus that would be generated if copyright protection were less lengthy (i.e., the increased unnecessary deadweight losses).

It has often been presumed that current copyright duration goes so far into the future that any changes at the margin are unlikely to have any noticeable impacts. The reason for this belief has to do with the concept of present value whereby payments that occur far in the future have less value today.

### *A. Present Values*

The issue of copyright extension necessarily requires an examination of revenues that would occur far in the future. Economists have a method for valuing future payments that is based on a fairly simple understanding of interest rates (sometimes called discount rates). It is necessary to review this topic briefly to assure that the material below is fully understood.

Present value is merely the value today of a payment or stream of payments occurring some time in the future. This value is dependent on interest rates. For example, even if there is no inflation, a future payment of 1.05 Euro one year from now would be worth somewhat less than 1.05 Euros now because anyone can put 1.05 Euro in the bank and earn some interest in the course of a year. If the interest that can be earned is 5% then the present value of 1.05 Euro paid in a year would be 1 Euro since if you were to invest 1 euro in a bank account now you would have 1.05 in a year. Essentially, the present value of a future payment is the amount one would need to invest now to have an amount equal to the amount of the future payment when that future payment is made. Obviously, the higher the interest rate the lower the present value of a future payment.

When we discuss the revenues generated by copyright extension in the sound recording market, which we do in Section VI it will be necessary to couch the language in terms of present values.

### *B. Payment versus creation*

Small increases in payment need not have equally small impacts on the creation of additional works. There is a possibility that a seemingly small increase in present value could make an important difference in creative output, perhaps because the additional revenue allows certain potential recording artists reach a point where they switch to full-time creation. This is discussed in greater detail in Liebowitz and Margolis (2005).

The idea has to do with the concept of elasticity. A market is considered elastic if a small change in price leads to a relatively large change in output. Either consumers or producers might be very responsive to relatively small price changes. The elasticity of interest here has to do with the responsiveness of sound recording producers to changes in revenues (prices). Sometimes a 5% change in price, for example, might lead to a 20% change in quantity, leading to an elasticity of 4. We shall see below that increasing the copyright length for sound recordings appears likely to lead to an increase in revenues of between 5% and 6%. How large an increase in production of sound recordings would follow from this increase in revenues would be an important datum to know if we wished to gauge the overall efficiency of such a change.

There has been surprisingly little serious empirical examination of these issues. Recently there has been some academic work trying to determine whether changes in copyright length have an impact on creation. A forthcoming paper by Baker and Cunningham (2006) demonstrates that when copyright laws are strengthened the market capitalization of firms in copyright industries increases. A paper by Png and Wang (2005) finds that extensions of copyright in various countries, including many in the EU, led to surprisingly large and significant increases in the number of copyrighted works with an implied elasticity of greater than one. Thus the small amount of empirical work, although not specifically related to sound recordings, indicates that there is reason to believe that producers do react to changes in copyright law.

One factor that would help determine the elasticity of supply would be the number of part-time creators who would move full-time into the market with only a small increase in revenues. Realistically, the constraint for sound recordings doesn't come from the musicians, of whom there are many willing to jump into full-time creation for a song, so to speak, but from the sound recording companies who must use scarce resources to sign and produce new groups. If they used a large portion of their increased revenues to find and produce sound recordings from new groups it is conceivable that the resulting increase in new sound recordings would be larger than the percentage increase in revenues. Of course, this is only a possibility for which there is no direct empirical data.

It is also possible, even without very elastic supply conditions, that the optimal copyright length might be infinite. Sufficient conditions for such a length are not difficult to imagine and are put forward in detail in Liebowitz and Margolis (2005). Whether those conditions hold, however, is unknown.

### *C. The Impact of Unauthorized Copying on Optimal Copyright Length*

When sound recordings first became popular, private copying was not possible. In the 1970s cassette recorders made it fairly easy to engage in duplication of prerecorded music. Digitization and the Internet have conspired to further increase the unauthorized duplication of prerecorded music, through file-sharing, in a manner which has diminished the revenues of the sound recording industry while at the same time increasing consumption of the content of sound recordings.<sup>6</sup> Although we cannot know the future, after thirty years of dealing with different varieties of copying technologies, it seems unlikely that unauthorized copying will disappear.

Since unauthorized copying generally has a negative impact on sales, the impact of it on optimal copyright length is fairly easy to establish. Copying allows individual to consume the contents of sound recordings without having to purchase sound recordings. This means that the underconsumption problem, which was area 5 in Figure 1 above, is smaller than it otherwise would have been. It also means that areas 3 and 4, the revenues available to pay for new titles, is also smaller than it would have been without such copying.

Even if the duration of the sound recording copyright had been the correct number of years prior to copying—i.e., if it had perfectly balanced the value of additional new titles and unnecessary copyright monopoly before unauthorized copying—it would now be too short in length. That is because consumption has increased while the rewards to the production of new titles have fallen. In order to bring the balance back to the original equilibrium, the sound recording copyright would need to be lengthened.

## VI. THE IMPORTANCE OF SALES DECADES AFTER CREATION

As we have seen, in traditional economic analysis the benefits of copyright extension are to be found in the increased production of copyrighted works. Thus, one of the most important questions in any determination of the impact of copyright extension is the impact of the extension on creative efforts. In order for copyright extension to have an impact on production

---

<sup>6</sup> There are numerous studies that have been conducted examining the impact of file-sharing. Zentner (2005, 2006), and Peitz and Waelbroeck (2004) each examine the European Market and conclude that file-sharing has a large negative impact on sales. Large negative impacts in the US are found by Liebowitz (2003, 2006), Blackburn (2004), Rob and Waldfogel (2006) and several others. I am only aware of one study that finds no impact.

there must be a nontrivial impact on revenues, since production is based upon revenues, or the hope of revenues.

In the following analysis I examine the likely impact of a copyright extension on the revenues of sound recordings. In order to accomplish this task it is necessary to determine how large the sales of recordings are (and by extension, will be in the future) that are many decades old. There are very few examinations of the sales of old works and I am not aware of any examinations of sound recordings.

There are two elements involved with a determination of the financial importance of sales many decades after creation. First we need to determine the likely stream of copyright payments that occurs in the future. This requires empirical evidence on record sales that might be used to make prognostications about the future. Second, we need to control for the fact that later sales which occur far in the future need to be discounted to account for the time value of money. We can determine the discounted value using the well established concept of “present value”.

These issues are covered, in reverse order, below.

#### A. *Present Values of Future Payments*

It has sometimes been claimed that the benefits from a copyright extensions occur so far in the future that it can not help but to have a *de minimis* impact on creators. Indeed, this very argument was made in a brief submitted by 17 prominent economists in the Eldred case that was argued in the United States, where the economists suggested that an extension of copyright in the US made little economic sense.<sup>7</sup> These economists, however, were arguing against an extension from a term of 50 years plus life to a term of 70 years plus life, which they assumed to be the equivalent of going from 80 years to 100 years.

Sound recordings have a shorter copyright duration than that analyzed by the 17 economists and because of this shorter life the present value of future payments from the extension are considerably larger than would be the case for more typical copyrighted works. In present value terms, extending copyright from 50 years to 95 years, because it begins in year 50 versus the assumed year 80, has a considerably larger impact on the present value of revenues than extending it from 80 to 100 years, as seen in Table 1.

Table 1 provides the amount (in present value terms) of additional revenue generated by forty five additional year of protection as a share of the revenues generated in years 1 through 50 (as proposed for the sound recording copyright) or an additional 20 years as a share of the revenue generated in the years 1 through 80 (assumed by the 17 economists for an extension from 50 to 70 years *after the death* of the author) under the assumption that sales are constant in each year. The impact of discounting future years is evident in that the value of those extra years is considerably below their share of years (i.e., forty five years is 90% of 50 years but the present values of the additional years are far less than 90% of the present value of the original 50 years.

---

<sup>7</sup> See the Brief of George Akerlof et al., (2002).

<b>Table 1: Relative Present Values of Copyright Extension from 50 to 95 or 80 to 100 Years</b>					
Change in Term \ Discount Rate	3%	4%	5%	6%	7%
Extra 45 Years as a Percentage of original 50	21.74%	13.57%	8.49%	5.32%	3.35%
Extra 20 Years as a Percentage of original 80	4.63%	2.47%	1.28%	0.66%	0.33%
Impact of Sound Recording Extension Relative to More Typical Extension Examined by 17 Economists	4.70	5.51	6.62	8.11	10.07
Extra 20 Years as a Percentage of original 50	13.19%	8.90%	5.95%	3.95%	2.61%

Table 1 demonstrates that, with an interest rate of 3%, the value of revenue generated in years 51-95 is 21.74% of the revenue generated in years 1-50. Similarly, the present value of years 81-100 is only 4.63% of the present value generated in the first eighty years. As the interest rate increases, the relative value of the later years falls, as one would expect, since higher interest rates reduce the present value of far off future years relative to close in future years.

The point of this analysis is that the relative value of the present value of Euros earned in the proposed sound recording extension is considerably greater than that that earned during the extension which was analyzed by the 17 economists. The third row provides the ratio of relative increases in income between the two scenarios, with a value of 1 indicating that the two scenarios are equal. The numbers in this row indicated that at low interest rates the sound recording extension is about a five times as large as the copyright extension examined by the 17 economists and at higher interest rates that ratio approaches ten to one.

Note that the greater value from the extension for sound recordings is not due to the extra 25 years in the term (a 45 year extension relative to a 20 year extension). The final row of Table 1 illustrates the increase in present value for a 20 year increase in the copyright term of sound recordings and it also is considerably larger than the 20 year extension that begins in year 80.

The reader will note that Table 1 provides a range of interest rates running from 3% to 7%. The results differ considerably as the interest rate changes, so the choice of interest rate is obviously important. The 17 economists used a rate of 7%.

These rates are what are called “real” rates, which means that they are net of inflation. This means that if inflation were running at 3% per year, the 7% real rate used by the 17 economists would translate into a 10% rate, what is referred to as the ‘nominal’ rate, meaning that it is the rate that actually exists in a market without adjusting for inflation. For many individuals, 10% would seem like a high rate of return in an environment where inflation is running at 3% a year. The reader would be forgiven for asking “Is there a clearly ‘correct’ interest rate to use”?

The answer, unfortunately, is “no”. The correct interest rate depends on the riskiness of the investment and the typical returns that are being earned. The 17 economists suggested that the revenue stream from a creative work has “a high degree of uncertainty” thus requiring a higher interest rate as compensation for the higher risk. In their words:

The second assumption is the choice of an interest rate. In general, much as investors require higher compensation for riskier investments, a higher interest rate is appropriate for the purpose of evaluating highly uncertain revenue streams. Seven percent is meant to be illustrative, but it is a realistic estimate, perhaps even conservative, given the high degree of uncertainty about the revenues resulting from the production of a creative work. (page 7)

They are certainly correct that risky items require higher rewards to compensate for the risk. They are most likely correct that for an individual creator the future stream of revenues is highly unpredictable. But sound recordings are quite different than many other copyrighted works. Sound recordings are produced by companies that have large portfolios of sound recordings. Just as diversification among holdings of individual stocks greatly reduces investment risk to investors in the stock market, so too does diversification in a portfolio of sound recordings reduce the risk to the record companies. Although there may be a great deal of uncertainty about the revenues from a single work or for a single artist, the revenues from a large portfolio are far more predictable. Further, the 17 economists were evaluating payments that occurred up to 50 years after the death of the creator. Some creators are likely to discount very highly payments that occurred after they died because they might not have families or other strong bequest motivations. But corporations do not die and should not be expected to discount future payments to anywhere near the same extent as individuals with weak bequest motivations.

For both of these reasons—lower risk and no after death bequest difficulties—the choice of a lower interest than that used by the 17 economists seems reasonable and correct. How much lower is a difficult question to answer. The social discount rate for the EU when it calculates costs and benefits from public projects appears to be a real rate of 5%.<sup>8</sup> This will be the number adopted in this analysis.

Using a 5% discount rate, we can see from Table 1 that an extra 45 years added to the current 50 would be expected to raise the present value of revenues by 8.49%. This assumes that there is a constant stream of revenues over the life of the sound recording. In the next two sections we examine the realism of this assumption.

### *B. The Pattern of Sound Recording Sales*

The lower future value of a Euro is one component in any determination of the value of future copyright payments. The second is the size of these revenues over time. It is well understood that sound recordings do not generate a constant and continuous revenue stream. Instead sound recordings are thought to normally have high initial sales followed by declines. Exactly how severe these declines are has been a topic upon which there has been speculation but little empirical examination.<sup>9</sup>

Data provided by the BPI for this project allow one of the first examinations of the pattern of sound recording sales. The BPI data actually provide information on the number of old recordings sold in 2004, which is not identical to following the history of sales of a cohort of recordings over time. However, it is possible to use the BPI data to provide an estimate of the pattern of record sales over time.

It is an informative exercise to first examine how the pattern of sales will work out over time. Table 2 begins with a very simple example. Assume that the recording industry begins

---

<sup>8</sup> See “Guide to cost-benefit analysis of investment projects” (Structural Fund-ERDF, Cohesion Fund and ISPA). Office for Official Publications of the European Communities, Luxembourg. This guide points out that there is wide variability in the choice of discount rates.

<sup>9</sup> The presumed decline in sales over time was supposedly supported by the small share (~15%) of books that had their copyright extended back when the US law allowed two consecutive 28 year terms. Only a small number of these renewed works (~10% for books and music) were still available in 1998. See Rappaport (1998). Liebowitz and Margolis (2005), on the other hand, pointed out that a large number of best sellers remained in print 50 years after publications.

anew in 2020. Assume that new sound recordings sell 100 units per year and continue to sell that many units in each later year. Assume as well that there are 100 new recordings every year. If that were the case each decade there would be 1000 songs created that decade as well as 1000 created in each succeeding decade. Each decade's songs would have an equal market share with every other decade's songs. Table 2 illustrates these calculations.

**Table 2: Hypothetical Record Sales Starting in 2020**

Sales of Records in:	Sales from Recordings Created in 2020-2029	Sales from Recordings Created in 2030-2039	Sales from Recordings Created in 2040-2049	Sales from Recordings Created in 2050-2059	Sales from Recordings Created in 2060-2069	Sales Each Decade	Each Decade's Share of Sales in 2069
2020-2029	1000					1000	20%
2030-2039	1000	1000				2000	20%
2040-2049	1000	1000	1000			3000	20%
2050-2059	1000	1000	1000	1000		4000	20%
2060-2069	1000	1000	1000	1000	1000	5000	20%

A more realistic example would have the sales of new recordings increase every decade as population and income increase. The numbers in Table 3 are adjusted in this way to increase realism somewhat. In Table 3 it is assumed that the size of the new recording market grows at 40% per decade (for example, new sales jump from 1000 in the first decade to 1400 in the second). To further add to the realism of the example, we assume that the quantity of sales of any cohort of songs decline over time. In Table 3, old recordings are assumed to have sales decline by half after the first decade, but then remain constant (for example, sales of the first cohort drop from 1000 in the first decade to 500 in later decades).

**Table 3: More Realistic Hypothetical Record Sales Starting in 2020**

Sales of Records in:	Sales from Recordings Created in 2020-2029	Sales from Recordings Created in 2030-2039	Sales from Recordings Created in 2040-2049	Sales from Recordings Created in 2050-2059	Sales from Recordings Created in 2060-2069	sales each decade	Each Decade's Share of Sales in 2069
2020-2029	1000					1000	6.8%
2030-2039	500	1400				1900	9.5%
2040-2049	500	700	1960			3160	13.3%
2050-2059	500	700	980	2744		4924	18.6%
2060-2069	500	700	980	1372	3841.6	7393.6	52.0%

Table 3 illustrates what happens in the market with these more realistic attributes. With these two new assumptions we can see in the last column the share of any cohort in the sales that occur during the last decade. One interesting result is that even though sales of recordings made in 2020-2029 have only dropped by half (from 1000 to 500 per decade) in the fifty intervening years after the recordings were made, sales of recordings from 2020-2029 only represent 6.8% of all sales occurring during 2069 (the fifth decade).

The points from Table 3 that the reader should understand are twofold. First, it is important to note that market shares in later decades might be small even when sales have continued at a relatively robust level (in this case, only declining by half during the fifty years). Second, the data we are going to observe below is similar to the data found in the rightmost column in the above table. Having seen the process that leads to the table above, we will essentially run it in reverse with the data at hand to infer how the sales of records for a given decade have changed over time. In other words, we will try to derive the original sales from the results found in the last column and a knowledge of historical growth rates. We now turn to that analysis.

*C. Using Current Data to Infer the Past and Future*

To determine the possible increase in revenues due to copyright lengthening we would want to know the pattern of sales of a fixed cohort of records over time and then calculate the present value of revenues in years 50 through 95 relative to the present value generated over the current fifty year copyright duration.

Obviously, we do not know how records that would have their copyright extended from fifty to ninety five years will be selling fifty years from now. It is possible, however, to measure how records that currently are or soon will be fifty years old are currently selling. We can then use the information about historical sales in the entire market to infer the pattern of sales over time.

The BPI have generated a data set based upon the top 10,000 UK albums in 2004, segregated by the year the sound recording was created.<sup>10</sup> The results are shown in Table 4.

These data show that old recordings have a much smaller share of the market than more recent recordings. Nevertheless, as we saw in Table 3, even if sales remained relatively large relative to the original sales of old sound recordings, market growth could reduce the share of sales of old recordings to make them appear very small. It is important to control for the growth rate of the market before we can determine how the sales of old records have persevered or deteriorated.

	Total Sales	% Of Sales
1940s & earlier	413,000	0.30%
1950s	1,853,000	1.30%
1960s	6,982,000	4.80%
1970s	13,839,000	9.50%
1980s	16,022,000	11.00%
1990s	17,941,000	12.30%
2000s	88,904,000	60.90%

Fortunately we have data on the historical sales of recordings in the UK (beginning with 1964) that allow us to determine the impact of market growth upon the current shares of old sound recordings. Table 5 presents this information. The right hand column presents the ratio of current sales (period 2000-2003) relative to previous periods. As one would expect, current sales

<sup>10</sup> The top 10,000 albums represent 91% of total sales.

are progressively larger relative to sales in previous decades. For example, current sales are more than six times as large as sales during the latter part of the 1960s.

decade	sales (millions of units)	current relative to past
50s		
64-69	37.117	6.24
70s	95.981	2.41
80s	124.567	1.86
90s	183.629	1.26
2000-2003	231.603	1.00

It is almost certainly the case that sales in the latter part of the 1960s (post Beatles, Stones, and so forth) were greater than in the earlier part, so that if we had the data on the early half of the decade the number in the rightmost column would be greater than the 6.24 value listed. Also left out of the table are sales numbers for the 1950s, which are also almost certainly smaller than the value for the 1960s. In the United States, a market for which I have data, inflation adjusted sound recording revenues were 2.5 times as high in the 1960s as in the 1950s and the average real revenues from 1964-69 were 1.5 times as high as in the period 1960-63. If the UK had experienced similar growth as the US, and if unit sales changed in line with revenues, the ratio for entire decade of the 1960s would have been 7.23 instead of 6.24 and the ratio for the 1950s would have been 17.4. Instead of using these numbers I will be conservative and use the 6.24 value found in Table 5 for the 1960s and will chose the number 10 (instead of 17.4) for the 1950s in the analysis below.

Decade	Total Sales 2004	% Of Sales	Current Market Size relative to Original Size	2004 Sales relative to Inferred Original Sales
1950s	1,853,000	1.30%	10.00	13.0%
1960s	6,982,000	4.80%	6.24	30.0%
1970s	13,839,000	9.50%	2.41	22.9%
1980s	16,022,000	11.00%	1.86	22.9%
1990s	17,941,000	12.30%	1.26	20.5%
2000s	88,904,000	60.90%		

Using this historical data we can infer the size of current sales of old recordings as a percentage of their original sales. These calculations are performed in Table 6. The fourth column, labeled “Current Market Size relative to Original Size” is taken from the rightmost column of Table 5 and represents the fact that the sound recording market was much smaller many decades ago and provides the size of the current market relative to the market in that decade. The number 10, in the first row, means that sound recording (unit) sales are ten times as great now as they were in the 1950s, which we believe to be an underestimate, explained above. The second column labeled “Total Sales 2004” reports the sales in 2004 that are derived from sound recordings that were first copyrighted in the 1950s, 1960s, 1970s and so forth and which appeared in Table 4 above. The third column reports the share of all 2004 sales due to sound recordings from each decade.

The key results are found in the fifth column labeled “2004 Sales Relative to Inferred Original Sales”. The numbers in this column are derived from multiplying the third and fourth columns. These key numbers represent the 2004 sales of an average sound recording from the prior decades relative to the sales in a typical year from the decade in which the sound recording first appeared. In other words, a sound recording first created in the 1950s generates sales in 2004 that are 13% of the sales that existed in an average year from the decade of the 1950s. Similarly, the 2004 sales of recording from the 1960s represent 30% of the sales that occurred in a typical year in the 1960s. Based on the numbers in Table 6, it appears that sales of sound recordings have an initial burst in the few years around their introduction and then decline from that level, but that in later decades sales continue at essentially a constant level. The relatively high level of sales many decades after the original recording might be considered something of a surprise.

This means that the assumptions used to calculate the present values in Table 1 (that sales were constant throughout the life of the sound recordings), although in need of some modification, are not terribly far from reality. If we assume that the higher value for the 1960s found in Table 6 is due to unique factors about music quality in that decade, and that the low values in the 1950s are due either to the conservative choice of estimated original size, or to the lower sound quality available in those recordings, Table 6 could be summarized as implying that after the first five years of sales (2004 is the fifth year in the decade starting with 2000), sales drop to approximately 25% of their initial level and continue at that rate. That is the assumption I am going to make in the next set of calculations, which provides the key results from this section.

	no discounting	3%	4%	5%	6%
Present Value of 100€for 5 years and 25€for 45 years	1625.00	1070.94	963.18	877.30	807.63
Present Value of 100€for 5 years and 25€for 90 years	2750.00	1233.03	1051.86	926.75	835.70
% Increase in Revenue due to Extending Copyright Length	69.23%	15.14%	9.21%	5.64%	3.48%

Table 7 provides the details of calculations to determine the present value of revenues that would be generated by extending copyright. The calculations are performed at different discount rates that are found in the different columns. We arbitrarily take sales to be equal to 100 per year during the initial five years of the life of the sound recording. Then, in keeping with the results from Table 6, we assume that sales drop to 25% of this level in each year of later decades, which would be 25 units per year.

The first row calculates the present value of a stream of payments that is supposed to represent the current copyright regime—50 years—with 5 years of high sales (100€) followed by 45 years of constant but lower sales (25€). The second row performs the same type of calculation, but for a 95 year copyright instead of a 50 year term. The third row gives the

percentage increase in revenues due to the increase in copyright term from 50 to 95. The different columns provide present value analyses with different discount rates.<sup>11</sup>

What is the end result of the analysis found in Table 7? First, contrary to the beliefs of many, the revenue generated by sales between years 50 and 95 is a very substantial fraction of the revenue that would be generated in years 1 through 50, somewhat more than two thirds of the revenue under the current copyright law. This is shown in the third row of the “no discounting” column.<sup>12</sup> Of course, since future payments are worth less than current payments it is appropriate to use positive discount rates. The next four columns provide these calculations for positive discount rates. The impact of discounting in lowering the revenue gains is apparent as you read from left to right. Nevertheless, the change in additional revenues, accruing from extending the copyright on sound recordings, are in excess of ten percent under some interest rates, and even under higher discount rate scenarios are all considerably larger than the vanishingly small numbers that have been suggested (by the 17 economists, among others) at other times for other changes in copyright.

What this means is that the change in copyright creates a large enough change in revenues to have an impact on the behaviour of copyright owners. For example, the percentage increase in revenues is 5.64% at a discount rate of 5%. Although five and a half percent may not seem like a large number, most individuals would much prefer to get a raise in their yearly income of that level rather than a raise of zero. Most companies would be thrilled at the possibility of generating an additional 5.6% of revenues without having to increase their costs. Potential sound recordings that were just below the margin now become worthwhile.

It is also true that if the present value of additional revenues is substantial, then it is also possible that the present value of monopoly losses, to the extent that they actually represent monopoly power, may also be substantial. Unfortunately there is no published research of which I am aware work attempting to measure the size of such losses.

It is also important to keep in mind that the benefits to consumers from copyright extension begin to occur almost immediately. Although the benefits to copyright owners occur will into the future, which is why we need to perform present value calculations, producers can be expected to change their behavior in anticipation of the future revenues. The producers of sound recordings, being profit maximizing firms, can be expected to anticipate future revenue increases and to immediately go ahead with some projects that would not have been considered sufficiently profitable under the old copyright regime. Thus consumers very quickly begin to benefit from these additional works brought forth by copyright extension although society does not suffer any possible related deadweight losses from these new works until many years in the future.

---

<sup>11</sup> Much of this gain from an extra 45 years comes from the early years, due to present value discounting. For example, using a 5% interest rate, more than 70% of the gain is derived from the first 20 additional years.

<sup>12</sup> These results are all conducted as if there were no inflation. Because there has been inflation and likely will continue to be inflation, the actual nominal Euros in later years will be considerably greater than the figures used in this analysis, but the actual value of those Euros will not be any higher. It should also be noted that inflation will increase the interest rate, and the discounts rates used in this analysis are assumed to exist in a zero inflation environment.

## VII. THE IMPACT ON DOMESTIC PRODUCTION WHEN INTERNATIONAL TERMS DIFFER

The previous section demonstrated that changing the sound recording copyright duration from 50 to 95 years would have a material impact on copyright owners, in present value terms. We now turn to a related question. If the sound recording copyright were to remain at its current 50 year level in the EU then the copyright term in the leading competing market, the United States, will be forty five years longer. Although it is to be noted that European sound recordings sold in the United States receive the same protection in the United States as sound recordings made in the United States, the differential between the two areas is still likely to have an impact on behavior of European creators.

There are differences between the two markets in terms of tastes, and of course, language. Some performers can easily appeal to both markets, but in many instances the transition is not so simple. In the most fundamental way, language matters. Sound recordings will almost never sell nationally in the United States if they are not recorded in English (although there is a growing 'Latin' market, it is only about 4% of the total market). Just as sound recordings tend to be aimed at particular audiences in terms of genre (a sound recording combining, say, rap, classical, jazz, and rock would be highly unusual) they can also be aimed at one geographical market or another.

In the continuum of sound recordings, ranging from those squarely aimed at the EU, or those squarely aimed at the United States, there are likely to be some, perhaps a large number, that could easily be aimed at one market or the other or somewhere in the middle. If the payments become higher in the United States than in the EU, at a most fundamental level, economic analysis would predict that this change will lead to more sound recordings being aimed at the United States and fewer at the EU. That might mean that a European group records in the United States instead of the EU, or tours more in the United States, or perhaps it just means getting an American producer to make the sound fit more closely to American tastes. Regardless of the form it takes, the direction is clear: it would be worthwhile for a producer to trade-off a decrease in EU sales for an equal increase American sales because the American revenue stream will last for a longer period of time, providing material long term payoffs.

This is not true just for recording artists, but equally well for recording companies. Just as movie producers analyze potential revenue throughout the world when determining whether a picture should be made, EU record companies will be cognizant of the ramifications of international sales. If the US copyright has a longer term than the EU copyright there should be a shift of focus with the intent of appealing more to the American market and less to the European market than would otherwise be the case.

Of course, economics is indifferent to whether sound recordings are all aimed at the US market or whether they are aimed at the EU market as long as the results flowed from unhindered market decisions. Nevertheless, regulators in many countries have historically had an interest in cultural markets even when there were no efficiency consequences. But in this instance markets are not unhindered and producers are not operating on a level playing field.

When production is tilted toward one market due to artificial regulations (whether subsidies or copyright differences), economics is no longer indifferent. Economic efficiency requires that consumers be allowed to choose the products they wish and that producers compete on a level playing field so that the most efficient producers drive out the least efficient producers. Markets are usually thought to be the best arbiters of efficiency, but they will not work properly in the

face of uneven regulations that benefit one set of producers over another. Although we cannot state with certainty whether the American or European copyright length on sound recordings is more efficient, we can state that differences between the two will lead to inefficiency.

## VIII. THE EFFICIENCY OF OWNERSHIP

Unlike the prior economic arguments, the ownership benefit of copyright always supports a longer copyright length since ownership benefits are maximized when property rights are maximized. We turn to that issue now.

### A. *The Benefits of Stewardship*

The issue is management of existing creative works. There are several reasons why society might benefit from the management of creative works independent of any impact on creation of those works. These ideas have been propounded in Landes and Posner (2003) and Liebowitz and Margolis (2005).

It might be useful to start with an example. Many consumers derive less utility if their home (or clothes) looks very similar to all of their neighbors. If the market could not find some way to take account of these preferences for variety or uniqueness, consumers would be worse off. The decisions of individual consumers might lead to a lack of variety, since individual homeowners are likely to hope that others choose the less preferred design while they choose the preferred design. When everyone acts this way everyone is less happy because there is too little variety. The problem arises because the harm to others from one additional use of a design does not directly enter that individual's calculations, which is an example of what economists call a negative network externality.<sup>13</sup>

Yet market mechanisms often are able to take care of these types of problems. Home builders usually vary designs and often enter into contracts obligating them to do so. The production of different styles increases the cost relative to building the same design over and over again, but the total value of a development must increase by more than these additional costs, or builders would discontinue the practice. This is but one example where ownership, in this case ownership over the housing development, leads to a superior result than having a competitive free-for-all among homeowners.

This is an example of a larger problem whereby the lack of ownership causes severe problems, such as overfishing or overhunting of unowned animals. Cows are not on the verge of extinction because they are owned; whales, which are also very valuable, are on the verge of extinction because they cannot be owned. Almost any microeconomics textbook will make reference to this potential problem where competition will not lead to ideal results, generally known as the "tragedy of the commons."

There are then two questions that apply to sound recordings. First, are there potential problems in the use of sound recordings if ownership were to disappear, as would happen if copyright expired on works about to enter the public domain? Second, how important are such problems?

---

13. See Stan J. Liebowitz and Stephen E. Margolis (1998).

Clearly, in answer to the first question, there are some potential problems that would be solved by ownership.

First we have the potential problem of low quality recordings flooding the market. When recordings by the Beatles, for example, can be sold by anyone, then someone might decide to sell them using the lowest quality discs and reproduction facilities. Fly-by-night operations would have more success in this industry because consumers, being used to CDs of major artists being produced by major studios, will not be on the lookout for low quality CDs.

Second, there is the possibility of overuse, rather like the housing example above. Sound recordings are used in movies, commercials and television programs in addition to the sound recording market. Songs can lose their appeal to consumers if they start to hear it in every advertisement and television program.

Third, there can be offensive or malicious uses of these works. Political parties can start using songs as themes that has the effect of alienating music listeners who do not like that political party, possibly lowering the value of the sound recording to society. Racists and demagogues, for example, can use these songs at their rallies.

The manner in which these new uses of a sound recording are put depends on whether the sound recording is owned or not. If the sound recording is owned, the owner will restrict uses to those which enhance the long term value of the work. Without copyright there are the possibilities of overuse, misuse, and consumer deception.

This is not to say that copyright is the only solution to these problems. It is true that while ownership will solve the consumer deception problem, there are other possible solutions. One solution would be for consumers to pay attention to the label and for labels, particularly those that might specialize in works that had fallen out of copyright, to work on promoting their brand names. There are, of course, costs in these latter solutions and those costs would need to be contrasted with the costs involved in allowing copyright to continue for those albums. Overuse and misuse, on the other hand, are less likely to be overcome by the market. There is no way to prevent overuse or misuse if there is no controlling owner of the product.

#### *B. Other "Quasi-Creation" Costs*

Even after the original recording has been made, there can be other costs that require investments that occur many years after the original creation. Changes in technology or tastes might require finding old recordings and bringing them up to whatever the current standards might be. For example, we are undergoing one of these technological transformations right now thanks to the Internet.

I am referring to a concept popularly known as the 'long tail' which claims that Internet sales allow consumers to consume a much wider variety of products than the old fashioned retail system. The logic goes something like this: old fashioned retailers have a limited amount of shelf space and using this limited space to hold slow selling inventory is a poor business decision. Thus CD retailers would hold only a small fraction of the total number of sound recordings (the popular ones) that had been produced. Consumers would have to special order the more obscure recordings that were still in the catalog or shop in a specialty store with a larger inventory. Because of this, record companies kept their catalogs relatively small, compared to the full set of sound recordings that had been produced. Consumers with somewhat more obscure tastes would have had difficulty getting the CDs they desired. Perhaps a few stores in large cities would have

a large enough selection to keep these consumers satisfied in those cities. In smaller cities the population would not be large enough to cater to these minority tastes. Thus the sound recording market would be more highly concentrated in a few top albums due to the reality of retailing.

The Internet frees up these constraints. Now the entire world is one large Internet city. Online sites can carry a much larger number of titles than can physical retail outlets. iTunes, for example, is said to carry in the vicinity of one million songs in its inventory, which is the equivalent of one hundred thousand albums. How many physical retail stores could match that output? And online music stores are still in their infancy. There is some academic work claiming that for consumers with access to this kind of inventory, obscure items make up a larger percentage of their purchases.<sup>14</sup> This is the idea of the long tail.

Although I suspect that some of the claims of the long tail are overstated, it is possible that the Internet will make it economical to bring back certain slow selling sound recordings that might not have had enough of a market to cover the costs of the physical store regime but which can be profitably sold on the Internet. If this is correct, there will need to be some upfront expense to find, catalog, restore and convert these sound recordings before bringing them to market. It is most reasonable to expect, as we normally expect, that these investments will be best made by owners, meaning copyright owners, who stand to profit from this activity.

Just as some property right is usually required to induce the production of entirely new works, some form of property right is likely to be required to engender the efficient resuscitation of old works as new technologies come along. The Internet is just one example and we can be sure there will be others down the road. Since there is no end to possible market changes, the requirements of quasi-creation require permanent ownership.

## IX. CONCLUSIONS

I have undertaken in this report to examine what some of the economic consequences might be if the EU lengthened their copyright law term for sound recordings to match that in the US. What has been learned as a result of this exercise? First, it must be admitted that economists are not able to state definitively whether such a change would be efficiency enhancing or not.

Nevertheless, there are sound economic reasons supporting a position that the EU should increase copyright length to match the US. This report has also raised some issues that are not usually decided on economic grounds alone but that are usually of concern to policy makers.

The most important finding is the positive impact on the production of new works that would be brought about by such a change. Contrary to some expectations that copyright extension couldn't have any impact on production because the revenues would be vanishingly small, the empirical evidence adduced in this report indicates that the revenues generated by sound recordings in years 50-95, the years of copyright extension being considered, are a very substantial proportion of revenues generated in the first 50 years of copyright. Even after reducing these nominal distant revenues to put them in present value terms, the amount of revenues generated in years 50-95 is a non-trivial percentage of the present value of revenue generated during the first 50 years. This means that sales of records more than 50 years after

---

<sup>14</sup> See Brynjolfsson et. al., (2003). The most popular version of this hypothesis (including several assertions I consider rather unreasonable) appeared in Wired Magazine, October 2004, in an article by Chris Anderson.

their original production are still a reasonable component of revenues and can therefore be expected to impact the behavior of record companies and their production of new recordings.

The current differential in copyright length between the EU and the US will tilt European record companies and recording artists toward producing recordings intended for the US market as opposed to producing records focused on the EU market. Although economic analysis is indifferent about whether countries have a sound recording industry that creates products intended for local consumption and consistent with local culture, most countries seem to consider having a healthy domestic recording industry focused on the local population a worthwhile goal.

Unauthorized copying has harmed the revenues of record producers and altered the balance between consumption and production that was envisioned in copyright law. If the balance had been proper prior to such unauthorized copying, then its impact would be to require that the current copyright length be extended.

Against these arguments are the costs of extending copyright. Economic theory, ignoring any benefits of ownership (stewardship) per se, posits that efficiency requires allowing copyright owners to receive not a penny more than the minimum necessary to persuade them to voluntarily create the product. Even ignoring ownership efficiencies, the ideal copyright law under these circumstances could nonetheless have a copyright length of infinity. The potential downside of copyright is the presumed reduction in consumption brought about by higher prices. Yet there has been no empirical examination of the size of the additional costs imposed on consumers by copyright. In the vast majority of instances, copyright provides no monopoly power to the copyright owner and the only cost advantage that would accrue to consumers of non-copyrighted works, would be the savings in not having to pay the creator of the work. When actual monopoly power exists, it is the type of monopoly power that is associated with the unique individual abilities of the creators. In those instances where such monopoly power exists, irrespective of the fact that economic efficiency would be improved if such monopoly power were reduced, such reduction would be at variance with the treatment of this type of monopoly power elsewhere in the economy. Thus the size of the potential harm is completely unknown and the removal of this harm has not been thought to be sufficiently important to try to bring it about in other part of the economy. It is not clear, therefore, how much weight should be given to this potential cost in a society that has other goals beyond that of economic efficiency.

Finally, there are benefits of copyright that are due merely to the fact that it provides ownership over valuable resources. These considerations, by themselves, argue for permanent copyright.

In conclusion, there are many economic arguments, and some non-economic arguments, that can be adduced to suggest that it would be rational for the EU copyright on sound recordings to be increased in length.

## BIBLIOGRAPHY

- Arrow, Kenneth J., "Economic Welfare and the Allocation of Resources for Invention", in R. Nelson (ed.), **The Rate and Direction of Inventive Activity**, Princeton, NJ: Princeton University Press, 1962).
- Brief of George A. Akerlof et al. as Amici Curiae in support of Petitioners at 12, *Eldred v. Ashcroft*, No. 01-618 (2002). <http://www.aei-brookings.org/admin/authorpdfs/page.php?id=16>
- Baker, M. J. and B. M. Cunningham (2006), "Court Decisions and Equity Markets: Estimating the Value of Copyright Protection", *Journal of Law and Economics* forthcoming.
- Blackburn, D. (2004), "Online Piracy and Recorded Music Sales", working paper, Department of Economics, Harvard University.
- Brynjolfsson, Erik, Hu, Yu (Jeffrey), Smith, Michael D. "Consumer Surplus in the Digital Economy: Estimating the Value of Increased Product Variety at Online Booksellers" *Management Science*, 49:11 November 2003, pp. 1580-1596.
- Demsetz, Harold, "Information and Efficiency: Another Viewpoint," *Journal of Law and Economics* 12, 1-22 (1969).
- Kitch, Edmund W., "Elementary and Persistent Errors in the Economic Analysis of Intellectual Property" 53 *Vanderbilt Law Review*, November, 2000.
- William M. Landes and Richard A. Posner, Indefinitely Renewable Copyright, 70 U. CHI. L. REV. 471, 485 (2003).
- Liebowitz, Stan J. (2006), "Testing File-Sharing's Impact by Examining Record Sales in Cities", working paper, University of Texas at Dallas.
- Liebowitz, Stan J. and Stephen E. Margolis "Seventeen Famous Economists Weigh in on Copyright: The Role of Theory, Empirics, and Network Effects." *Harvard Journal of Law and Technology* 2 Vol. 18, (Spring 2005) pp. 435-457.
- Liebowitz, Stan J. (2003), "Will MP3 Downloads Annihilate The Record Industry? The Evidence So Far", in G. Libecap (ed.), *Advances in the Study of Entrepreneurship, Innovation and Economic Growth*, JAI Press, pp. 229-60.
- Liebowitz, Stan J. and Stephen E. Margolis "Network Effects and Externalities" entry in **The New Palgrave's Dictionary of Economics and the Law**, MacMillan, 1998, Vol. 2, 671-675.
- Peitz, Martin and Patrick Waelbroeck "The Effect of Internet Piracy on Music Sales: Cross-Section Evidence" *Review of Economic Research on Copyright Issues*, 2004, vol. 1(2), pp. 71-79
- Plant, Arnold, The Economic Aspects of Copyright in Books, 1 *Economica* 167 (1934)
- Png, Ivan and Qiu-hong Wang "Copyright Duration and the Supply of Creative Work," working paper, National University of Singapore (2005).
- Rappaport E. (1998), "Copyright Term Extension: Estimating the Economic Values", Congressional Research Service, CRS Report for Congress. Available at <http://countingcalifornia.cdlib.org/crs/pdf/98-144.pdf>.
- Rob, R. and J. Waldfoegel (2006) "Piracy on the High C's: Music Downloading, Sales Displacement and Social Welfare in a Survey of College Students", forthcoming in *Journal of Law and Economics*.
- Zentner, A. (2005) "File Sharing and International Sales of Copyrighted Music: An Empirical Analysis with a Panel of Countries", *Topics in Economic Analysis & Policy*: Vol. 5: No. 1, Article 21. <http://www.bepress.com/bejeap/topics/vol5/iss1/art21>
- Zentner, A. (2006), "Measuring the Effect of Music Downloads on Music Purchases", forthcoming in *Journal of Law and Economics*.

## Annex B

### Bibliography on the Economic Importance of Copyright

1. **The Contribution of Copyright and Related Rights to the European Economy**, Final Report 20 October 2003, Prepared for the European Commission Directorate General – Internal Market by Media Group, Business Research and Development Centre, Turku School of Economics and Business Administration, Finland. [http://europa.eu.int/comm/internal\\_market/publications/docs/report-copyright-contribution\\_en.pdf](http://europa.eu.int/comm/internal_market/publications/docs/report-copyright-contribution_en.pdf)
2. **A Sound Performance: The Economic Value of Music to the United Kingdom**, a study prepared by KPMG for the National Music Council, July 1999.
3. Tristan Price, **The Economic Importance of Copyright**, published by The Common Law Institute of Intellectual Property, London 1993.
4. Jennifer Skilbeck, **The Export Performance of the Copyright Dependent Industries**, October 1989.
5. Jennifer Phillips, **The Economic Importance of Copyright**, published by The Common Law Institute of Intellectual Property, London 1985.
6. **Copyright Industries in the U.S. Economy: the 2004 Report**, prepared by Stephen E. Siwek, Economics Incorporated, for the International Intellectual Property Alliance. [http://www.iipa.com/pdf/2004\\_SIWEK\\_FULL.pdf](http://www.iipa.com/pdf/2004_SIWEK_FULL.pdf) (earlier reports available: 2002, 2000, 1999, 1996, 1995 report on 1977-1993, 1990).
7. Fritz Scheuch, **The Music Industry in Austria: Structure, Opportunities and Economic Importance**, Vienna 2000.
8. **The Economic Importance of Copyright in the Netherlands in 1994**, a 1997 report by SEO – the Foundation for Economic Research of the University of Amsterdam, commissioned by Stichting Auteursrechtbelangen (Dutch Copyright Federation).
9. **The Economic Importance of Copyright in the Netherlands in 1998**, a 2000 Report by SEO - the Foundation for Economic Research of the University of Amsterdam, commissioned by Stichting Auteursrechtbelangen (Dutch Copyright Federation).
10. **Economic Growth of Copyright Industries Report**, a survey prepared by the Copyright Council of New Zealand, September 1997.
11. **Copyright Reform to Promote Cultural, Economic, Job & Export Growth**, a study by the Copyright Council of New Zealand, February 1994.
12. **Employment Growth in Copyright Based Industries**, a study prepared by Business & Economic Research Ltd for the Copyright Council of New Zealand, March 1993.
13. **The Social and Economic Importance of Copyright**, prepared by Adolf Stoombergen, Jude Miller and Benedikte Jensen for the Copyright Council of New Zealand, February 1992.
14. Marlies Hummel, **The Economic Importance of Copyright**, [1990] vol. XIV (2) **UNESCO Copyright Bulletin** 14-22.

directives, adopted between 1973 and 1999, covering not only access to and exercise of non-life activities, but also more specifically vehicle insurance, credit insurance, travel insurance and legal protection insurance.

4.3. The Committee is also concerned that the proposed directive should not leave the way open for the principles and procedures laid down by the consolidated directives to be called into question.

Brussels, 24 January 2001.

*The President*  
*of the Economic and Social Committee*  
Göke FRERICHS

### **Opinion of the Economic and Social Committee on the 'Exhaustion of registered trademark rights'**

(2001/C 123/05)

On 13 July 2000 the Economic and Social Committee, acting under the third paragraph of Rule 23 of its Rules of Procedure, decided to draw up an opinion on the Exhaustion of registered trademark rights.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 10 January 2001. The rapporteur was Mrs Sánchez Miguel.

At its 378th plenary session of 24 and 25 January 2001 (meeting of 24 January), the Economic and Social Committee adopted the following opinion unanimously.

#### **1. Introduction**

1.1. The purpose of this opinion is to endorse the Commission's decision of May 2000 not to change the current Community exhaustion regime for registered trademarks, owing in part to the need to continue protecting European goods and services identified by trademarks.

1.2. Registered trademarks form part of the corpus of legislation governing industrial and intellectual property rights. At European level the discussion on registered trademarks has focused on the accession of the European Community to the Madrid Protocol and on the Community exhaustion regime.

1.3. Existing Community law<sup>(1)</sup> on industrial property rights (design, registered trademarks, copyright and similar rights) provides for the principle of Community exhaustion of rights. The purpose of this regime is to guarantee free movement of goods within the EU; it allows the owner of a trademark to prevent imports of products bearing that trademark which were first brought on to the market outside the EU.

<sup>(1)</sup> Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trade marks; Council Regulation (EC) No 40/94 of 20 December 1993 on the Community trade mark; Council Directive 87/54/EEC of 16 December 1986 on the legal protection of topographies of semiconductor products; Council Directive 91/250/EEC of 14 May 1991 on the legal protection of computer programs; Council Directive 92/100/EEC of 19 November 1992 on rental right and lending right and on certain rights related to copyright in the field of intellectual property; Council Regulation (EC) No 2100/94 of 27 July 1994 on Community plant variety rights; Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the legal protection of databases.

1.4. In November 1999 the Commission presented a working document that was intended to form the basis for future, more detailed, discussions in the group of experts appointed by the Member States at the request of the Council about a possible EU position on any change in the current Community exhaustion arrangements.

1.5. At the Internal Market Council of 25 May 2000, ministers exchanged contrasting views based on the outcome of recent discussions in the group of experts. At this Council, Commissioner Frederik Bolkestein informed the ministers of the Member States that the Commission had decided not to propose any change to the current Community exhaustion regime.

1.6. The exhaustion regime was included at the request of the European Parliament, under Article 13 of Council Regulation (EC) No 40/94 and Article 7 of Council Directive 89/104/EEC.

## 2. General comments: arguments for and against a change in the Community exhaustion regime

### 2.1. *The NERA study*

2.1.1. In November 1998 the Commission asked for a study to be carried out ('The economic consequences of the choice of regime of exhaustion in the area of trademarks') by National Economic Research Associates (NERA), S.J. Berwin & Co. and IFF Research.

2.1.2. The main aim of the study was to look at the potential economic consequences for the European Union of any change in the exhaustion regime for trademarks. The study analysed the effects that the exhaustion regimes (Community and international) might have on prices and trade volumes, market and product structures, and consumers, and the impact of these regimes on macroeconomic indicators such as employment.

2.1.3. The study concluded that the only obvious beneficiaries of a switch from the Community exhaustion regime to an international exhaustion regime would be parallel importers and the transport sector. National importers and exporters, and manufacturers, would suffer most.

2.1.4. A change in the regime would produce a barely perceptible reduction in consumer prices (0-2 %). The study also showed that the initial fall in prices would probably disappear over the long term.

2.1.5. The study did not quantify the potential job losses that a change in the regime would cause, although it indicated that jobs would probably be lost among 'national' suppliers of a product, while new ones would be created among 'external' suppliers.

2.1.6. Other conclusions of the study were that a change in the Community exhaustion regime would affect the quality of products, their availability to consumers and after-sales services.

### 2.2. *Public hearing*

2.2.1. On 28 April 1999 the Commission organised a public hearing attended by 180 representatives of various interest groups, including owners of registered trademarks from different industrial sectors, consumers, parallel traders and retailers.

2.2.2. At the hearing arguments were advanced for change and for maintaining the current Community exhaustion system:

- Those in favour of maintaining the current arrangements argued that an international regime would lower the economic value of trademark rights, which would have a negative impact on research and innovation, and reduce investment, causing higher unemployment.
- A number of participants argued against adopting the international exhaustion system on the grounds that there was a close link between parallel trade and piracy.
- Arguments supporting a change in the current regime focused exclusively on the fall in prices (0-2 % according to the NERA study) that would benefit European consumers.
- The potential broader range of products was another argument put forward by defenders of the international exhaustion regime.

### 2.3. *Groups of experts in the Council*

2.3.1. The Commission has held a number of meetings with the Member States and interest groups. Two meetings have been held with experts from the Member States on the basis of the working document prepared by the Commission in November 1999.

2.3.2. The ESC agrees in particular with the following arguments put forward by the national experts:

- The introduction and use of new technologies such as electronic commerce may make a wider range of products available to consumers at lower prices, so there would be less reason to change the current exhaustion regime for price reasons.
- In many cases products are protected not just by registered trademarks but by a number of intellectual property rights (industrial designs). Introducing an international exhaustion regime for registered trademarks would therefore have only a limited impact on a small number of sectors.
- In Europe, registered trademarks are governed by Directive 89/104/EEC (national trademarks) and Regulation (EC) No 40/94 (Community trademarks). It is essential that exhaustion regimes should be the same for both types of trademark (national and Community). Different co-existing systems would create confusion in the market, and among consumers, especially in terms of whether or not a product with a specific trademark had been brought onto the market legally.

### 2.4. *Consequences of a possible change in regime*

#### 2.4.1. *Community legislation*

2.4.1.1. First and foremost, the Committee feels it is essential that the exhaustion regime be the same for national and Community registered trademarks. However, it must be borne in mind that there can be no guarantee that the exhaustion regime would be changed in both the legal instruments regulating this area (the Directive for national registered trademarks and the Regulation for Community registered trademarks), since the Directive can be changed by qualified majority in the Council, whereas amendment of the Regulation requires unanimity.

2.4.1.2. It is likely that some Member States would resist a change in the Regulation, which might result in two different exhaustion regimes existing alongside each other, a situation that would only produce confusion in the market and among

consumers. However, the Community exhaustion regime also furthers integration of the single market. An international exhaustion regime could put European companies at a disadvantage, since there has been no equivalent process of integration at global level as yet; SMEs would be particularly affected, as they are covered by national trademark arrangements, these being cheaper.

#### 2.4.2. *Other intellectual property rights*

2.4.2.1. Registered trademarks are only a part of the corpus of legislation dealing with intellectual and industrial property. In practice, most products are covered by a complex of rights relating to industrial property, registered trademarks, patents, copyright and designs. It is rare for the trademark to be the only industrial property right covering a product. For example, in the case of an audio compact disc the music will be protected by copyright, the technology by patent and the trademark by registered trademark rights.

2.4.2.2. The legislative processes relating to intellectual and industrial property rights are likely to be complex and long-drawn-out. The European-level discussion about designs began in 1993 and has not yet finished. As the Commission recently noted<sup>(1)</sup>, changing the exhaustion regime for registered trademarks would not have much impact on the market because most products are covered by a number of intellectual property rights. The Commission does not consider it appropriate to introduce an international exhaustion regime for all intellectual property rights.

#### 2.4.3. *Economic growth in Europe*

2.4.3.1. A change in the Community exhaustion regime could in the long term inhibit investment in new products or even result in the withdrawal of products with registered trademarks that are already established on the market because they cannot compete with imported products.

2.4.3.2. Owners of registered trademarks might also decide to cut post-sales services or other features of their products that parallel importers do not provide to European consumers because they are not subject to a Community standard.

---

<sup>(1)</sup> Commission Communication of 7 June 2000.

2.4.3.3. The Community exhaustion regime meets the need to further integrate the single market. An international exhaustion regime would put European companies at a competitive disadvantage because such an integration process has not taken place at global level. Conditions of access to markets for products from third countries vary more at global level than within the EU.

2.4.3.4. The single market has brought about economic integration and a levelling-out of prices across the EU. These conditions do not however exist on the global market. The countries coming under the WTO thus do not form a customs or economic union like the EU, or even a free-trade area. Numerous tariff and non-tariff barriers still exist between these countries, as do major differences in terms of their economies, legal systems, levels of wealth and development, controls and regulations.

2.4.3.5. In addition to the possible consequences of a change of regime for European manufacturers, consideration must be given product marketing/distribution channels — especially of specialist products — and franchising. At present, franchising arrangements give European consumers access to high-quality products with clear references. A change of regime would give rise to confusion among European consumers, who could come across products with well-known trademarks but failing to meet their expectations of quality.

2.4.3.6. Another important single market issue is the risk of counterfeiting and piracy concerning products coming from non-EU countries. As argued in the Green Paper on counterfeiting and piracy and its follow-up communication<sup>(1)</sup>, account must be taken of:

- the negative impact of these products on the European economy;
- the risk of parallel import channels being used for such products;
- the need for action taken by the Commission in implementing the green paper to be consistent.

<sup>(1)</sup> ESC opinion in OJ C 116 of 28.4.1999, rapporteur: Mr Malosse. Green Paper — Combating counterfeiting and piracy in the Single Market (COM(1998) 569 final); Communication — Follow-up to the Green Paper on combating counterfeiting and piracy in the Single Market (COM(2000) 789).

2.4.3.7. Finally, differences in administrative requirements or labour costs may affect the costs of parallel trade. Community policy has prevented such differences occurring within the EU, which is not the case at international level.

### 3. Reasons to support the current Community exhaustion regime

#### 3.1. Consumers

3.1.1. The Committee believes that European consumers currently demand a certain level of quality and post-sales services, as well as competitive prices, and this is recognised in European law. But above all they expect to pay for what they believe they are getting. Sometimes producers of trademarks use different designs or variations for different customers. For example, the most popular brands of toothpaste in Europe are mint-flavoured, whereas in Indonesia the most popular ones are clove-flavoured. Another example would be lubricating oils for engines, whose composition can vary depending on the climate where they are to be used.

3.1.2. Access to products that are not designed to meet the climatic and technical requirements of European consumers could pose a safety risk to them. It is important in this part of the opinion to point to the possible impact on health in Europe of parallel imports of pharmaceutical products, bearing in mind that the pharmaceuticals sector in Europe is subject to considerable surveillance to protect consumer health.

3.1.3. Availability: the current Community exhaustion regime ensures the availability of all types and ranges, not just those that are most in demand. Thus an official vendor of jeans, for example, will offer its customers all sizes, not just those of the largest section of the population.

3.1.4. Post-sales services: European consumers expect a range of services to be provided by producers, which are not available to them with parallel imports. A television bought from an unofficial supplier may not come with any installation services or repair guarantee. Moreover, the instructions accompanying imported products are usually in the language of the country in which the parallel importer acquired the product, not that of the consumer.

3.1.5. Counterfeited and pirated products: The routes used by parallel importers are often the same as those used for pirated products. An international exhaustion regime might trigger an increase in pirated products in the EU, the harmful effects of which for the proper working of the single market were confirmed in the replies to the green paper. As indicated in point 2.4.3.6 above, the harmful effects on European economic growth would also have repercussions for consumers. The importers of such products are responsible for proving that they meet Community standards. It is also important to highlight the serious consequences of counterfeiting and piracy for consumer protection and public health and safety. Given that some counterfeited/pirated products are in everyday use, the risks are frightening. Among the most significant cases uncovered by the European Commission in 1999<sup>(1)</sup> were 530 000 counterfeit toothbrushes, 21 tonnes of counterfeit rice and energy drinks. The quality and origin of these products evade any form of control by the Community or Member State authorities.

3.1.6. Prices: Advocates of parallel trading cite reduced prices as almost the sole argument in its favour. In fact, the NERA study has now shown that price reductions are negligible (between 0 and 2 %) and that they tend to disappear in the long run. The NERA study also found that producers would lose up to 35 % of earnings, resulting in less investment in research and development for European products. But European producers must innovate constantly in order to compete and provide more added value to consumers. This added value is increasingly to be found in the 'intellectual' content of the brand (whether this is a technological or image-related innovation), which means that it is increasingly important for this intellectual property to be protected.

### 3.2. Community legislation

3.2.1. Keeping the current Community exhaustion regime would not lead to any change in Community legislation governing registered trademarks or any other industrial or intellectual property rights, particularly regulations or directives.

<sup>(1)</sup> 1999 annual report on the Community's customs operations concerning piracy and counterfeiting.

### 3.3. Single market

3.3.1. The Community exhaustion regime is a natural part of the single market, in which obstacles to free circulation of goods and people are being removed and the economies of the Member States are converging.

3.3.2. The purpose of EU competition law is to prevent any obstacles to integration of the market, including obstacles to consumers' freedom to buy what they want wherever they want in the EU. Competition law also provides an appropriate framework in which companies that consider themselves threatened or discriminated against in the face of potential dominant market positions can lodge any complaints.

3.3.3. The current Community exhaustion regime provides assurance to producers and suppliers with respect to investment in research and development for new products.

### 3.4. Trade relations with third countries

3.4.1. The first point to bear in mind is that the Community exhaustion regime is a natural part of the single market in which the Member State economies converge and which seeks to remove obstacles to the free movement of goods.

3.4.2. On a global level, there can be no valid comparison between European integration and the attempt to remove barriers to the free movement of goods on the one hand, and the WTO process on the other. Neither is there a parallel political process working to reduce existing differences between the EU and third countries.

3.4.3. Trademarks are important at international level. European companies competing on the world market must face companies with considerably lower production costs. The Community exhaustion regime offers a degree of protection to these companies and to non-European companies working within the single market.

3.4.4. An international exhaustion regime would mean that a trademark established in the EU would be unable to penetrate the markets of developing countries using marginal prices, since these products would immediately return to the EU, destroying the base market. Companies pursuing a marginal price strategy would have to choose between not exporting, or removing production from the EU to lower-cost markets.

3.4.5. It must also be borne in mind that parallel imports from third countries can have a significant deterrent effect on production and investment in innovation within the EU. This would probably result in reduced European exports and greater incentives to shift production to lower-cost locations than the EU.

3.4.6. EU competition law<sup>(1)</sup> represents the best way of dealing with possible abuses by certain companies.

<sup>(1)</sup> Especially the following articles: Treaty Article 82 on abuse of dominant positions.

Brussels, 24 January 2001.

*The President*  
*of the Economic and Social Committee*  
Göke FRERICHS

**Opinion of the Economic and Social Committee on the 'Proposal for a Directive of the European Parliament and of the Council amending Directive 80/232/EEC as regards the range of nominal weights for coffee extracts and chicory extracts'**

(2001/C 123/06)

On 23 October 2000 the Council decided to consult the Economic and Social Committee, under Article 251 of the Treaty establishing the European Economic Community, on the above-mentioned proposal.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 10 January 2001. The rapporteur was Mr Liverani.

At its 378th plenary session (meeting of 24 January 2001) the Economic and Social Committee unanimously adopted the following opinion.

The present proposal follows up the obligation undertaken by the Commission to amend Directive 80/232/EEC by adding the mandatory range previously contained in the Directive on coffee extracts and chicory extracts. The aim is to maintain a legal basis in Community law for the range. The range need not be adapted as it is sufficient to ensure free circulation of goods in the sector.

Entry into force will be 20 days after the publication of the Directive. This short period of time is justified because the range is already part of the *acquis* and therefore has already been implemented by all Member States.

The Committee endorses the Commission proposal.

Brussels, 24 January 2001.

*The President*  
*of the Economic and Social Committee*  
Göke FRERICHS