

The GOWERS REVIEW of INTELLECTUAL PROPERTY

A RESPONSE from the BRITISH PHONOGRAPHIC INDUSTRY

1. Introduction and Summary p2
2. General Questions p9

SPECIFIC ISSUES

3. Copyright Term of Protection on Sound Recordings and Performers' Rights p15
4. Copyright Exceptions – Fair use / Fair Dealing p30
5. Copyright – Digital Rights Management p36
6. Copyright – Orphan Works p41
7. Copyright – Licensing Public Performances p42
8. Legal Sanctions on IP Infringement p43
9. Coherence between Competition Policy and IP Policy p45
10. Parallel Imports p51
11. Other Issues:
 - a. Authorisation p58
 - b. Digital Stream Ripping p62
 - c. Copyright Office p65

Introduction and Summary

On behalf of the UK recorded music industry¹, the BPI would like to welcome the Gowers Review of Intellectual Property. We believe this Review:

- Marks the fruition of a growing governmental awareness of the role of Intellectual Property (IP) law in helping transform the United Kingdom into a creative led economy;
- Provides an opportunity to highlight not just the achievements of the record industry as an historic element in the UK's pre-eminence in popular culture, but also as a relative pioneer in increasingly adopting digital forms of distribution;
- Offers the opportunity to engage with the Government to bolster and help develop that success.

The UK recorded music market depends for its very existence on IP law. In broad terms the existing copyright framework has served creators, investors and the consumers well to the extent that the UK can boast one of the healthiest and most successful recorded music industries in the world. Its social and economic contribution is impressive:

- Some 56.1% of the UK population bought music in 2005². While the nominal trade value of the UK recording industry in 2005 was £1.176 bn³, UK consumption of music in all of its forms totals almost £5 billion a

¹ The BPI is a UK trade association with over 350 members of varying sizes who invest in and market recorded music for a global market. Its members' sales represent approximately 90% of UK recorded music sales. Its Council has equal representation from the major labels and the independent sector.

² TNS Audio Visual Trak Survey, 2006

³ BPI Trade Delivery Quarterly Report, 2006

year and music activities generate the equivalent of 126,000 full-time jobs in the UK⁴.

- The music sector benefits the UK's international trade. In 2004, the UK sector showed a trade surplus of £83.4m, earning £238.9m⁵ in export income.
- The UK boasts the highest per capita consumption of recorded music in the world⁶;
- UK record companies provide the consumer with one of the most diverse repertoires of music available anywhere in the world. In 2005 8,764 singles and 31,291 albums were released in the UK⁷;
- Independent research shows the price of top 10 chart CDs in London is the lowest in Europe⁸;
- The UK recorded music industry is second only to the US in its share of exports of music around the world, with for instance 8% of the US market and 12% of the German market in 2004⁹;
- Over a period from 2000-2004 when the worldwide recorded music market declined by 15.4%, the UK market grew by 3.4% in value terms¹⁰.

The recorded music industry provides ample evidence that the UK's copyright laws work well – to the benefit of music fan, record company and performer alike.

Even more so, the recorded music sector is the motor which drives the broader music industry. It is the recording industry's investment in sound recordings which is

⁴ National Music Council "Counting the Notes" 2002

⁵ BPI Survey of Record Companies, 2006

⁶ BPI Statistical Handbook, 2005, p105

⁷ Millward Brown / OCC, 2006

⁸ Dresdner Kleinwort Wasserstein Bank

⁹ BPI Research based on SoundScan & Media-Control data

¹⁰ IFPI – Recording Industry In Numbers

the key driver of the revenues of the £261.7m music publishing sector¹¹. It is also the recording industry's investment in artists and publicity which contributes to the health of the £487m live music industry¹².

With an investment of £207m in A&R (Artists & Repertoire) - the record industry's version of R&D – the recording industry is the biggest single investor in British music.

Key Assumptions

In this introductory section to our submission, we wish to raise two key assumptions which we believe should underpin the Review team's approach to the music sector:

The Difficulty in Capturing the True Value of Creativity

Music is society's blessing but the economist's curse. Although the data noted above is vital in measuring the sector's contribution to the economy, the traditional tools of economic analysis are infamously poor at capturing the full value of music to society. Beyond measurement of the financial impacts of music, accountants and economists are forced into silence on the wider cultural and social advantages that music brings.

This "knowledge gap" has implications for the present Review. The Call for Evidence notes that the state needs to ensure a balance is struck between incentives for producers of IP and the costs to consumers which a rights system may incur, such as "high prices". However, given that there are factors in the equation which are beyond measurement, such a decision cannot be made on the basis of statistics alone. A normative judgment needs to be made as to how to accommodate the "x-factor" of the true value of music.

The BPI does not propose a model for capturing the true value of music in this submission: indeed we suspect that creating such a model may be impossible. However, we do urge that the Review team attempts to recognise the intrinsic value of creativity when analysing the wider market conditions.

11 National Music Council "Counting the Notes" 2002, p10

12 National Music Council "Counting the Notes" 2002, p19 (n.b.: this represents non-classical concerts only)

The Distinction Between Creative and Technical IP

The BPI believes that the underlying intellectual property in the music sector is of a fundamentally different character to that in the technical and scientific sector. Consequently, we believe that the IP system must never adopt a “one size fits all” approach to rights management. There are two key areas of distinction.

First, broadly speaking, those engaged in innovation in the technical/scientific field are acting teleologically. That is to say, they are working towards an objectively definable goal and often as part of a wider endeavour (for example, creating the most efficacious drug or machine) or aiming towards definitively solving a technical problem. In the world of creating music it is entirely different. Creativity is more often than not undertaken for its own sake, with no wider goal in mind than the artistic expression of thoughts and feelings.

There is a strong argument that patents should fall out of protection within a short timeframe, so as to allow successive innovators to “stand on each other’s shoulders”. There is no such imperative for sound recordings or musical compositions and we believe that the right to choose how to control copyrighted works should stay with creators for a longer period (as we detail later in this submission).

Secondly, consumers and producers of IP in the creative world tend to stand in a very different relationship to those in the technical arena. Generally, it is easier for the consumers of music related IP to infringe rights than it is for those in the technical arena. Thanks to the capabilities of modern technology it is open to anyone to infringe copyright in a sound recording by, for example, illegal filesharing. Technical IP, on the other hand, can be infringed only by those with a certain level of technical know-how and capability.

The Challenges to Copyright

Fast moving changes in technology, manifested in digital music and consumer electronics advances, have made it difficult for legislation, the industry and the consumer to keep pace.

In the TECHNICAL arena, digitisation has created a multiplicity of formats on which music of the highest quality can simply be transferred, not just within the home but

from person to person across a global market place. Thus far the opportunities presented to the music industry by these changes have been outweighed by many consumers taking the opportunity to avoid paying for music, contributing to a global decline of 15% in the recorded music market in the last 5 years. This has been coupled with an increase in piracy of such significant proportion that it is clear that the decline is due, not to a fall in the popularity of music, but to the ease with which music can be consumed illegally without rewarding the legitimate content owners.

In the EDUCATION arena it becomes increasingly difficult to inform and educate the consumer about what is right and what is wrong given the array of options available to enjoy and transfer music. The internet, in particular, poses philosophical challenges with a vocal but not substantial lobby attacking the very basis of copyright.

In terms of LEGISLATION, it is not always easy to determine what can be achieved without legislative change, and where laws need revising and updating. It is important to note that the UK implemented the EU Copyright Directive in October 2003, less than 3 years ago, and in our view this continues to provide an appropriate and relevant basis for our industry in the digital age. The Gowers Review call for evidence has highlighted areas of concern and this BPI submission deals to those points, but in general terms the BPI believes that the legislative changes needed are minimal and not significant.

Summary of the BPI Submission

There are four main areas dealt with in this submission, but in some ways all have a central theme: *Is the Government prepared to take steps to incentivise the investor in sound recordings?* The record company (the investor and risk taker) currently faces the most challenging risk/reward ratios in the entrepreneurial world. And this is true whether one is a multinational or a minor player. All costs associated with funding, promoting and selling recorded music have risen year on year during a 20 year time frame in which the consumers' cost of purchase has actually fallen. In our view, all new Government initiatives should contribute directly or indirectly to the stimulation of investment in recorded music. In doing so they will be bound to boost the health of the wider British music and creative industries.

- **Extension of Copyright Term:** First and foremost the BPI believes that the UK Government must champion the cause for extending the current EU copyright term accorded to the sound recording. There are any number of arguments (listed in this submission) to support this request but pivotal amongst them is the need to support in every way possible the creator and investor in the recording above those who seek to exploit without investment.
- **Private Copying:** To the knowledge of the BPI, the UK recording industry has never acted against a consumer who copied music solely for his/her own private and personal use. The BPI accepts that it may now be time to define more accurately what consumers may do for their own private use and what activities they engage in (either wittingly or unwittingly) which harm the commercial exploitation of music and, as a consequence, the investment in new music. We recognise that the availability of different music formats does make possible and appealing to the consumer a degree of personal copying. However, the inherent dangers (whereby at a press of a button a consumer can offer up music, free of charge, to a global market place) must be factored into the equation. The BPI believes that an industry-wide voluntary regulated scheme that retains the right to authorise own use copying and leaves the consumer in no doubt of the extent of his potential liability is a viable solution. The BPI wishes to engage with the Gowers Review team to outline its thoughts.
- **Digital Rights Management:** The BPI believes that DRM does not distort existing copyright law but complements the protection of copyright provided in legislation. The development of markets in digital music would simply not be possible without DRM. We believe that there should be greater interoperability enabling consumers to play whatever music file they buy on whichever portable device they own subject to reasonable licence restrictions. However, we believe that this is a matter for industry co-operation in the development of open standards rather than for regulation.
- **Parallel Imports:** The BPI believes that international exhaustion of copyright would have a massively negative effect on music companies operating in the UK and on British music exploitation around the globe. UK companies would

not be able to develop artists and market their products with any confidence if non EU imports soaked up the demand created by UK investment. Moreover, companies would not license overseas for global exploitation in developing economies if they feared that cheaper products based on those economies' living standards would simply return to the UK. Such a move would simply increase piracy on a massive scale in the developing world in particular, which would in turn impact on local artist development everywhere.

GENERAL QUESTIONS

HOW IP IS AWARDED

As the Review team will be aware, copyright is not awarded in the same way as other IP rights such as patents, trade marks and registered design rights. Copyright is a property right which arises automatically upon the creation of a work¹³. There is no registry, application process or requirement to fulfil formalities¹⁴.

Copyright protection is necessarily flexible. It affords the copyright owner certain exclusive rights, so that creators can make a living from their craft, whilst ensuring that those who wish to utilise those creative works can do so along certain guidelines and with permission. Indeed a set of exceptions exists which permit various reasonable uses without permission or payment¹⁵.

HOW IP IS USED

Copyright and the UK Recorded Music Industry

The essential role of record companies is to discover, invest in, market and distribute new music to bring the highest quality content to consumers.

This makes it one of the riskiest of the creative industries. In 2005, 31,291 albums were released in the UK¹⁶. Just 228 albums sold over 100,000 copies¹⁷; less than one in 10 releases is a hit, with even fewer returning a profit.

¹³ See section 1(1), Copyright CPDA. Note that there is, contrary to popular opinion, no copyright in an 'idea'.

¹⁴ Indeed, the international agreements prohibit countries requiring formalities for the grant of copyright. See, for example: Article 5(2) of the Berne Convention for the Protection of Literary and Artistic Works, as also incorporated in the WIPO Copyright Treaty 1996 and the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights; Article 20 of the WIPO Phonograms and Performances Treaty 1996.

¹⁵ See later section of this submission on copyright exceptions.

¹⁶ BPI Research based on Official Charts Company (OCC) data 2005

Typically record companies sign artists to exclusive recording contracts whereby the artist receives an advance payment which is then recouped out of future royalty payments. The contract specifies a fixed recording commitment of one or more albums with the record company having an option to extend the contract further. The contract specifies the period of time for which the record company will have the exclusive right to exploit the recordings. In many cases the rights may revert to the artist after a given period. The contract also outlines the financial relationship between artist and record company. Over time, as an artist becomes more successful, they may renegotiate more favourable contractual terms.

Record companies generate revenue from recordings in a number of ways:

- Through direct music sales to retail, both physical and digital;
- Through licensing to third parties, for compilations, for instance;
- Through licensing the music for sale overseas;
- By granting synchronisation licences for recordings to be used in films, on TV and in adverts;
- Through public performance and broadcast royalties collected by collection societies such as the UK's Phonographic Performance Ltd (PPL).

Each of these revenue streams is based on copyright law.

The recording industry has developed a very sophisticated market in order to utilise fully copyrights both within the UK and internationally. In order to service that market it has set up an equally sophisticated infrastructure to ensure that royalties – wherever they may be collected around the world – end up with the UK artists to whom they are due.

In recent years the industry has seen a greater variety of contractual arrangements between artists and record companies and between independent labels and major labels than ever before:

- An artist contract may be a joint venture between an independent label and a major record company;

¹⁷ As above

- An artist may be signed to a production company which has an option agreement with a label;
- An artist may sign direct to an independent label which licenses recordings on to a major;
- An artist may sign to an independent label which reserves digital rights but has a pressing and distribution¹⁸ deal with a bigger label;
- An artist may produce a recording himself and then license it on to a label for a limited period.

The huge variety of these different business relationships demonstrates not just the centrality of copyright law – each of them is dependent on copyright to work – but also the robustness and flexibility of the UK’s existing copyright regime.

A key example of the ability of copyright law to deal with new situations was the way it was able to deal with the rise of sampling¹⁹ in particular in dance and hip-hop. None of those legislators who first drafted the 1956 Copyright Act could have envisaged that one day recording technology would allow musicians of the future to create new music directly out of the recordings of the past. Yet the 1956 Copyright Act provided a framework flexible enough to deal with this new form of creativity.

By establishing the intellectual property rights of the original copyright owner, copyright law has enabled a market to develop in which the creators of for example a unique drum sound or a haunting vocal, are able to be confident that they will be paid when their creativity is reused perhaps decades later.

The moral and economic rights of the creator have been upheld while at the same time new forms of creativity and music have been made possible - precisely what the original legislators must have hoped for.

It is also important to point out that unlike patent law, copyright in a sound recording does not, as is sometimes claimed, give the owner a ‘monopoly’ right²⁰. The investor in a sound recording takes an initial capital risk which is often substantial. In addition, the day the recording is released it is compulsorily licensed via broadcast

¹⁸ for the physical manufacture and distribution of CDs

¹⁹ the taking of an element of one sound recording and editing and mixing it to form the basis of a new work

²⁰ See later section on competition law

and Public Library into the Public Domain in perpetuity. Unlike ownership of a patent, ownership of a copyright does not allow the copyright holder to hamper, restrict or control another creator exercising their own creativity or ingenuity. It can be imitated, even to the extent of a 'soundalike' recording.²¹

It is dependent for its value not just on the cost of the recording, and the uniqueness of the performer, but also on the cost of maintaining, promoting, selling and distributing the copyright throughout its life. The only exclusivity enjoyed by the 'copyright holder', a partnership between investor and creator, is the right to exclusively distribute the recording for sale. Finally, even this exclusivity is removed after 50 years whereas the musical work, any accompanying video, and even the sleeve notes, remain protected for 70 years after the death of the creators – an anomaly further dealt with under 'Term of Protection' later in this submission.

HOW IP IS LICENSED AND EXCHANGED

The licensing issues which are relevant to the record industry have been dealt with above. The call for evidence asks about international barriers to trade, and we refer you to the submission of IFPI which draws the Review team's attention to the problems of high piracy rates, censorship and direct restrictions which all serve as international barriers to trade, particularly in territories like China and South East Asia.

HOW IP IS CHALLENGED AND ENFORCED

The BPI supports the submission made to this Review by the Alliance against IP Theft which outlines in detail specific problems enforcing IP rights encountered by those industries which rely upon IP to thrive. As members of the Alliance, we have chosen not to repeat its submission arguments here. In relation to the record industry, the key enforcement issues are as follows:

²¹ Subject to licensing use of the underlying musical work and ensuring that it is clear on the face of the recording that it is not the original sound recording, nor is it associated in any way with the original performing artist.

- Trading Standards having neither the power nor the duty to enforce copyright legislation²²;
- Equally, Trading Standards are inadequately resourced, although this problem may be alleviated in part by allowing them access to funds recovered from actions brought under the Proceeds of Crime Act 2002;
- Car boot fairs and markets up and down the country are notorious hotbeds for the sale of counterfeit and pirate music product. Currently it is difficult to enforce our rights against those who organise (and profit from) such fairs and markets, even when they are on notice of what is taking place at the events for which they are responsible.

²² See the section on Legal Sanctions, further below.

SPECIFIC ISSUES

In the following sections we address the specific issues raised in the Call for Evidence. In each case, we have taken the overall question as a starting point from which to outline our detailed position.

CURRENT TERM OF PROTECTION ON SOUND RECORDINGS AND PERFORMERS' RIGHTS:

Harmonisation of copyright term for sound recordings

Summary

The BPI believes that there are strong arguments for extending the copyright term for sound recordings. Harmonisation of term with either other creative works or other jurisdictions is first and foremost a matter of fairness and logic. For consumers, harmonisation would be likely to lead to an increase in the availability of music, with no impact on pricing. Finally, for the industry, extending the term will lead to an increase of £3.3bn in nominal revenue over the next 50 years. In the next 10 years, the impact would be £82.3m with a potential corresponding increase in A&R investment of £11.1m.

Copyright law defines the parameters within which the record industry invests in new music and then recoups that investment. Without adequate copyright law and meaningful enforcement provisions that investment is jeopardised. Unfortunately European law has put a strict time limit on the success of British recorded music – just 50 years.

The recording industry, led by the BPI, performer organisations and artist representatives have formed a broad alliance to urge government to champion the cause of a successful British industry facing economic hindrance as a result of an inequitable restriction on their IP rights.

The UK Government has declared that, to quote the Minister for the Creative Industries James Purnell MP, “*We wish to make Britain the world’s creative hub – to turn our creativity into industrial success – to turn talent into hits, and hits into profits. Industry must help us answer these questions.*”

The BPI position is that part of the answer to incentivise investment is to harmonise the term of copyright for sound recordings. Government has responded with sympathy but has made it clear that it will not act without a firm economic rationale.

The BPI believes that the arguments for harmonisation should now be irresistible for any Government committed to the development of the UK's creative industries. A failure to harmonise will be a significant blow to one of the UK's most successful industries. Implementation of harmonisation will have no short-term negative impact on the consumer, and will certainly have a longer-term beneficial effect as the industry's ability to invest in the music of the future is safeguarded and catalogues are maintained in good order for longer periods.

What is meant by harmonisation?

The term of copyright protection for sound recordings in the UK is discriminatory in two essential ways:

- In comparison with the protection afforded to similar creative works;
- In comparison with the term of protection offered by some of our most significant international competitors, in particular the US.

In calling for harmonisation, the BPI is requesting that copyright term be extended to put the recording industry on an equal footing with these other markets.

Other creative works

The recording industry is severely prejudiced by the disparity in term of copyright protection for sound recordings (50 years) when compared with other copyright works such as literary, artistic and musical works (an average 120 years). Other creators such as writers, composers, leading actors and directors retain the right to control their works for 70 years after they have died.

It is our view that the legislation should not discriminate between types of works. Under the current legislation, a mundane work such as a washing machine instruction booklet can be protected as a 'literary work' and thus attract around 120 years of protection while a sound recording, with all its concomitant creativity, endeavour and investment, is merely protected for 50 years.

The current regime creates anomalies even within the delivery of a physical CD. While the actual recording is protected for only 50 years, the cover artwork, musical works, lyrics and any associated music video may be protected for the life of the creator (the sleeve designer, composer or video director, for example) plus another 70 years.

Such anomalies are not only patently unfair, they also throw up absurdities in the law, and threaten to discredit the whole system.

International competitors

The recorded music industry is one of the few creative industries in which the UK can still genuinely claim to be a world power. From the dawn of the rock 'n' roll era in the late fifties and early sixties, half a century ago, the British Isles has produced more than its fair share of popular music's greats.

Consistently the UK has been the only credible worldwide competitor in pop music to the US. Although the US has the advantage of a huge domestic market – three times the size of the UK's – against which it can amortise its investment, the UK recorded music industry has consistently shown it can punch above its weight. Even today the

UK can boast an 8% share of the US music market²³ and a similarly strong position in Continental Europe, 12% in Germany for instance²⁴.

If the US market has long had the advantage of the sheer scale of its domestic market, since 1998 it has had another significant advantage, a term of copyright protection nearly twice that pertaining in the UK. Following the implementation of the "Sonny Bono Copyright Term Extension Act" on 27 October 1998, in a ringing endorsement of its own creative industries, the US extended copyright for all works by at least 20 years. This included sound recordings which, when regarded as so-called "works made for hire", attract a copyright term of 95 years from date of publication. This extension was made on the basis of actuarial advice that demonstrated that 95 years from publication is broadly equivalent to a period of 70 years from the death of the author given to other works in the US²⁵.

The significance of the Sonny Bono Act is (a) that it treated sound recordings similarly to other creative works, and (b) it marked a clear commitment by the US Government to support its creative and entertainment industries.

The US is not alone in adopting such a far-sighted approach. Another significant English language market, Australia has, since 1 January 2005, amended its Copyright Act 1968 to increase the term of protection for sound recordings from 50 years from the end of the year in which it was first published to 70 years.

In fact, a growing number of countries now also provide for a longer term of protection, including: Australia (70 years), Japan (70 years for music videos), Singapore (70 years), Mexico (75 years), Chile (70 years), Peru (70 years), Brazil (70 years), Ecuador (70 years), Colombia (80 years), Honduras (75 years), Guatemala (75 years), Turkey (70 years) and India (60 years).

There is an international drive towards the lengthening of copyright term from which the UK, as part of the European Union, is a significant omission.

Historical background

²³ British music in the USA, 2005, BPI

²⁴ British music in Germany, 2005, BPI

²⁵ Copyright Term Extension: Australian Benefits and Costs: July 2003 by The Allen Consulting Group - Report commissioned by the Motion Picture Association

Although the UK's current 50 year term of copyright for sound recordings was ratified as recently as 1995, it is important to point out that it has remained effectively unchanged for a century. It was the 1911 Copyright Act which first introduced a 50 year term of protection for sound recordings, then regarded as 'musical contrivances'.

Under the 1956 Copyright Act²⁶ sound recordings were separately defined and protected for 50 years. However, this was still substantially lower than the term of copyright for literary, artistic and musical works which was life of the author *plus* 50 years.

The discrimination in favour of literary, artistic and musical works was exacerbated when the European Commission "harmonised" the term of copyright across Member States with the EC Term of Protection Directive²⁷ ("the Directive"). The Directive was implemented in the UK by the Duration of Copyright and Rights in Performances Regulations 1995²⁸.

This extended the term of protection for literary, artistic and musical works for the life of the author *plus 70 years*. The main rationale behind the extension upwards for "authors' rights" was that certain territories in Europe had already adopted a longer term of protection. In essence, it was decided that it was easier to harmonise going up rather than down.

The European Commission set out a number of rationales for extending the term in the recitals to the Directive²⁹, which included a desire to provide protection for the author and his descendants and the fact that existing rights needed to be respected.

Based on the same logic, 'related rights' were reviewed by the European Commission and they found a greater variation of terms of protection ranging from 0 - 50 years. The UK, along with Ireland, France, Portugal and Sweden, all provided for 50 years, albeit with different trigger points for the term to run. Accordingly the term

²⁶ Section 12 Copyright Act 1956

²⁷ Council Directive 93/98/EEC on 'Harmonizing the term of protection of copyright and related rights

²⁸ Duration of Copyright and Rights in Performances Regulations 1995 SI 1995/3297

²⁹ Recital to Council Directive 93/98/EEC on "Harmonizing the term of protection of copyright and related rights"

was harmonised by the Directive to 50 years with a common trigger point and the position therefore remained the same within the United Kingdom.

An outdated term

As noted above, the 50 year copyright term for sound recordings dates back to 1911. At that time, recordings were made on wax cylinders and were not expected to last a long time, certainly considerably less than 50 years. Equally, according to the Office of National Statistics, the life expectancy of a British-born male was 51.5 years. On that basis a 50 year term very likely made sense as a whole-life term. By contrast, life expectancy is currently 76.5³⁰ years. So even on an actuarial basis, the current 50 year term does not reflect the reality of 21st century Britain.

The Economic Case For Extension of Term

There has been little in the way of published evidence on either side of the debate. To address this, the BPI commissioned PwC to produce an independent assessment of the economic impact of the harmonisation of term in March 2006 in direct response to the call for evidence of the Gowers Review. The full report is attached as an enclosure to this submission.

While there have been international studies of this issue the PwC study is to our knowledge the only independent UK study of the impact of the harmonisation of term. As such, we believe its conclusions deserve to be taken very seriously.

The PwC study makes two significant contributions to the debate over extension:

ONE: It finds no hard evidence to support the oft-heard consumerist argument against harmonisation – that it would lead to an increase in prices over what they might be if recordings were left to fall into the public domain. It also finds that harmonisation is likely to increase the availability of recordings.

Two: For the first time the report puts an accurate number on the potential cost in terms of revenue to British music – and, in particular, to British record companies and performers if term is not harmonised. PwC's analysis shows that *failure to*

³⁰ Office of National Statistics, Interim Life Tables for 2002-2004

match the US's 95 year term of copyright will deny the UK industry up to £3.3bn in nominal revenue over the next 50 years. In the next 10 years, the impact would be £82.3m thus denying the potential for a corresponding increase in A&R investment of £11.1m.³¹

Term of Copyright and Pricing

Much of the opposition to the harmonisation of term for sound recordings is predicated on the unproven assertion that the “monopoly” conferred by copyright would allow record companies to charge a higher price for older recordings than they might otherwise command if they were allowed to fall into the public domain.

The PwC study examines that hypothesis and concludes from its survey of recordings made between 1950 and 1960 that *“there are no statistically significant differences between the average price of popular recordings that are in copyright and the average price of recordings whose copyright term has expired”*.³²

In parallel with its study of popular recordings, PwC also mounted a smaller examination of prices of in-copyright and out-of-copyright classical recordings restricted to a sample of just 26 recordings (12 in copyright and 14 out of copyright). PwC did find more cases where in-copyright records were more expensive than out-of-copyright records. However, PwC conclude:

“We could not conclude from this evidence especially when combined with the statistical analysis that performers’ or labels’ in-copyright recordings tend to be any more expensive than their out-of-copyright recordings....The data does suggest that there are much more important factors driving the prices of classical recordings than term in copyright.”³³

PwC also cites two examples of online stores whose pricing policies tend to suggest that the copyright status of a recording has little or no impact on its selling price: Apple iTunes which sells music at a flat rate of 79p per track regardless of copyright status; www.curioquest.com which sells compilation CDs comprising recordings from

³¹ PwC Report, pages 3 & 4

³² PwC Report, page 49

³³ PwC Report, page 49

particular years (i.e. the '1950' CD contains only songs from the year 1950). PwC discovered that all the CDs from the years 1950 to 1960 are priced at £5.99, with no distinction made between in-copyright and out-of-copyright recordings.

The logic of those who suggest harmonisation would produce higher prices may appear compelling. They argue that expiry of copyright term allows competition in the market for a particular recording and when such competition is introduced, the former copyright holder will be forced to cut prices to compete.

The BPI's knowledge of the market for sound recordings confirms that at retail and wholesale levels pricing rarely if ever differs according to its public domain status, whether referring to the authors' rights or the sound recording rights. Moreover, with very few exceptions all recordings progress to mid and lower price levels during their life-span and almost all recorded music older than, say, 25 years is already sold at the lowest price levels. It is possible to conclude that it is not domain status that determines price in the marketplace, but other factors such as recording costs, nature of artist and repertoire and age of recording.

The BPI concludes that the PwC pricing study provides compelling evidence that the fear most often expressed on behalf of consumers – that a harmonised term of copyright would lead to increased prices – is without foundation.

Term of Copyright and Industry Revenues

The BPI also asked PwC to estimate the potential loss of revenue were the 'crown jewels' of British popular music of the Fifties and Sixties allowed to fall into the public domain.

PwC identified four types of revenues that would potentially be lost if term is not extended (page reference to be inserted):

- A loss in music sales to new entrants;
- A loss in licence fee income from third parties;

- A loss in royalty payments to PPL³⁴ for distribution to record companies;
- A loss in royalty payments to PPL for distribution to performers.

The overall conclusion is that a 45 year extension of copyright to equal that enjoyed by the UK's biggest international competitor, the US, would produce additional revenues:

- Over the next 10 years of £7.2m to £82.3m (£2.2m to £34.9m discounted for present value)
- Over the next 50 years of £69m to £3.3bn (£8.4m to £163m discounted for present value)³⁵

The wide range is driven by the impact on music sales, which varies according to the loss in music sales to public domain specialists. It is very difficult to ascertain the likely fall in market share because very few popular music recordings have entered the public domain. The sample of companies in the PwC study held very different views of the likely impact, therefore PwC made an assumption of a 50% cumulative year on year loss in market share. On this basis:

- Over the next 10 years additional revenues would amount to £66.4m;
- Over the next 50 years additional revenues would amount to £3.2 bn.

Impact on record companies – A&R

A failure to harmonise term will impact UK and European recording companies in numerous ways. In an industry driven by investment in new music, the loss of royalties from established copyrights will inevitably hit hard. Record companies with established artists will be faced with an unenviable moral dilemma: for an established group with perhaps 10 years of copyrights, do they stop paying royalties on each one as its term expires? If they do, they risk ruining an established relationship; if they do not, they will place themselves at a clear competitive disadvantage compared with

³⁴ Phonographic Performance Ltd is the collection society responsible for collecting and distributing royalties for the public performance and broadcast of sound recordings.

³⁵ PwC Report, page 3

new entrants who do not pay royalties and who have invested nothing in the development of the act.

The results of the PwC study suggest that failure to implement harmonisation of term will produce a significant negative impact on investment in new artists. Moreover, the BPI believes that this impact is the thin end of a wedge of losses that will increase over time as more works fall out of copyright.

An internal BPI study in early 2006 established that UK record companies re-invest 17.7% of turnover in Artists & Repertoire (A&R). The average figure across the past three years is 17%. This represents investment in advances to artists, recording costs and financial assistance to performers for live concert tours.

A&R in the music industry is the equivalent to research & development costs in other industries. This 17% of turnover investment puts the recording industry second only to the pharmaceutical industry in R&D, according to the Department for Trade and Industry R&D Scoreboard 2005. By contrast, a traditionally R&D-intensive industry like aerospace and defence spends only 12.3% and the IT industry only 4.8%.

Applying the 17% figure to the revenue projections, PwC estimates that if harmonisation of term does not take place then between £1m and £13.8m of potential A&R investment will not be made over the next 10 years³⁶.

Again to make a 50% assumption on loss of market share, the lost potential A&R investment is £11.1m. ³⁷ As A&R is a key driver of competition in the record business, these figures may increase.

Availability and Harmonisation

Much is made by opponents of term harmonisation of the alleged lack of availability of large quantities of copyright material. One common assertion is that “90% of all copyright works are not available to the public”. The implication is that somehow copyright owners are keen to “lock up” content, although the reality is that 90% of sound recording copyrights never become enduringly popular.

³⁶ PwC Report, p3

³⁷ PwC Report, p4

Record companies exist by virtue of the fact that they make music available to the public. In the digital age more and more of record companies' vast catalogues are being made available for purchase permanently by the public.

The PwC report analyses the arguments around availability, factoring in digitisation, and concludes that:

“The impact of copyright term on availability depends critically on whether rights holders would make more recordings available under an extended term than would public institutions and public domain specialists under current terms. The trends in increased digital music might well tip the balance in favour of the former as rights holders increasingly digitise their back catalogues and so make more recordings available.

“What is clear is that increased copyright term increases the incentive for incumbent record companies to make some recordings available.”³⁸

Furthermore, while it is true that in the days of purely physical sound carriers the constraints of manufacture, distribution and limited shelf space may have restricted the size of record companies active catalogues, technology is removing these constraints. Already UK record companies have made available around 2m tracks for download. This number is increasing rapidly. Moreover, the industry operates a significant sub-licensing practice that feeds many niche companies.

The BPI is committed to facilitating the resolution of disputes between content owners and potential licensees of content. To this end, BPI will be discussing with others in the music industry the introduction of a Code of Conduct detailing the responsibilities of content owners to deal with licensing requests in a timely and responsible manner. If content owners have no plans to make the requested content available then the presumption will be that they will license to bona fide licensees on normal commercial terms. The BPI is prepared to act as arbiter in any disputes that arise from this process.

³⁸ PwC Report, p51

However to return to the “95%” statistic, it is worth pointing out that recorded music is an extremely risky business. According to Millward Brown, compiler of the Official UK Charts, there were 31,291 albums released in 2005, yet just 228 sold more than 100,000 copies and only 476 sold more than 50,000 copies. It should be noted that even some of these latter were not included in the 31,291 figure. The biggest-selling album of 2005, James Blunt’s Back to Bedlam, was actually released in 2004.

The fact is that most releases do not succeed commercially. It is therefore likely that there will always be a large number of recordings which are not generally available since there is simply no market for them.

The BPI contends that harmonisation of term will have no negative impact on the availability of music. On the contrary the rise of digital download stores, and record company own sites, makes this less of an issue. While there will always be isolated exceptions of tracks which are temporarily unavailable – perhaps for marketing reasons – the core of a recording company’s business model is to make available what the public wants.

OTHER ISSUES ON TERM

The “Crown Jewels” Argument

The UK played a disproportionately creative role in the development of popular music. From Cliff Richard through to the Beatles, the Rolling Stones and a multitude of lesser known artists such as Freddie and the Dreamers, Billy J. Kramer, etc, the catalogue of British popular music of the late Fifties and Sixties to a large degree helped define what popular music is. It is a contribution to popular culture which is recognised worldwide (for example, it was reported this month that the city of Hamburg is rushing to build a monument to the Beatles in time for this year’s World Cup in Germany).³⁹

Much of that music is destined to fall into the public domain over the next 15 years. Far from this auguring in a golden age in which thousands of obscure recordings are suddenly rescued from the vaults and made available to a grateful public, the

³⁹ Daily Mail, p15, 18 April 2005

likelihood is that this will result mainly in a slew of poorly packaged 'hits' collections of variable quality, with none of the proceeds finding their way back to the original creators and investors. They will occupy already restricted shelf space in retail outlets and paradoxically REDUCE the availability of rare works to the consumer.

Even worse, unscrupulous companies are likely to take advantage over the confusion about the copyright status of individual tracks such that music near, but not quite at the end of term will also find its way on to such collections. Trading Standards departments will likely give up enforcing the difference between a recording that is, for example, 47 years old and one that is 50 years old. Presently, the number of popular titles entering the public domain is relatively small compared to what will be the case from 2008 (and increasing almost exponentially thereafter). Not only will these titles come into public domain individually, but it is likely they will be packaged as collections together with titles which are close to but not yet at expiration. This will create an impossible scenario for Trading Standards departments (and smaller companies) to monitor and enforce. The UK market is thus likely to end up as a concatenation of pirate, semi-pirate and legitimate recordings.

Inevitably many of the companies who will flock to exploit the fruits of others' investments will be offshore, leading to a significant loss not just to British artists and British record companies, but also to the British Exchequer. To see the British music "crown jewels" traded by offshore companies into a global marketplace would significantly reduce Britain's invisible earnings from its global music sales and deplete a source of funding for UK record companies that has traditionally been re-invested in A&R.

The BPI believes that such a fate should not befall the creators of, and investors in, some of the most potent music ever created in the UK. The BPI believes that for Government even to countenance this would betray the UK's rich cultural heritage of popular music.

Public domain companies

Companies operating under this description tend to specialise in re-issuing recorded music that after 50 years has fallen into public domain. Some such companies often also license similar niche material from its original owner to sell alongside its other

material. Some of these companies will also make limited investments in new music of niche material. The role played by these companies is a valid one and some of them are indeed BPI members.

Such companies tend to oppose “term extension” for the obvious reason that “free of charge” product would come to them later.

The BPI would like to make it clear that it has noted their views but nevertheless believes that the overwhelming arguments chronicled in this submission outweigh their concerns. The popular music explosion in the UK and elsewhere that began in the fifties and gathered pace in the sixties was unprecedented in its impact and endurance. For all the reasons noted it is too early for this material to fall into public domain and the consequent unregulated off-shore trading both on and off line.

The BPI believes that PD companies are not threatened by extension of term and that their businesses can continue to operate via investment, sub-license from other record companies and PD models.

Asset Value

In the same way that leasehold properties are valued against the time remaining on their lease so the intangible values of record company catalogues are influenced by the time remaining to exploit their exclusive rights.

The projected value of the underlying assets of any company is vital to informing key financial decisions such as future investment, the ability to secure borrowing and projection of growth and profits. The ability to borrow against catalogue value is especially important for smaller companies in an industry where borrowing against future recordings is proving impossible.

In summary, an extension of term will increase the value of every single recorded music company that owns even the smallest catalogue, enabling them to grow and compete in the global market place more successfully.

Conclusion

In conclusion, we believe that even if the Government is minded not to increase the term of protection for the sound recording copyright conceptually, it must nevertheless pay heed to the actuarial evidence of life expectancy and durability of software prevalent when the current term was introduced. In short, 50 years is no longer appropriate; the only issue is by how much should 50 be extended.

Beyond this clear need to change that status quo the BPI has made two compelling cases:

- (1) There is a further case to extend to 95 years in order to avoid advantaging the USA in the extremely competitive global music market place.*
- (2) There is a further case to equalise the term of the sound recording copyright to that of other music, literary or film copyrights at life plus seventy years in the pursuit of full harmonisation of creative copyright.*

It is vitally important that the UK Government champions the cause for review and extension of the term of protection accorded to the sound recording copyright contained in the relevant European legislation.

Copyright exceptions – fair use / fair dealing

Summary

To the knowledge of the BPI, the UK recording industry has never acted against a consumer who copied music solely for his/her own private and personal use. The BPI accepts that it may now be time to define more accurately what consumers may do for their own private use and what activities they engage in (either wittingly or unwittingly) which harm the commercial exploitation of music and, as a consequence, the investment in new music. We recognise that the availability of different music formats does make possible and appealing to the consumer a degree of personal copying. However, the inherent dangers (whereby at a press of a button a consumer can offer up music, free of charge, to a global market place) must be factored into the equation. The BPI believes that an industry-wide voluntary regulated scheme that retains the right to authorise own use copying and leaves the consumer in no doubt of the extent of his/her potential liability is a viable solution. The BPI wishes to engage with the Gowers Review team to outline its thoughts.

There is currently a significant lobby on behalf of some academics specialising in IP law and consumer advocacy groups suggesting that there needs to be a specific exception for private copying in UK copyright law.

This lobby has a superficial appeal. People question how it can be illegal to 'rip' music from a CD they have bought to a computer so they may listen to it on an MP3 player. Technically of course, without the authorisation of the copyright holder, not only the ripping of the CD but also the transfer to a further device, are violations of UK copyright law. Such a debate tends to generate more heat than light: "How can

record companies criminalise consumers in this way?” Of course, the reality to date is that no one has ever been ‘criminalised’ in the UK for such an infringement, or even sued in a civil court. Nor are they ever likely to be.

In fact, to the knowledge of the BPI, not a single consumer has ever been sued in the UK solely for the simple act of non-transferable copying for their own private use.

The BPI does, however, note that there is a considerable difference between format to format copying of purchased music for ‘own use’ and copying for dissemination to others. The current legal uncertainties facing consumers do need to be resolved. Having examined the issues, however, we nevertheless believe that legislative change would create more problems – for the consumer, for the industry and for Government - than it would actually solve.

Copyright exceptions under UK law: background

UK copyright law provides an extensive list of exceptions to copyright – 26 of them applying to sound recordings - that allow use of copyright works without the permission of the copyright holder. It has been established that the introduction of any exceptions must maintain the balance between the specific policy goal and the value of the rights in question. Indeed, each exception must comply with the 3-step test for exceptions⁴⁰ which provides that exceptions must only be permitted (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 rightsholder.

In October 2003 the list of exceptions was amended to deal with the challenges of digital technology⁴¹. The UK Government considered the issue of a “private copying exception” at that time and decided not to implement such an exception⁴².

⁴⁰ Article 9(2) Berne Convention , Article 10 WIPO Copyright Treaty, Article 5.5 EU Copyright Directive 2001/29/EC

⁴¹ Implementation of the Copyright Directive in the UK by way of the Copyright and Related Rights Regulations 2003 (Statutory Instrument: No 2498).

⁴² Article 5.2 gave Member States the option to provide for a variety of exceptions or limitations to the reproduction right, in particular the right in Article 5.2(b) *“in respect of reproductions on any medium made by a natural person for private use and for ends that are neither directly or indirectly commercial, on condition that the rightsholders receive fair compensation which takes account of the application or non application of technological measures referred to in Article 6 to the work or subject matter concerned”*

The arguments against a ‘fair use’ exception for sound recordings

As outlined above, various exceptions already apply in relation to sound recordings, ranging from fair dealing for the purposes of criticism or review to use for educational purposes. The BPI believes introducing a new exception for private copying would be a mistake for the following reasons:

FOR THE CONSUMER

It will create confusion.

The introduction of such an exception will not create clarity for consumers. On the contrary, it will create more confusion about what consumers are permitted to do within the exception. For example, consumers may believe that any new exception authorises downloading from unlicensed sites on the internet or making multiple copies of CDs for all their friends. They may see the new exception as a licence to make unlimited numbers of copies in multiple formats, to ignore agreed terms covering the extent of permissible copying or they may think they are entitled to hack through any DRM technologies which are used to implement such terms. All of these acts could substitute for sales and result in an entirely uncompensated permanent possession of the recorded music.

FOR THE INDUSTRY

‘Private copying’ inevitably leads to an increase in piracy.

One has only to check the auction sites on eBay and sites like morbidbackups.net where cynical sellers utilise the current exceptions to confuse and manipulate potential consumers. Disclaimers are used which inaccurately quote references to copyright legislation, references which are either misleading in their application to the types of good on sale or are designed, at a first glance, to provide comfort to the consumer that the seller’s auction complies with the law as well as with the terms and conditions imposed by the hosting website.⁴³

⁴³ For example, some of the eBay auctions state that the if the consumer adheres to the disclaimer, the auction “conforms with eBay’s rules and regulations”

These disclaimers, such as the ones prolifically used on internet auction sites, which state that “this is a copy and is for your personal use only to back up any copy you already have of this album that maybe [sic] scratched etc” encourage unsuspecting consumers unfamiliar with the precise scope of copyright exceptions to buy pirated goods.

Further, these sellers utilise such disclaimers in a disingenuous attempt to avoid a claim for copyright infringement. This allows the crafting of a defence based on the argument that the disclaimer ensures that the sale falls within a statutory exception. A ‘fair use’ exception will only proliferate such piracy by providing those who seek to circumvent the exclusive right of the copyright owner with a perfect defence. They will continue to control the reproduction of the work in question, will profit further from music piracy and will continue to confuse the minds of their most powerful and unsuspecting ally, the consumer.

In a world in which most commercial music piracy takes place in bedroom “factories” where 24-tray CD burners are connected to simple home computers, a private copying exemption could all too easily open the floodgates to further piracy.

It would provide commercial operators with a further defence to ‘authorisation’.

An authorisation claim is often the only recourse the record industry has against new invasive technologies such as unauthorised peer-to-peer filesharing services. But if the activity itself is legal – in this case private copying – it could be argued that those who ‘authorise’ private copying, even where they have no rights to do so, are equally exempt from liability⁴⁴.

FOR THE GOVERNMENT

It would have to be accompanied by a levy system.

European law dictates that any legislation which brings in a ‘private copying’ exception must be accompanied by a right to fair compensation⁴⁵, i.e. a levy. It is difficult to know where such levies should fall – to which products should they apply and who should pay the additional sums – the consumer or the retailer? If it falls to the consumer, then it would look and feel like a tax on music fans. Furthermore, it would hardly be fair on those who do not wish to copy protected works. Experience

⁴⁴ See following sections on authorisation and stream ripping

⁴⁵ Article 5.2 (b) of the Copyright Directive. See footnote 3 for full text.

in other European jurisdictions teaches us that levies create an administrative burden, are difficult to distribute equitably and do have a negative impact on the legitimate market. For example, Germany has a levy system and in the last five years has seen its domestic audio music market collapse (sales are down by more than 40% in volume terms in that period). Additional annual income of €5million is scant consolation for the damage done by unauthorised copying from illegal downloads and ripped CDs.

It would conflict with the 3-step test.

A general private copying exception would almost certainly be in conflict with the 3-step test noted above. It is difficult to imagine a private copying exemption that is limited to a 'certain special case'. A sweeping exception would also conflict with the normal exploitation of a work, and by undermining the enforcement and exercise of the reproduction right, would prejudice the legitimate interests of the rightsholders and damage the legitimate market.

Conclusion

The BPI has examined several ways of improving the consumers' ability to enjoy recorded music. They fall broadly into three main categories; **legislation, technical or education.**

We have noted the obstacles and dangers of **legislative** change which would require the implementation of a "right to remuneration" for private copying. The consumer would not wish to pay a levy, the industry believes that any such levy would not properly compensate for the impact on legitimate sales levels (as experienced in other countries) and the government may not wish to introduce what could be seen a new tax.

In the **technical** arena, DRM can go a long way to resolving private copying issues. Nevertheless industry attempts at copy control in the physical arena (as opposed to in connection with online services) have been fraught with problems. We believe that technology alone will not provide a full solution.

The industry has engaged in a great number of **educational** initiatives. Indeed, its law suits against egregious online infringers were rooted in education. But the problem persists.

Next Steps

The BPI believes that it is now time to create an industry-wide voluntary regulated scheme that retains the right to authorise copying in specific circumstances, thus leaving the consumer in no doubt of the extent of his/her potential liability. The industry would wish to do this with the support of government.

It is vitally important that we explore with the Gowers Review team this option and any others that might be deemed appropriate by government and industry alike to clarify and facilitate for the consumer the type of private copying that poses no threat to our industry.

Copyright - Digital Rights Management

Summary

The BPI believes that DRM does not distort existing copyright law but complements the protection of copyright provided in legislation. The development of markets in digital music would simply not be possible without DRM. We believe that there should be greater interoperability enabling consumers to play whatever music file they buy on whichever portable device they own subject to reasonable licence restrictions. However, we believe that this is a matter for industry co-operation in the development of open standards rather than for regulation.

The advent of digital music has made DRM essential for it is DRM which defines the terms on which a consumer buys music. It is DRM which makes it possible to protect, and therefore make available, digital music. DRM ensures that consumers get what they pay for and pay for what they get. Most importantly, the flexibility offered by DRM permits rightsholders to offer new and innovative products at a variety of different prices. The BPI believes that legislation is inappropriate for DRM, since in a developing market, consumer power will define the optimum solution.

The digital opportunity

The UK record industry has embraced the opportunities of the internet to offer new music services to the consumer. There are now over forty legal download sites offering around 2m different tracks in the UK including mass market operators such as the Apple iTunes Music Store, Napster and HMV and Virgin Digital as well as specialist offerings from companies such as 7 Digital Media and label sites such as Ministry of Sound.

Such services allow the consumer to listen to excerpts or whole works, to download to one or several computers, to copy onto CD-R, and to copy onto portable devices, such as the iPod or other MP3 players, depending on the specific portal operator's licence terms. For example iTunes currently allows users in the UK to purchase permanent downloads and use them on an unlimited number of iPods, otherwise on five PCs, and burn the same play list up to seven times.

The success of online music services has been dramatic. In the UK alone, from sales of effectively zero in 2003, download sales reached 5.7m units in 2004 and 26.4 m⁴⁶ in 2005.

The development of such a market would not be possible without DRM. Just as importantly, the new forms of music service made possible by DRM could not be brought to market. Examples include:

- **Portable subscription services**, such as Napster To Go. These services allow unlimited access to around 1m tracks in return for a monthly subscription fee. These tracks can be downloaded to portable devices such as MP3 players and enjoyed for as long as the subscription is paid. If the subscription ceases, the downloads become unplayable. It is DRM which manages this process.
- **Try before you buy**. This is an increasingly popular function which allows record companies to distribute downloads – typically of new acts – free of charge to consumers. These downloads are playable free of charge for three or five or 10 times, but when the free plays are exhausted, payment must be made in order to listen to the track again. It is DRM which manages this process.

Without DRM neither record companies nor artists could be assured of receiving any payment for their work or investment. But, needless to say, different record companies, as individual businesses, take different views as to how DRM should best be used – and very often this is simply a marketing decision.

Some smaller independent labels, for example, take the view that with limited resources available for marketing, the most important thing is that their music is

⁴⁶ OCC data 2005

heard. They take the view therefore that it is in their interests to do without any form of DRM which controls access to their music. They believe that there may be unspecified promotional value in such unrestricted access.

This is of course a legitimate view, but it is difficult to see how it could be adopted as a matter of policy by everyone in the industry. Without DRM rightsholders may have no effective control over their copyrights and therefore no certain prospect of being able to ensure that they are paid. In this case, it is difficult to see the incentive for them to make the necessary investments required to bring commercial product to market. On the other hand, any individual rightsholder is of course always free to decide not to utilise DRM to protect or manage rights in his or her work.

The BPI believes that the important principle to be preserved is that it is up to the rightsholder to decide what if any DRM to use, what if any usages they should allow and what if any price they should charge.

This is not a matter for legislation. It is something which the consumer and the market are best-placed to judge. The EU Copyright Directive and 1996 WIPO Treaties offer adequate and balanced provisions. There is a risk that additional legislation would impede the development of technical protection measures and rights management systems; these systems must be allowed to develop through market mechanisms.

The Government should facilitate and continue to promote the development of technology standards, including those used in connection with DRM, and could play a useful role in terms of educating consumers about the role of DRM and its potential to enhance consumer experience and choice.

This should include building on the work that has been done by the Broadband Stakeholders Group⁴⁷ and EU High Level Working Group on Digital Rights Management.

⁴⁷ See *Digital Rights Management: Missing Links in the Broadband Value Chain*, Broadband Stakeholder Group, 2003 http://www.broadbanduk.org/reports/DRM_report.pdf for a full explanation of DRM and the issues arising.

Issues on DRM

1) Interoperability

The legal download market is relatively new; it is therefore inevitable that there are a variety of technical standards, not all of which may be compatible with each other. Consumers have already been faced with restrictions on interoperability both through the advent of new music formats and through competition between manufacturers - it has never been possible to play a cassette tape on a CD or vinyl record player, nor has it been possible to play a VHS video cassette on a Betamax machine or a Microsoft Xbox game on Sony's Playstation 2 games console. Such struggles over format look set to continue with the competing next generation DVD formats that have been developed by Toshiba and Sony.

The recording industry believes that there should be greater interoperability enabling consumers to play whatever music file they buy on whichever portable device they own subject to reasonable licence restrictions.

The iPod is the most successful MP3 player in the world. Its iTunes Music Store is the leading retailer of downloads in the UK⁴⁸. However the iPod will only play unprotected MP3 files or songs downloaded from the iTunes Music Store.

The fact that other download stores and MP3 player manufacturers have been unable to license Apple's proprietary DRM has raised concerns among BPI members as to whether this is in the best interests of the market or the consumer.

While the record industry has no direct influence or control over the issue of interoperability, it is actively involved in a number of forums that aim to develop common standards including The Coral Consortium (www.coral-interop.org), an industry-wide technology initiative whose goal is to deliver an open standard for interoperability between DRM technologies for consumer devices and services. BPI members are also involved in the work of ISO standard bodies such as MPEG.

⁴⁸ XTN Data 2005

Ultimately full interoperability is something that can only be achieved by agreements among technology companies and online retailers. Record companies cannot dictate terms unilaterally.

2) Protecting consumers when DRM systems are discontinued

Solutions to this problem are found in the market place and depend on the situation in question. Often, DRM itself will be part of the solution. For example, if a consumer changes PC, they are able to 'unregister' the old PC and a licence will be reissued for the new PC. Changing standards and formats are not a new challenge. As has been the case in the past, solutions follow from the contractual arrangements, within the framework of consumer protection law.

3) Unintended consequences of DRM on computer functionality

It is important to recognise that any new software which is loaded on to a PC can, in some cases, have unintended results although this is not desirable. It is not something that is specific to DRM.

The two most common DRM systems – Apple iTunes and Windows Media Player are installed on hundreds of millions on computers with no adverse effects.

A recent cause celebre has been the problems encountered in November 2005 by SonyBMG in the US with its use of copy protection on CDs. One of the content protection technologies, XCP, was provided by a third-party vendor from the UK, First4Internet, and was designed to prevent unlimited copying and unauthorised redistribution of the music on the disc. As it later turned out, one aspect of the First4Internet technology could as a side effect also be abused to increase the risk for malicious attacks on the user's computer system.

SonyBMG took immediate measures in response to security concerns, including an additional posting of the deinstaller programs on their website, the recall of releases that carried the First4Internet XCP software, and a halt to the production of XCP-protected discs. SonyBMG has also devised an exchange program in the interest of consumers that had purchased XCP-protected discs. *For more details on the problem and the steps taken by SonyBMG in response see their dedicated website at <http://cp.sonybmg.com/xcp/>.*

Copyright - Orphan works

The BPI acknowledges that situations may arise when the copyright owner of a work cannot be located.

The BPI supports the introduction of a mechanism which permits those who have made good faith, reasonably diligent efforts⁴⁹ to locate the rightsholder to proceed with the proposed use without fear of unreasonable liability. If / when the rightsholder is found, reasonable compensation for the use must be paid. Any solution should ensure that on the one hand, the rightsholder 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 licence fee.

The BPI would be prepared to discuss appropriate solutions further with the Review team and Government, including the recent proposals made by the U.S. Copyright Office which are currently under consideration in the Congress.

⁴⁹ This would need to be legally defined. Proof of diligent search should remain the burden of the user.

Copyright - Licensing public performances

BPI refers the Review Team to the submissions made by PPL, which collects income generated by the licensing of public performances on behalf of the record industry. The BPI supports that submission and believes that such licensing regimes are working well.

Legal Sanctions on IP Infringement

Summary

The BPI supports the points raised on this issue in the submission of the Alliance Against IP Theft and calls for a damages regime with a stronger deterrent effect.

We highlight the following inconsistencies in the way in the law applies legal sanctions to infringement of different forms of IP:

1) Damages

Damages for IP infringement currently do not have a deterrent effect. Unless an award of additional damages is made, the reality is that an infringer only has to pay that which he would have paid had he secured a licence. There is little incentive for the infringer to act lawfully. It is difficult to obtain additional damages because under section 97(2) the court may, having regard to all the circumstances of the case and in particular to the flagrancy of the infringement AND any benefit accruing to the defendant by reason of the infringement award such additional damages as the justice of the case may require. The two pronged test means additional damages are difficult to secure. The lack of a deterrent effect is not remedied by the recent implementation of the Enforcement Directive⁵⁰ which provides that the courts must award damages which are appropriate to the actual prejudice suffered as a result of the infringement, including taking into account negative economic consequences and non-economic factors, such as any moral prejudice.

⁵⁰ The Intellectual Property (Enforcement, etc.) Regulations 2006 SI 2006 No 1028

2) ss107A and 198A Copyright, Designs and Patents Act 1988 (the Copyright Act)

Trading Standards authorities have a duty to protect trade marks and ensure that those who commit trade mark offences are prosecuted⁵¹. They are also given the relevant powers they need to do so⁵². There is no parallel duty and power to enforce the provisions of the Copyright Act. Government has indicated a willingness to bring into force the relevant sections (sections 107A and 198A) although this has not yet happened. The Review Team should highlight this and recommend to the Government that it does so. Trading Standards obviously need proper resources to fulfil these duties. This has been dealt with in part by ensuring that Trading Standards can now 'bid' for assets recovered from music pirates under the Proceeds of Crime Act 2002 (POCA).

Should criminal sanctions on online infringement be the same as those relating to physical infringement?

We believe that criminal sanctions should not differentiate between the method of delivery of product but rather should focus on the elements of the offence, in particular the harm caused by the infringement.

⁵¹ Section 93(1) Trade Marks Act 1994

⁵² section 93(2) Trade Marks Act 1994

Coherence between competition policy and IP policy

Summary

The BPI believes that competition law provides an effective means of addressing concerns about “unfair” practices linked to IP rights. As such we do not consider that it should have a greater role in regulating IP, in particular in relation to copyright.

The very nature of intellectual property rights includes the freedom to determine when and on what terms and conditions, a licence is granted to a third party. In the copyright sphere, this freedom is limited only by the permitted exceptions set out in the Copyright Act and the general application of competition law. The legitimate exercise of an IP right should not therefore be categorised as “unfair” merely because a third party considers that use of the subject matter of that right should be unrestricted.

Competition law prohibits two broad categories of commercial behaviour:

- (a) agreements that have the object or effect of preventing, restricting or distorting competition and practices (the Chapter I prohibition in the Competition Act 1998, Article 81 EC); and
- (b) abuses of a dominant position held in a relevant market (the Chapter II prohibition in the Competition Act 1998, Article 82 EC).

Competition law will generally only prohibit restrictive provisions in licence agreements where these foreclose competition in a relevant market and only in exceptional cases will competition law impose an obligation on a rightsholder to license IP. In the BPI’s view, this represents an appropriate degree of ‘regulation’ concerning the exercise of IP rights.

The interface between copyright and competition law

There is inherently a rational and appropriate "coherence" between competition policy and IP policy, which should be viewed as complementary rather than conflicting regimes. This is because the purpose of both legal frameworks is to increase consumer welfare through encouraging innovation, industrial development and competition. This common objective is achieved through different paths.

Copyright policy seeks to achieve this objective by awarding exclusive rights that encourage investment in and distribution of new creations; rights that ensure that new and innovative creative products can be made available to consumers.

Competition law outlaws practices that restrict competition and can harm consumers, for example, through artificially inflating prices, restricting output or product quality, or restricting innovation. However, competition law also recognises that consumers benefit from new generations of products and the important role that intellectual property rights play in encouraging innovation and in protecting the significant investment required to bring such new products to market. This recognition is an important aspect of the interface between IP policy and competition law

The effective application of competition law

The BPI is of the view that competition law provides an effective means of addressing concerns about "unfair" practices linked to IP rights. The key to this is the objective and consistent application of the general provisions of competition law by competent authorities on a case-by-case basis.

It is worth saying that refusals to license copyright will only in exceptional circumstances constitute an abuse of a dominant position.⁵³ However, the European Court of Justice (ECJ) has clearly stated that the exceptional circumstances under which refusal by a dominant undertaking to license a copyright protected product will constitute an abuse of a dominant position where that product forms an

⁵³ The Chapter I/Article 81 prohibition on anti-competitive agreements is likely to apply to collective decisions to refuse to license.

indispensable part of a separate product or service and the three following conditions apply:⁵⁴

1. The licence is required to offer a new product (the secondary market) for which there is consumer demand; and
2. The refusal is not justified by objective considerations; and
3. The refusal would reserve the secondary market to the rightsholder by eliminating competition.

On balance, the BPI believes that this is an appropriate test to be applied to refusals to license and to determine whether an obligation to license should be imposed. This test necessarily requires an assessment by a competition authority or court on the facts of each particular case. Any remaining uncertainties concerning the application of the test to copyright and other intellectual property licensing will likely be addressed by further jurisprudence.

Quite aside from situations where dominance might apply, there are many reasons that provide objective justification for a copyright owner to refuse to grant a licence. An obvious example that applies to the music industry is the concern to protect against the risk of piracy where potential licensees do not provide adequate protections (whether by means of DRM or otherwise) or warranties.

Previous market inquiries

All three competition authorities that have jurisdiction in the UK have used these powers to examine aspects of the music industry and the exercise of intellectual property rights. For example, the OFT as recently as 2002 conducted a market study on the wholesale supply of CDs⁵⁵ and in 1994 the Monopolies and Mergers Commission (as the Competition Commission was previously known, the “MMC”) undertook an in-depth market investigation into recorded music.⁵⁶

⁵⁴ Case C-241-242/91 P *RTE and ITV v Commission* [1995] ECR I-743 (“Magill”); Case C-418/01 *IMS Health v NDC Health* [2004] ECR I-5039.

⁵⁵ “Wholesale supply of compact discs”, report of the OFT under section 125(4) of the Fair Trading Act 1973, OFT 391 (September 2002), see <http://www.of.gov.uk/NR/rdonlyres/C7130105-5474-46B2-9D0F-37E81D068A82/0/of391.pdf>.

⁵⁶ “The supply of recorded music: A report on the supply in the UK of pre-recorded compact discs, vinyl discs and tapes containing music”, report of the Monopolies and Mergers

In its study, the OFT concluded that there was no evidence of continuing agreements with retailers concerning alleged practices to limit parallel imports into the UK from other EEA countries. The OFT noted that it has the power under the Competition Act to investigate any future allegations concerning the restriction of parallel imports from within the EEA, and that it has the residual power to make a reference to the Competition Commission where the Competition Act does not apply to prevent such restrictive agreements or concerted practices.

The 1994 MMC inquiry was prompted by concerns about the prices of compact discs (CDs) and that prices appeared to be significantly higher in the UK than in the United States. However, the MMC concluded that the UK was not experiencing systematically higher prices for recorded music despite the suggestions that had prompted the inquiry. It found that much of the apparent difference in fact related to different tax arrangements.⁵⁷ In addition to these inquiries, the MMC also undertook detailed investigations into other aspects of the music industry and issues relating to copyright in 1988 (collective licensing)⁵⁸ and 1996 (concerning PRS)⁵⁹.

The European Commission has also used its wide sector inquiry powers to look at alleged anti-competitive practices in the music industry. In 2001, the Commission opened five separate investigations concerning allegations of resale price maintenance in agreements between record companies and retailers. That inquiry was subsequently closed given that the only evidence of potential infringements, which related to Germany and Italy, had been ceased (the inquiry did not find any issues of concern in relation to the UK).⁶⁰

Commission, CM 2599 (June 1994), see http://www.competition-commission.org.uk/rep_pub/reports/1994/356recordedmusic.htm#full.

⁵⁷ In particular that sales taxes in the US were considerably lower than the VAT in the UK and that record prices were displayed without sales tax in the USA, whereas shelf prices in the UK include VAT. The inquiry also found that [will lead to changes in the measured US/UK price differentials.] and, to a lesser extent, variations in exchange rates. See above, paragraphs 1.3, 1.5 and 1.6.

⁵⁸ "Collective Licensing: A report on certain practices in the Collective Licensing of Public Performance and Broadcasting Rights in Sound Recordings", report of the Monopolies and Mergers Commission, CM 530 (December 1988), see http://www.competition-commission.org.uk/rep_pub/reports/1988/233collective.htm.

⁵⁹ "Performing rights: A report on the supply in the UK of the services of administering performing rights and film synchronisation rights", report of the Monopolies and Mergers Commission, CM 3147 (February 1996), see http://www.competition-commission.org.uk/rep_pub/reports/1996/378performing.htm#full.

⁶⁰ See European Commission press release IP/01/1212, (17 August 2001) <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/01/1212&format=HTML&aged=1&language=EN&guiLanguage=en>.

Should competition law have a greater role to play in regulating IP?

The BPI does not consider that competition law should have a greater role in regulating IP, in particular in relation to copyright. As explained above, the existing application of competition law to the exercise of copyright is appropriate. Competition law should continue to apply to the intellectual property sectors, including to the music industry, in the same manner as it applies to other sectors. In particular, copyright owners should have the same commercial freedom as other companies to freely determine with whom, and on what terms and conditions, they contract. There would certainly be no justification for the imposition of more restrictive rules on the freedom of rightsholders than those that apply to other industries, and certainly no reason why the possibility should be considered any further in relation to the music industry.

In addition, the suggestion that competition law should more heavily-regulate certain industries is, at a conceptual level, contrary to the very nature of competition law, which provides general prohibitions concerning certain commercial practices for application on the facts of each case. This is subject to the interpretation, practice and guidance provided by the competition authorities and the courts.

Competition law is not the appropriate tool for dealing with any perceived malfunctions in the UK's IP regime. Concerns about the scope and application of each area of intellectual property, including copyright, should be evaluated and (if necessary) addressed within each respective legal framework. In particular, the BPI would strongly oppose any suggestion that there should be provision through competition law or any other legislative tool including the CPDA, that would provide for the imposition of compulsory licensing in relation to copyright and related rights. The terms of a commercial licensing agreement should, first and foremost, be left to negotiation between willing participants, subject to the provisions of competition law concerning anti-competitive agreements and abuse of dominance.

The Review should be mindful of developments at the EC level looking at the music and copyright industry. DG Competition of the European Commission is currently reviewing a number of issues concerning licensing and the development of online music markets and it would be inappropriate for a review of the UK IP system to in any way pre-empt the outcome of this work. The Review should also give full

consideration to the requirements concerning the implementation of the European Commission's 12 October 2005 recommendation on the collective cross-border management of copyright and related rights for legitimate online music services.⁶¹

⁶¹ 2005/737/EC OJ L276/54, 21.10.2005.

Parallel imports / International Exhaustion

Summary

The BPI believes that international exhaustion of copyright would have a massively negative effect on music companies operating in the UK and on British music exploitation around the globe. UK companies would not be able to develop artists and market their products with any confidence if non EU imports soaked up the demand created by UK investment. Moreover, companies would not license overseas for global exploitation in developing economies if they feared that cheaper products based on those economies' living standards would simply return to the UK. Such a move would simply increase piracy on a massive scale in the developing world in particular, which would in turn impact on local artist development everywhere.

The BPI does not favour any change to the existing parallel importing regime, at least in so far as it applies to the exhaustion of trade mark and copyright rights in sound recordings. This issue has been considered at length in the past by the UK government in 1999 and by the European Commission in 2000. At that time the Trade & Industry Select Committee concluded that it was not in the UK's interests to lift parallel import restrictions for music copyright and trade marks⁶². There remains no evidence to suggest that allowing parallel imports of recordings put on sale outside the EEA would provide net benefits to the United Kingdom or the Community in general.

The call for evidence does not set out any policy reason that warrants the issue of international exhaustion being reconsidered at this time. Importantly, the various copyright and trade mark directives that address the question of exhaustion prevents member states introducing more permissive parallel importing rules concerning copyright or trade mark protection. Article 9(2) of the Rental and Lending Right

⁶² House of Commons Trade and Industry Committee Report on Trade Marks, Fakes and Consumers, Eight Report of Session 1998/99 (29 July 1999), <http://www.publications.parliament.uk/pa/cm199899/cmselect/cmtrdind/380/38002.htm>

Directive⁶³ and Article 4(2) and Recital 28 of the Copyright Directive⁶⁴ make it clear that the copyright and related rights law of member states cannot provide for international exhaustion. Similarly, the Trade Mark Harmonisation Directive⁶⁵ (Article 7(1)), as interpreted by the European Court of Justice,⁶⁶ imposes the same restriction on member states in respect of trade mark laws.

The impact on the UK record industry of a change in the current rules

Local Pricing

International exhaustion would significantly reduce the ability of the industry to price product to suit local conditions, as wholesalers would seek higher returns through arbitrage and the product would gravitate to higher income countries, including the UK. The international record companies would have to consider changing the structure of their business as they would not be able to price product to local conditions (e.g. to reflect much lower incomes in developing markets). Independent record companies, who have little control over the sale of licensed copies of their recordings in other markets, would have little choice in responding to the possibility of parallel imports entering the UK. Their only option in meeting this threat would be to decide not to license foreign distributors.

International exhaustion would also affect the ability of record companies to offer product in countries where piracy levels remain high at prices that are comparable to pirated copies, in an effort to convince consumers to purchase legitimate recordings.

In each of these situations, product first put on sale in those markets would be sought out by parallel traders seeking to re-export to the UK and the wider EEA, who would retain the majority of the price difference, at the expense of artists, record companies, retailers and consumers.

⁶³ 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.

⁶⁴ Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society.

⁶⁵ First Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trade marks.

⁶⁶ Case C-355/96 *Silhouette International Schmied GmbH & Co KG V Hartlauer Handelsgesellschaft GmbH* [1998] ECR I-04799, where the ECJ held that Articles 5-7 of the Directive must be construed as embodying a complete harmonisation of the rules relating to the rights conferred by a trade mark. As a result the Directive cannot be interpreted as leaving it open to member states to provide in their domestic law for exhaustion of the rights conferred by a trade mark in respect of products put on the market in non-member countries: see paragraphs 25-27.

Threat to Investment

This protection is essential to safeguard investment in and the development of new artists and repertoire. Parallel importers take a free ride on the marketing and promotion efforts of record companies and they make no contribution whatsoever to the further development of music and local culture. Parallel imports from outside the Community also reduce record company income and mean a serious long term threat for the British music industry. What is often overlooked is the fact that the nature of the investment cycle in the recording industry is dependent on re-investing profits in new artists. For record companies the displacement of a copy first put on the market in the UK with a parallel import from outside the EEA means less revenue realised in the UK for investment in new recording. A serious threat to record company revenue will therefore inevitably undermine the ability of record companies to invest in new British repertoire.

These effects will reduce the value of investment in local music sales and will also reduce British export earnings from music and artists income. Any short term benefit to consumers from small savings in the price of some titles would therefore result in the availability of less local repertoire.

Impact on Royalties

The serious detrimental effect of parallel imports on royalty revenues should not be understated. It is important to appreciate that royalties payable to record companies and artists from the sale of titles parallel imported from outside the Community will almost always be much lower than the royalties payable on the copy first put on sale in the UK. This is because the royalty payable is at the applicable rate under the copyright law in the country in which it was intended for sale, and on the value of the copy purchased in that market. This has particularly serious implications for artists and independent record companies, neither of whom have any control over the price at which the parallel imported recordings are put on the market in foreign markets.

Effect on Independent Record Companies

The exposure of independent record companies to the double-effect described above arises from the fact that independent companies license the exploitation of their repertoire for distribution in foreign markets, generally only in exchange for a royalty income based on a fixed percentage of wholesale value. Every parallel import that

displaces the sale of a copy released first in the UK will therefore mean much lower rewards for British independent record companies and British artists. This would have a devastating effect on recording companies, including independent companies which rely predominantly on recovering the full cost of investment in a recording from the British market and already operate on very low margins.

Impact on Consumers

The detrimental effects of parallel imports from outside the EEA on investment in local music – in particular for independent record companies – will inevitably reduce the choice of home-grown music that can be made available to consumers in the UK. Any short term benefit to consumers from small savings in the price of some titles would therefore be at the expense of less choice and cultural diversity for consumers.

Piracy

The Review team should not overlook the effect that a move to international exhaustion would have on the industry's efforts to combat piracy in the UK. Allowing parallel imports from any country in the world would provide for a significant increase in the potential channels through which pirated sound recordings could enter the UK.

Pirate recordings are now extremely sophisticated and often indistinguishable from authorised copies without forensic evidence. It can therefore be expected that less-scrupulous importers would attempt to import pirated recordings and pass these off as legitimate copies, both to retailers and consumers. The industry will therefore face increased costs in attempting to detect and enforce its rights in relation to pirate recordings. It should also be noted that UK border control, and across the EEA, would necessarily become less effective in detecting and processing pirated product if it also had to deal with large volumes of parallel imports from countries outside the EEA.

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

There is no evidence that allowing parallel imports of recordings put on sale outside the EEA would provide net benefits to the United Kingdom or the Community.

Indeed, the most recent reviews of the issue in the UK and at the Community level found quite the opposite.

NERA Study

The most recent detailed European Commission initiative to look at this issue - the 1999 NERA study undertaken for DG Competition⁶⁷ - found in favour of retaining the existing regime of Community exhaustion. The report concluded that the obvious beneficiaries of a switch from a Community exhaustion regime to international exhaustion in trade mark law would be parallel importers and the transport sector, while national importers and exporters, and manufacturers (including record companies and other rightsholders) would suffer significant detrimental effects.

Proponents of a relaxation in parallel import rules usually argue that international exhaustion will lead to a reduction in consumer prices and stimulate competition in local markets. However, the NERA study demonstrates that these claims are grossly overstated; it concluded that international exhaustion would not lead to a significant fall in consumer prices in the short-term and would have no impact on pricing in the long run. In relation to music recordings,⁶⁸ the NERA study concluded that average price reductions from a move to international exhaustion would only be around 0.6%, but with an impact on record companies who “would suffer from a reduction in profitability, with incentives to invest in new acts being correspondingly reduced” from a reduction in profits of 14%. This represents a very small price saving for consumers at the expense of a significant blow to the health of the British recording industry.

On the basis of the NERA study and a public hearing attended by 180 representatives of various interest groups, the European Commission in 2000 decided not to propose changes to the current regime of Community-wide exhaustion regime for trade marks.⁶⁹

⁶⁷ “The Economic Consequences of the Choice of Regime of Exhaustion in the Area of Trademarks - Final Report for DG XV of the European Commission”, report prepared by NERA, SJ Berwin and IFF Research (8 February 1999).

⁶⁸ See above, paragraphs 83-84.

⁶⁹ See European Commission Communiqué of 7 June 2000 from Commissioner Bolkestein on the issue of exhaustion of trade mark rights, http://europa.eu.int/comm/internal_market/indprop/docs/tm/comexhaust_en.pdf.

The European Economic and Social Committee Opinion

The NERA study findings and the Commission's decision not to propose changes were both supported by the European Economic and Social Committee (EESC), which produced an opinion for the report and the issue of exhaustion, concluding that:⁷⁰

“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 in the EU. This would probably result in reduced European exports and greater incentives to shift production to lower-cost locations than the EU.”

The 1994 MMC Inquiry

The conclusions of the NERA study are also in line with the findings of the MMC in its 1994 inquiry into CD pricing, where the MMC concluded that a move to international exhaustion was unlikely to result in a reduction in the price of recorded music generally. As already noted⁷¹, MMC rejected suggestions that price differential with the US that was alleged to exist at the time could be eliminated if the record companies' ability to control parallel imports from outside of the EEA was removed. The MMC did not believe that this would be the case and was concerned that such a move (even if not inhibited by the Rental Rights Directive) would be damaging to the industry because of the increased risk of piracy and the general weakening of copyright protection, which is territorially based.⁷²

The 1999 Trade & Industry Select Committee (the “Committee”) Inquiry

Similar findings concerning the potential detrimental effects of a change from the current regime were also established by an inquiry undertaken by the Committee in 1999 when it examined the issue of international exhaustion for trade mark rights in the EU. This was a wide-ranging inquiry looking at the issue of exhaustion, and involved the Committee taking detailed submissions and evidence from industry and other interested parties. The Committee's report⁷³ on the inquiry to the Commons included a separate section looking at the issue of exhaustion in relation to the music industry. It concluded that the music sector is in many ways different from the other

⁷⁰ “Opinion of the Economic and Social Committee on the ‘Exhaustion of registered trademark rights” OJ C 123/28, 25.4.2001, paragraph 3.4.5.

⁷¹ See the response above to the question of coherence between competition policy and IP policy.

⁷² See above, paragraphs 1.10-1.11.

⁷³ House of Commons Trade and Industry Committee Report on Trade Marks, Fakes and Consumers, Eight Report of Session 1998/99 (29 July 1999), <http://www.publications.parliament.uk/pa/cm199899/cmselect/cmtrdind/380/38002.htm>.

sectors examined in the inquiry (e.g. motor vehicles, clothing and footwear, cosmetics) and - as a result - that international exhaustion of trade mark rights may have a damaging effect on UK copyright industries.⁷⁴ The Committee also noted that there was no demand for changes in the copyright regime towards international exhaustion and, given the importance of the copyright industries to the UK, recommended the exercise of great caution before proceeding down such a path.⁷⁵

In response to the Committee's conclusions and recommendations,⁷⁶ the Government stated that it accepted that special consideration would apply in the case of the music industry. In particular, the Government stated that it recognised that one aspect of these considerations is pricing policies which have to be adopted, particularly by independent record companies, as well as concerns about piracy.

The BPI does not consider that the situation has changed in any material way since the Committee inquiry and the NERA study were published.

The BPI would also recommend that the Review team takes a cautious approach in evaluating or making any comparisons with smaller countries that maintain more permissive parallel importing regimes (e.g. Australia, New Zealand and Singapore). Countries that have smaller or less developed local recording industries are generally more dependent on imports. Moreover, the US and most other developed countries do not apply international exhaustion. If the EU or the UK ultimately adopted this regime unilaterally, it would be making an important concession to its main trading partners and getting nothing in return.

⁷⁴ Above, paragraph 66.

⁷⁵ Above, paragraph 95.

⁷⁶ See Above, Appendix, paragraphs 20.

OTHER ISSUES

Authorisation

The BPI would welcome clarification on the liability of online services, particularly peer-to-peer (P2P) services, which induce or promote the use of their services for purposes of infringement. Such clarification would enable us to bring action against the P2P service providers and would obviously be a more efficient alternative to action against end users, as it would target the problem at source.

The record industry has suffered massive losses over recent years due to the widespread use of P2P services to make available and download unauthorised copies of sound recordings. These services use P2P technology that enables individual computer users (“peers”) to connect to computers of others, search the files made available on their hard drives, download copies, and also make the resulting copies available to other users.

Market research indicates that use of unauthorised P2P services has caused considerable damage to the legitimate market for music. For example, a recent study commissioned by BPI, which studied the behaviour of illegal downloaders over a period of three years, found that over time, illegal downloaders purchased significantly less music, with resulting losses to UK record companies in the region of £1.1bn (over the three years), had illegal downloaders music spend matched that of the overall market⁷⁷.

The international recording industry has pursued a multi-pronged approach to dealing with the problem of P2P piracy. This includes promoting legitimate online music services, engaging in public awareness campaigns, working with governments to

⁷⁷ TNS Downloading Survey 2006

ensure an adequate legislative framework, seeking to improve ISP cooperation, and pursuing litigation. The success of these measures will depend on eliminating the ability to operate business models making music available to the public without authorisation or payment. It is impossible for legitimate services to compete with 'free'.

In the area of litigation, IFPI's worldwide campaign of taking legal action against major uploaders on unauthorised P2P services has resulted in several successful actions. More importantly, it has proved successful in educating the public as to the illegality of unauthorised file sharing, and has had a significant deterrent effect. For example, research conducted in November 2005 revealed that 35% of illegal file sharers had cut back or stopped their infringing activities, and half of these had done so due to concern about legal consequences.⁷⁸

As to the operators of the services, courts around the world have recently confirmed their potential liability, rejecting arguments that they cannot be held responsible for the actions of their users. These decisions (in the US, Australia, Japan, Korea and Taiwan)⁷⁹ have made clear that the providers of P2P or other online services should be liable when they induce or encourage others to infringe copyright, and do not take steps to prevent the use of their services to exchange infringing content. Although the decisions are based on different legal systems and principles, there are notable common features which suggest a converging approach worldwide.

Each of the courts concluded that the provider of the P2P service could be held liable, with the following factors generally identified as particularly significant:

- **Knowledge of infringing activity.** In all the cases, the court stressed the provider's full awareness that the service was being used to infringe—and to infringe massively.

⁷⁸ This research is summarised in the IFPI Digital Music Report 2006, available at <http://www.ifpi.org/site-content/press/20060119.html>

⁷⁹ *MGM v Grokster*, US Supreme Court, 27th June 2005; *Universal Music Australia Pty Ltd v Sharman License Holdings*, Australian Federal Court, 5th September 2005; *FashionNow, Kuro* Taipei District Court, 9th August 2005; *Asia Media Inc v Yang, Soribada*, Seoul District Court, 2004; *Nippon Columbia v MMO* Tokyo District Court, 29th January 2003.

- **Statements made or steps taken to promote or encourage infringing uses.** In *Grokster*, the provider had deliberately targeted former Napster users as its customers. KaZaA invited users to “Join the Revolution” against record companies. In Taiwan, the provider advertised that it had “500,000 of the most recent MP3s”.
- **Failure to take any action to prevent infringing activity.** The courts in all cases focused on the failure to take steps to prevent infringing activity, including through the use of filtering technology. In the Australian, Taiwan and Korean cases, the courts accepted factual evidence that such technologies were available and their use was feasible.
- **Financial benefit from infringement.** The courts also pointed to the financial benefits received by the providers, whether in the form of direct payment from users or revenues from advertising, which increased along with the volume of available infringing files.

In the UK, the legal tools exist for a finding of liability against an unauthorised P2P provider. Such liability would be based on the statutory concept of “authorisation”, contained in section 16(2) of the Copyright, Designs and Patents Act 1988 (the Copyright Act), and/or common law principles of joint tortfeasor liability, that render liable a person that procures or facilitates an infringing act, and/or acts in a common design with another to carry out an infringing act.

The leading UK authority in this field is *CBS Songs Limited -v- Amstrad Consumer Electronics PLC*⁸⁰. That decision, made well before the advent of P2P technology, held that to “authorise” means “to grant or purport to grant the authority to undertake the act complained of”. The House of Lords refused to impose liability on the distributor of copying equipment on the basis of authorisation or common law tort, based on the reasoning that the equipment could be used for legitimate purposes and the distributor retained no control over its subsequent use.

Despite its holding, *CBS Songs* should not prevent a finding of liability against a P2P provider that has induced or encouraged infringing uses, particularly where it has gained revenue from the infringing uses, and has not taken reasonable steps to

⁸⁰ [1988] AC 1013

prevent them. Indeed the result in the *KaZaA* case in Australia, based on the similar Australian concept of authorisation, confirms this view.

However, the outcome of a case against a P2P provider in the UK remains unpredictable. In light of *CBS Songs*, obtaining a definitive judicial interpretation would likely involve pursuing proceedings all the way to the House of Lords. This is borne out by experience in the US and Australia, where the *Grokster* case was pursued to the US Supreme Court, and the case against Kazaa still continues after several procedural and substantive appeals.

Under current UK law, proceedings against a P2P provider (the only real alternative to bringing proceedings against “end users”) are likely to be costly, time-consuming and not without risk. A clarification of the law would allow courts to hold liable businesses that facilitate, procure, aid or abet and/or authorise copyright infringement. Legislation should be enacted which, consistent with the emerging international consensus in cases such as *Grokster* and *Kazaa*, would establish clear liability for businesses that induce and feed off the unlicensed copying and making available of copyright works.

Stream ripping

BPI recommends that s.70 of the Copyright Act be amended to ensure that digital stream ripping is not covered by the exemption. There may be several ways of doing this, including by prohibiting the selection and recording of individual content items based on metadata is not permitted.

BPI also draws the Review team's attention to a pressing problem caused by the latest cutting-edge technologies: stream ripping.

"Stream ripping" is the process of converting streamed content into a stored file. Stream ripping devices and software allow the user to convert linear sources such as radio or internet webcasts, which are intended for transient and non-interactive listening, into permanent copies of recordings available on demand on the listener's equipment.

Advances in digital recording technology, particularly software or devices designed for recording digital broadcasts, enable individuals to automatically isolate individual sound recordings that they wish to copy from a digital broadcast. Using these stream ripping services, the recording of different parts of the broadcast containing the desired tracks can then be "cut and organised" to create a database of sound recordings in a digital format such as mp3.

This represents a significant threat to music industry revenues. The most advanced stream rippers allow users to automatically split streamed content into individual songs, each labelled with artist and track information, creating massive song libraries that substitute for legitimately purchased digital downloads or physical copies. Moreover, stream ripping applications and devices are becoming ever more sophisticated, and their popularity is likely to increase.

In the US, new and proposed devices for satellite and HD Radio, including satellite services XM and Sirius, will permit subscribers to keep permanent copies of songs included in programming without ever listening to the program. Such functionality is the equivalent of permanent downloads, for which consumers are usually charged and for which legitimate services pay a licence fee.

Stream ripping applications that allow listeners to enjoy for free internet streams that would otherwise be available only through on-demand services are also becoming more common.

DAB digital radio services have been launched in most Western European countries, but with very different degrees of take-up. Progress has been fastest in the UK, where DAB is now mainstream. DAB is actively promoted by the Government and by the BBC and more than 2.7m DAB receivers have already been sold. In the UK and other European territories, radio programming is already being carried digitally via DVB systems such as 'FreeView' and sometimes via satellite. Regardless of the transmission medium used, the issues raised by digital streaming services are similar to those raised by DAB.

Given the importance of DAB in the UK market, there has been an immediate need to put in place interim measures to address the threat of stream ripping from DAB transmissions. BPI has negotiated and now agreed guidelines on the transmission of metadata with the BBC and with the commercial broadcasters (via their trade association, the CRCA). These guidelines make it more difficult for stream ripping devices or applications to use metadata to disaggregate recordings from within a digital broadcast by disguising the artist and track data within the data stream. This agreement is only a first step towards achieving meaningful protection. It illustrates that broadcasters share the concerns of the recording industry, given the potential impact on their business models of such disaggregation of their programming.

The threat posed by the ripping of internet streams is at present more prevalent than the threat from digital radio since (i) computer software is generally more sophisticated and flexible than hardware devices; (ii) computers have internet connections allowing for metadata to be supplied automatically from online databases operated by entities such as Gracenote, FreeDB and MusicBrainz; (iii) users have access to an almost unlimited number of sources of internet streams, including both licensed and unlicensed webcasts; and (iv) the quality of internet streams may in some cases exceed that of digital broadcasts.

Of the exemptions to copyright infringement in section 70 of the Copyright Act regarding recording for the purpose of time shifting is of particular concern with respect to stream ripping. Under section 70, the copying of a radio or TV broadcast

by an individual in his or her own home for 'time-shifting' purposes does not infringe the copyright in the broadcast or any of the sound recordings it contains.

The selection and recording of individual sound recordings using stream ripping services and tools should not qualify for this exemption, as such conduct clearly does not take place solely for the purposes of listening to the broadcast at a more convenient time. Rather, the purpose is to create and keep a permanent copy of the particular sound recording. Given the risk posed by stream ripping, however, we believe this provision needs to be clarified to ensure that it does not offer an unintended and inappropriate safe harbour to such activities—or to the providers of the tools designed to enable them.

Copyright Office

The Government's increasing awareness of the contribution to the UK economy and society of IP raises the question of how copyright should best be dealt with within Government.

Currently copyright falls within the ambit of the Patent Office whose focus is clear from its very name. A copyright which is acquired by virtue of the act of creation is by definition a different kind of right to a patent which is granted. It faces different challenges and emerges out of a very different kind of industry.

The BPI believes that in order to capitalise on the opportunities for the creative industries in the digital age, the Government should consider (a) how it addresses the creative industries as a sector; (b) naming its own copyright champion, and (c) reviewing whether copyright sits best within the Patent Office, within its own Copyright Office or in a more broadly-focused Intellectual Property Office.

**BPI
APRIL 2006**

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