Copyright_Levies_Reform
Alliance

The Copyright Levies Reform Alliance (CLRA)

STAKEHOLDER CONSULTATION ON COPYRIGHT LEVIES IN A CONVERGING WORLD

July 14, 2006

Question 1. WHAT ARE COPYRIGHT LEVIES?

A & B **Do you agree with this description of copyright levies? Are there elements that you consider should be added?**

We agree with much of the description in Section (1). For the sake of completeness, we would recommend adding the following key elements:

1. **Levies as *remuneration* does not reflect the principle of *fair compensation***: The first sentence of Section (1) describes a levy as a form of "remuneration" for right holders. However, the EU Copyright Directive (2001/29/EC, hereinafter "Copyright Directive") uses the term "fair compensation" - not remuneration. The principle of fair compensation - i.e. the notion that where statutorily permitted private copying causes actual harm to a right holder, then the right holder should be compensated - is distinct from pure remuneration, particularly where remuneration refers to a contractual relation. That said, we recognise that in their current form, which dates back to the analogue era, copyright levies indeed remain a form indirect remuneration - contrary to the Copyright Directive.
2. **Levies are a form of indirect compensation not only because of who pays them, but also because of who collects them.** Section (1) describes levy systems as "indirect" because the levy is not imposed on those doing the actual copying. We note that levies are indirect for another, equally significant reason: they are not collected by, nor fully distributed to, those whose works are being copied. Instead, collecting societies serve as intermediaries in the process, collecting the relevant amounts and remitting some percentage to the relevant authors.
3. **EU law provides a series of important rules relating to copyright levies.** Section (1) nowhere mentions the important EU rules - including Copyright Directive Articles 5.2(b), 5.5 and 6, and recitals 35 and 39 - that govern levies and the private copying for which they are intended to compensate. The description should refer to these rules, which establish the framework with which national levies regimes must comply.

4. **In addition to being indirect, levies are also inexact.** Levies traditionally have been established on the basis of negotiations between the relevant stakeholders over the appropriate levy tariff for private copying. Unfortunately, however, governments have failed to foster an equitable balance in these negotiations. Instead, collecting societies have gained a dominant and exclusive position - and negotiations with them invariably produce levies that are closer to taxation than compensation.
5. **Levies have nothing to do with copyright piracy.** There is considerable confusion over the relationship between levies and piracy. Copyright Directive Article 5.2(b) provides for fair compensation where a Member State allows for private copying - that is, private, non-commercial and legal from a legitimate source copying which causes actual harm that has not been compensated by other means. Levies should not be used to compensate for copyright piracy.
6. **Only *private* copying from a legitimate source can be subject to levies.** As noted in point 5, levies are intended to compensate for private, non-commercial copying. Business end-users should therefore be excluded from the payment of levies. In practice, however, levies are paid not only on products sold to private individuals, but also on products sold to those consumers who clearly fall outside the scope of the private copy exception.

C Do you believe it efficient that the debtor of the copyright levy is not the party that carries out and controls the private copying?

We believe that levies systems are inefficient for a variety of reasons. First, as noted, the debtor is not the party that carries out the private copying. This inefficiency is compounded by the fact that levies are paid not only on products sold to end-users who are private individuals, but also on products sold to business end-users (who are not authorised to make private copies). Often, levies are passed on to consumers in the form of higher prices; this leaves many who are not carrying out private copying subsidizing the acts of a few who are.

Of course, there are several other reasons why the levy system is inefficient from an economic perspective. In addition to the improperly aligned allocation of costs, the overall amount collected bears no relation to the actual harm caused by the private copying involved. And the amount distributed to authors (which is only a fraction of the amount collected) bears no relation to the actual value and use of that author's particular work.

There are also significant structural inefficiencies in the system. For example, levies are collected by an intermediary - large, heavily bureaucratic collecting societies - who often reinvests a significant percentage of the levy back into the collection and administration process. These collecting societies often contract companies or associations that cooperate in the collection and administration of levies with a fee of up to 25% of the original levy. This fee is on top of the collecting society's own collection costs, which can reach up to 15% (Dutch example). In practice, this means that up to 40% of the levy may be spent on the collection of the levy alone - before repartitioning and distribution of the levy, a process which adds additional costs.

And just as the collection process is inefficient, the process of administering levies within paying companies is likewise costly and burdensome. Often this effort requires significant and expensive accounting resources to monitor the movement of different products within and across the Member States and pay the relevant tariffs arising therefrom.

All of these factors contribute to a system that is inefficient in nearly every aspect.

Question 2. WHO ADMINISTERS COPYRIGHT LEVIES?

A & B **Do you agree with this description? Are there elements that you think should be added?**

We agree. We would, however, add a reference to the fact that collecting societies currently enjoy what amounts to a de facto monopoly position in the areas in which they operate. As a result, their bargaining power on levies-related issues is often disproportionate when compared to authors or industry; indeed, collecting societies often more closely resemble state revenue authorities than author's rights societies.

C **Are you satisfied with how the collection and distribution of copyright levies functions?**

No. We have several concerns in this regard:

- **Lack of transparency**: The methodology collecting societies use to determine whether a device or media should be subject to a levy and, if so, what criteria should be applied to determine the amount of the levy is rarely clear. Generally Collecting Societies' methodologies are not published or rarely clear. Likewise, there is virtually no transparency with regard to amounts actually collected or distribution of those amounts.
- **Multiple collection points**: In several markets, there are numerous collecting societies, each representing specific categories of rights and each with the authority to assess levies on a particular product. This results in some products being subject to multiple levies - a result that is unfair both to consumers and manufacturers/importers. In systems of interoperating products (for example, personal computers, CD drives, memory sticks, printers and scanners), levies often apply at various points in the product chain, despite the fact that these products are included in the same system - again producing an unfair result.
- **Under-enforcement/selective enforcement**: It has been our experience that collecting societies often selectively enforce the collection of levies against only the most prominent manufacturers and importers in a particular market, while under-enforcing against others. This leaves targeted manufacturers with two choices: absorb the cost of levies or increase the sales price of their products. Either way, selective enforcement puts those who pay the levy at a serious competitive disadvantage against those who do not. Selective enforcement also reduces the total amounts collected, to the detriment of authors. For example, the Czech collecting society INTERGRAM has been making increasingly pressing demands to only a few select companies active in the Czech market, while ignoring all the others. In Italy, only three collecting society employees supervise the entire market

- rendering comprehensive enforcement against all manufacturers and importers impossible. And in Holland, Stobi (the debtor to Stitching Thuiscopie) has repeatedly complained of under-enforcement ranging between 30-50%. Collecting societies must guarantee that an agreed levy on a certain product is collected on all such products in the country.

- **Collection of levies on exported products:** As a general rule, under national levy regimes, no levy is due on exported products. However, the collection process adopted by national collecting societies is so complex that, in practice, exported products are often subject to levies. In Germany, for example, levies paid by manufacturers/importers are passed on to wholesalers in the price of the products; the wholesalers then claim back the levies paid on the products they export from the collecting societies. Certain German collecting societies, however, will deal only with importers/manufacturers. This means that manufacturers/importers and wholesalers must engage in a complicated coordination and calculation process to determine who reports what figures to whom, and who receives compensation from whom. The same problem exists in Spain with the collecting society CEDRO, which only wants to deal with importers / manufacturers and ask exporters to claim such levy back not to CEDRO directly but to importers / manufacturers.

- **Collection of levies on products destined for business use:** By definition (i.e. reproduction by a natural person for private use and three step test), the private coping exception does not apply to the business environment and institutions. Unfortunately, there is no systematic means for excluding levies on products destined for business uses. Levy systems need to ensure that the business segment is exempt from levies.

- **Absence of an independent, specialist arbiter to resolve levies-related disputes:** In most Member States, there is no tribunal with specialised expertise and full authority to resolve disputes between collecting societies and manufacturers/importers. Instead, recourse is to national courts that lack the necessary experience in this complex area. This leaves stakeholders with little ability to meaningfully contest levy amounts or collections.

D Do you believe that rights holders who are (1) nationals of other Member States or who may be resident in another Member State other than that of which they are nationals; or (2) third country nationals receive a proportion of copyright levies that corresponds to the actual amount of copying of their works or other subject matter (such as phonograms of broadcasts) including in comparison to nationals themselves?

No, because there are different national arrangements for collection and repartitioning of levies, the compensation that a right holder receives can vary significantly depending on where the right holder resides and where his/her works are copied. Ultimately, this produces inequitable results for right holders.

Differing national arrangements take a variety of forms:

- First, Member States apply entirely different tariffs for compensation - meaning consumers in different Member States who use similar or even identical products and who have similar consumption levels may nonetheless pay dramatically different amounts.

- Second, the repartitioning of levies proceeds differs from Member State to Member State. While the details of how proceeds are repartitioned are unclear, in many Member States play lists for music radio are used. This method, which harks back to the 1980s, when double deck music cassette recorders were used to tape radio programs, does not correspond to today's consumer's usage of content. Moreover, the national play list method is likely to over-represent national artists - and disadvantage non-nationals - as compared to retail music sales which generally include a significant portion of international repertoire.
- Third, some Member States use varying percentages of levy proceeds to support national artistic and cultural initiatives. These sums are deducted before repartitioning - leaving differing amounts for distribution to right holders.
- Finally, reciprocity agreements are the key determinants of whether right holders in the State of collection receive more compensation than their colleagues in other Member States. As a general rule, two types of reciprocity agreements have been made public: (1) Type A involves an exchange of funds between collecting societies with regard to foreign repertoire; this advantages artists within those collecting Member States where repartitioning is based on national repertoire such as radio play lists; (2) Type B arrangements assume that mutual collection averages out and thus that no transfer of funds is necessary. This approach unfairly penalises those artists that live in Member States where few or no levies are collected.

E How can current distribution keys reflect the actual amount of copying of works or other subject matter?

Because of the non-transparent way in which collecting societies operate, we have virtually no information about distributions of amounts collected. Without such information, it is difficult to respond to this question. That said, we are sceptical that current distribution keys bear any relationship to actual amounts of private copying. To date, little if any market research has been done to demonstrate actual harm caused by private copying. The research that has been done often suffers from empirical weaknesses. For example, an initial study on DVD usage indicated that the number of DVDs in use was 10 times greater than the number of DVDs sold into the market; it ultimately became clear that many respondents were confusing DVDs and CDs.

Absent meaningful economic research on harm, no accurate linkage between distribution and copying is possible. Moreover, private copying subject to levies appears to be in decline - as a result of the application of TPMs, which prohibit private copying beyond what has been paid for; home production of data; copying from legal services in which the consumer pays to make a copy; and online pirate copying. A recent study of blank DVD usage demonstrated that 75% of the uses are unrelated to private copying of copyrighted works; the remaining 25% of potentially related uses includes a significant percentage of private copying.

F **Do you think that there should be greater accountability of collecting societies with respect to the application, collection and distribution of copyright levies and if so, in what form?**

Absolutely. Currently, there is very little oversight of collecting societies, leaving them largely free to charge and distribute what they like. Moreover, there is little meaningful opportunity for stakeholders to participate in the levy-setting process or to object to levies once established. As a result, the entire levies system can often be arbitrary and unfair.

To increase the accountability of collecting societies, we would propose:

- **Mandating transparency**: Part of the challenge in holding collecting societies accountable is that there is very little transparency with regard to their levies-related activities. To address this, collecting societies should be required to provide greater public access to information - preferably through publicly accessible websites. Available information should include collecting society terms of agreement with their members as well as information regarding how levies are calculated, what levies are collected, and how levies are distributed. The objective should be to make it as easy as possible to obtain information regarding how much has been collected and how much of the amounts collected end up in the hands of rights holders.

  Among the specific disclosure obligations:

  - Collecting societies should be required to specify the uses for which they claim fair compensation. For example, a collecting society representing right holders in the area of music/sound recordings would list uses such as creation of compilation of music CDs; creation of music play lists; platform shifting; copies made for the user's car, second home etc.
  - Collecting societies should be obliged to explain fully the basis upon which the amount of any levy claim has been determined upon the request of any party who is paying a levy or against whom a levy claim is made.
  - Any survey, data or other information used by a collecting society to determine the amount of any levy should be made fully and publicly available.
  - Collecting societies should be obligated to take steps to develop a more uniform and common approach throughout the Member States to determining applicable levy amounts. If the amount of a levy or levy claim in a Member State differs materially from levy amounts claimed or paid in other Member States, the collecting society should be obliged upon the application of any party who is paying a levy or against whom a levy claim is made to explain fully the reason for such differences.
  - Collecting societies should be obliged to explain fully the basis upon which the levies it collects are divided and distributed upon the request of any party who is paying a levy or against whom a levy claim is made or who claims to have a right to receive a share of such monies or represents such a party.

- **Establishing mechanisms for independent review:** Users must be in a position to contest tariff amounts and to receive a fair and balanced hearing of their claims.

To this end, each Member State with a levies regime should establish an independent forum, with specialised expertise, competent to review any levy or claimed levy. These independent fora should be supported by an EU-level oversight body, open to participation by all stakeholders.

More specifically, we would propose that:

- Each Member State with a levy regime establishes a Copyright Tribunal. This body shall be independent in its organisation, legal structure, composition and decision-making from any collecting society, right holder interest or applicant for a reference to the Copyright Tribunal.
- The Tribunal should have authority to review any levy amount or levy claim upon the application of any party who is paying a levy or against whom a levy claim is made.
- The Tribunal should likewise have the authority to review in detail the justifications provided by the collecting society on the uses specified, harm assessment and the availability/application of DRM and TPMs. The Tribunal may request additional information as necessary.
- The Tribunal should have the power to vary any applicable levy amount in any way - or abrogate it altogether - as it may determine to be reasonable in the circumstances.
- The refusal or failure of a collecting society to provide an explanation, survey, data or information requested by those paying a levy or subject to a levy claim should be considered by the Tribunal in its decision-making on matters.

When a complaint is made to a national Copyright Tribunal, the complainant should be required to make a parallel filing with the EU level body - or with the European Commission - for review and opinion. Filing with the European Commission ensures consistent application and interpretation of the Copyright Directive's rules on levies throughout the EU and avoid distortion of Single Market trade.

Finally, it would be critical that copyright levy claims have not retrospective effects (otherwise they would imply an obligation for manufacturers / importers to pay an amount that has not been collected from those authorized to make private copies), but that they are effective only once such national Copyright Tribunal has provided its ruling on due levies.

- Increasing consumer awareness: European consumers are often largely unaware of the existence of levies, and have little understanding of how they work, on what products they are imposed, and in what amounts. Likewise they are unaware that they might be paying levies multiple times and that they end up paying multiple times for the content they acquire: for the licensed download or purchase and for the levy.
- Member States should be encouraged to educate consumers about national levies regimes and collecting societies should be required to provide greater information

to consumers. Empowering consumers to make educated choices will add greater accountability to the levy system.

Question 3. DISTRIBUTION OF COPYRIGHT LEVIES

A What conclusion can be drawn from the above Table with respect to the relationship between the levy collected and distributed and the administrative cost of distribution?

The Table demonstrates quite starkly the dramatic range in administrative costs among Member State collecting societies. In some Member States, collecting societies are expending up to 20% of collections on administrative costs. There is virtually no transparency as to what these costs include (the Consultation notes that it does not reflect the collection service).

When these costs are added to the amounts spent on cultural/collective purposes, the impact on authors becomes clear. Austria provides a case in point: with 50% of levies going to cultural/collective efforts, and another 7% on administrative costs, authors receive only 43 cents from every euro collected. The situation is only slightly better in markets like France and Hungary. This result is neither equitable nor sensible.

Ultimately, the Table reaffirms the need for a better understanding of how collecting societies use and distribute the money they collect. The Table also highlights the importance of alternative compensation systems - such as digital rights management technologies - that enable authors to get a better rate of return on their creative investments.

We also note that the Table appears to be incomplete in some respects. In the Netherlands, for example, while the Table features Lira (the collecting society for literary works), STK is the relevant collecting society. Although there is very little transparency into STK's distribution model, it appears that it has yet to distribute millions of euros collected between 1993 and 2001.

B What conclusion can be drawn from the above Table with respect to the ratio of distribution at national level as opposed to distribution to other Member States?

Except for the issues raised in Question 2 another significant question that the Table raises is whether the market shares truly reflect the actual use of multinational repertoires. In Germany, for example, according with such table, it would appear that over 70% of privately copied music is either German or created by German residents In Austria, this share would be even higher - 76.6%.

Question 4. DIGITAL RIGHTS MANAGEMENT AND DIGITAL MUSIC SALES

A & B **Do you agree with the above assessment on the growth of digital and technologically protected sales? Are there other elements that you consider relevant?**

We share the view that DRM-enabled content delivery systems are becoming increasingly commonplace. As evidence, we would point the Commission to a 2005 Study published by the Business Software Alliance. The Study demonstrates that the DRM-enabled online music market is growing exponentially in Europe, and is expected to reach €559.1 million by 2008, compared with €27.2 million in 2004. A more recent study by Forester Research forecasts an increase from €21 million in 2004 to € 1,136 billion in 2008. By 2011, the online music market in Europe is expected to grow to €3.895 billion, representing 35.7% of the total music market (online and physical carrier sales).

While Section (4) accurately reflects the increasing prevalence of DRMs, it fails to note the implications of DRM expansion on existing levy regimes. The EU Copyright Directive makes clear that levies must be adjusted to reflect the application of DRMs. As a recent CLRA Survey reveals, however, national levy systems have failed to implement this obligation in practice. Indeed, exactly the inverse is occurring - despite the increased application of TPMs, collecting society demands and collections continue to grow. Estimates by the consultancy Rightscom suggest that levies collection will triple between 2001 and 2007, from €535 million to €1.78 billion, in the nine EU markets surveyed. (This estimate excludes claimed but disputed levies; if such levies are added, levies collection in the countries surveyed rises to €3.313 billion in 2006).

This trend penalises the consumer most heavily. Where DRMs are in place, levies on digital products mean a consumer may pay two or more times for private copies. For example, when a consumer purchases a song through a DRM-enabled on-line music store, the purchase price includes use of the song and a specified number of private copies. In addition, however, that consumer may also pay a levy on his or her MP3 player, on the PC in which he/she stores the song, on the CD-burner embedded in the PC and on the blank CD used to hold the song. This decreases consumer enthusiasm for DRMs; it also means right holders have little incentive to apply DRMs to their works.

The Copyright Directive anticipates this development and requires that levies be adjusted to reflect the application of DRMs. Unfortunately, however, to date virtually no Member States have implemented this obligation. To ensure compliance with the Copyright Directive's mandate, levies should not be applied to products where the copying mode, or - in the case of a device having more than one copying mode - each copying mode, is protected by a technological protection measure. For devices which have more than one mode of copying, wherein at least one mode is protected by a TPM and the other mode is not so protected, the levy amount should take into account the relative use of the respective modes and should not normally exceed 50% of the amount applicable to a corresponding device without TPM protection.

Further, levy revenues should decrease year-on-year, in line with empirical evidence of the availability and application of TPMs and DRMs for specific categories of content and/or products. Member States should establish processes for measuring progress concerning the availability and application of TPMs and DRMs over time, and monitor the reduction in levy revenues relative thereto.

C. In your opinion, which system can provide better remuneration of right holders–licensing models through digital sales or the copyright levy system?

Without question, licensing models through digital sales provide "better" remuneration of right holders.

Copyright levies, as the Consultation notes, are not based on actual consumption of specific works, but instead are an approximation - thus enabling only "rough-justice" compensation for authors. At the same time, levies force those consumers who do not copy (whether businesses or individuals) to bear the burden of levies alongside those who do copy. These various imperfections in the system were accepted in the analogue era, because there was no viable alternative.

Today, however, DRM systems enable content owners to articulate and enforce terms of usage directly, to establish prices based on permitted usage, and to collect payment directly - charging consumers only for the actual uses they make of works and ensuring authors are fully and exactly compensated for the relevant usage of their works.

Indeed, DRM systems can enable collecting societies to administer their authors' rights more effectively and efficiently by reducing administrative costs and more accurately matching compensation to usage. DRM systems can interface with different right holder systems, and various technical schemes are in fact now available or under development to ensure the interoperability of collective management information (CMI) metadata and direct payment to authors. For example, MPEG-21, Part 15, currently under CD ballot, deals with the reporting of usage events. When this becomes an ISO specification, it could be used to exchange information about the use of rights. This, and other systems like it, should enable more accurate royalty collection and distribution. This would in turn provide much greater financial accountability than that available by charging levies on blank media and on equipment.

What this means is that, far from becoming obsolete, collecting societies will continue to have a role representing authors - albeit a new one. As DRM systems evolve, so too do the opportunities for collecting societies.

D. Do you think that the current levy system has an impact on the development of digital sales in Europe?

Absolutely. Levies often increase the selling price of digital products to the end consumer. Indeed, as storage capacity increases and prices decline, levies are a growing percentage of the end-user price. In France, for example, levies on blank DVDs are estimated to represent over 47% of the final end-user price; absent levies, French consumers would have the buying power to purchase nearly twice the number of DVDs they purchase currently. The impact of levies on product pricing is compounded by the fact that some digital products bear multiple levies from different collecting societies. Other products bear levies on several different components, further increasing prices.

By increasing the cost of digital products, levies lead directly to a reduction in sales of both the levied product and related products that might or might not be levied - including digital music sales. For example, when a levy on personal computers (PCs) reduces PC sales, there will be parallel reductions in the sales of dependent products, such as printers, blank CDs, legal online music etc. At the same time, products or services available

elsewhere in the world are delayed in Europe because of the cost, complexity and uncertainty of negotiating with collecting societies over licensing and levies.

Nathan Associates recently completed a Study, which examines how levies on digital equipment undermine consumer purchasing power and reduce digital sales. In the 15 European countries surveyed, the Study concluded that levies currently being applied cost producers nearly €750 million in lost sales revenue (resulting from the higher price and lower unit sales), with a total effect (on producers and consumers) of €2.1 billion in 2005. Levies claimed but disputed add another €2.3 billion to this figure. Taking France as a representative market, the Study estimated that had levies not been imposed on MP3 players, 974,000 more of these products would have been sold in the market. Increased sales of MP3 players would, in turn, have led to an estimated €1.8 million in sales of legal online music. By 2008, lost sales of online music due to the French MP3 player levy are predicted to reach €12.3 million. In light of this, it is no surprise that despite Europe's larger population, the region still trails the U.S. in terms of the total size of the online music market (€27.2 million vs. €207 million respectively in 2004).

In addition to decreasing direct sales of digital products and delivery systems, levies also undermine new innovation in these areas. Reduced sales mean fewer resources to invest in research and development of new products. Likewise, the legal uncertainty inherent in the levies system forces ICT companies to set resources aside for pending levy claims - resources that would otherwise be put, at least in part, to funding further innovation. (Some estimates put these reserve resources in the region of €250-300 million year-on-year.)

Question 5. COPYRIGHT LEVIES AND THE NOTION OF HARM BASED ON PRIVATE COPYING

A Do you agree with the above assessment?

Yes. Existing copyright levy schemes are, as noted above, largely premised on a "rough justice" notion. Despite the Copyright Directive mandate, collecting societies have to date failed to quantify the actual harm caused by private copying.

B Do you believe that private copying causes harm to rights holders and if so, how can this harm be reliably quantified?

Collecting societies have made virtually no effort to quantify, by meaningful economic analysis, the harm caused by private copying. Absent such analysis, it is difficult to say definitively whether private copying causes harm.

What is clear, however, is that levy income exceeds this harm. There are numerous examples in support of this contention. A 2003 analysis conducted by the Spanish Internet Users Association, for example, demonstrated that the levies applied on CDs and DVDs in Spain represent a level of compensation far above the harm caused by legal private copying. Similarly, the 2006 Rightscom Study cited earlier reveals that the progressive extension of levies will more than triple levies collection by 2007 in the nine countries surveyed, from €535 million in 2001 to €1.78 billion in 2007. No extension of the private copying exception has been introduced that would justify these increases.

To reliably quantify harm, we believe the following principles should be followed:

- **Collecting societies should bear the burden of demonstrating harm.** A basic tenet of copyright law is that the burden of proving damages rests with the claimant. Applying that tenet here, collecting societies should be required to establish levels of private copying and to demonstrate exactly what economic losses have been suffered as a result of such copying. In so doing, collecting societies should be required to produce solid economic evidence - mere speculation is not adequate.
- **Harm should be based on actual *economic* harm - i.e. it should reflect *only* those private copies that cause material economic harm or damage.** When calculating harm, it is not appropriate to think in terms of license revenue lost by every private usage - many of which impose no harm at all. Consistent with the Copyright Directive's guidance, those copies that cause no economic harm or nominal harm should not be included in the calculation.
- **Pirate copies must be excluded from harm calculations.** Levies are not used to compensate for copyright piracy, but only for private, non-commercial and legal copying. Accordingly, harm calculations should not encompass pirate copies.
- **No double dipping.** In calculating harm, copies for which right holders have already received payment in some other form (for example, as part of a license fee or included in the sales price of the relevant content) should be excluded.
- **The application of TPMs must be factored in.** For content categories with a high penetration of DRM/TPMS, levels of actual harm should be lower than for content categories in which DRM/TPM has not been deployed significantly. To ensure accurate calculations in this regard, we would encourage the Commission to carry out a study to look at DRM/TPM implementation for different content categories and distribution forms.
- **Collecting society calculations should be wholly transparent, as should the data underlying them**. Any economic harm analyses should be publicly available and subjected to careful scrutiny and broad input.

Until collecting societies have demonstrated actual harm consistent with the principles outlined above, we would support a freeze on the extension of levies to any digital products not currently levied. A freeze of this sort will have no impact on the current income of collecting societies, but will provide strong economic incentive to comply with EU law principles on actual harm.

C How can harm to rights holders be identified? Have situations been identified or account been taken of instances where no obligation for payment would arise on the basis that there is no harm?

There are a variety of situations where the right holder will suffer no or nominal harm as a consequence of private copying. Often a consumer will make a private copy of a work simply in order to enjoy that work in a more convenient way. For example, this holds true in the case of:

- "Time shifting" (e.g. recording a broadcast programme to enjoy at a more convenient time);
- "Back-up copies" because a vulnerable medium is used such as vinyl records, memory chips, hard disks etc.
- "Recompiling" (e.g. combining favourite musical tracks from a CD, but omitting other tracks which happen to be on the same CD).

The above activities generally do not result in a lost sale because the consumer would not have purchased an additional copy of the same work in these circumstances. Accordingly, these acts do not result in any material harm to the right holder.

Independent user behaviour studies can be helpful in identifying harm. A study on printers by GfK, for example, surveyed over 1000 printer users in Germany about their usage. The survey revealed that a very small percentage - under 5% of the total print volume of 150,000 printed pages - potentially included content eligible for a copyright levy. In fact, less than 3.5% of usage could be identified as being of the type subject to a levy.

Another study on multifunctional printers (MFPs) in Spain run by TNS Technology reveals that only a 6.6% of all consumers using the copying functionality of such device have "ever" used the device to copy any pages from a book. This implies that 93.4% of users are paying levies because of such book copying functionality without making any copyright levy relevant usage ever. Comparable data showing low copyright relevant usages exists as well for German users of multifunctional printers.

D How can harm be quantified where the equipment or media has a dual or multifunction?

1. We would propose the following approach: Levy amounts should normally be determined with regard to actual usage of all the respective functions. If the private copying function is less than 10% of overall usage of the device functions as a whole, then private copying should normally be regarded as a side function causing minimum harm to the right holder in which case the multi-function device should not normally be subject to levies.
2. Where levies on multi- function devices are justifiable, the amount should be calculated based on the value of the specific function of the device which enables private copying - not on the value of the whole device. Below are examples of simple calculation methods that reflect the level of multi-functionality.

   a. For multi-function devices having two functions, one of them being a recording function, the private copy compensation should not normally be more than 50% of the levy applicable to a corresponding device which has a dedicated private copying functionality. Moreover, the levy applicable should be based on the actual harm as described in section B and C of Question 5.

   b. For multi-functional devices having more than two functions (including a recording function) the private copy compensation should not normally be more than 20% of the levy applicable to a corresponding device which has

a dedicated private copying functionality. Moreover, the levy applicable should be based on the actual harm as described in section B and C of Question 5.

The printing industry advocates a specific cap in the context of multifunctional printers (MFPs). MFPs are capable of copying, although their primary function is use as a printer to print out non-protected (own) material. The printing industry cap - set at a maximum of 3% of the importer selling price - corresponds to this subsidiary use of MFPs. The cap is premised on the cost of transportation between Member States, which is estimated at 2% of the price of the device. If the levy is higher than 2% of the selling price, it encourages consumers to purchase their product in neighbouring countries with lower or no levies. The proposed cap avoids cross-boundary trade distortions and minimizes unfair competition.

E Are there other elements that you consider relevant?

We would suggest that Section 5 include a reference to the EU Copyright Directive rules on harm. The Copyright Directive makes clear that where there is no harm or where harm is nominal, no payment may be due. Despite this guidance, to the best of our knowledge, no Member States with levy regimes have reduced levy tariffs to reflect "no harm" or "nominal harm" copying.

Question 6. THE CRITERIA FOR ESTABLISHING WHETHER A LEVY IS IMPOSED ON PARTICULAR EQUIPMENT OR MEDIA

A Do you believe that levies should be applied to hard disks or removable memory cards as "blank media"?

No. Hard disks and memory cards serve a variety of purposes, the vast majority of which are unrelated to private copying. For example, many uses of this equipment are business-related, and thus fall outside the private copy exception. Others are personal, including storage of personal documents and photographs and media materials. Still others involve copying and storage of pirate copies. None of these uses provide any justification for the application of levies. Indeed, private copying is, at best, incidental to the primary functions of such media.

Accordingly, there is no rationale for applying levies to these products; instead, a levy on such products forces a large number of users who do not engage in private copying to subsidize the activities of the small group who do. Moreover, applying levies to storage media necessarily opens the door to the application of levies on all sorts of other devices equipped with hard-disks/memory: radio and television sets, digital cameras, digital video units, telephones, car stereos, automobile information systems, mobile phones etc.

The mere suitability of the product to copy must be completely irrelevant to attract levies (however, such mere suitability principle is the basis of some national legislations and the basic argument used by German collecting societies to abusively claim levies on PCs, printers and multifunctional printers).

B Do you believe that these items are dedicated to the production of private copies?

No, as outlined in our response to Question A.

C Do you believe that the dedicated function of an item or recording device should play a role in deciding whether a levy is applied to it?

Yes. The dedicated function of an item or device is relevant in determining whether a levy should apply. However, the fact that a device is dedicated to making copies should not in and of itself be a sufficient basis to apply or claim levies. Before a levy may be claimed, collecting societies must: (1) specify the uses for which they claim compensation; (2) demonstrate actual harm arising from the uses for which they claim compensation. If there is no harm, or only nominal harm arising from the use in question, then no compensation should be due; (3) take into account evidence that right holders represented have already been compensated in some other form; and (4) consider the application of DRM/TPMs for the content for which they are claiming compensation.

More specifically, we support the following parameters on levies for dedicated products:

1. Levies should preferably be applied as a percentage of the price of the device, not as a fixed amount, unless there is good reason to the contrary.
2. In unusual cases where it is justifiable to apply levies as a fixed amount, account should be taken of the fact that market prices for electronic products tend to drop over time, and the levies tariffs should be reduced to reflect the fall in market price of the category of product in question.
3. The levy amount should be capped at a maximum of 3% of the selling price and should correlate to evidence of actual harm caused to the right holder, for the category of product in question. It is not expected that such harm would normally exceed 3% of the selling price of any digital device, and it is anticipated that evidence of harm would demonstrate that only lower percentage amounts are normally justifiable (including a zero percentage if there is no harm or minimum harm). A higher percentage than 3% would challenge the assumption that the harm caused is due to non-infringing uses of the product.
4. Levies must not be applied in relation to products/media that are used for professional or business purposes.
5. Recording capacity should not be the basis for levying a product. Due to rapid changes in technology, collecting societies will never be able to keep up with the capacity changes; moreover, the level of recording capacity does not change the private copying behaviour of consumers. Levies should be applied per product, based on a percentage of sales value, not per recording capacity.
6. Likewise, the quality of the copies should not be the basis for differentiating levies tariffs.
7. Double compensation to right holders is not justifiable and must be avoided e.g. in media/device chains such as levies on CD media, CD-burner integrated in a PC, on the PC itself and payment via an on-line DRM service.

8. If a system of intercommunicating component products is needed in order to make a copy, it is not justifiable to apply levies to every component in the system, but only to one of the components, normally the component which is functionally most associated with the private copying functionality. Application of a levy to one component product in a system should normally exhaust any claim to levies on other component products in the same system.

9. A clear and transparent distinction should be made in the amount of levies applicable to devices whose main function is making private copies and multi-function devices whose main function is not copying (we discuss this in greater detail below, in response to Question 5(D)).

D **Do you believe that levies should only be applied to equipment and/or blank media that are dedicated to the production of private copies?**

Yes, subject to the conditions identified in our response to Question C.

D **Do you think that there is an objective and verifiable standard on whether equipment or media is dedicated to the production of private copies?**

Yes. With properly structured user behaviour studies of products, performed by qualified and independent market research institutes, the percentage of usage dedicated to cover copying can be defined.

E **What kind of legal disputes are you aware of concerning the issue of whether certain recording equipment or other items are dedicated for the production of private copies?**

Currently, Epson, Kyocera, Canon, HP and Xerox are disputing copyright levies on printers in Germany in litigation against VG Wort. Levies on PCs are also disputed in Germany. Finally, printing companies are also disputing the amount of levies claimed by VG Wort on multifunctional printers sold in Germany. An important matter is that in all such disputes, collecting societies base their claims basically on the mere suitability of the products to make private copies, not on the actual usage of the devices for private copying purposes.

Question 7. COPYRIGHT LEVIES AND CONVERGENCE

A **Do you agree with the above analysis?**

Yes. The analysis demonstrates the dangerous "slippery slope" Europe faces if analogue levies are applied in the digital world without adjustment. The levy system was created for recording technologies (carriers) that were used almost exclusively to copy audio and audio-visual works. Today, this world has changed dramatically and a wide range of affordable semi-professional digital technologies cover a wide variety of applications

including video, audio, data and photography. Consumers use these products in very different ways than they used the early recording products. Trying to impose the old system on these new and rapidly converging technologies will soon result in virtually every digital product bearing a levy. Moreover, because many digital products interoperate in larger systems, the problem is compounded; levies can be due on each and every component in the system, increasing consumer prices to unsustainable levels.

Ultimately, as the trends of convergence and connectivity intensify, it may become necessary to take an entirely different approach to the question of right holder compensation. We put forth two possible approaches:

- Compensation to right holders through Member States' budgets: One option would be to transfer responsibility for levies from collecting societies to national fiscal and financial authorities. Indeed, as levies grow farther away from the notion of compensation and closer to the idea of a technology tax, a transition of this sort makes good sense. Several Member States appear receptive. In Denmark, for example, the Tax Ministry issued a report in late 2004 stating that the Danes would be better off abolishing levies altogether and instead providing compensation through the government.
- Fair compensation close to source - ideally levied on the content carrier itself: A second option would be to make levies payable on the original content by the end-user, rather than by manufacturers, importers and distributors. This would result in a more direct system, where those making the copies are paying the levy.

B Do you consider that multi-function equipment or multi-purpose of the sort described above should attract a copyright levy and if so which criteria should apply?

No. The principles that underlie the levies regime do not sit well in the context of multi-functional devices. The personal computer provides an example here: PCs are used for a broad variety of purposes, including creating and processing a user's own works, accessing the great variety of content available for free on the Internet, and taking advantage of the ever increasing variety of Information Society services. While some usages may involve private copying of protected content, it is clear that these uses are incidental. To impose a levy on these devices is thus not justified.

Moreover, a levy on multi-function devices forces the many users of these devices to subsidize the activities of only a few private copiers. Often, public authorities and private businesses bear the bulk of this burden, as they are among the largest users of ICT equipment. These users would pay a significant proportion of any levies - while accounting for very little private copying. German printer levies provide a relevant example here. A standard, colour multifunctional printer in Germany would retail at around €77.00 (excluding VAT); VG Wort claims a levy of €102.26 - over 130% of the product's retail price - increasing the overall price significantly, despite the fact that most users will not be using multifunctional printers for private copying.

If levies are applied to multi-function equipment, at a minimum there should be only one point of application in the case of a network or system of interoperating products (e.g. a scanner and a printer attached to a computer). If a levy is applied on one component in

the system, whether equipment or medium, it should not be applied to other components of the same system.

C **Do you consider that infrastructure services should attract a copyright levy in a converging world?**

Absolutely not. Recently, some have proposed extending levies to broadband or other infrastructure services, to compensate for losses to authors due to peer-to-peer piracy of their works. These proposals are bad public policy. First and foremost, a levy of this sort would legitimate piracy and convert authors' exclusive rights into mere rights of remuneration. Indeed, users already often mistake levies - which are intended to compensate for lawful private copying only - for an open license to copy content freely. Infrastructure levies will lend support to this misinterpretation.

Infrastructure levies are also inefficient, as they would force the many users of broadband or other services who are not making private copies to subsidize the activities of those who are. In addition, infrastructure levies would increase the cost of access to online services, suppressing demand for such services, increasing the digital divide and slowing the growth of Europe's Information Society. This approach would be wholly inconsistent with the Community's Lisbon objectives.

D **Do you believe that there is a link between levies on multi-function devices (such as a computer hard disk) and the development of the digital economy?**

Yes. The Nathan Associates Study cited above demonstrates the impact of private copy levies on consumer purchasing power. By increasing the cost of multi-function devices, levies reduce the uptake of such devices - necessarily slowing the growth of the digital economy.

The PC again provides a relevant example here. Collecting societies in Germany have long sought to extend levies to PCs and peripheral products. Had they succeeded in their demands, consumers would have been forced to accept the following additional costs for a complete computer package:

PC	+ €30.00 (VG Wort)
	+ €18.42 (ZPU)
Multifunctional Printer	+ €76.70
CD Burner	+ € 7.50

When VAT is added, this increases the total overall cost by over €132. This increase in turn reduces demand for and sales of digital goods.

E **Do you think that copyright levies on multi-function devices have an effect on new business models for the distribution of content?**

Yes. In support of this conclusion, we refer to the Nathan Associates Study cited in our response to Question 4(D), which demonstrates the direct connection between levies on mobile phones with MP3 capability and sales of ringtones. The Nathan Study estimates that currently applied, and claimed but disputed levies on mobile phones with MP3 capability in European countries reduces sales of such phones by 3.7%. This reduction in sales is predicted to in turn reduce ringtone sales by €30 million by 2008.

Reduced sales of MP3-equipped mobile phones will no doubt have similar effects on the sales of legal online music. The Forrester Study cited by the Commission indicates that mobile technology is increasingly empowering consumers to download music; downloads to mobile phones accounted for 40% of the value of the legal online music market in 2005. If phone sales decline, so will downloads.

Levies on other multi function devices, such as PCs, will have similar dampening effects on the uptake of online content delivery systems. This comes at a particularly inopportune time, just as public interest in legal sites grows, as more firms enter the online delivery market, and as EU Member State services (such as Musicload in Germany, Fnac Music and VirginMega in France, and MSN Music in the UK) emerge as significant market competitors.

Question 8. THE INTERNAL MARKET AND DIFFERENCES IN COPYRIGHT LEVY SYSTEMS

A **Should consumers that buy equipment or blank media from online retailers in other Member States for delivery offline be considered importers?**

B **How can online retailers or consumers have certainty in cross border transactions that goods can be marketed and bought at a particular price?**

C **Do you consider that selective enforcement of copyright levies distorts competition to the detriment of major producers of equipment or media?**

Yes, as we described response to Question 2(C). Selective enforcement of levies reduces the ability of those manufacturers who do pay levies to compete against those who do not. France provides an example of the distorting impact of selective enforcement. French customs often refuse to check whether levies have been or will be paid for products imported into France. This gives importers a significant price advantage in a market where levies on blank DVDs represent nearly 50% of the final end-user price. Similarly, in Spain, where levies on multi-functional printers can increase the final price by up to 66%, selective enforcement creates a significant competitive disadvantage for those manufacturers paying levies. (To address this, the ICT industry has been in negotiations with the relevant collecting society to reduce applicable levies on low-end MFPs; while the parties have agreed to a reduction in levy applicable on low-end MFPs – which was accepted by the relevant collecting society under the condition of adding scanners to the list of products subject to levies - it still adds somewhere between 10% and 20% to the final end-user price.)

In some instances, selective enforcement has left manufacturers unable to pass the levy on to the end-user. This is because parallel imported products from other Member States and products ordered directly by consumers online (which are generally not levied) effectively establish the price level in the market - making it impossible to charge more for the same product. An internal survey covering Philips' sales organisations across Europe, for example, revealed that on average 80% of the levies paid by Philips could not be charged to the end-user for just this reason.

Of course, selective enforcement is not the only feature of levies systems that distorts competition. The entire levies regime results in fragmentation of the internal market. No two Member States have identical levy regimes. Instead, very different amounts are charged for the same products or categories of product in different Member States. The basis of calculation also varies - in some Member States it is a fixed amount, in others it is a percentage. This lack of harmonisation and differential pricing significantly distorts trade among Member States.

Question 9. TRANSPARENCY FOR STAKEHOLDERS

A How do you explain the above discrepancies?

Without conducting a detailed economic analysis of the Eurocopya figures, it is difficult to explain the discrepancies with certainty. That said, one possible explanation for at least part of the divergence is the under-enforcement and selective enforcement of levies. The BSA calculations are based on levies applied to 100% of the relevant market. In practice, however, levies are not fully enforced on all products sold in particular markets - meaning the levies actually collected may be significantly less than the total levies collectible. Likewise, the BSA figures do not reflect levy collection rebates - i.e. the fees paid to those who actually collect the levy.

Another important reason behind such discrepancies is that Eurocopya figures only include figures for audio and video private copying levies, but not private copying levies on book reproduction equipment (which are wrongly classified by Eurocopya as "reprography levies"). Such copyright levies are very important. For example, they amounted to 26 million euros in Spain, what represents a 44% of the amounts already reported by Eurocopya for Spain in 2004 (59.72 million euros).

B Are these discrepancies due to the fact that copyright levies are being litigated in many jurisdictions?

This is unlikely as industry figures clearly distinguish between currently collectible levies and levies that are claimed, but disputed.

C Are the above discrepancies due to the fact that enforcement of levies remained selective due to copyright levy avoidance?

Quite possibly, as noted in response to Question 9(A).

Question 10. STAKEHOLDER OPINIONS

Does the above text correctly reflect the different stakeholders' positions?

As representatives of the ICT and CE industry, we would add the following key points to Section 10(4) (summarizing the ICT industry viewpoint):

1. First, industry takes issue with collecting society claims regarding the alleged lack of availability of DRMs. Cable and satellite TV; secure physical media; and Internet-based downloads and streaming (enabled by technologies such as Windows Media and RealNetworks, and services such as Fnacmusic, Virginmega.fr, iTunes, Napster, Movelink and CinemaNow) are all made possible through DRMs. In online music alone, the market has grown exponentially. Earlier this year, Apple iTunes sold its one billionth download, with user traffic to iTunes growing by over 240% in 2005. Within five years, Forrester estimates that 36% of all music sales will come in the form of legal music downloads. In short DRMs are not some unsubstantiated spectre, as collecting societies would have us believe.

2. Second, industry takes issue with collecting society claims regarding DRM security and interoperability. While collecting societies have made much over the alleged security concerns raised by DRMs, the truth is that with the exception of a few well-publicised mis-steps, there are very few examples of DRM security breaches. DRMs do not inherently gather data on individuals and are not innately "threatening" to user interests such as privacy or security. Moreover, the existing legal regime in Europe provides safeguards against misuse. For example, the EU's stringent data privacy rules (Directive 95/46/EC) apply to DRM technologies and obligate those who use such technologies to respect user privacy. Failure to comply with these rules - which cover issues including the purpose for which data is used, the need for notice, and restrictions on subsequent transfers and direct marketing - infringes the law.

   While we take on board collecting society claims (and consumer concerns) regarding interoperability, we note that market forces have and will continue to drive increasing levels of DRM interoperability in recent years. DRM interoperability exists today on a number of different levels - multi-vendor implementation, approved downstream outputs, and several ongoing efforts to achieve more universal trust mechanisms for interoperability.

   With regard to the first level, many DRM technologies are openly licensed so that they may be implemented by virtually all the device makers in a given industry. Examples of this include DTCP, WMDRM, Helix, CSS, CPPM/CPRM, AACS, OMA DRM, to name a few. Through such open licensing policies, literally hundreds of competing software and hardware providers are able to implement these systems so that content can be delivered interchangeably to any competing manufacturer's devices.

   As to the second level, many of these DRM systems are licensed under rules that permit the handoff of content to other DRM systems, provided that these other systems are recognized as "trusted" based on their ability to maintain downstream security for the content at a level that is acceptable to content owners. Content owners vigorously scrutinize these lists of approved outputs, and in many such

contexts insist on levels of control over new outputs through "change management" rights whereby they can veto or seek arbitration over whether approval of new downstream DRM outputs compromise the security of their content.

Given the substantial work involved in negotiating such approved output lists one by one with content owners, pressures have arisen to pursue broader market driven interoperability schemes, including the Coral Consortium, the Content Managing Licensing Administrator group, and varying efforts around XrML - currently engaged on this important issue.

3. Last, but certainly not least, we wish to stress our willingness to work with collecting societies to find a common path forward. For example, we have suggested collaboration to develop technical means to interconnect collecting society databases for royalty collection/distribution and DRM-enabled delivery systems. (See our response to Question 4(C)). This would result in direct remuneration for small and large authors whose works are being distributed through DRM-enabled download platforms, hopefully going some way to addressing collecting society concerns regarding the exclusion of small authors from DRM-enabled systems.

The CLRA and its Membership

The Alliance was officially launched on April 5, 2006. It represents the European information and telecommunications technology, consumer electronics, digital media and digital media recording industries. The Alliance members are: Business Software Alliance (BSA), European American Business Council (EABC), European Digital Media Association (EDiMA), European Information & Communications Technology and Consumer Electronics Association (EICTA) and the Recording-media Industry Association of Europe (RIAE).

European Information & Communications Technology and Consumer Electronics Association (EICTA): Leo Baumann
Leo.Baumann@eicta.org

Business Software Alliance (BSA): Francisco Mingorance franciscom@bsa.org

Recording-media Industry Association of Europe (RIAE): Maria Laptev
laptevm@fleishmaneurope.com

European Digital Media Association (EDiMA): Lucy Cronin
lucy.cronin@edima.org

European American Business Council (EABC): Sara Tesorieri
sara@eabc.org