BEGGARS GROUP RESPONSE TO THE EU REFLECTION DOCUMENT – CREATIVE CONTENT IN A EUROPEAN DIGITAL SINGLE MARKET: CHALLENGES FOR THE FUTURE

Summary

As an independent record label we shall restrict our views to the issues affecting the music industry.

The principal hurdles facing the growth of the EU digital music market as we see them are as follows:

1. The widespread availability of illegitimate free digital music throughout the EU.

2. The existing legislation affording technology companies protection from copyright infringement claims and thus dis-incentivising them from co-operating with content owners to reduce digital piracy.

3. The licensing practices of the large technology companies – a point which we believe flows from the previous point.

4. The licensing practices of the major record labels.

5 The current state of play of music publishing clearances in the EU.

We support the following actions to help grow the EU digital music market:

1. Legislation to remove or restrict the mere conduit defence for information society services in EU law so that their interests are more aligned with content owners.

2. Greater transparency on the terms of the licenses being agreed by the major labels and the technology companies.

3. The development of a global rights database to assist licensees in identifying the correct owners, rights and territories.

4. Greater flexibility afforded to single licensing entities under competition law.

5. The conjoining of the music publishing rights into one license for EU wide digital services.

6. The creation of one or more EU wide collection societies for music publishing rights.

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7. The creation of a compulsory, non-precedential license for all rights owners for limited term trials of certain types of government backed experimental digital services.

8. More research into the public's apparent reluctance to adopt legal digital services on a more widespread basis.

9. Legislation to be brought in to allow customers to privately copy and share with their friends music offline in return for a right to remuneration in respect of storage and transferral devices. We fully support the UK's Music Business Group's position on this issue.

10. Positive action from the EU to ensure the survival of SMEs in this market place because SMEs have been the sector by far the most responsible for providing the vibrant cultural diversity that is such a European strength. This could be achieved in many ways, including, but not limited to, reducing the tax burden of SMEs in the sector.

Details

1. Introduction

We are a leading independent recording company headquartered in the UK but with a significant presence in all countries of the EU, and in some countries our own staff (e.g. France, Germany and Benelux). We also have a large office in New York. Our turnover per annum is in the region of 30 million euros and we employ about 90 people in the EU.

In 2009 we were successful in selling records throughout the EU. By way of illustration, we achieved a number one album in Germany with the Icelandic/Italian artist Emilana Torrini and in Holland with the UK artist Adele.

And outside the major record labels we are the largest creator of original modern music in the UK, releasing in the region of 50 new albums each year.

However, there are very substantial problems facing our industry and we believe they are problems that will need some state/EU based intervention, and we therefore welcome the Commission's paper as taking a step in that direction.

In particular it is pleasing to read that the Commission highlights the importance of copyright and the creative industries to the EU and accepts its duty to safeguard both.

We will in the below restrict our comments to the music industry since that is the industry we know.

We note that the penetration and growth of digital music services in the EU has, with some exceptions, been very slow. From our own figures we can see that the take up rate for digital services outside the UK is extremely limited, lagging well behind the UK, which in turn is falling ever increasingly far behind the USA. For example, the digital market in the UK grew by about 16% in 2009, but in France by only 3.5% (with some even worse percentage increases in France in previous years).

This is extremely worrying to us and has implications for our ability to invest in artists and even the continuing viability of our business. Physical record sales are in steady decline and if the digital market does not increase sufficiently to offset those losses, one by one recording companies such as ourselves could go out of business.

Certain sectors applaud the decline of recording companies, and consider them to be an anachronism in today's digital and disintermediated world. Artists and their managers themselves however still value the investment, support and infrastructure recording companies bring to them, as they have skills that are not easy to replicate and are willing to invest in ways that financial institutions or private funds would not contemplate.

2. Digital Piracy

There are various hurdles faced by any attempts to grow the digital market, as we see it. The first and most important is the widespread availability of free digital music in the EU, a matter which we feel is not given sufficient consideration in the Reflection Paper. It is a massive disincentive for new players to invest in the digital music market when they know they will be competing with free. And the effect of this is especially chilling in the EU, where a much more conservative investment environment than in the USA prevails.

3. Mere Conduit Legislation

In our opinion the principal reason we have arrived at this point of very widespread digital piracy is the legislation in the EU and the USA of the 1990s which provided technology companies with immunity from prosecution for copyright infringement: the safe harbour or mere conduit protection. We appreciate that the reasoning at the time was that telecommunication companies should not be responsible for what happens over their networks, just as telephone companies should not be liable for what people say to each other over their telephone lines, but we do not believe that the analogy has held true, as has been show by subsequent events. The operators of telephone lines are a very different proposition to broadband operators or companies such as Google. The way the Internet has developed since that legislation was introduced has clearly shown that broadband operators and digital services companies have far more control and visibility over what happens on their networks than telephone companies ever did.

4. Licensing Problems with Technology Companies

The problem with the mere conduit/safe harbour legislation is that it encouraged entire new businesses to be built under the protection it afforded. The classic example of this was YouTube, which has always operated under the umbrella afforded by the legislation and has structured its business very precisely on that legislation (to the detriment some would argue of even their profitability). Relying on this umbrella, these companies have been reluctant to license copyright owners. Google also, which purchased YouTube in 2005 for US$1.65 billion, has been slow to recognise copyright owners' rights or has used its power to force settlements through without the consent of all the relevant persons (e.g. the USA book settlement).

These new businesses have grown into enormous companies with revenues equivalent to the GDPs of small countries. And the size of these companies dwarfs the music industry. With their vast size they are able to push to the very limits the copyright laws of various jurisdictions and spend millions of dollars in litigating any claims: e.g. the EPL and Viacom cases against YouTube in the USA which were started 2 years and are nowhere near conclusion. And if large corporations such as the EPL and Viacom are encountering such difficulties, it is hard to see how any SME content owner could succeed.

The result is that a huge divergence has developed between the content creators/investors and the persons who actually earn revenues from the exploitation of the content, i.e. the technology companies, the broadband operators and the user generated content websites. Their interests are at odds with each other, when there should in truth be far more of an overlap in their interests since the technology companies are massive users, compilers and exploiters of content but create absolutely none themselves.

Consumers have tended to side themselves with the technology companies. The ability to access on demand all the music you could ever want for free is clearly very attractive. And unfortunately, industry attempts to take or threaten legal action against consumers (which we have never supported) has pushed public opinion further away from the music industry, although given the protection afforded technology companies by the mere conduit legislation it is completely understandable why the customers were targeted by content owners in their attempts to reduce digital piracy.

Also, we have a very serious problem with the way the mere conduit provisions places the onus on the copyright owner to find the infringement before the technology company needs to take action. We, like all SMEs, have very limited resources, and we simply do not have the manpower to send takedown notices to every site with infringing copies of our recordings. The only way effective action can be taken is via a technological solution at source, implemented by the technology company. But because of the law as it stands there is little incentive on technology companies to implement such solutions, the legislation incentivises them if anything the other way, to not look at what is happening over their networks. And some technology companies provide content filtering software but only to content providers who have signed up to onerous non-negotiable terms with them.

We therefore recommend a wholesale revisiting of the mere conduit legislation to make the interests of the technology companies more in line with the protection of copyright and with the interests of the content creators and investors.

We are aware of and indeed support the various legislative initiatives which are attempting to deal with digital piracy (e.g. in the UK and France), but those initiatives seem fixated on the liability of the consumer rather than the technology companies, who are the ones with the power and control to really change the market. Only when the technology companies' interests are more aligned with creators and copyright owners will any serious inroads be made into decreasing digital piracy.

So reducing digital piracy is key to enabling the growth of the EU digital music market: new digital music services are understandably very hesitant at entering into a market in which they have to compete with free.

5. Licensing Problems with the Major Record Labels (viz. Universal, Sony, EMI and Warner)

The other side of the coin to piracy is the licensing of new innovative digital services that will provide consumers with a service that persuades them to switch from free. We have been licensing such services for over 10 years. The Association of Independent Music (a UK organisation representing independent record labels) licensed the original Napster service, at the time it was trying to become a legitimate service, and we fully supported that. Looking back at that time, we think that even certain people within the major record companies would now accept that killing off the original Napster by the majors through litigation was a mistake (and of course one of the majors (BMG) was supporting and funding it), since it spawned a whole new set of illegitimate music services that used different technologies to evade legal sanction. And the key was that the original Napster was trying to become properly licensed. This has been a feature unfortunately of the decade: the major record labels have been loath to license new services. Independent record labels, as natural licensors, have in marked contrast been very supportive of the new services, and the digital income as a percentage of overall income at independent labels when compared to major labels reflects that.

It seems that the major record labels' perspective has been that they must retain their collective hegemony over the industry, even at the cost of damaging the emerging digital market. That hegemony is largely premised on a business model based on physical record sales, with few channels available to market, large infrastructures required for distribution, and dominance of retail and promotion (radio, television and magazines) space. New digital services have obviously posed a threat to that hegemony and the majors' response has been to either not license the service and litigate it or to set up their own service, owned and controlled by them, thus maintaining their power and control over the market. The services that were formed by the majors to date have been unsuccessful (e.g. Pressplay) and so a third response has been to license key services (e.g. YouTube) or to enter into joint venture deals with digital services (e.g. Myspace Music and Vevo – although the latter is not available in the EU).

From what we understand, the majors' licenses and joint ventures with the digital services contain terms that are designed to maintain their hegemony over the music market. For example, a common provision in these deals is that the digital service must give the major licensor the same retail space or web presence on the service as is commensurate with (or even greater than) its market share (which will be based on overall market rather than just digital thereby inflating the larger companies' digital shares) and which in some cases will be a fixed minimum percentage.

This presents problems for us as an independent record label. For a start there is obviously the problem in getting shop window space where the largest proportion of sales are transacted, and secondly it means that the digital services, having concluded their licenses with the majors, treat the other licensors as the place where they can make back some margin, resulting in far poorer terms being offered to non-major record labels. The terms agreed with the majors are sometimes unrealistically favourable to the majors and so the digital service will feel obliged to balance that with concessions from the independents. An example of this was

YouTube. Before it was purchased by Google, licenses were concluded with all the major record labels. The terms of those licenses were never made public but we believe they involved large upfront payments in return for a waiver of claims. No independent label we are aware of agreed licenses on such terms, and many still remain unlicensed on YouTube. From YouTube's perspective, having secured the major label licenses, they could sit back and use the billion dollar litigation fund we understand they have to fight any claims that any remaining content owners were brave enough to try.

Another example would be Myspace Music, a joint venture between the major labels and News Corporation, owned by those parties, and launched without most independent labels being approached. And when approaches were made, again the terms offered were comparatively unfavourable to independent labels.

Our final example of the majors' approach in this area is the Playlouder Music Service Provider. The idea here was to bundle a broadband subscription package with an unlimited peer to peer music service, so to the consumer it felt free: like the illegitimate peer to peer services but with better quality and no spoof files. Licensing discussions with the majors went on for years until it finally became apparent that despite initial encouraging words, no licenses would be forthcoming from the largest players. Instead, what then happened was an alliance between Universal Music and Virgin ISP, recreating a very similar service (which is due to be trialled in the Isle of Man). Clearly, the missing ingredient in the first initiative was control by a major label of the service.

To be completely transparent, we ourselves are undecided on how best to structure an unlimited all you can eat music service, and have some concerns about its potential to destroy the main component of our market which consists of very keen, loyal and high spending customers. Also, we do have sympathy with the major labels' predicament: the new technologies have questioned their core business model and the pace of change has been incredibly rapid, occurring in just the last decade. We also agree that the content owner should retain the absolute right to reject a license if they feel that the return will not be sufficient (but in the absence of transparency it's impossible to know if the major labels' expectations are reasonable). However these examples do show that major labels are very reluctant to license unless they can ensure in some way that their hegemony in the new service is maintained.

We in contrast are very open to licensing new digital services. As mentioned we licensed the original Napster through AIM, and we currently have over 100 digital licenses. These range from standard download a la carte services such as iTunes to advertising supported services such as Spotify. We licensed eMusic, a subscription service begun in the USA and now operating in the EU, over 7 years ago. This is a service which the majors (with the exception of Sony who recently started providing them with their catalogue releases) steered clear of on the basis that it made available unprotected mp3 files, which format the majors only finally reconciled themselves to in the last couple of years.

But we think it is self-evident that the major labels' licensing practices over the last decade have not been conducive to the growth of a robust, balanced and

transparent digital market. The shining exception to all this is iTunes. This was a massive success from the moment it was launched and as far as we know, Apple treats all labels, large or small, approximately the same: the prices are similar and there are no shop space guarantees for the major labels, at least that we have heard about.

It is worth pointing out that iTunes has not been the runaway success in all countries of the EU as it has been in the UK and USA. Obviously licensing from the majors is not a problem, since Apple was big enough to persuade them to play ball, and iTunes has always been conscientious about and successful in their licensing, and they have a presence in most of the major music markets of the EU. Rather, the problems we think stem from the effect of widespread digital piracy. As previously mentioned, only once digital piracy is substantively reduced will customers turn to the legitimate services on offer. But there may be other factors at play here: please refer to section 11 below for further views on this.

Also, although iTunes is an excellent service, providing customers with an incredible amount of choice at low prices, we recognise that there is a demand for different kinds of digital services. There have been laudable attempts by new digital services to enter the market with innovative business models, notwithstanding the difficulty in competing with free. Spotify is a notable, European, example and although the revenues being generated are currently fairly small when compared to the usage figures, we have high hopes that it will consolidate its position in the market and grow its revenues.

To conclude this section, in order to tackle the ongoing problems digital services have in licensing from the major labels and that smaller labels have in licensing the digital services, we would advocate greater transparency in the deal making between the major labels and the technology companies. We are aware of competition law concerns, but it would be beneficial to digital services and indeed all players if there was greater visibility over the licenses being concluded. At the moment the terms of these deals are confidential but we believe that in order to get the market to grow more sunlight is required in this area.

6. Problems with EU Music Publishing Digital Clearances

The problems facing new digital services include, as we have outlined above, the stranglehold the major labels have over any new entrant, but also, and this seems to be a key concern of the Reflection Document, which we share, the issue of obtaining publishing clearances. It makes no sense whatsoever in our view for the music publishing rights (i.e. the rights to the musical and literary works embodied on sound recordings) to be split into two (the communication to the public right and the reproduction right) notwithstanding that the beneficiaries of such rights are the same people. We, as the owners of the copyright in sound recordings do not license a digital service and then tell them they must also go away and enter into a separate license in respect of the public performance or broadcast right with the PPL or the applicable sound recording performance collection society. But that is precisely what the owners of the publishing rights expect digital services to do. This is especially noticeable on straightforward a la carte download services: the idea that

you need a public performance/broadcast license for such services makes no sense (and we understand has been thrown out by a US court recently). The rationale behind this was presumably to exact a greater level of income for music publishers but the unintended effect is, as the Reflection Paper notes, that a digital service must agree a license with every single publisher performance collection society in every country in order to offer an EU wide service. We would therefore recommend that this practice stop, and that a digital service should only be obliged to make the one license for the music publishing rights.

Further complications have been created by the withdrawal by some publishers from the publisher collection societies. There is obviously a great deal of upheaval ongoing in the world of collection societies, but it would be extremely beneficial to digital services if there was an EU wide publisher collection society, for the combined rights.

We do not consider that the licensing of the sound recording right is remotely comparable to the music publishing position. Leaving aside the issues surrounding the major labels, at least they are able to grant EU wide licenses for all sound recording rights, as are we and as are the independent label aggregators. We do not therefore support any move to combine the sound recording with the music publishing rights.

7. Global Database

We wholeheartedly support the Reflection Document's solution of a freely accessible ownership and license information global database. It would help us enormously with the problem we currently face of the widespread mis-registration of our sound recordings' metadata by third parties, usually major labels, which in turn affects both our digital income and our income from the various public performance and broadcast collection societies. A single global database would also help greatly with encouraging and facilitating new digital services to enter the market, and to help them do so much earlier.

8. Compulsory Licenses for Trials

We believe that compulsory licenses may in some cases be appropriate, for both the music publishing and sound recording rights, to allow experimental digital services to trial for a limited period of time, provided that these trials had the approval of a government agency. All the information surrounding the trial would need to be 100% transparent and it would need to be clear that no precedents are being set, but we think that this could help bring into being some very innovative services.

10. Competition Law and Single Licensing Entities

We also believe that the EU should relax the laws on competition to allow single licensing entities to operate with more freedom. By way of example, we were partly responsible in setting up Merlin, a body that was designed to obtain for independent

labels the kinds of digital licenses and settlements previously only available to the majors. But because it represents a collection of many separate labels, rather than the one corporate person, it is hemmed in and restrained by competition law to the detriment of its effectiveness. Greater flexibility could be accompanied by greater transparency, since the independent sector as a whole is far more comfortable with greater openness.

11. Public Attitude

We are concerned at the very slow even negligible adoption of digital services in the EU when compared to the USA. And, for example, why does iTunes perform so much better in the UK than in the rest of the EU? In case there are reasons beyond the widespread accessibility of free illegal music, we believe that EU wide research should be undertaken with the public to ascertain what other impediments there are. We are thinking of for example credit card ownership (from our conversations with Apple that appears to be a key factor when they decide whether to open up an iTunes in a particular country) and alternative payment methods.

12. Private Copying and Remuneration

We would also advocate legislation allowing consumers to privately copy and share music off line in return for payment in respect of storage and transfer devices, per the proposal set out in detail by the UK's Music Business Group. This would we hope bring the public back on side with copyright law, and allow us to concentrate separately on tackling unlicensed online digital activity.

4th January 2010