

EUROPEAN COMMISSION

Creative Content in a European Digital Single Market: Challenges for the Future

A Reflection Document of DG INFOSO and DG MARKT

Response from Ingenious Media, UK

December 2009

Introduction

1. Ingenious Media is the UK's leading media investment and advisory company. Founded in 1998, the company now employs over 150 people across five businesses. The company has raised a total of more than £5 billion to invest in film, TV, games, music, live events and other media and entertainment assets. It is the largest independent investor in the UK media market with over 5,000 clients.
2. Following an introductory comment on the Document our response addresses the following sets of issues: (i) technology, creative content and the idea of "free"; (ii) copyright and the creative economy; and (iii) copyright reform; and multi-territory licensing.

General comment on the Reflection Document

3. We welcome the publication of the Reflection Document. It is a thoughtful and balanced summary of the issues. We especially welcome the Commission's acknowledgement (page 4) that "making professionally produced content available online is proving to be a high-risk business..." That is certainly our perspective as major investors in creative content.
4. The Document largely skates over the economics of the cultural and creative content sector, and does not attempt to analyse the implications of digitisation for creative business in terms of their distinctive and generic risk profile. Investing in content has always been a high risk activity because of the irrecoverable sunk costs incurred in most production and the general impossibility of mitigating risk by producing "prototypes" (of the book, film, song and so on). In this sense creative industries differ from other knowledge-based industries.
5. Content markets in all genres are "hit-driven". Historically the "hits" have generally been outnumbered by the "misses". The box-office risk characteristic of these markets was acute even in the pre-digital age, but before digitisation the demand for physical products (DVDs, CDs) allowed

significant profits to be made in the distribution phase of the value chain. These conditions (and profits) are fast disappearing. A combination of structural factors (digitalisation and resulting market fragmentation) and cyclical factors (the recession) has brought about quite brutal market conditions for large numbers of content creators, producers and investors, and for the media sector in general.

6. It is becoming increasingly clear that the “hits” can no longer be relied upon to pay for the “misses” in the digital world because they generate much lower profits. The effects at company level are serious: few businesses apart from the very biggest “majors” (most of them American) can now afford to invest significant funds in new and untested talent. The Document underplays the extent of this threat to the future of content markets. There are certainly investment opportunities too, but these are akin to finding pebbles on the beach; from a commercial perspective the opportunities are much less visible than the threats.
7. One feature of the current policy environment is the repeated invitation to the business sector from politicians, officials and consumer organisations to come up with “new business models”.¹ This has become part of the rhetoric of the political class; it sometimes appears as if the market did not exist! Although the Document does not quite fall into this trap, calling instead merely for “practical solutions to *encourage* new business models...,” it too insufficiently acknowledges the abundance of new models already present in audiovisual markets in Europe. In this respect the market context has changed dramatically over the least three to four years. There is plenty of innovation around: new content download and streaming services are being introduced almost on a daily basis, though few of them are gaining any commercial traction in markets awash with “free” content, much of it illegally distributed.
8. Creative business entrepreneurs are continually experimenting with “new models”, some of which have obtained a degree of backing from media companies or other investors. However there is no magic solution to the problems triggered by collapsing value chains in “old” media businesses and lack of revenues in “new” ones. The transition is proving to be exceptionally painful. The Document talks about the encouragement of “attractive legal offers” but these words are of course subjective: for large numbers of consumers *no* business model competes with “free”.
9. Revenues generated by digital content offerings are increasing in some markets, but profitable businesses are still a rarity in the digital creative economy. In 2008 digital sales in the UK record industry grew by 48% to £184 million, whilst physical sales fell by 12% to £1.1 billion. That looks like progress, but many businesses offering legal fare have gone down or are struggling to stay alive. Spiralfrog and Ruckus both collapsed earlier this year having failed to make an ad-supported service pay despite the backing of record labels. The jury is still out on better known names like Spotify and We7, neither of which are yet profitable.

¹ See the attached Annex for a rejoinder to a recent example from the consumer organisation BEUC.

10. This narrative of commercial failure may be transformed in time subject to certain conditions, of which a remodelled framework of copyright regulation, the proportionate but rigorous enforcement of copyright law and the introduction of fit-for-digital purpose licensing regimes are likely to be the most important. But for the present total revenues in many content industries, including music and TV, are declining, and in the UK at least aggregate investment in creative content is falling².
11. Few commentators believe that revenues from “new” media business models will substitute for revenues lost from “old” media models within the foreseeable future. Many analysts doubt that full substitution will *ever* take place.
12. Against this background it is sadly utopian to imagine that all the “stakeholders” involved, including rights-holders, commercial users, distributors and consumer bodies, will be able to agree a way forward on the key issues. There is little or no prospect of across-the-board agreement between rights-holders and ISPs, for example, either at national or European levels. Objective conflicts of interest between them have been repeatedly exposed at all levels of consultation. Similarly there is no prospect of agreement between rights-holders and the “open rights” lobby or camp-followers of The Pirate Party. Debates in the European Parliament on the Telecoms Package highlighted the full extent of the lack of consensus on creative economy and internet matters.
13. These conflicts must be addressed robustly by the political authorities if Europe’s content industries are to hold on to the *possibility* of competitiveness in an increasingly global creative economy. This will be a major test of the new Commission’s ability to provide leadership in 2010. Failure to confront these issues effectively by putting in place appropriate measures for the re-regulation of copyright and effective enforcement will lead to disinvestment and decline, thereby jeopardising Europe’s future economic prospects in terms of the Lisbon agenda.
14. In a European Digital Single Market *creativity* is not the issue: the challenge is to maintain *creative business capacity*.

Technology, creative content markets and the idea of “free”

15. It is generally acknowledged that technology and technology-enabled changes in consumer behaviour have outstripped the legal frameworks required to regulate the relevant markets. There is also, however, an ideological dimension to the debate about the future of intellectual property (IP) in the form of a challenge from self-styled internet “libertarians” to the principles of

² The UK media regulator OFCOM estimates that total spending on UK originated content was £341 m lower in 2008 than in 2004. *Digital Britain*, final report, TSO, London, June 2009, p.118. There may have been a further and more dramatic fall of 10% in 2009 according to some provisional estimates.

copyright. This challenge, rooted partly in ignorance of the economics of creative content business and partly in the widespread but erroneous belief that “piracy” is a victimless crime, fundamentally threatens the future viability of Europe’s content industries.

16. Some technology pundits and cultural critics have gone so far as to suggest that the defining precepts of copyright are no longer appropriate to the digital age, and that all content should be regarded as falling within some conception of the “creative commons” by virtue of its being universally accessible on the internet. That so many consumers, especially amongst the ranks of Rupert Murdoch’s “digital natives”, should apparently share or at least sympathise with this view is one measure of the problems facing Europe’s media and creative sectors. This situation is however recoverable in the medium term given the pursuit of the right policy balance between public education, “sticks” (enforcement) and “carrots” (easier access to content at multiple price points).
17. Internet “libertarians” pose a significant threat to such a balanced programme of action, based as they are on bad economics and questionable ethics. Although it is true that the marginal cost of replicating and distributing a song (or movie or game) is close to zero in the digital economy, the costs of *production*, though generally lower than in the analogue age, are still substantial due to the labour-intensive nature of most creative processes. The activities of the *soi-disant* libertarians are inappropriate to serious discussion of the economics of creative business, and disrespectful to the creative and productive classes. They should be more vigorously contested at every level of public debate.
18. Scarcely less damaging to the future of Europe’s content industries are the pundits of “freemium”, represented by the self-publicist Chris Anderson, editor-in-chief of *Wired* magazine. Anderson’s book *Free* advances the idea that publishers should aim to make a financial return only by charging premium prices for “value-added” content to a minority of consumers, while giving the “basic” product away free:

“free is a good price to have when people don’t want to spend, and freemium models can work well when just 5% of users convert to premium, thanks to the near zero marginal costs of serving the other 95%.”³
19. Stripped of hyperbole “Freemium” is certainly an interesting model. It may work in some digital markets (it is too early to say) and it has its place in the gallery of experimental “new” business models. But Anderson’s wider prognosis for the future of the creative economy – a combination of freemium, user-generated (free) and advertising-supported (free) online content - spells ruin for a majority of creators, content providers and the wider creative and support services communities. It would be likely to lead to market failure of epic proportions leaving little available to future generations of consumers except a handful of expensive “blockbusters” at the top end and vast quantities of user-generated trivia at the other.
20. Why? In the UK the reason is clear from the analysis done by Analysys Mason for the Department for Culture, Media and Sport as part of the government’s *Digital Britain* process. The authors carried out an examination

³ Chris Anderson, “What Recession Means for Free”, in *After the Crunch*, Creative and Cultural Skills, London, 2009, p.73.

of the flow of funds into the content value chain – taking into account both old and new media. They estimate total net industry value for 2008 at £55.6 billion, of which consumer payments accounted for £41.9 billion, advertising for £11.9 billion, and the rest (government procurement, production finance and foreign buyers) a paltry £1.8 billion⁴. In other words in the “Andersonian” view of the world a staggering 75% of net industry revenue would be at risk on the basis of current revenue flows.

21. This is a frightening scenario. That, too, was clearly the conclusion drawn by Lord Carter’s *Digital Britain* team. Whilst recognizing that the content industry faces enormous challenges and agreeing that “the current model is not working”, his final report is emphatic about the need to protect and reward creativity:

“As throughout history, there need to be workable mechanisms to ensure that content-creators are rewarded for their talent and endeavour. And the need for investor confidence is key. User generated videos can be hugely popular, but there remains a healthy appetite for big movies costing many millions to produce.”⁵

22. The Reflection Document also recognises “the need to protect and reward creativity,” but is less clearly robust about the potentially disastrous consequences for the future of Europe’s creative industries if the challenges posed by the ideology, economics and punditry of “free” in its various manifestations are not addressed vigorously. There is little “investor confidence” in the market presently because future revenues across the sector as a whole are too uncertain.
23. The Commission should better equip itself for this debate by commissioning a study of the European content sector on a flow of funds basis comparable to the work by Analysys Mason for the UK government.

Copyright and the creative economy

24. By way of context, we make the following broad distinctions between different types of creative business based on our experience as investors: creative *content* businesses (for example in film, TV, music and publishing); creative *process* or *service* businesses (for example in advertising, design and software); and creative *distribution* businesses (mainly large media companies like the BBC and Vivendi). Copyright is at the core of the business model of all cultural and creative businesses, but is more important for *content* businesses than for other types of creative business.
25. Although copyright issues matter to all creative businesses to some degree, including process and distribution businesses, they are absolutely vital to the economic well-being of content businesses. In music publishing, for example, copyright is everything. The value proposition is commensurate with the ownership of, and the copyright term of, the copyrights owned. This is not equally true of all other parts of the music industry, where revenues can

⁴ Analysys Mason, *Fostering Creative Ambition in the UK Digital Economy*, May 2009, London, p. 3.

⁵ *Digital Britain*, Final Report, TSO, London, 2009, p. 109.

be driven by other non-copyrightable forms of commercial activity, for example live events. In short, copyright matters to all creative businesses throughout the business value chain, but it matters most of all to those content businesses whose business models revolve around the creation of content and/or the acquisition of rights to licence content.

26. The Document correctly observes that the issue of rights clearance is especially crucial for commercial users of copyrighted content, but it is also a legitimate concern for domestic consumers because of its complexity and relative obscurity. Digitisation has brought about a fundamental economic shift in this respect. As Gregory Paulger noted in his speech in Prague in March 2009, copyright issues have crossed over from the business to business (B2B) environment of the analogue world into the business to consumer (B2C) environment of the digital world⁶.
27. From an *investor* perspective the copyright system is both too complex and too lacking in international uniformity. The effect of technical complexity is to drive up the costs of due diligence incurred in the process of acquiring rights, and to put barriers to entry in the way of new businesses wishing to become rights aggregators and exploiters. Complexity also acts as a disincentive to active programmes of enforcement, particularly where cross border issues are involved. The net effect, perhaps, is to inhibit the development of creative businesses in the digital economy.
28. From an *economic* perspective however the issue is less clear. Economic value can be enhanced by complexity, and frequently is in media markets. In sports media for example – football, cricket or motor racing - a simple, or simplified, package of rights (one platform, one territory) will generally secure lower aggregate revenues than a complex and highly differentiated package (multi-territory and multi-platform). Complexity in the sense of multi-platform and/or multi-territoriality tends to drive up value (as in TV rights for football), which benefits investors and possibly others (grass-roots sport in some scenarios).
29. The relationship between copyright and business interest is therefore complex and any generalisation fraught with difficulty. As the Document observes arrangements for rights clearance vary significantly both within genres and between genres, and from country to country, whilst European collective rights management organisations (CMOs) are at very differing stages of adapting to the digital environment.
30. There is of course an *a priori* argument for a Single Market in online digital rights clearance, possibly involving the creation of one or more new Europe-wide meta collection agencies using the latest rights tracking software. There are powerful vested interests opposed to suggestions of this kind, as the UK government discovered when it floated the idea of a national Rights Agency in its interim report on *Digital Britain*. (The idea has since been abandoned.)

⁶ Creative responses to “creative destruction”, Gregory Paulger, delivered to the Czech Presidency’s Media Literacy Conference in Prague, 19th March 2009.

31. At European level the obstacles are greater. There has been a history of policy conflict in the Commission's engagement with CMOs, whilst cultural policy remains the prerogative of national and regional authorities and sensitivities in this area are considerable. The interests of individual member states as regards cross-border activity in the rights arena are frequently asymmetrical.

Copyright reform; and multi-territory licensing

32. We accept that copyright law must evolve to embrace new, digitally enabled possibilities for content exchange and dissemination, as well as "fair use", however defined, but it must do so without undermining incentives for creators and entrepreneurs. As the Document acknowledges in practice it will be formidably difficult to get this balance right. The devil will often be in the detail.
33. In principle we favour the harmonisation of copyright legislation at EU level accompanied by a universal system of enforcement. Harmonisation will be difficult to deliver to general satisfaction given the differences between the Anglo-Saxon model and continental systems. However it is clear to us that rights-holders' interests are best protected in markets governed by a homogeneous system of regulation and common enforcement provisions.
34. We do not favour multi-territory licensing, except as an *additional* option to national licensing. To some degree harmonisation of copyright would weaken the argument for multi-territory licensing, but even if that were not the case we would argue on commercial grounds for the preservation of national licensing by rights owners. Rights-holders, especially in the smaller member states, would be faced with the prospect of reduced negotiating power *vis a vis* international "majors" if national licensing systems were to be superseded.
35. The optimal set of arrangements from an investor and commercial perspective would be to have a system of "umbrella", harmonised copyright protection providing rights owners with the option of contracting *either* on a multi-territory basis *or* a national basis for specific rights, retaining the option of splitting rights packages between different counter-parties on different platforms.
36. Finally, although our interests are primarily investor-focused, we wish to record our view that the Document pays insufficient attention to the *moral* rights of artists and producers. When a film director like Claude Lelouch complains bitterly (at a French presidency event in Paris in 2008) about the repeated and unauthorised "mashing" of his film *C'était un rendez-vous* over a thirty year period, it is hard not to sympathise.
37. Important moral as well as economic issues are raised by the appropriation of another person's IP. Some artists – the American folk singer Woody Guthrie comes to mind – were or are always happy to waive their rights under copyright and licensing regimes and to encourage a free-for-all. That is their

prerogative. What no-one is entitled to do is, either to assume that others will follow suit, or to predicate an argument on any such assumption. The issue of authorial consent is central and should remain central in any new copyright regime.

MS
4.12.09

ANNEX

BEUC policy statement on Creative Content Online: a rejoinder

The European consumers' organisation BEUC, an umbrella coalition representing 43 independent national consumer bodies from 31 countries, has published a document entitled *BEUC's 8 Priorities for the Spanish Presidency*. One of the eight work strands covered in this policy manifesto is "Digital and Telecoms", a platform which embraces a wide range of issues from universal service obligations for broadband providers to data protection and content licensing regimes.

The position adopted by BEUC in this document as it applies to the Creative Content Online agenda is highly damaging to Europe's €50 billion creative content sectors (film, TV, music, publishing, newspapers and games). It is also morally ambiguous insofar as it appears to decline to condemn *any* illicit consumer downloading (or theft of intellectual property) no matter how serious, premeditated or repeated the infringement.

BEUC's world view is curiously uninformed, sweeping and out of date. The Council says that "more attention is needed with regard to the fostering of innovative business models that would provide legitimate content online." This undifferentiated statement might just have been justifiable some three or four years ago, but a choice of "legitimate content online", including video on demand (VOD) and a variety of music services, is now available throughout Europe. (At the time of writing there are no less than 35 legal, digital music services available in the UK.)

BEUC ignores the flow of innovation in the market-place. New business models are being rolled out on an almost daily basis. The great majority of those "new model" providers still in business do not generate significant revenues, still less make a profit. New model digital businesses fail for a variety of reasons but the single most important reason is that no business model can compete with free.

The Council paradoxically acknowledges "the need to ensure the protection of IPR – especially on the internet – and for artists to get a fair remuneration for their works," but having apparently accepted an appropriate policy *objective*, declines to contemplate any practical scheme for *implementing* it. Worse, it makes the ethically extraordinary suggestion that a distinction should be made "between counterfeiting/piracy and practices carried out by numerous private consumers...without commercial motivation", and that sanctions should "only apply to commercial infringers". Why? Is "private" theft less reprehensible than "commercial" theft? When did such a proposition apply in the analogue world?

BEUC's statement has the effect of seeming to condone, if not actually to abet, illicit P2P downloading, an activity that costs the content industries hundreds of millions of euros a year with consequential loss of employment in a key segment of Europe's knowledge economy. This is a serious error of judgement.

The Council has some valuable points to make about a range of other issues, including licensing regimes and orphan works. However it is hard to take these representations seriously whilst it continues to be in denial about the economic consequences of mass illicit downloading within its own constituency.

It would be charitable to describe BEUC's views on these matters as naïve. They are certainly contrary to the objective, longer term consumer interest.

The Council should reconsider its position.

MS
6.12.09