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REGULATING COPYRIGHT COLLECTING SOCIETIES: CURRENT POLICY IN EUROPE

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1. INTRODUCTION

Copyright collecting societies (CCS) are probably unique economic institutions in that they provide a private solution to the administration of statutory copyright law via Collective Rights Management (CRM) (Brousseau and Bessy, 2005). There is a small and varied economic literature on CCS dealing with a range of economic aspects of these institutions surveyed in Towse and Handke (2007). The analysis usually begins with the observation that CRM can reduce transaction costs by exploiting economies of scale in the administration of rights since they are natural monopolies within one country, and in addition, they make international agreements with 'sister' CCS in other countries that make possible worldwide CRM.

The motivation for this paper is that the European Commission (hereafter 'the Commission') has recently taken an active interest in CCS. The Commission believes that cross-border licensing should become competitive and is at present seeking to regulate those CCS throughout the European Union that administer rights for the distribution of music online on the basis of competition law and on the grounds that CCS are national monopolies; this is in addition to existing regulation of CCS that exists in one form or another in every country. The Commission believes that technological change has altered the market environment substantially and that in this new context, cross-border licensing should become competitive, leading to greater efficiency in the administration of copyrights online and helping the emergence of new markets. There does in fact seem ample scope for innovation and greater efficiency in CRM.

However, CCS are not adequately addressed only as intermediaries that help to reduce transaction costs. In many cases they also function as authors' trade unions, as instruments of cultural policy and as a form of social insurance (or a type of common

carrier – we are unable to find the correct analogy) for rights-holders, particularly ‘small’ creators. Within the EU, there exist several national models of regulating national, monopolistic CCS in order to retain such functions and it is not clear which elements of this system would survive the introduction of pan-European competition between CRM providers.

In this paper, we argue that technological change – including digital rights management (DRM) – and regulation is unlikely to fundamentally alter the tendency towards natural monopoly in the administration of certain copyrights. Even if the removal by the Commission of what it calls ‘customer allocation rules’ and territorial restrictions succeeded in creating competition among CRM providers, the tendency to economies of scale would soon reinstate monopolies or very narrow oligopolies of CRM providers on a European Union-wide level. There is no adequate regulatory framework in place to deal with such a situation, however, nor are such regulations envisaged in the EC’s publications and recommendations (but see some of the criticism in the so-called *Levai Report* by the European Parliament (EP) (2007)).

The paper is structured as follows: we begin by sketching recent developments in EU policy on copyright and then (in section 3) outline the main ways in which CCS are regulated at present. The main part of the paper in section 4 discusses the Commission recommendation in the light of various functions of collective rights management, which we identify as: reduction of transaction costs, finance of cultural projects, performing the ‘solidarity’ functions of a trade union and of social insurance. In Section 5, we offer some ideas on the implications of competition between CCS for CRM and Section 6 presents our tentative conclusions.

2. RECENT DEVELOPMENTS OF EU COPYRIGHT POLICY

EU policy initiatives on copyright hinge on the justification of the reduction of barriers to trade in the internal ‘single market’. The EU does not have authority over culture independent of this economic aim. Article 151 of the Treaty, introduced with the Maastricht revision in 1991,¹ requires the European Community (EC) to take cultural aspects into account in its actions but not to develop a cultural policy *per se*. Accordingly, the predominance of economic objectives is not only a question of the preferences of current EU decision-makers but it is built into the very legal structure of the EU. It is thus hardly surprising that economic objectives tend to predominate over other concerns in EU policy even when, as with the subject of this paper, there are strong cultural consequences. Accordingly, the EC’s approach to copyright roughly resembles the traditional Anglo-Saxon perspective rather than the continental European *droit d’auteur*/authors’ rights tradition (Koelman, 2004). While copyright is viewed in Anglo-Saxon terms as an economic property right, authors’ rights law emphasises the non-economic role (moral rights) and the inalienability of a creative work from its author. Thus, arising from different legal traditions, there are different views as to the role of copyright and its administration through CRM as well, and this also translates into the purposes of the and governance of the CCS. We discuss some implications of this difference later on.

¹ See European Community (2002), Title XII – Culture, Article 151, paragraphs 4 and 5.

With the *Directive on the harmonisation of certain aspects of copyright and related rights in the information society* (EC, 2001), the so-called ‘Information Society Directive’, the European Commission began to define central concepts of copyright policy at the EU-level (Röttinger, 2001). This Directive was motivated by the perceived challenges to the internal market and European copyright regimes in the ‘Information Society’, mainly digitalisation and the delivery of information goods by Internet, and was developed to comply with the World Intellectual Property Organisation’s (WIPO’s) so-called ‘Internet’ treaties, which the EU signed on behalf of all member states.² The ‘Information Society Directive’ (EC, 2001: paragraphs 25 and 29) aimed to resolve ‘legal uncertainty regarding on-demand transmission of copyright works (and related rights)’ by adapting copyright regulations to capture this new technology. To do so, the Directive has gone far beyond the scope of previous EU-level copyright initiatives. Therefore, the humble title is misleading. The ‘Information Society Directive’ (EC, 2001) appears to set EU copyright policy on a path towards a coherent legislation (Bayreuther, 2001; Röttinger, 2001), as a significant middle-layer between wider international arrangements and national legislation in the member states.³

The Commission regards music to be the driver of a European market for online content services (European Commission, 2005b) and CCS involved in this market are now being investigated by the EU for anti-competitive behaviour. The starting point of this current policy problem was that in 2004, the Commission issued a notice about the so-called ‘Santiago agreement’, an agreement between Europe’s 16 large authors’ and composers’ CCS to provide a ‘one-stop-shop’ for the right to communicate to the public via online services:

‘.....the so-called ‘Santiago agreement’ is potentially in breach of European Union competition rules. This is because the cross-licensing arrangements that the collecting societies have between themselves lead to an effective lock up of national territories, transposing into the Internet the national monopolies the societies have traditionally held in the offline world. The Commission believes that there should be competition between collecting societies to the benefit of companies that offer music on the Internet and to consumers that listen to it. The lack of competition between national collecting societies in Europe hampers the achievement of a genuine single market in the field of copyright management services and may result in unjustified inefficiencies as regards the offer of online music services, to the ultimate detriment of consumers. The Commission considers that the territorial exclusivity afforded by the Santiago Agreement to each of the participating societies is not justified by technical reasons and is irreconcilable with the world-wide reach of the Internet’.⁴

The Commission continued to address aspects of the administration of copyright with the Commission Recommendation of 18 May 2005 *On collective cross-border management of copyright and related rights for legitimate online music services* (European Commission, 2005a). A related study (European Commission, 2005b) and an impact assessment (European Commission, 2005c) lay out the official reasoning and considerations behind these initiatives. The explicit motivation of the EC is to establish an efficient market for licensing online music services. The Commission

² WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT) that are the first international intellectual property treaties to address the digital network environment.

³ However, the Information Society Directive (EC, 2001) does not cover moral rights.

⁴ European Commission press notice of European Commission proceedings against the 16 national CCS in the ‘Santiago Agreement’.IP/04/586

notes that the market for legitimate music services online trails behind that of the USA (European Commission, 2005b) and suggests that this is due to difficulties with cross-border collective rights management (CRM) in Europe.

This interpretation is, however, problematic. As a related study by the European Commission (2005b) concedes, CRM is certainly not the only factor that has affected the differential growth of online music services in the EU and the USA. Purchasing power and access to ICT and broadband Internet connections differ. In many European countries, mobile telephony networks are used much more frequently than the Internet to download music (IFPI, 2007). In any case, the service that popularised authorised music downloads and continues to dominate the market, Apple Inc.'s *Itunes*, was introduced in the US by April 2003 but only arrived in some EU member states by 15 June 2004 (France, Germany and the UK). It started operating even later in most other EU member states and still does not provide services in some member states such as Slovenia. The question is whether Apple's breakthrough and its decision to introduce *Itunes* in the USA first had anything to do with differences between CRM systems between the two regions and to our knowledge there is no conclusive evidence.⁵ Indeed, one of the abiding problems of this controversy is that there is little hard empirical evidence or apparently concern with it.

That said, the Commission has picked up an important point with its initiatives regarding the control of national copyright collecting societies (CCS). It is unsatisfactory when a single provider of an online service delivering music throughout the EU has to negotiate licences with CCS in all 25 member states. However, the CCS had tried to mitigate this problem themselves by adopting reciprocal agreements for the authors'/publishers' and record producers' right to communicate to the public (Santiago and IFPI/Simulcasting and Webcasting), as well as online reproduction rights (BIEM/Barcelona). In all these cases, CCS had made reciprocal arrangements to administer the rights affected by online services within their territory for any rights-holder registered with another CCS that participated in the agreement. In this way, CCS offered a more or less efficient solution that allowed online content services without the need to clear the rights with every national CCS individually. But some of these reciprocal agreements contained measures that restrict rights-holders in directly cooperating with a CCS other than that of the territory in which the rights-holder is based. The EC has taken issue with territorial restrictions as well as with what it perceives to be the discrimination of some right holders and inefficiencies concerning the cross-border distribution of royalties (European Commission, 2005b). The behaviour of authors' CCS, in particular those taking part in the Santiago agreement, were seen to be especially problematic on both these counts. Authors' CCS claim that they had to let the Santiago agreement expire in 2004 because of pressure from the Commission to abandon the territorial restrictions on CCS' activities within the EU. If that is true, it would seem that the Commission is now trying to solve a problem partly of its own making.

The Commission's explicit motivation for addressing CRM is technological change in the copyright industries (see e.g. European Commission, 2005; EP, 2007b). The Commission is under the impression that the existing structure of CCS creates

⁵ In fact, Apple conventionally introduces many of its products considerably earlier in the USA than in Europe and so do many other multinational electronics and entertainment service suppliers, including the major record companies that struck a deal with Apple to make *Itunes* possible.

obstacles to the emergence of efficient markets for copyrighted content online. On the one hand, the Commission's staff working document (European Commission, 2005b) argues that the "ubiquity of the online environment exposes online content providers to liability for copyright infringement in all territories in which his service is technically available" and that this situation requires new licensing solutions rather than an extension of the reciprocal arrangements established by existent CCS. This argument can only be fully appreciated when it is understood that the Commission regards the operation (and thus the regulation) of many national CCS to be inefficient (European Commission, 2005b) or, as the Commission recommendation (European Commission, 2005a) has it, the potential for the "rationalisation" (paragraph 10, paragraph 13) of CRM services more generally. This includes concerns with static inefficiencies due to their monopolistic position. The Commission is also concerned with dynamic inefficiencies where CCS do not fully exploit the potential for innovation.⁶

In 2005, the Commission took action by issuing the above-mentioned recommendation on collective cross-border management of copyright and related rights for legitimate online music services (European Commission, 2005a). The central recommendation of the Commission is that right holders are to enjoy a free choice of:

- whom to entrust with the management of "rights necessary to operate legitimate online music services" (paragraph 3);
- the specific rights to be entrusted for collective management (paragraph 5a),
- the territorial scope of the mandate (paragraph 5b) irrespective of the nationality or residence of the either the right-holder or the CRM provider.
- Right-holders should also have the right to withdraw any of the online rights and transfer the multi-territorial management of those rights to another collective rights manager (paragraph 5c) and CCS should then ensure that their repertoire is withdrawn from reciprocal representation agreements between CCS (paragraph 5d).

If such measures were to be put into place, both rights-holders and users would be able to shop around for the services of copyright administration by the CCS that offers them the best deal.

Furthermore, the recommendation (European Commission, 2005a) deals with governance issues, suggesting that CCS should grant commercial users licences on the basis of objective criteria and without any discrimination among users (paragraph 9). Distribution of royalties is to be equitable and CCS are to provide comprehensive information on any deductions (paragraph 10-12). No "discrimination" of any category of rights-holders is to be tolerated and the "the representation of right-holders in the internal decision making process" is to be "fair and balanced" (13). For the moment, the status of a Recommendation implies that these are non-binding suggestions that give guidance to stakeholders on what the Commission would like to see happen or may legislate in the future.

⁶ Because of incumbent CCS' market power and informational advantages, as well as due to divergent interests among members, member control might not provide a quick solution, either (see Macqueen and Peacock, 1995; Towse, 1997; Towse, 1999; Wallis et al, 1999a; Kretschmer et al, 1999; Kretschmer, 2002b; Gayer and Shy, 2006; Handke and Towse, forthcoming; Oksanen and Välimäki, unpublished). The EC is concerned with a lack of transparency and ineffective member control.

These moves by the Commission have created a furore in the whole creative industry sector. The European Parliament has strongly criticised the policy and the Commissioner in charge of it. A report adopted by the EP (2007) in March 2007 – the so-called *Levai Report* – objects to several aspects of the Commission's 2005 recommendation. It wants to avoid a 'big-bang' style introduction of open competition into the collective management of authors' rights because it fears that that would wipe away all measures in the current CRM system aimed at safeguarding cultural diversity in Europe (thus reflecting the schism between the 'economic' view of copyright and the support for creativity in authors' rights).

In order to judge the merits of the Commission's Recommendation, we need to understand the basic aspects of the very complex economic and legal world of CRM and the way the CCS work.

3. EXISTING REGULATION OF CCS

Most CCS are supervised and regulated by public authorities. National arrangements differ and range from direct political control or continuous scrutiny by specialised supervisory bodies to a simple application of competition and contract law (Rochelandet, 2003; Besen and Kirby, 1989; Besen, Kirby and Salop, 1992). There are a number of control variables at the disposal of regulators: licence fees, distribution of fee income, scope of the rights the CCS may administer and the type of licence, damages for infringement and, most relevant to this paper, rules for membership. There are also state supervised arrangements for dispute settlement between CCS and users.

Most CCS are required by custom and in many cases by law to accept all creators with a minimum repertoire of works to their name as members (Besen, Kirby and Salop, 1992). For some rights, for example, public performance of musical recordings on UK radio stations, rights-holders are even obliged to deal with a collecting society under compulsory licensing arrangements mandated by the legislator, including the EU itself (Towse, 2001). Frequently CCS are also permitted (or expected) to use up to 10% of their revenues for cultural projects such as support to high art events or musical education, rather than distributing them to their members. There is no clear best practice regarding the performance of CCS under the various regulation systems (Rochelandet, 2003).

In the economic literature on CRM, the extent to which CCS should be regulated is contentious. Merges (1996) argues that the legislature or judiciary is inherently inferior to industry insiders in shaping a proper framework for the commercialisation of copyrights. To him, spontaneously founded collecting societies illustrate the ability of the industry to create its own solutions on the basis of property rights. Kretschmer (2002b) takes the opposite view and favours a scenario in which collecting societies would be unequivocally treated as regulatory instruments. Watt (2000) believes that, when the CCS is a natural monopoly, public supervision and regulation would promote efficiency. Economic arguments for regulating collecting societies include the need to limit the market power of monopolistic societies vis-à-vis users as well as new members (Besen, Kirby and Salop, 1992). Wallis et al (1999) regard collecting societies as providing a public cultural service by financially supporting newcomers, niche productions, in particular 'serious' music, and music education. Kretschmer

(2002a) suggests such measures would improve economic efficiency – as well as promoting equity – and might constitute an alternative justification for collective administration of rights. This aspect of the system would be threatened by competition not least because major conglomerates seek to appropriate the full value of their repertoire. Several authors have incorporated other problems, such as vertical and horizontal integration in the market for works (typically in the music industry) into the analysis of CCS (Wallis et al, 1999a; Wallis et al, 1999b; Kretschmer, 2002a; to some extent, also Katz, 2004).

With its Recommendation (European Commission 2005a) the Commission has begun to add another layer of regulation to the various forms of national and international regulation built into the CRM system. If the EC's central recommendation – to open up the market for CRM services throughout the EU for cross-border competition – turns out to be effective, it looks set to limit member states' ability to regulate CRM on national level. This will be the case not only because member states will have to pass legislation in line with the Recommendation (or a subsequent Directive if deemed necessary) but also because rights-holders and users that are able to shop around for a CRM provider will simply abandon the CRM systems of countries that impose restrictive regulations.

4. THE COMMISSION'S RECOMMENDATIONS AND THE FUNCTIONS OF THE CCS

In this section, we address the Commission's Recommendation to increase competition in the administration of online rights between CCS throughout the EU using the insights from the economic literature on CRM and CCS (though the Levai Report (EP 2007) suspects that the intention might ultimately be broader). We structure our argument in the following way: we first address the core function of CRM providers of reducing transaction costs; then take into consideration three further functions of many CCS and discuss the possible impacts of cross-border competition on these social and cultural aspects of the CRM system.

4.1 CRM reduces transaction costs

From the economic point of view, the main rationale of CRM and the CCS is the minimisation of transaction costs both for creators (suppliers of copyright works) and for users (intermediate and final consumers). In extreme cases, where these transaction costs exceed the value of copyrights to users, no market will develop (Besen and Kirby, 1989a; Hollander, 1984; Tournier and Jourbert, 1986). However, there are economies of scale in the administration of some copyrights and these are reaped in particular by the use of blanket licences that cover all works in the repertoire of all members of a particular CCS. The CCS itself usually controls a specific bundle of rights, such as the performing right. The fixed costs of administering the rights to any bundle of works – which requires the setting up of databases of millions of works and of a diverse population of creators and subsequent rights-holders and arrangements for the monitoring of use among a great number of users and negotiating the terms of use – are high, while the marginal costs of administering an additional work are relatively low (Besen and Kirby, 1989a; Hollander, 1984; Watt, 2000). By exploiting the economies of scale in the administration of copyrights, a CCS can reduce transaction costs substantially and make markets more efficient and even enable new markets to develop (Hollander,

1984; Besen and Kirby, 1989a; Besen, Kirby and Salop, 1992; Merges, 1996; Watt, 2000, Katz, 2004).⁷ In addition to the cost advantages, users' preferences for more comprehensive licences will favour larger CRM providers, a single licence covering all available copyright works of a particular type guarantees legal security and this is typically supplied by the CCS as a blanket licence. This preference seems to be a peculiar type of network effect: *users'* valuation of a collective licence does not depend on the number of other *users* that utilize the same licence. Instead, *users* value a licence more, the more comprehensive the repertoire covered is, i.e. the more *rights-holders* participate in the licence.

Thus, the blanket licence reduces many kinds of transaction costs – the costs of contracting and of price setting and search and information costs – for both rights-holders and for users. But the blanket licence, while administratively efficient is not economically efficient (Liebowitz, 2005; Watt, 2000) and furthermore, it would not be feasible without monopoly control over a bundle of rights to the relevant repertoire that can be efficiently administered together.

One question that therefore arises is whether contestability would come from a further debundling of rights administration and whether 'online' and 'offline' rights can be administered separately. For the purpose of fostering the emergence of new services online, it may be an advantage to separate rights management online (whether individually or collectively managed) from CRM of traditional rights for the same works, though that would increase costs for users; since the blanket licence fee is presumably an average of all the prices that would be set if each work were to be priced individually, without it, the most popular works would command a higher price, thus making their users worse off. Users apparently now want online licences to cover a broader bundle of rights, particularly rights for cross-border use but maybe also other rights that have so far been administered separately by different CCS. But that might not be in the interests of rights-holders. A point to note in the context is that when the PRS (Performing Right Society) in the UK merged with another CCS, the Mechanical Rights Protection Society (MCPS) that administers the rights of composers and music publishers in licensing sound recording, film music and suchlike, the advantage was that it saved the duplication of costs for members (and the merger was not held to be anti-competitive). This may be significant as it represents the merger of CCS that administered previously different rights. The economic logic of the proliferation of CCS would be that there are indeed separate markets for the services of administering specific bundles of rights: for example, broadcasting rights operate in a separate market from that for performance rights in music and accordingly, the services of administration benefit from specialisation in the different markets. Cross-country comparisons show that where CCS developed spontaneously without state intervention, almost identical divisions between CCS have developed (Rochelandet, 2003). Other anecdotal evidence suggests that where many different rights are administered together because the state set up CRM that way, the administration costs are much higher than those of the specialised CCS; the Italian authors' CCS, the SIAE, which is tightly controlled by the state, is a case in point (Monopolies and Mergers Commission, 1996). Thus the evidence, such as it is,

⁷ For criticism of the justification in terms of transaction costs and an overview over alternative justifications see Katz (2004), also Kretschmer (2001) and Watt (2005). Some alternative rationales for CRM are addressed below.

is mixed and we have little to go on (and nor does the Commission). As yet, the specialised economic literature on CCS has hardly addressed this issue.

4.2 CCS and the cultural function

As mentioned earlier, CCS, especially those in authors' rights jurisdictions, often have a policy of stimulating creativity and promoting cultural diversity by setting aside a portion of revenue as cultural subsidy, the so-called 'cultural deduction': a percentage (usually 10%) is deducted from all revenues of a national CCS (including those due to foreign CCS members whose royalties are being collected and repatriated under a reciprocal agreement) and spend it for cultural purposes. Many European CCS have this function as part of their statutory duty but even those that do not, such as those in the UK, often voluntarily donate for cultural purposes. The cultural deduction is a transfer payment from all members to high culture or fringe suppliers. As a minority of high-earning CCS members typically account for the bulk of revenues, they also largely pay for this transfer. The cultural deduction has been a cause of controversy for some time. The Commission's Recommendation (European Commission, 2005a) does not bode well for the future of this institution. If rights-holders and users were able to shop around for the CRM providers, those CRM providers that have the least cultural deduction – if any – would be at an advantage in attracting profit-maximising members.

In addition to the cultural deduction, CCS often operate a policy of cross-subsidisation between genres of works when it comes to distribution; musical performing rights societies may well have a rule that favours 'classical' composers (for the UK's PRS, see Monopolies and Mergers Commission, 1996). According to Wallis et al (1999), both cultural deductions and cross-subsidisation between genres are more significant in author-dominated collecting societies, such as the German GEMA or Sweden's STIM, and they reflect authors' preferences in comparison to those of publishers.

4.3 CCS as authors' trade unions

CCS bargain collectively in agreeing the licence fee with users and this 'solidarity' is due to the blanket licence. This is particularly important for new entrant creators whose works have not yet established themselves on the market and who would have a serious disadvantage in bargaining individually. It is well known that all but the top few superstar artists have weak bargaining power with the industries that use their work (Caves, 2000). It is in this sense that CCS act as a trade union in collective negotiations – typically, it should be noted, with the monopoly trade association of users, such as the representatives of shopkeepers, airlines, restaurants and bars, sports halls, discotheques and the myriad other types of businesses that use copyright works as inputs – a 'classic' countervailing force in bargaining fees that forms a bilateral monopoly situation. However, regulation intended to break up market power on one side of this arrangement could have the unintended consequence to favour the other side.⁸

⁸ Note that in Germany, the members of the German chapter of the International Federation of the Phonographic Industry (IFPI) (including all major record companies and representing around 90% of the market in terms of revenues) and the authors' CCS *Gesellschaft für musikalische Aufführungs- und mechanische Vervielfältigungsrechte* (GEMA) had a prolonged conflict over the demand of the IFPI to

All rights-holders – both creators as well as subsequent rights-holders such as publishers and record companies – share an interest in exacting the highest possible licence fees from users. However, they also need to bargain within the CCS for the royalty share that each of these groups of rights-holders receives (Kretschmer, 2002) and in this respect the trade union analogy breaks down because unlike the typical ‘workers’ union’, the CCS also has members from the ‘employer’ side. In the music industry, the publishers and record labels seem to be more adept at promoting their economic interests than creators (Wallis et al, 1999; Kretschmer, 2002). Recent evidence shows that the publishers’ share in the revenues far exceeds those of creators.⁹

There are two different ways of dealing with this ambiguity in the relationship between authors and publishers. Where publishers play an important role in CCS, creators tend to organise their interests outside of CCS, for example, in professional associations. In some cases, authors are privileged within the CCS (or other rights-holders are even barred from membership). Where that is the case, the CCS function is similar to creators’ trade unions (Besen and Salop, 1989). However, the Commission (2005a: paragraph 13) explicitly demands that there should be no discrimination against any category of rights-holders in CCS. This could come to weaken the position of authors’ CCS in their negotiations with the dominant right-holders and users, especially in countries where artists’ trade unions and professional associations are not well organised outside the CCS. Rights-holders that control very large and popular repertoires as well as the dominant suppliers of music services online will have great leverage within a CSS once they compete with one another for the business of online licensing.

4.4 CRM as ‘social insurance’ or ‘common carrier’

There is another aspect of the system of solidarity that is incorporated in European CCS that seems to be even more significant than the (modest) support for cultural diversity and collective bargaining. We argue that by being required to admit all eligible rights-holders as members, national CCS operate similarly to an insurer that is regulated in order to provide an essential service for everyone in the market it serves, analogously, for example, to a private health insurer that is prevented from excluding high risk categories from its insurance. This seems similar to the ‘common carrier’ requirement imposed by regulator in transport and telecommunications and the like. In the present context, it has implications for creativity.

The relative benefits from CRM are greater for smaller market participants with many works that are not highly valued than for the larger ones or those with more valuable works. Without CRM, the smaller rights-holder would lose relatively more than larger competitors. Without CRM, the smaller rights-holder would end up with a permanent competitive disadvantage and might even find it impossible to generate any revenue at all from copyrights and so the copyright incentive to create (such as it is) would be

substantially reduce mechanical royalties that included a concerted move by IFPI members to withhold their payments to GEMA in 2004/05.

⁹ As reported by Rettman (2006), ‘the record labels pocket the most cash from the digital sector - for every euro spent to download a track, the record labels take over €0.60, tax and banking costs eat €0.25, the artists get around €0.10 and just two or three cents go to the new publishers, such as Apple or Vodafone’.

ineffective. The larger rights-holder could benefit in various ways from this constellation: she could benefit from reduced competition in the market for works and so could raise prices; she could buy the rights that are otherwise of low value to the smaller competitor or she could sell services in the administration of rights to the smaller right-holder. Without the cooperative non-profit constitution of the membership CCS, smaller members would be charged higher fees and the rights management provider would also exclude many small members when the ratio between the administration costs and revenues for the repertoire of the work is high. At present, the price concessions that today's CCS make to larger rights-holders and the extent to which they exclude smaller rights-holders is very limited. On the one hand, this is certainly influenced by their status as non-profit collectives in which the multitude of small members have some say. On the other, this is the result of statutory regulation. CCS are usually forced by the terms of their statutory grant to make membership open to all rights-holders.¹⁰ It is in this sense that the CRM system operated by CCS is analogous to a system of social insurance supplied through a private provider.

To make open membership meaningful, the prices that CCS charge for administering repertoires by low-income members cannot deviate too much from the prices that larger members have to pay. The common practice of CCS to charge a flat percentage fee of the revenues collected for members to finance themselves is favourable to smaller members.

The combined effect of these measures is to make the market for the copyrighted works themselves more competitive because more works are included in the blanket licence at a very low cost. Without open-membership CCS, many small rights-holders would be virtually excluded from some royalty sources. The possession of a valuable repertoire would be the precondition to participate in the market and thus established rights-holders would be shielded from competition. Whether many right-holders are included into the market administered by CCS makes an important difference to the supply of creative work and as long as market access is not barred, even the smallest right-holder could strike gold one day, given the unpredictable nature of demand in these markets. Alonso and Watt (2003) have argued that risk-sharing is part of the economic logic of CRM and that is provided by blanket licensing.

5 THE IMPLICATIONS OF COMPETITION FOR THE CRM SYSTEM

The CCS are 'natural' monopolies, meaning that as monopoly suppliers they are more efficient in the sense of having lower costs than if there were competition, but natural monopolies are monopolies and whether the existence of a single supplier of CRM services for a particular bundle of rights is beneficial for society at large depends on the extent to which CCS exploit their monopoly position to raise prices or to tolerate inefficiencies within their organisation or how successfully they can be regulated. It is probably fair to say that most economists believe a natural monopoly is best left in tact but regulated (Baumol, 2003) and this tends to be economists' view of CCS (Watt, 2000; but see Merges, 1996). This is not the vision of the Commission, however, as it emphasises the merits of competition; instead, it aims to dismantle the monopolies of national CCS in the administration of online rights. It may believe that

¹⁰ In practice, some discrimination of very small right-holders is allowed in order not to compromise the efficiency of CCS' operations excessively.

the size of a European market is so large that two or more competing CRM providers could administer the same rights to different repertoires but it is questionable how much competition there would be. Even in the largest integrated markets for copyrights, namely, the US and Japan, there is no effective competition between CRM providers; moreover, network effects in the market for CRM will favour the largest CCS even if it does not have a cost advantage. Due to the high fixed costs of entry, contestability in the market for rights management is probably always going to be low. It seems to us that even if there were competition in the short run, mergers would very soon take place to benefit from economies of scale and network effects as defined above and natural monopoly would reassert itself.

Regarding dynamic efficiency, the Commission's argument seems to be that the market conditions for online licensing differ from those in traditional markets. It may also be the case that it regards conditions in the market for online music distribution as different from those of 'hard copy' sales, which is very likely the case: however, we do not discuss the music industry per se in the paper (except to note that music publishers and record labels are often dominant members of CCS); we concentrate only on rights administration. We believe the Commission has underestimated the tendency to natural monopoly in the administration of rights. Of course, digital rights management (DRM) – either the application of advanced 'digital' information and communication technology to administer all types of copyrights or the more narrow task of the administration of copyrights for works that are distributed in digital form – could reduce some of the costs in the administration of copyrights (even if new challenges like unauthorised copying and a greater diversity of users need to be taken care of).¹¹ Indeed, in the former sense, DRM is already being used by CCS. Perhaps the Commission has in mind the possibility of 'specialist' DRM rights management suppliers that would contest the incumbent CCS. But any administration of rights requires a high sunk cost while marginal costs are very low and even close to zero. This inevitably leads to natural monopoly as the lowest cost provider. Moreover, the network effects of the type mentioned above would reinforce that tendency, putting the largest provider at an advantage. Economies of scale and network effects make a monopoly (or at least a very narrow oligopoly with perhaps a few fringe suppliers) the much more likely outcome in an integrated market for the EU and if that were regulated, the outcome would probably be the most beneficial. Moreover, the basic advantage of regulated monopolies in comparison to unregulated competition – next to the avoidance of duplicative fixed costs – is that policy-makers can easily exert some influence over the monopolist's pricing and the distribution of its profits if that is deemed to be desirable (Armstrong and Sappington, 2006), which is what the nation states do on a territorial basis at present.

Another argument for the Commission's initiative is that competition would spur innovation. As it is, monopolistic and highly regulated non-profit CCS have little incentive to invest heavily in innovation because they will not be able to appropriate much of the surplus generated by lower costs. CCS may also fear that low prices for online licences would cannibalise the traditional market that accounts for the bulk of their revenues and those of their members.¹² What is more, CCS may experience lock-

¹¹ It has been widely questioned whether interoperability between different DRM techniques is feasible and this could be a serious barrier to universal adoption for copyright administration.

¹² Especially as the bulk of this is in 'analogue' form and, with copyright lasting 70 years after the death of the author, that is likely to be the case for years to come.

in (as did the major right-holders in the music market) not only due to economic reasons but also because their activities are regulated by law. The Commission has taken the view that CCS are using their market power to hold back experimentation with alternative solutions including DRM techniques that might well offer more efficient and more flexible solutions than the more traditional, one-size-fits-all CRM services but this appears to ignore the benefits of blanket licensing. If territorial restrictions were lifted either by the CCS themselves or by their national regulators, the prospect of attracting business from all over Europe could encourage incumbent CCS to compete with each other if competition were to improve conditions for their members. That would have to come in the form of higher revenues or lower costs. Higher revenues would mean higher licence fees for users or lower costs of administration. An unregulated for-profit supplier of DRM services would have the advantage of starting from scratch but would have to compete business away from incumbent CCS suppliers that have the benefit of a huge repertoire and the associated economies of scale and network effects.

Introducing competition would almost certainly lead to cream-skimming and to price discrimination. Competition among CCS would mean that both rights-holders and users would be able to shop around for the services of copyright administration by the CCS that offers them the best deal. Other things being equal, rights-holders seeking to maximise income from online distribution would prefer the CSS that pays the highest royalties net of administration costs for the particular repertoire of the rights-holder. Moreover, with competition, a large rights-holder could go to a different CCS to administer different works, say, by genre, but if that were to happen, you would get the tragedy of the 'anti-commons', that is, excessive debundling of rights and that would vastly increase search and other transaction costs for users. It would therefore seem necessary to keep works and authors in the same CCS – no doubt why some CCS require authors to assign all their works to them – and that would be equally true of digital works that are supplied online alongside the CD or DVD version. Even cream-skimming, though apparently cost effective from the point of view of the CCS, could easily lead to an overall welfare loss not just for the 'small' copyright-holders but also for users who would have much higher compliance costs (and they vastly exceed the copyright holders in number).

Users would prefer the CCS that charges the lowest licence fee for a particular repertoire and for the permitted types of use. For-profit rights management providers would compete with closed membership CCS using pricing policies that fully reflecting the ratio of costs to revenues of members' repertoire. They could offer better terms to larger right-holders and larger users if they excluded smaller participants. The question is whether this would be more efficient overall. Thus we need to ask which rights-holders and which users look most likely to gain and who will be losers. The losers are almost certainly the small, minority repertoire authors (classical and 'national' music, for example) who play an important role in innovation and cultural diversity. The Commission argues that because most of the royalty payments accrue due to a small minority of works – those of the international superstars - the claim that a 'legitimate online music service would, in the absence of collective management of copyright, have to negotiate with thousands of songwriters or music composers is untrue'. However, that is misleading: it may be true at any point in time but works' popularity changes constantly and that is crucial for creativity. Separation of conventional CRM and the collective administration of

online rights adds another level of complication for rights-holders if they deal with more than one CCS.

Several points emerge from this:

1. CCS are natural monopolies so adding in more repertoire and members does not cost much, especially as increasingly water-marking, ID numbering systems (like ISCR and ISBN) and DRM techniques are used by CCS and online membership is easy to administer.
2. Competition could increase the costs of licensing to rights-holders in general.
3. Certain kinds of competition would increase costs to users and would also raise the price of the licence fee.
4. Blanket licensing is administratively efficient but not economically efficient so there is a trade-off here for both right-holders and users. It is difficult to imagine blanket licensing without a monopoly provider of rights management.

One more point merits discussion: does a CCS inevitably have to combine the services of royalty collection via the licence with those of distributing the revenues? In other words, could radical regulation split up these functions? The unit of output for the services of royalty collection and for licensing is the work but the unit of output for distribution is the author or rights holder. Obviously, there is no correlation between the two: some authors produce many works and others just one but the one might be a best seller and the many are duds. As far as the cost of the services of royalty collection and distribution are concerned, these are separate functions and are in some cases split up: for example, the distribution facilities (the database of artists' names, addresses and bank information) of a CCS are used to distribute the proceeds of blank tape levies and computer taxes etc in countries where these apply; they are collected by the government and passed on to the relevant CCS. But royalty collection and licensing are clearly joint activities and a work has to be linked to a rights-holder so presumably some sort of 'common carrier' arrangement of databases would have to be made if these functions were to be severed. This question gets some way from the analogy of CRM with social insurance but it is not totally removed: for instance, a national health service combines the functions of health provision with health insurance though these are distinct services.

6. CONCLUSIONS

It is obvious from the above that this is a complex situation for a regulator – in this case a competition authority that is more used to dealing with the steel and telecoms industries. It is also obvious that the CCS monopolies are due to a complex combination of economic and legal forces and that their purposes and governance are determined by their role in making copyright workable as an incentive to creativity. As in all matters to do with the cultural sector, sensibilities are easily roused and the age old clash between art and commerce is readily invoked as has been witnessed in the recent strong lobbying of the Commission and European Parliament.

The Commission proposes to deregulate the CCS by forcing them to extend their services of administering copyrights beyond their territorial boundaries. In doing so, it is adopting a 'traditional' competition law approach, no doubt because it has no mandate for intervention in cultural matters, only in economic and internal market affairs (though the latter includes copyright law). But this stance ignores several

important features of CCS: first, many have been set up with a grant of monopoly by a national government that already regulates them; second, copyright law is national law and is territorial; thirdly, the purposes for which CCS were set up are not only economic, they also include a cultural mandate the same as that of copyright law itself, that is, to stimulate creativity and to protect authors' rights. Copyright law is not selective (as is patent law); many types of works and creators are protected by copyright without registration or quality control and it is left to markets to select successful works, not only in the short run but also in the long run over the duration of the copyright. It is hard to see how the Commission can achieve its aims without fundamentally changing copyright law. It could even be argued that the root of the problem lies with copyright law itself which by proliferating rights has created the need for an ever more complex system of CRM to make it workable. Without CRM, the majority of creators and other rights-holders would not be able to enjoy the benefits of copyright law, thus defeating its purpose. CCS are the spontaneous private solution to government failure in the enforcement of copyright law; however, when they collaborated in order to facilitate online rights licensing (the Santiago Agreement) it was dubbed collusive.

The hope of the Commission is that tearing down boundaries in the market for CRM of online music would introduce competition among CCS and create a more efficient and dynamic market in which new services of copyright administration appropriate to Internet distribution would establish themselves more quickly. A more efficient and dynamic market for authorised online services is expected to better withstand unauthorised use ('piracy'). Competition between CCS might also motivate them to allow rights-holders flexibility in exploring self-help systems such as DRM (digital rights management) as well as using their services.

In this paper, we have argued that technological change – including DRM – and additional regulation is unlikely to fundamentally alter the tendency towards natural monopoly in the administration of some copyrights even with DRM. Competition in a situation of natural monopoly causes prices to rise and the accepted solution is to allow the single supplier to offer its cost efficiencies while being regulated to prevent it exploiting its market power. Thus, a pan-European monopoly might be the most efficient solution, if properly regulated. However, there is no adequate regulatory framework in place to deal with such a situation, nor are such regulations envisaged in the Commission's publications and recommendations, though the status and organisation of the CCS even for the same bundle of rights varies quite a bit across borders. Indeed, copyright/authors' rights law also varies somewhat as between member states, significantly in relation to online use of music by private individuals (one country's piracy is another's 'fair use').

There seem to be some critical issues regarding the regulation of multi-territorial CRM that are largely ignored in the current debate. The first issue is the potential for largely unregulated for-profit CRM providers entering the market and replacing highly regulated non-profit collective CCS. (Of course, existing CCS could also change their statutes.) Unless universal service regulations are in place in every single EU member state, those CRM providers would be at an advantage that 'cream skim' only the most profitable customers. A second issue is the potential for vertical integration of CRM providers with large right holders or large commercial users. Both cream-skimming CRM providers as well as vertical integration could reduce

competition upstream (among producers/right holders) and downstream (among commercial users). One of the most difficult questions is the trade-off between administrative and economic efficiency posed by blanket licensing but this is not a topic that the Commission has addressed. That should also include questioning the role of industry bodies in negotiating licence fees and conditions for their members, something that if found to be collusive and stopped, could well add significantly to the cost of using copyright works. We have not found much guidance in the literature on more radical measures to regulate the CCS, such as splitting off their different functions and making them contestable.

To be sure, there is much to say in favour of removing restrictions for pan-European rights management. Eventually, it seems the Commission or other EU-wide statutory bodies will have to develop the expertise and instruments to deal with a European copyright law as well as the administration of copyright, including issues in cross-border trade and competition. The present lack of competition between CCS, however, is mainly due to legal restrictions and the limitations of territoriality in copyright law – which the CCS themselves have attempted to overcome by bilateral agreements and the Santiago initiative. The legal restrictions have no doubt lead to the problems identified by the Commission. The immediate solution therefore seems to lie with the governance of the national societies. However, this presents the Commission with a problem as it has no jurisdiction over cultural matters and it is instead using its economic powers of regulating monopoly. Before regulations on EU-level are in put in place, however, introducing competition between CRM providers could have a range of unintended consequences.

In particular, without effective regulations stipulating that rights management providers be open to all rights-holders without extensive price discrimination, services for right-holders and users might be diminished as CRM providers focus their services on the market leaders. Therefore, in the immediate future it could well be that the established system of reciprocal representation by incumbent CCS – in spite of their apparent flaws – continue to provide the best solution that is available in practice for online rights management and they should be tolerated for the time being. The Commission's threat to force them to compete might well help to promote innovation among CCS and it could be coupled with standard means of regulating monopolies, such as price caps that take account of technological change and systematic cross-border comparisons in order to identify inefficiencies. There would then be institutional evidence on which to base future policy. The danger of the Commission's current stance is that the baby is thrown out with the bathwater. It is our judgement that the benefits of CRM via regulated natural monopoly providers on balance outweigh the costs of competitive suppliers, particularly if they are for-profit unregulated firms.

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