representing the
recording industry
worldwide

IFPI Submission on the Productivity Commission's Draft Report on Australia's Intellectual Property Arrangements

June 2016

IFPI – representing the recording industry worldwide - thanks the Productivity Commission for the opportunity to submit comments on the Draft Report on Australia's Intellectual Property Arrangements (the "Report"). IFPI represents some 1,300 record companies in 63 countries and affiliated industry associations in another 57 countries, including in Australia (Australia Recording Industry Association (ARIA) and Phonographic Performance Company of Australia Ltd (PPCA)). The recording industry, represented by IFPI, is at the cutting edge of innovation and developments in the digital content markets. Globally over 50 % of industry sales revenue comes from digital services, and in Australia digital services account already for two-thirds of the industry sales income.

As the Report recognises, evidence should underpin any policy recommendations or decisions in the areas covered by the Report. Unfortunately, it appears that the facts about the current state of the Australian digital music market have been overlooked in making recommendations that would undermine the continued development of this market, and would put Australia out of step with international developments. In this submission, we set out some background information and statistics about the digital music market and explain the harm that could be caused were the aforementioned recommendations to be adopted.

THE DIGITAL MUSIC MARKET – OVERVIEW

The record industry has invested substantial resources to enable the growth of the Australian digital music market. Consumers have access to more music more easily than ever, and as a result music is consumed more than ever – thanks to great music and easy access. **Australian consumers have access to over forty million tracks on some twenty-six digital music services**[1]. The record industry continues to work to make music as widely available as possible, to the benefit of artists and consumers alike.

The benefits go wider than this. Music has driven innovation in new technologies and consumer uptake of new digital services. For example, 28 of the top 30 most watched YouTube videos are music videos[2], and 6 of the 10 most followed twitter accounts belong to recording artists[3]. Spotify, the Swedish music streaming service, has been a trailblazer for a new business model for distributing digital content. This in turn stimulates the economy of

[1] http://www.pro-music.org/legal-music-services-australasia.php
[2] https://en.wikipedia.org/wiki/List_of_most_viewed_YouTube_videos
[3] http://twittercounter.com/pages/100

the internet infrastructure, from access providers to mobile developers. For example, entertainment content streaming services are driving increased consumption of internet bandwidth, showing that this content underpins the growth of the internet infrastructure.

The long term stimulation of the Australian digital market will be achieved through ensuring that the legal framework enables continued investment in the content that is the rocket fuel of the digital economy. It will not be achieved through eroding copyright protections for the short term benefit of certain market participants who would prefer not to pay fairly or at all for the very input that lies at the heart of the value of their businesses.

THE DIGITAL MUSIC MARKET - THE ROLE OF RECORD COMPANIES

The Report states (at page 95) that *"Many intermediaries rely on copyright-protected material as input to their own processes, such as music and film studios, literary publishers and television and broadcasters."*

This mischaracterises the role of record companies. Record companies are the primary investors in the careers of musicians, and play a vital role in discovering talent, producing recorded music and marketing artists and their music. These investments are not supported by any guarantees of returns other than the common interest of artists and producers in making the recordings popular and commercially successful. Global statistics show that on average between 7 and 8 out of every 10 newly signed artists do not break even, meaning that the money invested in them is lost in whole or in part.

Worldwide, the record industry invested US$4.3bn in Artists & Repertoire (A&R) and marketing in 2013. Between 2009 and 2013 the amount invested in A&R and marketing was in excess of US$20bn.

The real intermediaries relying on copyright-protected content as input are the digital platforms that use third party content. While the Report is correct in identifying that online intermediaries have facilitated the dissemination of vast amounts of non-commercial works (p.109), these services rely on professionally-produced music to attract users to their platforms. For instance, professional music videos are by far the most popular content on YouTube, comprising 21 of the 23 videos that have been viewed over 1 billion times, and utterly dominating the most popular video charts.

Meanwhile, contrary to the assertions in the Report, the move to digital has not resulted in substantial reductions in the costs of creating content. While digital developments have made it easier for amateur creators to record and make available their work, the costs of producing the professional content that has fuelled innovation and has driven the uptake of digital services has been largely unaffected.

It remains the case that breaking a new artist in a major market requires very substantial investment:

Typical investment by a major record company in a newly signed artist

Advance	US$50,000–350,000
Recording	US$150,000–500,000
Video production	US$50,000–300,000
Tour support	US$50,000–150,000
Marketing and promotion	US$200,000–700,000
TOTAL	**US$500,000–2,000,000**

Source: IFPI member record companies

Despite significant declines in revenue, record company investments in artists & repertoire and marketing remain at their very high level of approximately 27% of revenues.

THE DIGITAL MUSIC MARKET – AUSTRALIAN CONSUMERS HAVE UNPRECEDENTED ACCESS TO MUSIC AT LOW COST

The Report states that across 70 music products Australian products were, on average, 52 per cent more expensive, while the median difference was 67 per cent. This finding simply does not reflect the reality of the Australian digital music market that accounts already for two-thirds of recording industry sales income in Australia (we note that the Report does not state which products were analysed).

The actual market picture is that consumers have never before had access to so much music at such low cost.

Comparative Cost of Music Streaming Services in Australia

The typical price in Australia for a monthly subscription to a music streaming service with unlimited access to a catalogue of over 40 million tracks is AU$11.99.

This is less than the typical monthly cost of these services in the US and Western Europe (US$9.99, GBP £9.99 and EUR 9.99). Meanwhile, music downloads are priced equivalently to Western Europe.

The Productivity Commission's aim of making recommendations that would "allow access to an increased range of quality and value goods and services" appears to be a solution in search of a problem that does not exist in the music industry.

THE DIGITAL MUSIC MARKET – THE VALUE GAP

Although the digital music market is expanding exponentially, the revenues resulting from that consumption are not being returned fairly to those who create, own and invest in the music. This is the problem known as the "Value Gap".

It is caused by the misapplication of online liability "safe harbours", which enables some digital services to use and distribute music without negotiating fair licenses before they start, claiming the protection of the "safe harbours" and then to negotiate licences that undervalue the music that is so important to the success of their services. These online liability rules are the very safe harbours that the Report recommends extending.

The result is a market distortion leading to a growing Value Gap between the value some services extract from the use of music and what they pay right holders. This is the primary obstacle that is impeding growth in digital markets and one which is resulting in international scrutiny of the legal privileges (or safe harbours) that are behind this market distortion.

THE GLOBAL VALUE GAP ILLUSTRATED

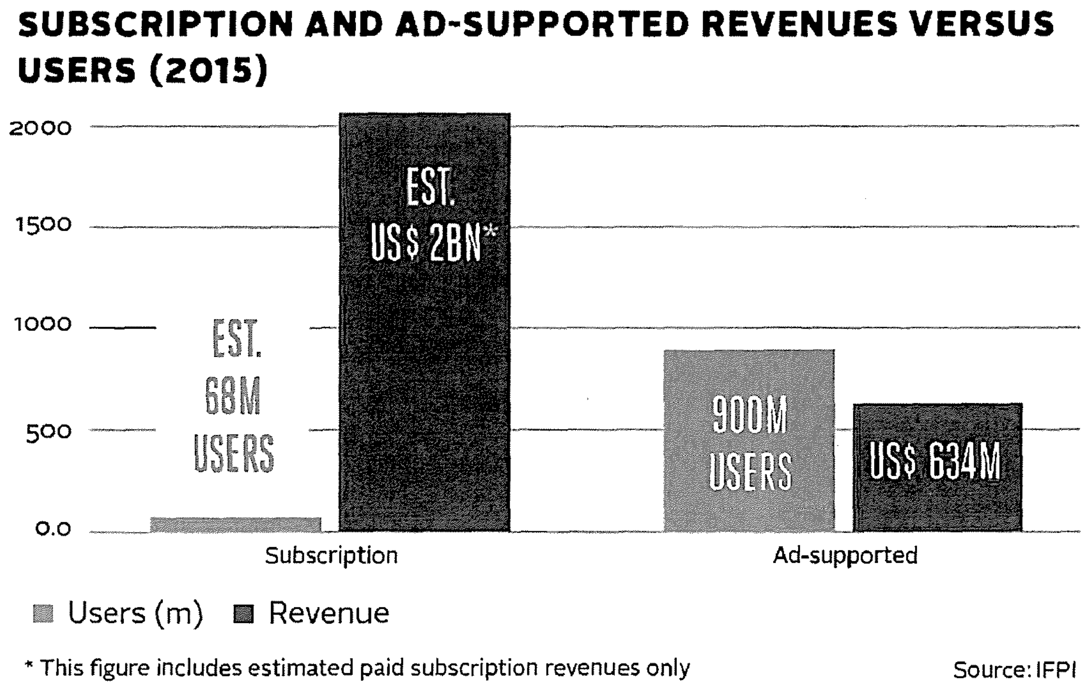

Fig. 1

The services in the left-hand column are those which do not claim the benefit of the safe harbours. The services in the right hand column are those which do. The stark difference between these annual per-user payments to right holders by services which both offer music on-demand illustrates the market distortion caused by the framework within which right holders are forced to negotiate.

Put simply, record companies are unable to capture adequate revenues for the use of their music because of market distortions caused by overly broad safe harbours. While the proportion of revenues re-invested by record companies into talent remains at approximately 27% globally, the losses in record industry revenues is reducing investments proportionately, to the detriment of the cultural economy. These losses in investment in the cultural economy are not being made up by any other institutions or entities. This issue is addressed in a study by economists, Oxfirst, *From Enabling to Levelling: The need to change the policy rationale of the intermediary liability regime.*

THE PRODUCTIVITY COMMISSION'S RECOMMENDATION TO EXPAND SAFE HARBOURS WOULD UNDERMINE DIGITAL MARKETS AND PUT AUSTRALIA OUT OF STEP WITH INTERNATIONAL DEVELOPMENTS

The Value Gap needs to be addressed to ensure that all music right holders receive fair return for use of their music, and the Report's recommendation to *expand* safe harbours is entirely at odds with international developments in this area. The recommendation appears to be made on the basis of submissions by market participants that would stand to benefit from the proposal, but does not consider the evidence of the harm that has been caused by overbroad safe harbours elsewhere.

"*Everyone on the artist side of the business, especially the artists, needs to understand that music consumption is growing and revenues have drastically declined... Legitimate digital music services can't make money to pay artists if they have to compete with services that are shielded by out-of-date safe-harbor protections.*" (Irving Azoff)

ISP safe harbour provisions were designed almost two decades ago to protect crucial internet infrastructure companies from secondary copyright liability law suits while, as the US put it, preserving *"strong incentives for service providers and copyright owners to cooperate to detect and deal with copyright infringements that take place in the digital networked environment"*[4].

As the US Congress explained in 1998, with *"constant evolution in technology, the law must adapt in order to make digital networks safe places to disseminate and exploit copyrighted materials"*[5]. Similarly, in Europe, the European Commission stated in 2000 that the intermediary liability regime in the E-Commerce Directive[6] was intended to strike *"a careful*

[4] Senates Report 105-190 page 20, http://digital-law-online.info/misc/SRep105-190.pdf
[5] *Ibid.* p.2
[6] Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce)

balance between the different interests involved in order to stimulate co-operation between different parties and so reduce the risk of illegal activity on-line"[7].

In other words, intermediary liability regimes around the world were intended to enable the internet to grow and function in a way that promotes innovation in both technological and creative industries. However, in the US and the EU the policy objectives behind the intermediary liability regimes have not been fulfilled; overly broad safe harbours have caused harmful market distortions to the detriment of the creative industries. They have provided on the one hand a pretext for brazenly infringing services to plough their trade, and on the other hand the opportunity for some online services to free-ride and use copyright material without entering into a market-value licence or any licence at all for the use of those works.

As the EU Commission puts it in its 2015 Copyright Communication[8]:

> *"platforms can also consider that they are not engaging in copyright-relevant acts at all, or that their activities are of a merely technical, automatic and passive nature, allowing them to benefit from the liability exemption of the e-Commerce Directive.*
>
> *This has prompted a growing debate on the scope of this exemption and its application to the fast-evolving roles and activities of new players, and on whether these go beyond simple hosting or mere conduit of content."*

As part of its flagship Digital Single Market initiative the European Commission is reviewing the European intermediary liability regime. A legislative proposal for addressing the Value Gap is expected later in 2016.

Meanwhile in the US, in recognition of the problems caused by the US DMCA section 512 safe harbour provisions, the US Copyright office has announced it will launch a study on the impact and effectiveness of the DMCA safe harbours.

In its notice and request for public comment, the Copyright Office states:[9]

> *"In enacting section 512, Congress created a system for copyright owners and online entities to address online infringement, including limitations on liability for compliant service providers to help foster the growth of internet based services. The system reflected Congress' recognition that the same innovative advances in technology that would expand opportunities to reproduce and disseminate content could also facilitate exponential growth in copyright infringement."*
>
> *"Recent research suggests that the volume of infringing material accessed via the internet more than doubled from 2010 to 2012, and that nearly one quarter of all internet bandwidth in North America, Europe, and Asia is devoted to hosting,*

[7] European Commission Press Release IP/00/442, *Electronic commerce: Commission welcomes final adoption of legal framework Directive*, Brussels, 4 May 2000
[8] COM/2015/0626, available at http://www.ipex.eu/IPEXL-WEB/dossier/document/COM20150626.do
[9] http://copyright.gov/fedreg/2015/80fr81862.pdf, page 81862

sharing, and acquiring infringing material. While Congress clearly understood that it would be essential to address online infringement as the internet continued to grow, it was likely difficult to anticipate the online world as we now know it—where, each day, users post hundreds of millions of photos, videos and other items, and service providers receive over a million notices of alleged infringement.

As observed by the House Judiciary Committee's Ranking Member in the course of the Committee's ongoing multi-year review of the Copyright Act, and consistent with the testimony of the Register of Copyrights in that hearing, the operation of section 512 poses policy issues that warrant study and analysis."

(Emphasis added)

Several hundred artists/songwriters, managers and creators (including Katy Perry, Christina Aguilera, Cee Lo Green, Billy Joel and Jon Bon Jovi) have signed a petition calling for reform of the US DMCA safe harbours:

"One of the biggest problems confronting us as songwriters and recording artists today is the Digital Millennium Copyright Act. This law was written and passed in an era that is technologically out-of-date compared to the era in which we live. It has allowed major tech companies to grow and generate huge profits by creating ease of use for consumers to carry almost every recorded song in history in their pocket via a smartphone, while songwriters' and artists' earnings continue to diminish. Music consumption has skyrocketed, but the monies generated by individual writers and artists for that consumption has plummeted. The growth and support of technology companies should not be at the expense of artists and songwriters.

Section 512 of the DMCA has become the all-purpose shield that tech companies hide behind while they threaten the livelihood of music creators.

[...]

The tech companies who benefit from the DMCA today were not the intended protectorate when it was signed into law nearly two decades ago. We ask you to recommend sensible reform that balances our interests as creators with the interests of the companies who exploit our creations for their financial enrichment. It's only then that consumers will truly benefit."

The petition in full is available at:
http://memberdata.s3.amazonaws.com/mu/musicfirst/files/3765647633935.pdf

Conclusion on Safe Harbours

The intermediary liability regimes designed almost two decades ago are no longer fit for purpose for today's online environment dominated by Web 2.0 services, such as participatory networks and User Upload Content services. These services are unrecognisable from the nascent online infrastructure providers that the safe harbour regimes sought to nurture. The balance in the online content market place has been distorted, and both the US and the EU are looking again at their online intermediary liability regimes.

In making its recommendation to expand the existing safe harbours the Productivity Commission has not addressed the growing international debate about how the legal framework should be updated to reflect developments in digital markets. We respectfully urge the Productivity Commission to reconsider its recommendation in light of international developments and the evidence of the market distortion that is being caused by the application of overbroad safe harbours of the sort recommended in the Report.

THE RECOMMENDATION TO INTRODUCE FAIR USE WILL CREATE LEGAL UNCERTAINTY AND THREATEN INNOVATION

The music industry exists because of copyright. Copyright drives innovation and creativity, enables record companies to invest in artists and repertoire, and gives creators an income. It is no coincidence that those who champion the "flexibility" of fair use exceptions/defences typically are those whose business models depend on unfettered access to copyright works. Indeed, this is recognised on p.144 where the Report refers to submissions stating that fair use would support the growth of Internet intermediaries and content-dependent industries. In other words, it would increase the possibility of such intermediaries growing their businesses on the back of protected content without paying fair value for that crucial business input. Unfortunately, the statement in the Report that *"fair use does not replace payment for copyright works that are available to users, but reinforces the consumer interests that should ultimately lie at the heart of Australia's copyright system"* overlooks the motivations of many of the proponents of fair use.

We respectfully urge the Productivity Commission to be highly sceptical of those that claim that innovation cannot happen without fair use. So far proponents of fair use have not been able to produce any credible evidence in support of their claim. Neither is there any evidence of a market failure that would justify the introduction of new or broader exceptions to copyright. In reality, innovative content distribution services are thriving and new licensing models – including for user uploaded content -- are developed around the world without fair use. Despite the rarity of fair use in copyright regimes internationally, in recent years there has been a global proliferation of technological innovations which have use of third party copyright content at their hearts (typically content distribution). Record companies alone have licensed over 40 million tracks and some 400 digital music services in 200 countries worldwide. Therefore, fair use is evidently not a pre-requisite for innovation, and there is no substantiated public policy argument to support the introduction of a fair use exception.

Claims that fair use drives innovation are without merit, as was recognised in the UK in Professor Hargreaves' report *Digital Opportunity: A review of Intellectual Property and Growth*, which concluded that:

> *"Does this mean, as is sometimes implied, that if only the UK could adopt Fair Use, East London would quickly become a rival to Silicon Valley? The answer to this is certainly not. We were told repeatedly in our American interviews, that the success of high technology companies in Silicon Valley owes more to attitudes to business risk and investor culture, not to mention other complex issues of economic geography, than it does to the shape of IP law."*

Furthermore, the idea that the absence of fair use results in "prohibitions" on certain uses of works or protected subject matter is simply false. What proponents of fair use so often mean is that fair use offers an alternative to paying a fair price for the use of content.

For example, the Report considers the possibility of fair use obviating the need to obtain licences for music sampling. The Report presents sample licensing as extremely costly and complicated, but in reality sample licensing is a standard practice in the recording industry. So also with remixes that are widely licensed through a number of online platforms (see e.g. www.dubset.com). This highlights some of the fundamental problems with implanting fair use in territories without accompanying jurisprudence, which include the reduction of legal certainty and the incompatibility with international obligations (most notably with the three-step-test for the introduction and application of limitations and exceptions to copyright). The US jurisprudence could not simply be imported into the Australian jurisprudence. Even if it could, the question of whether that would be desirable from a policy perspective would require an analysis of the outcomes of the numerous authorities to determine (a) whether there is an evidence-based policy rationale for importing each particular outcome, and (b) whether doing so would be consistent with Australia's international obligations.

Licensing, not exceptions to copyright, drives innovation. Innovation is best achieved through licensing agreements between content owners and users, including technological innovators. Licensing agreements are truly flexible and tailored to the precise circumstances of the market place, which is driven by consumer demand, and have enabled services for example to allow their users to make copies of content across their devices even where the law does not provide an exception for private copying. As set out in detail above, music is available more widely than ever before and is driving a proliferation in innovative digital content platforms. There is simply no evidence that the Australian economy or consumers are suffering as a result of not having a fair use exception. Quite the opposite.

We urge the Productivity Commission to re-consider whether there is a solid evidential basis for assertion that the introduction of a wide-ranging exception for "fair use" will benefit the Australian economy and consumer. The US jurisprudence illustrates the serious threat that fair use would pose to Australia's creative economy.

TERM

In view of the Australian Government's public statement that it will not pursue the Productivity's draft recommendation to reduce the term of protection, we will not address the points made in the Report on term. However, we note with concern that this section also includes sweeping statements that are not supported by evidence, such as the proposition that the commercial life of most works is less than 5 years.

CONCLUSION

The Australian digital music market is thriving. The record industry's cutting edge business models have enabled rapid innovation in digital services. Professionally produced music is a huge driver of the digital economy, but its production is dependent upon a legal framework that enables the music industry to derive fair value from music to reinvest in future artists and repertoire. The Productivity Commission's recommendations addressed in this submission threaten the ability of the industry to continue its high level of investments, to the ultimate detriment of the consumer. We respectfully ask the Productivity Commission to reconsider its recommendations in view of the evidence of the harmful long–term effects that they would have.

We thank the Productivity Commission again for the opportunity to make this submission, and we stand ready to assist the Commission with further information.

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