Opportunities in Online Goods and Services: Issues Paper
Apple/iTunes Response

Topic Area One: Constraints on Online Distribution of Copyrighted Content

European Commission Questions Summarized: *Commissioner Kroes is concerned that the online provision of digital content is often limited to within the same territory in which the consumer accessing the service is located. The provision of the same content in a physical format is usually not subject to the same territorial limitation, so there can be borderless sales. As a result, there currently is a more fragmented European marketplace for the online sale of copyrighted products available in electronic format, than for the same content in physical format. What potential legislative solutions to this problem exist, including suggestions such as multi-repertoire, pan-EU publishing licensing by collecting societies?*

Response:

Coverage of the iTunes Store

The iTunes Store is currently available in 15 EU countries (plus Norway and Switzerland). The reason it is not available in every EU country is that many of the countries do not offer a large enough marketplace to justify the expense and effort required to sell in that country. To sell music in any EU country, iTunes must first obtain the rights in the sound recordings and the musical works on a country-by-country basis, as well as comply with varying national local consumer law requirements. Since this cannot be done on a pan-EU basis, iTunes has to examine the situation in each country individually to determine whether the benefits are likely to outweigh the costs of distributing content into that country.

Pan European Licensing—European Commission 2005 Recommendation[1]

The iTunes Store has a catalogue of approximately 8.5 million songs. With respect to each, iTunes needs both the mechanical right and the performing right in order to be permitted to distribute those songs (embodied in sound recordings) to consumers. Further, because each song may have been composed and/or have lyrics written by multiple authors, each of whom may have their own separate publishing deal, each mechanical and performing right may be shared among multiple rightsholders. iTunes does not know who owns the rights in the musical compositions embodied in these 8.5 million tracks due to the absence of available information. Prior to the 2005 Recommendation, this was not a problem as each national collecting society was able to offer a so-called blanket licence (i.e., for all repertoire, globally), for sales by iTunes in their own territory, which covered both mechanical and performing rights in each work in their repertoire. Therefore, the possibility of multiple authors and/or multiple publishers each having an ownership interest in a given work, did not impact iTunes' licensing situation. The withdrawal of rights from collecting societies by various publishers that has happened under the auspices of the 2005 Recommendation means that the local national collecting society is no longer able to offer a so-called blanket license, but rather the various rights may now have to be sought via a myriad of different licenses from different licensors. In the context of

[1] Commission recommendation No 2005/737/EC of 18 May 2005 on collective cross-border management of copyright and related rights for legitimate online music services.

this quagmire, iTunes needs to find a way to be able to (a) determine from whom to license each right; and (b) be certain that all necessary rights are licensed.

Being able to get a multi-repertoire, pan-EU publishing license from a single licensor would allow iTunes both to license all rights necessary for the iTunes Store more efficiently and with greater legal certainty, which development would spur investment in the marketplace in general, as well as to offer the iTunes Store across the EU far more quickly.

Following from the 2005 Recommendation, the recent CISAC decision leaves open the possibility for (although does not require) the reciprocal agreements between collecting societies to be dissolved. In these agreements, the collecting societies cross-license each other rights to use all the others' collective repertoire for a society's exploitation within its own country. If that were to happen, then the licensing situation would become unmanageable; with respect to sales of repertoire not directly licensed on a pan-European basis, iTunes would most likely have to report to and pay a society other than the national society in the country of sale, thereby further complicating an already complex situation of determination of ownership of rights and country of sale, as well as reporting.

To some extent, the reciprocal agreements have already lost their benefits. With respect to repertoire that is no longer included in so-called blanket collecting society licensing schemes, some performing rights societies are not permitting societies that may be entitled to license mechanical rights on behalf of a particular publisher to also license the performing rights of their author members, causing a split between the society that is able to license the mechanical rights and the society that is able to license the performing rights, doubling the complexity.

Further, in the absence of so-called blanket licensing, and with the emergence of multi-territory, single-repertoire licensing, the absence of a central repository for data about who owns what rights in a song, and a central place to which we can report and pay for publishing, makes what we do even harder.

While it is clear that the European Commission's intentions behind issuing both the 2005 Recommendation and the CISAC decision have been to foster competition and a healthy environment in the field of cross-border copyright licensing, because of the legal uncertainty and strenuous efforts that are required, the consequences have been steps backwards from the simpler country-by-country multi-repertoire licensing of musical works that we had enjoyed at the inception of the iTunes Store in Europe. While it may be the case that, given sufficient time, enhanced competition might cause the marketplace to find its balance, it is not clear that developing online businesses can outlast an unpredictable transition. And it is already the case that new business models in the online world are being delayed and taking longer because of the arduous path.

Suggestions for Streamlining Licensing

1. *Require Performing Rights to Follow Mechanical Rights*

- **It may be worth exploring a requirement that the performing rights always follow the mechanical rights, i.e., if one may be licensed by a given society,**

then so can the other. Performing rights societies should not be permitted to refuse to allow the relevant mechanical rights society to license the performing rights in the same works, whether via sublicense, or agency. A more effective bundling of the mechanical rights and performing rights would allow the licensing of content online to more closely replicate licensing of content in physical formats.

2. *Publishers should not be permitted to refuse to license their rights to collecting societies*.

- Publishers should not be permitted to refuse to license their rights to collecting societies, with that society having a right to sublicense to users such as iTunes or to other collecting societies via reciprocal agreements. This would allow collecting societies to reconstitute licenses that cover substantially all relevant rightsholders' repertoires.

- To the extent that publishers are permitted to withdraw their rights from collecting societies, exclusive arrangements are not conducive to a healthy licensing environment. It increases the number of licenses required by abandoning the opportunity to obtain blanket licenses, and also requires determination of rights on song-by-song, territory-by-territory, bases.

3. *Create a Central Repository for Ownership Information*

- There is currently a significant information deficit with respect to the identification of copyright ownership in Europe. Neither collecting societies nor licensees have complete information as to ownership of copyrights, at least apparently not to the extent to enable them to identify rights that have been withdrawn by particular rightsholders, or even determine and quantify the split ownership of copyrights. Even if publishers were required to license their rights through collecting societies, in the absence of blanket licenses whereby a single licence covers substantially all repertoires in a given territory neither the need for this information nor the problems caused by its absence would be diminished. Moreover, to the extent information is currently available, it is only accessible in a variety of inconsistent formats.

- A central repository of ownership information, into which all collecting societies and other rightsholders feed information in a common format, and which could be accessed by licensees, would ease problems caused by the information vacuum, and foster timely and accurate remuneration.

- It may also be worthwhile to explore a regime where reporting of all sales in all European territories by distributors would be provided only to this central body, each collecting society or other licensing entity could access information about sales of its content in territories for which it is licensing rights, and any disputes as to ownership of rights would be resolved directly between rightsholders prior to invoices being issued to the licensee. In that way, licensees could feel assured that they are properly licensed, and that they are not being invoiced for more than 100% of each work sold, which certainty is absent under the current regime.

4. *Permit Labels to License Publishing Rights from Publishers, Authors and Collecting Societies.*

- Another means of stemming the fragmentation of rights, and therefore of licensing, would be to prohibit publishers, authors and/or collecting societies from refusing to license their rights to labels in some manner that would allow labels to either sublicense those publishing rights (both mechanical and performing rights) to users such as iTunes as part of a complete bundle of rights in both sound recordings and musical compositions to licensees, or provide them as an agent on behalf of the ultimate rightsholder.

- However, if this solution were to be adopted, it would need to happen in a transparent setting of full disclosure that would contribute to open and honest competition.

5. *A Single Pan-European Copyright.*

- It may be worth exploring the creation of a single Pan-European copyright, as opposed to the current country-by-country basis of national copyrights. However, there would be significant hurdles to overcome, including how to handle the vast catalogue of existing works that may currently have different rightsholders in different EU countries. This, however, would not eliminate split ownership in a single copyright because of the contribution of more than one author, and the possible need to license each share from a different licensor.

Topic Area Two: Constraints on Online Distribution of Goods

European Commission Question: *For exclusive distribution systems (territorial exclusivity) EU competition policy distinguishes between active and passive sales. In particular, restrictions on active sales, such as restrictions on sending e-mails directly addressed to customers in the exclusive territory of another distributor, are permitted under certain circumstances.*

- *Do you agree that this distinction between active and passive sales is useful in an internet* context*? Could you elaborate further on the criteria used for this distinction in addition to those foreseen in the Guidelines?*

- *What* other *clarifications or changes of policy would you consider necessary or useful?*

Response:

The distinction between active and passive sales for online distribution is a valid and useful distinction that should be defined in a manner that can be effectively applied to online distribution. For example, active selling parameters should recognize the broad reach of online activities that can compromise a lawful exclusive distribution model; such as activities that specifically target consumers in the territory of another distributor.

European Commission Question: *For selective distribution systems, EU competition policy requires that selected dealers also be allowed to fully use the internet for active and passive sales, but otherwise does not generally interfere with the selection criteria the producer applies to select its dealers.*

- *Do you think it is in the interest of consumers that a producer can use as one of its selection criteria that its dealers have a brick and mortar shop or showroom to taste/feel/experience the product and thus exclude internet-only-shops from its distribution network?*

Response:

The features and complexity of the product may mean that the consumer benefits from a face-to-face retail experience by having, for example, technically trained staff capable of demonstrating a product or by having a showroom to demonstrate the look, feel and experience of the product. Nevertheless, availability of products online is a vital option for consumers, so a selective distribution system does not and should not prevent online sales by its dealers even if it requires these dealers to have a brick and mortar shop.

European Commission Question: *How would you ensure that the criteria used to select dealers do not bias against their use of the internet by imposing criteria for internet selling which are comparatively more severe than the criteria for sales from the brick and mortar shop?*

Response:

The current law provides that any criteria used in a selective distribution network must be proportionate and not go beyond what is necessary so any disproportionate criteria could be prohibited on this basis.

European Commission Question: *How would you ensure that selective distribution systems and consequent limitations on internet sales are not used for products the nature of which does not require selective distribution?*

The European Commission currently has the power to withdraw the benefits of the Block Exemption Regulation from selective distribution systems where the nature of the product does not necessitate selective distribution. This power would apply in a situation where selective distribution was used purely to limit internet sales and where the nature of the product does not require selective distribution.

European Commission Question: *How would you ensure that selective distribution systems do not hinder the development of new methods of distribution?*

Response:

We do not believe that selective distribution will hinder the development of new methods of distribution. Indeed, consumers expect to be able to buy goods online and consider online sales vital. All manufacturers and suppliers have an interest in embracing online distribution and to authorize dealers in a selective distribution network to sell online.

European Commission Question: *The rules on Vertical Restraints are applicable to agreements between firms but are not applicable to unilateral conduct (i.e. behaviour which is decided only by an individual company and does not derive from any agreement that company has with a third party). For example, these rules do not apply if a company directs its local subsidiary in a particular territory not to sell goods/services online to customers located in other territories in which the distribution is carried out by other subsidiaries. However, such practices can also restrict online sales and may support price discrimination between final consumers located in different territories (i.e. by rerouting the consumer to the company's website of the country where he/she is located and where prices for the same products are higher).*

Should competition law or regulation prevent such unilateral conduct, where the company has market power? What, if any, circumstances could justify such unilateral conduct?

Response:

The commercial decision to set up an online store for consumers in a country is based on a variety of factors, unrelated to price discrimination between the territories. A company may have many reasons to create an online store or online sales in a particular territory or to direct a local subsidiary to carry out those sales. This may have to do with penetration and market strategy in that territory. Alternatively, it may concern security of online payments and capacity to deliver goods in the country. In any event, competition law and specifically Article 82 EC applies to any instances of discrimination by a dominant firm that could be deemed to constitute an abuse of dominant position.

As regards price discrimination between final consumers located in different territories, there are many factors that could justify different prices, for example different VAT regimes, copyright levies, currency fluctuations, etc.

European Commission Question: *Should competition law or regulation prevent such unilateral conduct, where the company does not have market power? What, if any, circumstances could justify such unilateral conduct?*

Response:

The decisions on market strategy in relation to online sales or direct sales are based on a variety of factors such as market penetration, investment in sales channels, capacity to deliver and local market conditions. Rather than seeking to regulate companies that engage in this activity, we believe that the emphasis should be on harmonizing national regulations which may lead to price discrimination between final consumers – such as different VAT levels, copyright levies, currency differences etc.