

## **EXECUTIVE SUMMARY**

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### **The Directive**

The directive on the legal protection of services based on, or consisting of, conditional access (Directive 98/84/EC, hereinafter CAD) was adopted on 20 November 1998.

The objective of the CAD is to provide conditional access (CA) systems protecting services that are remunerated, effectively Pay-TV and on-demand services, with a common standard of legal protection. In other words, it aims at compelling all Member States to adopt a certain level of sanctions and remedies in order to efficiently fight CA piracy.

The directive covers both broadcasting (television and radio) and interactive online services (information society services - ISS) that use some form of conditional access.

### **The study in brief**

The study first examines why conditional access services (CAS) play a different role in non-media ISS and in media content distribution. It then describes the economics of audiovisual content distribution and the role played by conditional access devices in this domain, showing that piracy incentives are numerous along the distribution chain. A legal evaluation of the CAD application is then carried out, revealing that a number of weaknesses restrain the efficiency of such a regulation.

The study is based on a sample of member states, selected on the basis of the importance of national markets and with a view to ensure a balanced representation of large/small, old/new member states; another criterion for the sample selection is the issue of linguistic proximity, whereby linguistic areas transcending national borders are examined. The sample therefore includes eleven countries: the United Kingdom, Germany, France, Italy, Spain, Ireland, Austria, Sweden, Belgium, Poland and Lithuania.

The study conclusions justify the importance of opening a discussion at EU level on how to build systematic intellectual property (IP) protection by improving the existing regulatory framework (including the CAD) and ensuring appropriate enforcement of the existing measures, as well as improving cross-border cooperation in the monitoring and enforcement of the CAD.

### **The economic analysis**

The first finding of the economic analysis is that the economic functions of encryption devices strongly differ in non media and in media applications. While in non media services, Conditional Access Systems directly participate in the utility supplied to the consumer, in the case of media content delivery CA systems are basically both an exclusion and discrimination tool. In other words they are technical means aiming at selecting among consumers and extracting from them the price they are willing to pay for media goods. The term discrimination is hereinafter used as an economic concept, and should not be confused with the notion of discriminatory practices which are forbidden by EU Internal Market rules.

From an economic perspective, media goods are opposed to communication services (so-called non media ISS) by the fact that their demand patterns as well as their renewal or diversity objectives require a discriminatory pricing strategy usually called “versioning”. Because of the diversity of its linguistic and cultural communities, Europe shows a highly specific distribution of media content preferences. These are largely related to territoriality but may also exceed it. Moreover, depending on its own evaluation of media externalities, each European country has followed a specific audiovisual path leading to a wide diversity in TV industrial organisation, in audiovisual (AV) content delivery systems, in AV version market structure and in national regulation. The wide differences in the penetration rates and the turnover of pay-TV markets illustrate this phenomenon. Such a cultural, industrial and regulatory landscape does not favour cross-border versioning.

Compared to its American competitors, this situation places Europe in a very adverse position. While its industry is highly fragmented and ruled by national and politically sensitive media regulations, the European Union as a territory has to cope with high discrimination costs. The harmonisation of the EU media regulations which would efficiently help the reduction of these discrimination costs raises many issues regarding the legacy of the multiple media development paths, the setting up of a common evaluation of media externalities as well as common internalisation rules to be applied across the EU. By aiming at facilitating cross-border exchanges through protected discrimination devices, the CAD probably missed the sophistication of this point. However, because they are discrimination tools, CAS should be protected so to be maximally efficient.

The fragmentation of the European audiovisual industry as well as the competition between Free-To-Air (FTA) and pay-TV versions create many incentives for CAS hacking or piracy. These incentives are mainly attributable to moral hazard. And yet, right holders, who are the first ones to suffer because of moral hazard issues, claim they cannot resort to the CAD.

The economic analysis shows the extensive level of moral hazard in these markets which is likely to increase as new delivery modes develop (IPTV, mobile TV etc), most often, thanks to free content. The existence of moral hazard may imply that certain forms of piracy are encouraged because they help the roll-out of new delivery systems. The analysis demonstrates that this moral hazard is greater in the EU than in the US. In effect the horizontal and vertical integration of the US audiovisual industry allows a leaner vertical control of the distribution by the right holders. The vertical integration of broadcasters with CAS suppliers provides more efficiency in fighting piracy. As a result, not only Europe has heavier discrimination tasks to perform, but also its discrimination tools suffer more moral hazard. Moral hazard may also raise competitive and piracy issues on the set-top-box (STB) markets. The analysis suggests that competition policy should account for the economic benefits of vertical integration and the costs of interoperability within such markets.

Another aspect that should be taken into account is the expansion of P2P (peer to peer) practices (virtually non existent when the CAD was adopted) which creates a structural moral hazard in content distribution over broadband networks: any Internet access provider is simultaneously a deliverer of legal and illegal content. P2P undermines the exclusivity of rights licensed by rights holders on a given platform/territory, thereby reducing the value of those rights.

The existence of moral hazard makes it extremely difficult to assess the impact of the CAD even to the extent that data are not made available to make empirical estimations. Nevertheless the CAD can play its deterrent role to assist in the suppliers of services to maximise revenues generated by their services.

The grey market arises from new discrimination needs associated with the increasing movement of EU citizens. In general, the grey market appears not to be conflicting with the CAD. An essential distinction has to be drawn between the infringement of CAS (piracy) which is the object of the CAD and the breach of contractual obligations imposing territorial restrictions to rights exploitation, which is in fact a tool to discriminate at the cheapest costs the disseminated consumers living out of their cultural zone. Such an objective is in line with the containment of discrimination costs provided by the CAD. Right holders should be adjusting their contracting strategy when the transaction costs of grey markets overwhelm their benefits.

For the time being, the costs of reaching those consumers through a grey market tolerance still appear to be much cheaper than reshaping the distribution contracts on a non territorial basis. However, in view of the growing size of grey markets across Europe, and taking into account the political goal of establishing an Internal Market, the Commission could broker some discussions with stakeholders on a better apprehension of the grey market and its handling to prevent copyright infringements.

### **The legal analysis**

The legal analysis is carried out across the sample of selected member states – eight relevant topics for analysis are singled out:

1. Competent authorities overseeing the implementation of the CAD
2. Dates of Implementation of the CAD
3. Relevant national regulations in force before the CAD
4. The CAD's implementation in the selected countries
5. Alternative legal rules used to fight piracy
6. Scope of the infringing activities
7. Sanctions and remedies
8. Relevant case law

The results of the analysis show that the implementation of the CAD has succeeded in harmonising to some extent the legal protection of CA services within the internal market. It is far from being the priority of public authorities (compared to copyright law or cyber crime legislation for instance). In fact, in the countries where no specific legislation addressing the circumvention of CAS existed, no public consultation or debates have been held to transpose the CAD and the transposition has been mainly a “copy-paste” of it.

However, it seems that in these countries the CAD has made it easier for the stakeholders to enforce their rights and in that regards it has improved the situation. The CAD in particular has filled existing legislative gaps insofar as horizontal or very broad legislation such as competition, copyright or criminal law were perceived as rather inadequate tools to fight a specific form of

infringement such as CA piracy. The CAD has made it easier for concerned stakeholders such as pay-TV operators or CA industries to take legal actions and have legal standing in courts.

On the other hand, in the countries where an existing specific legislation used to exist, the implementation of the CAD has brought little added value in terms of protection and has mainly consisted in enlarging the scope of the existing law to cover ISS.

The main difference between the different legal orders with regard to the implementation of the CAD lies now in the sanctions applied to the infringing activities adopted by each of the Member States, and in particular between those countries which choose to additionally sanction private use (not required by the CAD) and those which choose to only sanction the commercial use of illicit devices. In theory, the inclusion of private use in the list of infringing activities should act as a strong deterrent tool to prevent CA piracy. Yet, the quantity and quality of data collected is insufficient to draw such a swift conclusion. Data on piracy is practically non-existent at public level and there is also a relevant lack of case law. The development of a legitimate CA-related AV market in different countries is dependent on too many factors to correctly assess the role played by sanctions for private use of illicit devices in determining the growth of the market.

Sanctioning the private use of infringing devices would help reduce the moral hazard existing in the AV value chain at the level of the end consumer, thus strengthening the legitimate offer. Similarly to what exists for counterfeit trademarks, the possession of an infringing device should be considered as an offence independently from its usage. If not, private use, whose control is impossible to enforce and which therefore should remain an exception, creates huge incentives for circumvention.

The lack of case law (it seems that most of the cases are settled out of courts) is a major impediment in correctly assessing the importance of the CAD to fight CA piracy. The CAD operates as a complementary tool to other pieces of legislation protecting copyright or against unfair competition. The major advantage of the CAD for CAS providers is that it allows them to acquire legal standing in cases of CA piracy (whereby right holders can also rely on copyright law).

Overall, it seems that business operators benefiting from the CAD are satisfied with its adoption and its implementation into national law, although most of them call for further upwards harmonisation of the law in terms of sanctions, remedies and inclusiveness of the list of prohibited activities. Yet this call cannot be accompanied by empirical evidence that the CAD has been effective in tackling cross-border piracy nor that its objectives in terms of Internal Market have been met.

Another aspect that needs to be brought to the fore is that the lack of knowledge and interest in the CAD shown by public authorities has had as a consequence that no cross-border administrative cooperation has been established on this subject. The CAD was intended to address Internal Market issues but its implementation and monitoring have been carried out without any tangible trans-national dimension. The Commission may remedy this situation by setting up an expert working group (on the model of the expert groups existing in the framework of other Directives such as the E-commerce Directive or the Television without Frontiers (TWF) Directive).

## **The main conclusions**

- The CAD aims at protecting encryption technologies and the related “encoded services” with references to a wide range of policy motivations with the noticeable exception of IP protection. Essentially it promotes the idea that a better securitisation of remunerated information services will facilitate cross-border trade as well as Internal Market efficiency.
- In general, the grey market appears not to be conflicting with the CAD. An essential distinction has to be drawn between the infringement of CAS (piracy) which is the object of the CAD and the breach of contractual obligations imposing territorial restrictions to rights exploitation, which is in fact a tool to discriminate at the cheapest costs the disseminated consumers living out of their cultural zone. Such an objective is in line with the containment of discrimination costs provided by the CAD. Right holders should be adjusting their contracting strategy when the transaction costs of grey markets overwhelm their benefits.
- However, in view of the growing size of grey markets across Europe, and taking into account the political goal of establishing an Internal Market, the Commission could broker some discussions with stakeholders on a better apprehension of the grey market and its handling to prevent copyright infringements. The political goal of establishing an internal media market should be in line with improving discrimination efficiency while reducing transaction costs.
- The CAD has been quite well fitted to the needs of the pay-television industry. This industry has been able to get legal protection for its technical delivery systems, and therefore, for the added-value of its business. However, the application and enforcement of the directive shows many weaknesses: lack of interest from member states in the implementation and monitoring of the CAD, low level of harmonisation and weak political willingness from Member States to fight against copyright piracy.
- Public authorities are unaware of the trans-national effects of the CAD. No cross-border co-operation has been established in this domain. To remedy this situation, the Commission should consider setting up a working group composed of Member States’ representatives in order to improve monitoring and discuss ways of enhancing the effectiveness of the CAD.
- The CAD achieved a low level of harmonisation, which only includes minimal prescriptions with regard to the level and nature of sanctions applicable to the circumvention of CAS. Sanctions and enforcement are considerably different across member states, and some safe harbours still exist. The majority of stakeholders involved in the CAS-related media business underline the importance of including the private use of infringing devices in the list of activities subject to sanctions. Stronger sanctions (in particular, criminal sanctions) are also considered to be more effective in fighting piracy.
- The IP legal status of digital content and its effective enforcement and application appear as the key driver of efficient markets and distribution systems. This driver appears not to be properly addressed by the CAD. Right holders consulted in the course of the study

estimate that as they are not explicitly included in the scope of the CAD, they have no legal means, through this instrument, to fight downstream piracy by themselves. They therefore rely on their pay-TV distributors or CAS providers whose market power is, in theory, reinforced by that tool. This issue should be the object of careful consideration from the European Commission in the context of a possible amendment of the CAD.

- Technology based regulation is threatened by obsolescence, complexity, and inefficiency. In this context, it is useful to draw comparisons with other pieces of EU and international legislation addressing similar issues as the CAD. The EU Copyright Directive as well as the Enforcement Directive, the proposed Criminal Sanctions Directive and the Draft WIPO Broadcasting Treaty appear more suited to rule fair economic relations in content distribution systems. In particular, they affirm the economic value of IP goods and explicitly condemn all forms of circumvention of “effective technological measures” at every stage and for any purpose.
- It appears that a convergence of the CAD with the approach set out in the above mentioned pieces of legislation would reinforce its role as an essential tool in the legal arsenal available at European level to counter IP piracy across all digital platforms. The protection of technical systems should be the consequence of the protection of content and not the opposite. As it stands, the CAD seems imbalanced in favour of providers of technical systems. The European Commission should redress this situation.
- The study also raises a series of issues which deserve further consideration and analysis in view of assessing the CAD in the wider context of the EU media sector regulation. These issues concern notably the moral hazard endemic in the roll-out of broadband networks (through the expansion of P2P circumvention practices) and the role played by internet services providers (ISPs) in this context; the question of legal protection for media right holders falling outside the scope of the copyright regime (such as sports right holders); and finally the relevance of competition policy to structure media markets in Europe. These topics should be discussed at EU level between the European Commission and relevant stakeholders.
- The CAD has been conceived as an internalisation tool for expanding digital service markets. Its evaluation through this study brings an opportunity to re-think the externalities and the harmonisation of the European media markets. Media markets will not be harmonised through technology because, conversely to telecoms, their value is directly related to content. IP is then the key internalisation tool of positive media externalities. A possible review of the CAD provides an opportunity to discuss the adequacy of the existing corpus of EU regulations in addressing the problems brought by new digital platforms to Europe’s media market.
- This approach has wide-ranging implications touching upon key aspects of the EU’s Internal Market, competition and information society policies. A consultation on these topics, open to all interested parties is therefore recommended, in order to launch a debate on the future of the European media industry in the digital environment.