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Private Copying and Fair Compensation:
A comparative study of copyright levies in Europe[2]

A Report for the UK Intellectual Property Office

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[2] The research was funded by the Economic & Social Research Council (ESRC grant: RES-173-27-0220) as part of an academic fellowship at the UK Intellectual Property Office (IPO). A summary of the findings as well as the underlying empirical data were made available to the Hargreaves Review of Intellectual Property and Growth, and published in April 2011 as a working paper on the website of the Centre for Intellectual Property Policy & Management (CIPPM). The Hargreaves Review cites the research in developing a recommendation to introduce a limited private copying exception without compensation. *Digital Opportunity, A Review of IP and Growth*, section 5.30: "As right holders are well aware of consumers' behaviour in this respect, our view is that the benefit of being able to do this is already factored into the price that right holders are charging. A limited private copying exception which corresponds to the expectations of buyers and sellers of copyright content, and is therefore already priced into the purchase, will by definition not entail a loss for right holders." However, it should be noted that this academic research, and the Hargreaves Review commissioned by the UK government were entirely separate processes. Whilst this report indeed deplores the incoherence of the EU concept of fair compensation based on harm, and advances a *de minimis* interpretation for a narrowly conceived private copying exception, it also finds that there may be an economic case for statutory licences with levy characteristics. This report just represents the author's view.

ABSTRACT

Following the Information Society Directive of 2001 (introducing the concept of "fair compensation" for private copying into EU Law), total collection from levies on copying media and equipment in the EU tripled, from about €170m to more than €500m per annum. Levy schemes exist now in 22 out of 27 Member States (with only the UK, Ireland, Malta, Cyprus and Luxembourg remaining outside). Despite their wide adoption, levy systems are little understood, both in respect of their rationale and their economic consequences. Tariffs are increasingly contested in court, leading to a large gap between claimed and collected revenues. The European Commission has announced "comprehensive legislative action" for 2012.

This report offers the first independent empirical assessment of the European levy system as a whole. The research consolidates the evidence on levy setting and collection, reviews the scope of consumer permissions associated with levy payments, and reports the results of three product level studies (printer/scanners, portable music/video/game devices, and tablet computers), analysing the relationship between VAT, levy tariffs and retail prices in 20 levy and non-levy countries.

Key findings:

- There are dramatic differences between countries in the methodology used for identifying leviable media and devices, setting tariffs, and allocating beneficiaries of the levy. These variations cannot be explained by an underlying concept of economic harm to right holders from private copying.
- The scope of consumer permissions under the statutory exceptions for private copying within the EU does not match with what consumers ordinarily understand as private activities.
- In levy countries, the costs of levies as an indirect tax are not always passed on to the consumer. In competitive markets, such as those for printers, manufacturers of levied goods appear to absorb the levy. There appears to be a pan-European retail price range for many consumer devices regardless of levy schemes (with the exception of Scandinavia).
- In non-levy countries, such as the UK, a certain amount of private copying is already priced into retail purchases. For example, right holders have either explicitly permitted acts of format shifting, or decided not to enforce their exclusive rights. Commercial practice will not change as a result of introducing a narrowly conceived private copying exception.
- A more widely conceived exception that would cover private activities that take place in digital networks (such as downloading for personal use, or non-commercial adaptation and distribution within networks of friends) may be best understood not as an exception but as a statutory licence. Such a licence could include state regulated payments with levy characteristics as part of a wider overhaul of the copyright system, facilitating the growth of new digital services.

*This short report explains key findings of the research in policy relevant language. Three underlying studies were performed: Study I entitled "**Legal and policy context**" reviews the implementation of levy systems in the EU; Study II entitled "**Empirical effects of copyright levy schemes**" reports data on the relationship between VAT, levy tariffs and retail prices for three products in 20 levy and non-levy countries; Study III entitled "**Framework for analysis**" reviews possible rationales for state regulated levy systems. These supporting documents are made available as separate files.*

1. Legal basis

In EU copyright law, private copying has been given a specific meaning relating only to the reproduction right (i.e. not: communication to the public, distribution to the public, public performance or adaptation). Private copying is included among the closed list of exceptions permitted under Article 5 of the 2001 Information Society Directive. Article 5(2)(b) reads: [Member States may provide for exceptions or limitations to the reproduction right] "in respect of reproductions on any medium made by a natural person for private use and for ends that are neither directly or indirectly commercial, on condition that the rightholders receive fair compensation which takes account of the application or non-application of technological measures [referred to in Article 6]."[3]

[3] Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society. See Supporting Study I.

2. Blurring between private copying and communication to the public

The narrow focus of the reproduction right does not map well onto typical copying behaviour in digital networks. Users may consider activities under the following headings to be private:

(i) Making back-up copies / archiving / time shifting / format shifting

(ii) Passing copies to family / friends

(iii) Downloading for personal use

(iv) Participation in file sharing networks / sharing digital storage facilities

(v) Online publication, performance and distribution within networks of friends

(vi) User generated content / mixing / mash-up (private activities made public)

In the analogue world, the private copying exception was aimed to permit discrete copies for non-commercial use in categories (i) and (ii). In digital networks, the distinction between private and public spheres has become blurred. Regularly, new services are invented that challenge earlier divisions (P2P, social networks, cloud lockers).

3. Implementation of the private use exception in EU countries

Under the Information Society Directive, only activities (i), (ii) and (iii) can possibly fall only under the reproduction right (and therefore be eligible for a compensatable exception as private copying). Even within these groups of activities, the scope and legal construction of private copying differs considerably between countries. In some countries, sources need to be lawful, in others not; in some countries, there are a set number of permitted copies specified, in others there are definitions of private circles; in some countries, the levy is constructed as a statutory licence, in others as a debt; in some countries compensation is only due for private copying of musical works, in others for printed matter (reprographics) and audio-visual works.

As a mechanism for “fair compensation”, 22 out of 27 European Union members have chosen to meet the requirement through a levy system. The exceptions are the UK and Ireland (only time-shifting of broadcasts is permitted), Malta, Cyprus and Luxembourg

(private copying treated as *de minimis*). Within the 22 countries who provide for a compensated private copying exception, levy schemes vary widely in the following respects:

- levies apply to different media or equipment that can be used to make copies (e.g. recordable carriers, hard disks, MP3 players, PCs);
- levies differ in tariffs for the same media or equipment, and apply different methods of calculation (e.g. memory capacity, % of price);
- levies differ in whether they are imposed on the manufacturers, importers or distributors of media or equipment, or consumers;
- levies differ in beneficiaries (music, audio-visual, reprographic rightholders; wider cultural or social purposes);
- regulatory structures differ (processes for setting tariffs and distribution, contestability of tariffs, governance and supervision of agencies).[4]

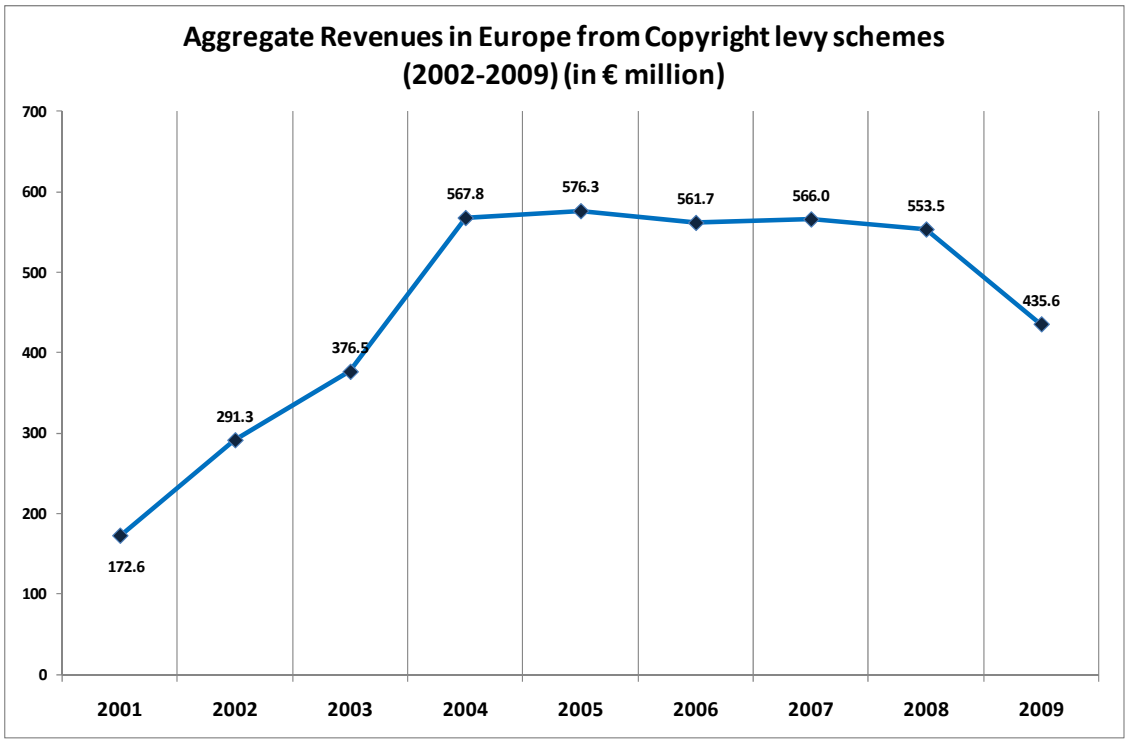
[insert EU map: levy density/revenue per capita]

Following the 2001 Information Society Directive, total revenues from levy systems in the EU increased from €172 million in 2001 to €567 million in 2004. Collection plateaued around the €500 million mark between 2004 and 2008, and is now beginning to fall as blank tapes, CDs and DVDs are disappearing from the market, and levies on new products are increasingly contested. The system as a whole is deeply irrational, with levies for the same devices sold in different EU countries varying arbitrarily.

[4] These variations have been documented in detail in numerous European Commission documents, annual reports by Dutch collecting agency *de Thuiskopie*, and lobby submissions (see Supporting Study I).

Graphic 1 Aggregate Revenues from Copyright levy schemes (2002-2009)

Source: European Commission; de Thuiskopie; Business Software Alliance



Notes:

1. 22 May 2001: Information Society Directive (2001/29/EC): requirement of "fair compensation" for statutory "private copying" exception.
2. Collected fees need to be understood in a volatile context of claimed (but unpaid) and paid (but contested) tariffs. Key examples include: 1 January 2008: Amendment to German copyright law (*UrhG 2. Korb*): Tariffs in law replaced by negotiated tariffs between manufacturers and collecting agency ZPÜ; about €20m of fees withheld by manufacturers. 24 February 2009: Decision by highest Austrian court (OGH, 4 Ob 225/08d); PC levy cancelled; compensation can only be due on equipment that is designed for copying. 21 October 2010: Padawan SL v Sociedad General de Autores y Editores de España (SGAE), Case C-467/08, ECJ: Business media and equipment not leviable; Spanish collecting societies may have to return certain fees collected under Art. 25 of the *Ley de Propiedad Intelectual*. 11 April 2011: Dutch State Secretary for Public Safety and Justice Fred Teeven announces phasing out of levies (levies on recordable CDs will not be replaced by schemes on new media or equipment). Across the EU, there are currently nine countries where levies for mobile phones are claimed but contested, amounting to about €192 million in 2010 which may or may not become payable.

4. Empirical effects of levies on retail prices

The following products were investigated –

(1) printer/scanners: levies are applied in 14 out of 27 Member States ranging between €0.72 and €56 per unit for an HP 4500 laser printer;

(2) portable music/video/game devices: levies surveyed in 9 Member States ranged between €1.42 and €19.40 for Apple's iPod Touch 64GB;

(3) tablet computers: may be classified as a personal computer in 3-4 Member States (carrying a possible levy per unit of €12.15 in Germany, €8.00 in France and €1.90 in Italy).

The empirical analysis, plotting retail prices in 20 countries against levy and VAT rates, indicates that markets for printer/scanners are highly competitive. Manufacturers find it difficult to pass on higher indirect taxes to the consumer. In some high levy countries (such as Germany), the HP 4500 laser printer is retailing at a similar price as in non-levy countries (such as the UK), and there appears to be no systematic link between wholesale and retail pricing. For producers of premium products, such as the iPod Touch, there is a statistically significant correlation between total indirect taxation and the retail price, suggesting that manufacturers are able to pass on higher costs to the consumer.

Generally, there appears to be a pan-European retail price point for consumer devices, regardless of divergent levy schemes, with only Scandinavian consumers willing to pay more. Product launch decisions for innovative products (such as tablet computers) seem unaffected by the level of indirect taxation.

Details of the empirical research can be found in Study II.

[insert EU map of levied products]

5. The concept of harm

In the 2010 *Padawan* decision, the European Court of Justice held that the concept of "fair compensation" "must be regarded as an autonomous concept of European Union law to be interpreted uniformly throughout the European Union".[5] With reference to Recitals 35 and 38 of the Information Society Directive, the Court found (at 42) that "fair compensation must necessarily be calculated on the basis of the criterion of the harm caused to authors of protected works by the introduction of the private copying exception".

The concept of harm is problematic, and has failed to acquire a coherent meaning. From the jurisprudence on awarding damages, harm in law is likely to be interpreted as a lost licensing opportunity, i.e. a fee that could have been charged.[6] However, there is a circularity here: if there is a copyright exception, there is no infringement, and no licence could have been issued. Thus by definition there is no harm in law from a permitted activity.

In economics, harm is a lost sale, i.e. if copying replaces a purchase that otherwise would have been made. Evidence on the extent of private copying presented to the Copyright Board in Canada shows that in 2006-2007, portable music players (such as iPods) contained on average 497 tracks of music, of which 96% were copied.[7] In total, 1.63 billion copies of tracks were being made in Canada from July 2006 to June 2007. Of these, about half (808 million) were copied on digital recorders; of these 808 million, about 345 million (42%) came from the Internet. Only 20% of these tracks were authorized downloads (e.g. from iTunes). Thus, from July 2006 to June 2007, there were

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[5] *Padawan SL v Sociedad General de Autores y Editores de España (SGAE),* Case C-467/08, 21 October 2010. The intellectual origins of the concept of "fair compensation" can be traced to a decision of the German federal court in 1964 (BGH, NJW 1964, 2157; GRUR 1965, 104 – *Personalausweise*), and the copyright law of 1965 (UrhG). See Supporting Study I.

[6] Under the common law concept, damages shall put the claimant in as good a position as if no wrong had occurred: *Robinson v Harman* (1848); *Livingstone v Rawyards Coal Co* (1880).

[7] Exibit CPCC-3: *Étude de marché sur la copie privée d'enregistrements musicaux au Canada 2006-2007* (11 January 2008); 695pp report prepared by Réseau Circum for Société canadienne de perception de la copie privée (CPCC). The methodology is based on monthly telephone surveys of about 1,000 Canadians (above the age of 12), a sample representative of all Canadians. The data in the report are based on 12,011 "entrevues" between July 2006 and June 2007.

646 million copies being made from unauthorised Internet sources that found their way on the average portable music player.

How many of these downloads have been listened to, rather than stored? How many have replaced purchases? How many have led to purchases? These questions (illustrated here by reliable Canadian data) are hotly contested in the academic literature, and empirical studies have come to opposite conclusions.

Hal Varian shows (developing Liebowitz' concept of "indirect appropriability")[8] that we need to distinguish the number of works produced and the number of works consumed. If sharing is permitted, or takes place, the producer is likely to sell fewer units of the work, but since the consumer derives greater value from each unit, the producer's profit may even increase (if pricing is right). However, if the availability of free copies pushes the retail price to marginal cost, the original seller will find it hard to raise the price to a level where he can recover the cost of production. The basic idea remains the same: "if the willingness-to-pay for the right to copy exceeds the reduction in sales, the seller will increase profit by allowing that right."[9]

6. Distinction between "priced into purchase" and "statutory licence"

Reconsider the consumer activities listed in section two above. For (i) [Making back-up copies / archiving / time shifting / format shifting]; and (ii) [Passing copies to family / friends], a certain amount of copying appears to be already priced into the purchase (Varian's argument). For example, right holders have either explicitly permitted format shifting, or decided not to enforce their exclusive rights. There is no lost sale, and the European criterion of harm may be treated *de minimis*, i.e. no compensation is due. Commercial practice will not change as a result of introducing such a narrowly conceived private copying exception.

[8] Hal A.Varian (2005), "Copying and Copyright", *Journal of Economic Perspectives* 19(2): 121-138; Stan Liebowitz (1985), "Copying and Indirect Appropriability: Photocopying of Journals", *Journal of Political Economy* 93(5): 945-57.
[9] Varian, ibid. p. 130.

A more widely conceived exception that would cover private activities that take place in digital networks [activities (iii) to (vi)] might be better understood as a statutory licence. Possible rationales for issuing such a licence include: making the copyright system more permissive for consumer led innovation, as well as non-economic arguments (such as influencing the bargaining position of creators versus producers, or preserving fundamental rights of privacy).[10] The concept of "compensatable harm" contributes little towards assessing an appropriate tariff for such a licence.

How do state regulated licences with levy characteristics compare to privately negotiated levies (such as Apple's iCloud proposal to legalise collections of music files, regardless of origin, for $25 per year)?[11] This is in urgent need of further empirical research to inform "comprehensive legislative action" regarding private copying levies announced by the European Commission for 2012.[12]

[10] See Supporting Study III.

[11] Announcement at Apple Worldwide Developers Conference (WWDC, 6 June 2011). Apple will offer in the U.S. a service that scans computers for music files, and then give access to these on any device from Internet (cloud) servers for a fee of $24.99 per annum. The terms of Apple's agreement with right owners are not known. What is the share of royalties between publishers and labels, what is the split between major and independent labels, how much will be passed on to artists? These details matter greatly for an assessment of the intervention of intellectual property rights from a competition perspective.

[12] *A Single Market for Intellectual Property Rights: Boosting creativity and innovation to provide economic growth, high quality jobs and first class products and services in Europe*, Communication from the European Commission (COM(2011) 287 final). Section 3.3.4. reads: "The proper functioning of the internal market also requires conciliation of private copying levies with the free movements of goods to enable the smooth cross-border trade in goods that are subject to private copying levies. Efforts will be redoubled to kick-start a stakeholder agreement built on the achievements of a draft Memorandum of Understanding (MoU) brokered by the Commission in 2009. A high level independent mediator will be appointed in 2011 and tasked with exploring possible approaches with a view to harmonising the methodology used to impose levies, improve the administration of levies, specifically the type of equipment that is subject to levies, the setting of tariff rates, and the inter-operability of the various national systems in light of the cross-border effects that a disparate levy system has on the internal market. A concerted effort on all sides to resolve outstanding issues should lay the ground for comprehensive legislative action at EU level by 2012."