

Multi-Territory Licensing of Audiovisual Works in the European Union

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The opinions expressed in this study are those of the authors and do not necessarily reflect the views of the European Commission.

EXECUTIVE SUMMARY

Europe is recognised for its cultural diversity and its vibrant creativity. Its audiovisual sector, valued at € 96 billion and producing more than 1100 films per year, possibly best embodies these unique assets. However, only a fraction of Europe's audiovisual works are enjoyed outside the countries where they are produced. The European Commission (EC) wishes to assist European creators and audiovisual enterprises to develop new markets through the use of digital technology, and asks how policymaking can best help to achieve this.

Promoting a competitive and diverse single market for audiovisual works is a top European Union (EU) policy priority. Policy makers acknowledge that our future depends on Europe's creative capacity to innovate, and that a competitive audiovisual sector has important economic spill-over effects on other industries. As a core element of Europe's creative industries the sector will be shaped by several important recent policy strategies – notably EU 2020, the Digital Agenda for Europe and the Cultural Agenda.

The economics of the audiovisual industry and current trends in digital distribution

Audiovisual content markets are undergoing significant transformations due to digital technology. VOD is on the rise and close to 700 on-demand and catch-up services exist in Europe. VOD turnover in Europe is expected to grow to approximately € 2.2 billion in 2013.

Moreover, digital technology has a wider impact on the sector: social media applications and personalised recommendation and search technologies influence how users discover and select audiovisual works, so providing an opportunity to develop new audiences. As audiovisual services and systems converge (more than 8% of US-sold televisions were internet-enabled in 2008) these online trends increasingly matter to the entire industry.

Furthermore, the emergence of VOD (as well as the continued severe impact of online copyright infringements) continues to put pressure on more established version markets, such as pay-TV and DVD (global DVD sales declined by 13% in 2009). Consequently, the audiovisual industry has put digital distribution – and VOD in particular – at the top of its strategic agenda.

An understanding of the economic basis of audiovisual content distribution is vital to project how the sector might develop in the future:

Firstly, the industry depends on copyright, and neighbouring rights, which foster content creation. Copyright grants rights holders an exploitation monopoly that enables them to decide how to roll out new services to address the needs of consumers and their financial interests. For example, the film industry has in the past continuously expanded the exploitation of its works on multiple distribution channels — theatrical, DVD, VOD (various pricing models), pay-per-view, pay-TV, free-TV — with the goal of maximising the global exploitation revenue for each title. New technical versions have been inserted in the exploitation schedule on the basis of the benefits they would bring to the consolidated revenue across all version markets – a calculation of the revenue each version individually brings in as well as of the impact on revenue one version will have upon another. This means that sophisticated distribution techniques are used to efficiently distinguish between consumers' preferences and to capture their willingness to pay. Financing audiovisual creation and promoting cultural diversity crucially relies on the efficiency of this process.

Secondly, the audiovisual sector is a high-risk sector because media products are 'experience' goods, which are valued differently by each consumer as well as by different cultural communities. Because of the linguistic and cultural specificities across borders, the European audiovisual industry is structurally fragmented. Cultural and linguistic versioning is therefore essential to create consumer demand for each film or television programme. The investment associated with linguistic versioning, and more generally with the marketing of each audiovisual work, is specific to each territory. Each licensing contract requires negotiation on the size of the investment and on how the risks will be shared between distributors and rights holders. There are no economies of scope and scale, and no risk mutualisation in marketing one single technical version of several products in several linguistic markets. Conversely, there are economies of scope and scale in selling audiovisual rights of several content versions to the same distributor, who can handle the discrimination of the work for a given cultural/linguistic market. Marketing efforts made in this market may then benefit exploitation in all release windows.

Finally, the pre-financing of audiovisual works requires significant involvement from stakeholders from the territory they are designed for, especially when this linguistic market is restricted. As a consequence, rights holders will always give priority to exploitation in their own financing territory, and will subordinate foreign distribution to the needs of these investors. As distribution in foreign territories requires specific investment (advertising, labelling, subtitling, dubbing, etc.) to make the product attractive to the local viewer, the selection of a distributor for each territory will rely on the efforts this distributor is ready to make to sell the product, as well as its willingness to pay the highest acquisition fees. This report confirms the direct correlation between such investments in distribution and the success of titles in theatres and on VOD.

The EU audiovisual sector is mainly characterised by its fragmentation, which is at the same time both cultural and industrial. This fragmentation goes a long way to explaining why European audiovisual content is licensed primarily on a territorial basis.

How does digital technology impact on the dynamics of audiovisual content distribution?

VOD decreases distribution and storage costs. It enables various players to enter the distribution market and creates more competition in the entire audiovisual value chain. Established players (e.g. broadcasters, distributors, exhibitors, etc.) seek to retain their position while new entrants, such as telecommunications providers, internet service providers, cable operators or hardware manufacturers, set up new distribution platforms (also with the goal to further finance the take up of their equipment).

At the consumer level, audiovisual consumption patterns need to be increasingly considered in the context of a proliferation of digital communications and social media. The fact that an increasing number of open European VOD platforms are directly linked to social networks illustrates that social media tools and other interactive applications enable the audiovisual industry to target more fine-grained audience demographics, and can be utilised by rights holders and media service providers to promote culturally-diverse European content. In this context, this report contains a number of case studies that illustrate that the industry is considering the opportunities of the digital shift to develop its market share.

Changes to the position, duration and chronology of different release windows show that the entire industry is dealing with these transformations. However, there are also important factors that inhibit a rapid roll out of VOD which are primarily connected to limited market demand (see further below) and related gaps in finance:

- Distributors and broadcasters, traditionally important pre-financiers of audiovisual production, have little incentive to enter the VOD market given that the returns in VOD are still far smaller than in theatrical distribution, broadcasting and DVD.
- Independent production companies and talent require pre-finance from distributors and broadcasters to create audiovisual products. If these players are primarily interested in other version markets independents stand little chance of benefiting from VOD.
- So far most new operators of digital distribution platforms have not entered into production finance, and are unlikely to do so as long as their returns remain marginal compared to those of other version markets. An exception to this is the company Orange. The great majority, however, does not provide minimum guarantees, nor do they buy exclusive rights to exploit new works on VOD. As a result, VOD offers primarily contain older works that have already been exploited in other windows.
- Private investors so far are reluctant to bridge this financing gap, and few public funders have invested strategically in VOD to enable rights holders to enter VOD at an early stage.

Further integration between these trends, which currently characterise digital distribution (i.e. non-exclusive licensing), and the economic processes of the entire industry (i.e. the importance of pre-sales) has yet to occur.

Market demand is forcing stakeholders to adapt their business strategies. It is shaping licensing practices in the sector. Rights for VOD exploitation are currently licensed on a non-exclusive and short-term basis (two to three years). Territorial licensing continues to prevail. Technology allows access to be restricted on a geographical basis according to licensing terms.

The report argues that, as VOD markets across Europe grow and more players enter digital distribution, the requirements of commercial users and rights holders will also evolve:

- VOD service providers stress the need to make rights licensing more efficient by streamlining licensing processes, and by establishing more ‘one stop shops’ particularly because they are often interested in buying catalogues of rights rather than individual titles.
- Digital distribution of catalogue titles (older works, vintage titles, titles that have not been sold in certain territories) require laborious and costly rights clearance which service providers cannot afford. This penalises European rights holders, which are often small entities and favours large catalogue owners such as the Hollywood studios.
- European rights holders also find it hard to retain rights for digital exploitation as they are often acquired by distributors and broadcasters who do not enter VOD exploitation until revenues from other windows are secured. The dominant position of commercial users vis-à-vis small and medium-sized rights holders prevents the latter from acting strategically and building up a catalogue of rights for later exploitation.

Most individual European audiovisual companies may in the future be in a weak negotiating position when they wish to access VOD platforms on beneficial terms, and would therefore benefit from collective approaches to facilitating rights licensing. In this context, this report identifies a number of innovative market-driven and voluntary initiatives across Europe that seek to facilitate easier rights licensing, to the benefit of commercial users and rights holders.

The audiovisual sector is in an important phase of transition. This phase is an opportunity to develop new audiences both nationally and internationally.

Economic analysis of the trade of audiovisual works in the European Union

The current state of the market can be summarised as follows:

- On the supply side, the number of VOD services and service providers in the EU is growing. It depends significantly on socio-economic features (e.g. there are five times as many VOD services in the Netherlands as there are in Bulgaria).
- Rental business models are chosen by the majority of VOD services in Europe (e.g. 22 in France; 2 in Poland – indicating the different stages of development of local markets). However, on the demand side, subscription-based business models have recently become more successful than rental and electronic sell-through (in Europe in 2008: € 283 million vs. € 261 million).
- On the demand side, the EU VOD market represented a total turnover of € 644 million in 2008 and had increased by 250% in two years. Significant differences exist across EU Member States. The performance of France, Italy, Spain and the UK outrank other Member States.
- Compared to other audiovisual version markets VOD revenues remain marginal. The share of VOD turnover in relation to total audiovisual turnover is estimated to be between 0.2% (Finland) and 1.79% (Belgium).
- This relevance of the VOD market is confirmed when analysing the distribution of revenues of a sample of films examined. It is also reflected by other research. For example, VOD represented 1% of the overall film audience in the UK in 2008.

Data concerning the diversity of consumption at EU level is difficult to obtain. In France, VOD does not lead to more diverse consumption than in theatres. In the UK, total gross value of EU works on VOD was lower than in other version markets. However, this picture is more varied when it comes to analysing the origin of films available on VOD and comparing it to, for example, theatrical distribution. In theatrical distribution the share of non-national EU films is 8%. On VOD, this share varies from country to country (e.g. 9% in Germany; 20% in Spain).

Finally, this report shows that dematerialised distribution of audiovisual works allows some cost reductions, which might favour circulation of unexploited titles in certain territories. This includes EU films.

The economic analysis projects future VOD market developments over the coming 5 – 10 years based on a number of future scenarios.

Some predicted trends in relation to technological, economic and regulatory (territorial vs. multi-territorial) factors concern all Member States:

- VOD turnover will increase significantly in the next five to ten years. A more rapid development of the macro-economic factors that shape the audiovisual industry, as well as faster roll out of digital infrastructure, would further accelerate the growth of VOD turnover.
- The number of VOD services will increase in every market, although generally at a slower pace than VOD turnover. International licensing and/or a rapid development of macro-economic and communication facilities would lead to a greater increase in the number of VOD services.
- EU films' circulation would increase as VOD markets expand. This circulation would be greater in an environment based on international licensing.

- International licensing would lead to greater concentration of the VOD market, i.e. fewer service providers will control most of the market. A successful VOD market would place competitive pressure on other audiovisual version markets, notably video and pay-TV.
- Telecommunications operators would benefit from a rapid development of macro-economic and communication facilities. From an economic standpoint, these operators have an interest in bundling VOD services together with access when it helps them to win new clients. When their market is saturated, however, they have no competitive advantage over broadcasters in selling only one content version.

Other predicted developments vary considerably according to Member States. This is notably the case for the growth of VOD turnover. For example, countries with lower revenue per capita for audiovisual markets (i.e. Portugal, Romania, Slovenia) will experience much faster growth of VOD turnover than countries with higher revenue per capita (France, Germany, Italy, Spain, UK). Furthermore, a regulatory environment that favours international licensing would lead to varying levels of exports and imports of audiovisual works across the EU.

Greater circulation of audiovisual works does not necessarily imply greater levels of consumption. Investment in marketing is required to allow digitised works to be consumed on a larger scale across borders, as they will be competing against works which have been marketed locally in other version markets (notably those that received a theatrical release) as well as being made available on VOD. Some rights holders – especially those that will implement sophisticated cross-border digital marketing campaigns – will benefit from greater cross-border demand for their works. Nevertheless, due to the economies of scope and of scale described, it will be challenging to compete against audiovisual works for which several technical versions have been sold on a territorial basis. Furthermore, the long-term impact of international licensing on audiovisual production funding is unclear, as it remains to be seen whether internationally-operating VOD providers will be able to meet the levels of finance that broadcasters and local distributors currently invest in the ecosystem of audiovisual finance.

Consequently, a favoured policy option is to promote cross-border demand for digitised European audiovisual works, to invest more in marketing to give European programmes visibility and to ease existing copyright licensing processes notably by decrease transaction costs (see further below).

Towards a single market for audiovisual content: the legal environment

How should EU policy-making promote a single market for digitised European audiovisual works and thereby strengthen the competitiveness and the cultural and social contributions of Europe's creative industries?

The main justifications and the legal basis for EU intervention in the audiovisual sector are based on EU Treaties and the Union's international obligations:

- The promotion of the internal market.
- The implementation of competition rules.
- The promotion of cultural diversity and support for cultural and creative industries.
- The representation of consumers' interests.
- The implementation of international treaty obligations.

Furthermore, the “acquis communautaire” is built around four principles which are important features of the seven directives harmonising copyright and neighbouring rights legislation in the EU. They largely implement international norms which are notably enshrined in the WIPO Treaties:

- Contractual freedom – the right of authors to freely decide about the terms and conditions under which they wish to exploit their works.
- Exclusivity – the right to grant exclusive exploitation rights (a right linked to contractual freedom).
- Territoriality – the right of the rights holder to decide on the geographic scope of a licence (a right linked to contractual freedom).
- Enforcement – the right to prevent by law unauthorised exploitation of copyright-protected works.

Each of these principles is essential to the functioning of the audiovisual industry. Each of them safeguards rights holders’ abilities to exploit films and television programmes in a commercial fashion and enables them to invest in the creation of new audiovisual works.

The European Court of Justice (ECJ) has recognised the characteristics of audiovisual content exploitation which are directly linked to contractual freedom and exclusivity in the *Coditel II* case. The territoriality principle has been enshrined in international law in Article 5(2) of the Berne Convention, and in all EC directives dealing with copyright and related rights. The ECJ has confirmed this principle when considering the compatibility of territorial exclusivity with internal market and competition rules. On the basis of international law, ECJ jurisprudence as well as EU legislation, the territorial nature of copyright can be described as “quasi-acquis communautaire”.

EU harmonisation of intellectual property has achieved much in removing national disparities in standards of protection in order to promote intra-community trade. Nevertheless there are conflicts between the territorial exercise of intellectual property rights and the principles of the free movement of goods and services across the EU. The EU institutions have therefore taken different steps to try to reconcile internal market objectives with copyright principles. Hence, secondary EU legislation has established the country of origin principle and mandatory collective licensing in relation to cable retransmission. The ECJ has developed the principle of exhaustion of rights to promote parallel imports for physical goods protected by intellectual property.

However, these measures have so far not significantly remedied audiovisual market fragmentation in the EU, which is primarily the result of market constraints.

Are there other challenges in relation to promoting a single market for digitised audiovisual works?

Both rights holders as well as audiovisual media service providers would benefit from more ‘one stop shops’ and a more seamless and internationally-connected digital licensing infrastructure. This would lead to more efficient licensing and decrease transaction costs in the acquisition process. It would enable VOD service providers to buy more diverse European content at lower costs, and at the same time enable rights holders to access distribution platforms and to negotiate favourable deals with them.

The EC has clearly identified the need to facilitate rights acquisition in order to promote a digital single market, and recognises that one-stop shops are a solution to the issue. In music, EU authorities promote an evolution from domestic one-stop shops towards a European one. Furthermore, it should be highlighted that the key issue in relation to making available international offers in music is not copyright territoriality, but rather the rights licensing process underlying pan-European exploitation. Potential

providers are first and foremost interested in greater transparency with regard to the availability of rights at international level, as well as in one-stop shopping opportunities for rights acquisitions.

Concentration in rights management is unlikely to happen in the audiovisual sector, as large European AV companies and Hollywood majors (the stakeholders who control the most economically-valuable rights) will most likely continue to license on an individual basis. Nevertheless, small and medium-sized European film companies that produce two to three films per year (and constitute the vast majority of Europe's industry) would benefit from stronger cooperation and collective initiatives. In Europe European films achieved an estimated theatrical market share of 27% in 2008) whereas US films have a market share of 67%. The ability of EU rights holders to act collectively to offer a catalogue of rights to VOD service providers will determine to a large extent the availability of these titles on international VOD platforms.

In this context, collective management structures might play an important role in the future digital distribution of European audiovisual works. Requests by commercial users and rights holders to optimise the rules regarding transparency and governance of collective rights management organisations in music may, in this context, also benefit rights licensing in other creative content sectors.

Finally, while policy debates concerning the challenges to developing a digital single market for audiovisual content in Europe primarily focus on copyright and its territorial exercise, they often do not take sufficient notice of other obstacles. Many regulations and policies at national level either raise additional transaction costs for cross-border trade of audiovisual works, or contribute to establishing an imbalance in the environment for pan-European VOD services:

First, insufficient harmonisation regarding copyright enforcement leads to legal uncertainties. One important bottleneck to the development of a single digital market is the increasingly disparate solutions for tackling online copyright infringements across the EU at consumer level. If investments into audiovisual creation are to continue at their current level, copyright enforcement has to become more effective. Copyright is a key economic institution designed to stimulate creativity, knowledge production, the arts, culture and entertainment.

Second, important legal uncertainties continue to exist regarding the licensing of audiovisual works for digital distribution, notably with regard to orphan works or the implementation of authors' exclusive rights. Furthermore, VAT rules differ across the EU and distort competition between audiovisual service providers. They penalise audiovisual consumption online compared to other forms of access.

Third, regulations and public policies relating to content production and distribution also influence the development of a digital single market (public funding guidelines, rating systems, etc.). Despite significant regulatory and judicial efforts to mitigate the exercise of copyright, the structure of the sector, which is essentially linked to audiovisual economics and to linguistic and cultural consumer preferences, remains fragmented.

The regulatory focus should therefore shift from any notion to review copyright standards (for example by considering a European copyright) to promoting more efficient and less costly licensing processes.

Conclusions and policy recommendations

More than 1.7 billion people worldwide are now online and broadband connects 56% of European households. The audiovisual sector – a vital part of Europe’s increasingly important and recognised creative industries – is considering the digital shift as an opportunity to access new markets.

Copyright, related rights and their exercise are essential to the success of Europe’s audiovisual sector. They provide rights holders with a mechanism for content versioning, bundling and price discrimination; all three are important business practices that help rights holders to maximise their returns on investment in a high-risk industry, an industry in which audiovisual works are valued differently by each consumer and in each market, due to the fact that they are ‘experience’ goods.

Copyright standards are therefore not a bottleneck to the emergence of a single market – the real issue is the rights licensing process. To ease licensing practices the EU should promote the establishment of internationally-connected digital rights-licensing infrastructures. It should also support the multitude of small and medium-sized European audiovisual companies to collaborate, on a voluntary basis, to jointly formulate strategies that enable them to monetise their digital rights on national and international VOD platforms.

However, increased international availability of audiovisual works will by itself not lead to a significant increase in cross-border demand for such works. In cultural markets, consumer demand needs to be stimulated. Consequently, public policy should also help audiovisual SMEs to implement digital marketing strategies to reach wider audiences.

There are two sets of policy recommendations. One relates to efforts to further promote the emergence of an internal market, and the other to measures that promote cultural and industrial policy objectives.

I. Recommendations to support the establishment of a single market for digitised European audiovisual works

Decrease transaction costs

Two sets of measures are considered to contribute to the establishment of a licensing infrastructure in Europe that would be more conducive to cross-border trading of audiovisual works and better access for European audiovisual works to digital platforms:

- > The EC should give support to European rights holders to establish voluntary collective licensing initiatives and mechanisms to access VOD platforms on fair terms and offer easier and cheaper licensing solutions to operators.
- > The EC should also promote ‘one stop shop’ solutions developed by the market, inter-operability between existing services and tools, as well as stronger co-operation between rights holders, users and technology stakeholders. This would eventually contribute to the establishment of more seamless and internationally-connected licensing infrastructures.

Further legal harmonisation

Further legal harmonisation – or at least an examination of the potential impact of such harmonisation – is further suggested to promote the digital single market:

- > As regards copyright enforcement, the EC should take the lead in promoting more effective practices across the European Union. This includes, among other suggestions, a proposal to introduce new legislation to harmonise criminal sanctions, as well as an impact assessment concerning the appropriateness and effects of the graduated response mechanisms in Member States.
- > Considering the predicted growing importance of collective rights management, it is proposed to introduce a framework directive that promotes greater transparency and governance requirements for collective rights management bodies.

Other recommendations to promote the single market suggest:

- > That the EC enables authors' societies to collect remuneration on behalf of authors when their works are exploited abroad: An unwaivable equitable right to remuneration for the "making available right" should be introduced.
- > A reduced VAT rate for VOD transactions, similar to those that apply to the sale of theatrical tickets, should be introduced.
- > The commissioning of an impact assessment concerning the application of the country of origin principle for the distribution of audiovisual content on digital networks, coupled with a mandatory collective licensing regime in relation to the simultaneous and unabridged digital distribution of TV programmes.
- > As regards easier licensing mechanisms for orphan works, the current impact assessment by DG Internal Market in relation to orphan works should encourage the EC to consider audiovisual in the scope of the future draft directive that is announced for the end of 2010.

Coordination with Member States

Further co-ordination efforts with governments and public sector agencies in Member States and regions should be undertaken:

- > Encourage national agencies in developing common descriptive criteria for national ratings. It should promote the use of signalling techniques and standardisation of ratings through different media (not necessarily across borders).
- > Network national and regional audiovisual policy makers, public funding agencies and industry associations to help establish a range of support projects that promote a European dimension in VOD development.

II Recommendations to promote cultural diversity and a competitive European creative sector

Creating demand for European audiovisual works

The EC should support the European audiovisual sector in developing and implementing innovative marketing and branding strategies to reach new audiences.

- > Marketing support should be given to films that win awards at A-list festivals or European prizes, to further encourage international VOD releases and promote European cinema and its image.
- > EU support programmes should give more support to rights holders who wish to further fine-tune and implement their digital marketing strategies in order to access video-on-demand markets. Funds should be available to develop and adapt digital applications that help to understand

consumer behaviour, facilitate closer engagement with target audiences through social media, and test new business models.

- > The MEDIA Programme should continue to encourage subtitling and dubbing to enable cross-border access to foreign language content.

Support risk taking and innovation

Public policy should encourage EU rights holders to experiment with new forms of digital distribution and test new business models in order to understand the new market place and its requirements.

- > The EC should promote the idea that a share of public support given to producers in the EU should allow those that wish to do so to retain some rights for digital exploitation, rather than selling them in bundles with other exploitation rights. This would allow them to build up a catalogue of rights to experiment and make the most of digital distribution.
- > Film-funding bodies across Europe should consider the establishment of audiovisual innovation funds linked to existing technology innovation funds.
- > Broadcasters and digital operators should be encouraged to return digital distribution rights to independent producers after a certain period of time and/or if these rights remained unexploited.
- > More flexible or shorter release windows should be considered, in particular with theatre owners in relation to European titles that were given no or limited theatrical release..
- > Better co-operation efforts within the sector must be reflected by the public sector. EU programmes and projects that could be to the benefit of VOD (MEDIA, CIP ICT PSP (Digital Libraries), Europeana, FP7/8, Lifelong Learning, Culture, etc.) need to be more in sync.

Finally, the sector must develop its skills relevant to the new digital market place, its general awareness of new information technology trends and its understanding of new consumption behavior. Training programmes to develop these capacities, as well as an innovation voucher scheme specifically tailored for the needs of the European film industry, are suggested in this respect.