Le Secrétaire Général

By e-mail, fax (00.32.2.295.01.28) and express mail

May 26, 2005

Mr. Herbert Ungerer
Head of Unit – Media
Directorate General for Competition
European Commission
Rue de Genève / Genévestraat, 1
1140 Brussels
Belgium

Re: Case COMP/C2/38.440 – Universal Music v. BIEM

Dear Mr. Ungerer,

I am writing to you in answer to the letter you sent me last May 18 enquiring about the "*state of play*" of the issues we discussed during our March 11 meeting, for which we must thank you once more.

As indicated at the end of such meeting, the concerns you shared with us required careful attention in order to carry on in a constructive manner our valuable dialogue. An internal reflection was therefore launched within BIEM.

After a brief presentation of the status of the on-going negotiations with IFPI (**a**), please find hereafter the results of the reflection reached at this stage concerning the minima / maxima provisions contained in the BIEM-IFPI Standard Contract (**b**) and the vertical effect you deemed to exist with regard to the BIEM-IFPI Standard Contract (**c**).

a) The on-going negotiations with IFPI

During their last meeting which took place on April 7, 2005, the BIEM and the IFPI representatives were not able to reach an agreement on the outstanding issues which were discussed with you at the March 11 meeting. Therefore it was decided to resume discussions at the end of the summer period.

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However, as the President of BIEM stressed in his letter to the Chairman and CEO of IFPI in a letter dated May 18, 2005, the decision adopted on April 12 by the *Schiedsstelle beim Deutschen Patent- und Markenamt* (the Arbitration Board at the German Patents and Trademarks Office; hereafter the "*Schiedsstelle*")) in the dispute between GEMA and the *Deutschen Landesgruppe der Internationalen Vereiningung der Phonographischen Industrie e.V.* (the German Group of IFPI) "*has created a new situation for the present period*" (see Enclosure 1).

As you may recall, application was made by the German Group of IFPI to the *Schiedsstelle* to settle a dispute with GEMA concerning equitable remuneration for audio carrier licenses. In its April 12 decision, a copy of which was sent to you by BIEM's outside counsel, Hugues Calvet last April 29 in its original German version (a copy of the decision in the language of the case is enclosed – see Enclosure 2), the *Schiedsstelle* fully confirmed GEMA's views and legal positions in all respects and rejected all of IFPI's arguments. The *Schiedsstelle* thus considered that a royalty of 9.009% of the Published Price to Dealers (PPD) is equitable and emphasized the need for a minimum royalty.

According to the German regulation on arbitration procedures, the *Schiedsstelle*'s decision was in fact a proposal on a way to solve the dispute between GEMA and the German Group of IFPI which would become final, failing a challenge by one of the parties within a four week deadline. Due to the absence of any appeal by the German Group of IFPI within the set deadline before the Munich Court of Appeals, the *Schiedsstelle*'s proposal constitutes the agreement between the German Group of IFPI and GEMA containing reasonable terms and conditions for the use of musical works on sound carriers. As a result, the 9.009% royalty rate provided by the BIEM-IFPI Standard Contract as well as all the other provisions of the BIEM-IFPI Standard Contract, *inter alia* the minima / maxima provisions, are applicable from July 1, 2000 to December 31, 2005 in Germany, the most important market of the European Union.

Therefore, such decision from the national regulator obviously creates a new environment for the BIEM-IFPI negotiations which must be taken into account in the negotiations with IFPI, whose arguments against the minima / maxima provisions and the equitable character of a 9.009% royalty rate were rejected.

b) The minima / maxima provisions

As has just been mentioned, the decision reached last April 12 by the *Schiedsstelle* stresses the importance of the minima / maxima provisions contained in the BIEM-IFPI Standard Contract for the protection of the right-holders' interests and entirely confirms BIEM's position on this point.

Indeed, it should be emphasized that under the Standard Contract, authors grant users a blanket license which enables the subsequent exploitation of their works, generally without any further authorization. Thus authors renounce the right to refuse at a later stage, for reasons of insufficient remuneration, their authorization. Authors abandon their fundamental prerogative, in other words their exclusive right to authorize or to refuse the exploitation of his work.

It should be specified that the Standard Contract does not however give authors or the collecting societies any control over the basis of the royalty, in other words the prices applied by the producers.

Under these conditions, the minimum remuneration, as well as the maximum number of works or tracks to be included on the same carrier[1], is only the indispensable compensation for the abandonment by authors of their right to refuse the reproduction of their works for reasons of insufficient remuneration.

The assurance given to the users of an unconditional access to musical works would seriously affect the very existence of copyright should authors, having abandoned their right to refuse their authorization, be moreover deprived of the inherent guarantee necessary to the abandonment of this prerogative, the minimum royalty. The latter is obtained through the provisions concerning the minimum royalty and the maximum number of works or tracks to be included on the same carrier.

The minima / maxima provisions are in fact nothing else than the recognition of a minimum wage for authors for the exploitation of their work by the industry. These provisions have the same function as that of a right to a minimum wage for wage earners. Numerous elements of cost – national insurance contributions, social security benefits and modalities of remuneration – are of the same nature as that of the minimum royalty.

The importance of such provisions can be illustrated by the following example, which is far from being hypothetical. Should a producer choose, in order to promote a given carrier, to give away other carriers, what would the remuneration of the author whose works are being given away be? Nothing because an author's remuneration is calculated on a sales price.

It should be added that agreements containing such provisions guaranteeing remuneration are standard in the musical industry. For instance, contracts between record producers and performing artists very often provide for minimum royalties (non-refundable advances), as the Commission could easily establish. Agreements by which a producer grants a license to another producer in fact also contain minimum royalties in the form of non refundable advances, for instance where the license is granted for compilation purposes.

The minima / maxima provisions are clearly necessary, as the *Schiedsstelle* recalled, for the protection of the right-holders' interests and more generally of copyright. In this respect, BIEM fails to see how they can be contrary to competition law all the more as they affect all the producers in the exact same way and thus create absolutely no distortion of competition.

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[1] It should be recalled that the provision concerning the maximum number of works or tracks that can be included in a single sound carrier in no way prevents the inclusion of a greater number of works or tracks on a given carrier. It only means that should a producer wish to add more works or tracks on a given carrier, he will pay a higher royalty, calculated proportionally to the number of works used. The maximum in no way increases the royalty due to the author. Its sole purpose, on the contrary, is to maintain this remuneration for the exploitation of a given work since the price of a carrier, basis of the royalty, does not increase with the number of works or tracks included. In the absence of such maximum provision, the more works a carrier would include, the lower the authors' remuneration would be for the exploitation of each work.

c) The vertical effect of the BIEM-IFPI Standard Contract

During our March 11 meeting, you expressed some concern regarding the vertical nature of the BIEM-IFPI Standard Contract, especially if this was accompanied by elements of foreclosure. I am happy to point out to you that such foreclosure does not exist. Indeed, alternative licensing schemes can and indeed do exist in addition to the BIEM-IFPI Standard Contract.

First of all, it is already possible for users to obtain a license on a work by work basis. In this scheme, payment is made upon manufacture of the sound carrier and there is no administrative burden linked to the reporting of sales.

Moreover, in at least two countries, France and Germany, alternative agreements to the BIEM-IFPI Standard Contract have been signed with associations of independent producers.

In France, the agreements signed with the independent producers differ from the agreements concluded on the basis of the BIEM-IFPI Standard Contract and are particularly suited to the needs of independent producers. In particular, they provide specific terms for returns and TV advertisements (see Enclosure 3 for the model contract entered into by SDRM with independent producers, which only exists in French).

In Germany, apart from the BIEM-IFPI and the work-by-work licensing schemes, GEMA proposes two contracts:

- A contract for small labels

  For small labels, *i.e.* labels whose payments to GEMA are lower than 2.500,00 € per quarter, GEMA proposes a simplified framework contract which differs from the BIEM-IFPI Standard Contract where returns and advance payments are concerned (see Enclosure 4).

  Such framework contract was concluded with the *Verband Unabhängiger Tonträgerunternehmen, Musikverlage une Musikproduzenten e.V.* (hereafter, "VUT") as well as with the *Verband Deutscher Musikschaffender* (hereafter, "VDM") and the *Deutscher Rock und Pop Musiker Verband e.V.* (Association of German Rock musicians).

  To this date, 755 members of VUT and 31 members of VDM have concluded contracts on this basis.

- A contract for bigger labels

  For bigger labels, *i.e.* labels whose payments to GEMA exceed 2.500,00 € per quarter, GEMA and VUT have agreed on the content of the full BIEM-IFPI Standard Contract (see Enclosure 5).

  Such contract is available since October 2004 and so far, two members of VUT have signed such agreement and GEMA is negotiating with approximately 20 more members.

These examples show that the BIEM-IFPI Standard Contract as it now stands allows BIEM members to enter into agreements with other groups of users than IFPI and that flexibility exists in the BIEM-IFPI system.

In any case, I would like to stress that the application of the BIEM-IFPI Standard Contract by the BIEM societies stems from Article 7 of the BIEM statutes which were notified to the European Commission on February 24, 1998. It should be added in this respect that the Standard Contract as such was at the heart of the notification of the BIEM Statutes: its importance as well as its rationale were explained at length. The BIEM Statutes were granted clearance by way of a comfort letter in the following terms: "*It* [the examination of the case] *showed no reason for the Commission to intervene on the basis of the provisions of Article 81.1 as regards the notified agreement as this agreement does not restrict competition in a sensitive manner within the meaning of this provision*" (Free translation of the letter dated December 4, 2000 – See enclosure 6).

As underlined in the notification of the BIEM Statutes, which provide for the BIEM-IFPI Standard Contract, this Standard Contract does not prevent the development of centralization agreements which the Commission has considered as having created competition between collecting societies.

Such Standard Contract in fact is pro-competitive insofar as it leverages the playing field between the users. Indeed it guarantees that **all** producers have access to the whole range of repertoires managed by the BIEM member societies in rigorously non-discriminatory conditions. The big producers, *e.g.* the four majors, which hold approximately 80% of the worldwide record market and the small and medium record producers alike have access to the repertoires managed by the BIEM member societies. And the access to the repertoires is guaranteed on a non-exclusive basis.

Furthermore, alternative solutions, such as individual negotiations taking place within each collecting society, inevitably raise the question of transaction costs which prove prohibitive both for the right holders and the users and result in a decline in the right holders' protection.

The advantages of a standard contract in terms of transaction costs are undeniable and have been underlined by the US Supreme Court, in the following terms:

> "*This substantial lowering of costs, which is of course beneficial to both sellers and buyers, differentiates the blanket license from individual licenses. The blanket license is composed of the individual compositions plus the aggregating service. Here, the whole is truly greater than the* (…) *sum of its parts; it is, to some extent,* a *different product. The blanket license has certain unique characteristics: It allows the licensee immediate use of covered compositions, without the delay of prior individual negotiations, and great flexibility in the choice of musical material. Many consumers clearly prefer the characteristics and cost advantages of the marketable package, and even small performing-rights societies that have occasionally arisen to compete with ASCAP and BMI have offered blanket licenses. Thus, to the extent the blanket license is a* different product, A*SCAP is not really a joint sales agency offering the individual goods of many sellers, but is a separate seller offering its blanket license, of which the individual*

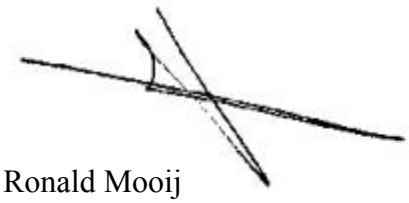
> *compositions are raw material*. A*SCAP*, (…) *in short*, *made a market in which individual composers are inherently unable to compete fully effectively*" (*Broadcasting Music Inc. v. Columbia Broadcasting System*, 441 US 1 (1979)).

Finally, I wish to add that in the absence of any collective agreement concluded with users, the majority of users would inevitably refuse the terms and conditions set by the collecting societies for the exploitation of the works they manage and try to pay the least possible. As a consequence, right holders will not be receiving the royalties due for the exploitation of their works and the collecting societies will be forced to go to court and litigate to protect their interests, which will obviously prove detrimental both time-wise en cost-wise for right-holders.

I hope the above answers your queries. I can assure you that I am open to any comment or any observation you may have that would enable us to continue our constructive exchanges and welcome any opportunity to carry on our dialogue.

I remain at your disposal.

Yours sincerely,



Ronald Mooij

Encl. (due to their size, the six above-mentioned enclosures will not be faxed but only sent by e-mail and express mail)

BIEM N° 0517

Cc: Messrs. Torben Toft and Alain Andriès