

CONSULTATION RESPONSE



Communications Review
Department for culture, media and sport
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DATE: - 7th July 2011
TO: - Rt Hon Jeremy Hunt MP
RESPONSE BY: - Dr Robert Reid, Which?

Communications review for the digital age

INTRODUCTION

Which? is a consumer champion. We work to make things better for consumers. Our advice helps them make informed decisions. Our campaigns make people's lives fairer, simpler and safer. Our services and products put consumers' needs first to bring them better value.

Which? is a not for profit consumer organisation with around 700,000 members and is the largest consumer organisation in Europe. Which? is independent of both Government and industry. We welcome the opportunity to respond to the open letter from Jeremy Hunt on the Communications Review for the Digital Age.

We agree that the review's focus on removing barriers and encouraging innovation in the communications sector is the right approach to ensuring the UK's future competitiveness in this market. However, we also think that it is essential that the outcome of the review and any subsequent legislation sets a balance between ensuring that consumers are protected and maximising competition as well as releasing industry from restrictive rules to encourage innovation.

**For all
consumers**

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Which? has not formed a view on many of the questions set out in the Secretary of State's letter and as such we will respond to that for which we have the most evidence:

Question 12 - What barriers are there to innovation in new digital media sectors, including video games, telemedicine, local television and education?

Over regulation in the digital media sector

Which? has already stated in its response to the recent "Independent Review of Intellectual Property and Growth" prepared by Professor Ian Hargreaves that it considers over-regulation a significant factor restricting innovation in the digital media sector.

The example provided to the Hargreaves review was that of ATVOD licences. In this field, the Association for Television on Demand ("ATVOD") currently regulate on demand programme services. At present this means that website owners who provide online video content via their own websites must pay a fee in the sum of £2900.00 to ATVOD. This impedes the ability of website providers to offer new innovative on demand technologies even where it is not a separate broadcast. Over regulation such as this inevitably stifles attempts by website providers to provide content through new innovative channels.

Barriers of rights clearances

Which? maintains that an impediment to growth in the digital media sector is the relative lack of multi-territory and pan-European rights licensing. Which? believes that both individual corporate rights holders as well as collecting societies should actively seek to offer and promote multi-territory licensing solutions. Which? is aware that the European Commission's Communication on a Single Market for Intellectual Property Rights (Ref: COM (2011) 287(final)) addresses this subject. However, this Communication provides no details as to the system to be put in place to achieve these goals.

Which? has also seen and protested against the abuse of territorial licensing to the detriment of the consumer. Without doubt some international rights holders use IP rights to control distribution and thereby pricing and availability of goods across member states.

Opportunities and barriers in the provision of goods and services

The internet has been one of the truly revolutionary changes of modern times, and there is no doubt that the opportunities it offers to manufacturers, retailers and consumers are immense.





Online opportunities exist in more or less every commercial sector, although they are more obvious in some, for example, in relation to music, film, books, and travel. At present, opportunities appear to be more limited in the luxury sector or for high value purchases such as cars. However, the success of eBay shows that consumers are, given the choice, willing to purchase almost anything online and that it may be difficult to accurately predict what consumers will want from online goods and services.

Accordingly, Which? would suggest that any review of public policy should aim to create the greatest amount of consumer choice by encouraging innovation but should also take care not to prejudge consumer needs prematurely. Principles-based governance and deregulation are one way of encouraging innovation, but this must not be at the expense of consumer protection.

Consumer behaviour as a barrier to uptake of innovative goods and services

An OFT study published in August 2010 found that one in five (19 per cent) UK consumers never buy online or have not done so in the last year. Of the 80% who had bought something online on the year preceding the research, 40% were concerned about being ripped off or conned by companies they buy from online and 61% were more worried about this in an online environment than an offline one. When these consumers were asked why they still buy things online despite these concerns, the top answer given was that I only visit the sites that I trust (40%). Such a high level of mistrust of online shopping, even amongst those regularly engaging in e-commerce, is likely to act as a significant barrier to the uptake of innovative new goods and services for which familiarity will be low.

Reasons given by consumers for not engaging with e-commerce mostly centre on a lack of trust and concerns around the security of data such as financial details. The OFT research found that 69% of those engaging in e-commerce in the UK have concerns over being conned or others accessing their personal data.

In addition to the barriers to e-commerce are additional barriers to cross-border e-commerce. Eurobarometer data published in March 2011 has shown while a significant proportion (37%) of EU consumers made a purchase online over the 12 months preceding the report, far fewer shopped cross border, only 7% of EU consumers bought goods or services via the Internet in the 12 months preceding the research from a seller/provider located in another EU Member State.

We have found that the key barriers to cross-border e-commerce are concerns over whether customers can get an exchange or refund should something go wrong (62%), preferring to support



UK companies (57%), concern over personal data (36%), and negative perceptions of delivery time (33%).

Given that the key concerns of consumers that currently act as a barrier to their taking up online goods and services are related to their protection online it is of absolute import that any steps to deregulate innovative service and content providers do not result in behaviours that will further erode consumer trust. Such a move would only be damaging to the digital content industries in the long term.

Intellectual property rights and exclusive distribution agreements as a barrier to the uptake of innovative goods and services

Although the vertical block exemption prohibits restrictions on passive extra-territorial sales, the practical reality is sales of goods across territories are relatively rare¹. There are a number of practical ways round this prohibition which are commonly used by manufacturers. A key mechanism is the use of intellectual property rights and in one form or another, such rights will exist in virtually every product. Given such rights are territorial in nature, a single country licence will always act to prevent extra-territorial sales.

Specific consideration of the issues concerning IP rights are discussed below. But even where a distributor has licensed the IP rights in a number of countries, there are additional mechanisms that are frequently used to generate a degree of territorial protection.

For example, in an exclusive distribution network, a manufacturer will know what the national demand is for each product and supply his national distributors accordingly. The practical result is that a distributor only has sufficient stock to service his market.

In addition, exclusive distributors will be aware of the commercial intentions behind the distribution network, and will know that even if allowed to passively sell outside their territory, engaging in such activity is unlikely to be met with approval. The threat - whether real or fictitious - of having reduced supplies and/or poorer trading terms in the future deters extra-territorial sales. Why take the risk when there is little reason to?

¹ Roughly three-quarters (74%) of retailers in the EU did not sell products or services to customers in other EU countries. This proportion was slightly higher than was measured in 2009 (71%), but similar to what was observed in 2008 (75%), Flash Eurobarometer 300, March 2011



Similar considerations will apply to retailers, and it is for such reasons, that all too frequently we see online companies refusing to deal with customers outside of their home territory. In some instances the refusal can be justified for example due to the different or excessive costs of cross border delivery. In others, the refusal will simply stem from a unilateral decision to legitimately focus the business on a core set of customers (for example, to maintain service levels).

However, in some situations, the refusal to deal is more manipulative. This is particularly the case online where technological advances have, for example, allowed businesses to influence the websites that consumers visit. Many multinational companies automatically direct consumers to the local website through technology that recognises the nationality of the ISP or the IP address being used. It is true that in some cases, consumers will welcome the convenience of such a mechanism, but this is not always the case. For example, Germans living in the UK may prefer to use the German website instead.

For much of the time this technique enables different prices and/or trading terms to be offered in different countries by rights holders/retailers. This is a frequent problem in the travel industry, and while it should be addressed by the Services Directive, Which? is concerned that the practical reality may be little different given the breadth of the exemptions that will be available.

Selective distribution systems

Competition policy provides for the use of selective distribution systems by certain manufacturers in certain situations. We accept that such systems can be justified in some circumstances, for example on certain health and safety grounds. However, it is our contention that too many selective distribution arrangements are used in circumstances that cannot be objectively justified.

As the eBay experience shows, consumer needs and the business expectation of what a consumer needs are not always aligned. While the brand owner may believe that a certain level of staff qualification or after sales care, or a particular kind of sales ambience is required, Which? questions whether the average consumer would always share the same view.

Nevertheless, we acknowledge that there will always be some goods that consumers would prefer to buy offline because after-sales support is needed or because it is necessary to speak to an expert while sampling the goods. However, much greater scrutiny of the grounds on which a selective distribution system is justified is required to ensure that intra-brand competition (or



inter-brand) is not restricted, in particular, where the criteria of selective distribution is used to maintain territorial exclusivity.

Territorial Protection founded on IP rights

It is our experience that IP rights are used by manufacturers to manipulate the markets in the physical world. For example, companies regularly sell slightly different products in different countries but using the same trademark. This means that while the doctrine of exhaustion on first sale applies and the products can be moved freely around the EU, the goods cannot be sold as equivalent to the national product.

For example, assume a manufacturer sells product A in country A and a slight variation, Product B, in country B. A retailer will be able to buy Product A and sell it in Country B, but he will not be able to sell it there as if it is a Product B equivalent - the fact it is different needs to be made clear. The practical reality is a product that is less attractive to consumers and therefore territorial protection.

Examples where this arises include toothpastes (where different levels of fluoride are used); washing powders (where different chemical compositions are used); cds (where an additional track is included or different track order is used); and dvds (which have different language versions and different additional features).

Nevertheless, one cannot ignore the importance of intellectual property rights to business and the development of Europe as a whole, and Which? would certainly not advocate measures that seriously undermine such rights. However, there is a conflict within the European Treaty that needs to be resolved, and this requires compromise. There are circumstances where it seems that the pendulum is swinging too far in favour of the rights holder.

It seems that territorial protection is more justified in some circumstances than others. The challenge is to draw an appropriate line. Where businesses are taking advantage of the law to segment markets, arguably steps should be taken to prevent this. The use of IP law to create territorial protection for identical products would seem to fall into this category. So too would situations where artificial differences are made to products (e.g. using different trade names, or slight variations in compositions) so that essentially identical products can be sold as “different” products in different territories.

However, there will be situations where product differences will be necessary and where the territorial protection could be justified. For example, due to different national requirements,



needs or tastes. These need to be identified and the appropriate protection for the rights holder assured.

Issues of copyright in the music industry specifically - the case of iTunes

The creation of a competitive single market economy on the one hand and, on the other, the right for IP rights holders to exploit those rights freely, creates a conflict within the European Treaty that has been recognised for some time. However, the issue has received greater attention recently as a result of the iTunes case, where a solution to the problems Which? identified could not be solved without addressing this overriding conflict.

Which? lodged a complaint with the European Commission because it did not seem right that consumers in the UK were paying more to download songs from iTunes than their European counterparts. Which? was also concerned that UK consumers could not access the foreign iTunes stores to overcome this price differential. Although Apple agreed to align the prices across the EU, consumers are still unable to shop cross border. This prevents consumers in some countries from accessing iTunes at all, while others are prevented from accessing all the songs they want.

While our complaint related just to music, Which? is aware that similar issues will arise in other circumstances, such as in relation to downloadable films and videos.

The predicament was explained to us as follows. While Apple wished to offer a pan-European iTunes service, they could not as they did not have all the necessary IP rights. The music industry is very fragmented meaning that the relevant IP rights are spread across a large number of companies and individuals. The position is further complicated because in any given musical composition, there are a variety of different copyrights and these are often owned by different individuals e.g. artist, publisher etc. As a result, not only is it difficult to identify who owns what, but in order for a retailer to offer a wide range of music, it is necessary to negotiate with a large number of counterparties. Furthermore, collecting societies operate on a national basis, having failed to establish a pan-European operational model, which effectively forces companies, such as iTunes, to operate on a country by country basis.

To date, it is probably fair to say that the policy of IP rights protection has overridden competition policy and so been allowed to impede the creation of a single European market. As such, until and unless the market compartmentalisation that is permitted under IP law is addressed, it will not be possible to deliver the full benefits that competition can bring.



Of course it would be useful if the record companies, retailers such as iTunes and the collecting societies could reach an agreement as to how pan-European copyright licensing can work effectively in practice. Each party says this is what they want or need to achieve in the long term. However, if that is the case, why has no solution been forthcoming so far? The argument that the issue is too complex is not sustainable - where there is a will, there is a way.

If no such solution can be found in the short term DG Competition should ensure that consumers in the EU are not prevented from shopping cross border by IP rights. When the Single Market and free movement of goods and services are heralded as cornerstones of the European Union, it is illogical that IP law be permitted to prevent consumers from accessing goods and services cross border.

