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Barriers to the creation of cross-european video on demand services and compatibility of the existing practice of market fragmentation with the freedom of movement of goods and services

di
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Executive Summary: Development of Video On Demand services and other online marketplaces for audio-visual content is hampered by the complexity of building cross-national services capable to exploit the benefits of the Single Market. Commercial practices currently put in place by rights-holders in licensing online content rights, based on the principle of territorial exclusivity, make it very complex, if not impossible, to launch such cross border services. The authors assess the compatibility of such practices with the cornerstone of the EU Treaty, i.e. the freedom of movement of goods and services, in the light of the recent decision of the European Court of Justice concerning the use of foreign satellite decoder cards for the broadcasts of Football Association Premier League. Alternative possible policy approaches to balance conflicting interest are explored, including principles applied to distribution agreements by the EU Guidelines on Vertical Restraints 2010/C130/01.

1. The cross-national dimension of VOD

Following the digitization of content, the IP based distribution of entertainment and information services is proliferating, representing a valuable opportunity for Europe. The online distribution of audio-visual content has, in fact, the twofold potential to improve the consumer welfare, by responding to the end users' growing needs and demand to shift to online services, as well as to increase business opportunities for all the operators involved in the audio-visual value chain.
Video on demand (VOD) is emerging in many countries as the most promising business model for IP-based distribution of content. It involves developing and making available a library of premium and other content (movies, documentaries, series) so that user may select and view what he wants when he wants it. VOD is the natural chain substitute of the more traditional physical Home Video rental/sell-through business, making content distributed online available to end users for a limited period or permanently, either through streaming, download or different mechanisms such as the "digital locker" in which the content is stored in the cloud and made accessible by the purchaser via multiple devices.
Although its flexibility and potential makes VOD appealing to consumers and distributors of audio-visual content throughout Europe, the impossibility to launch a cross-national service represents a huge barrier and slows down its development. Scale is, in fact, a key element in the successful deployment of any VOD business.
Unlike the traditional Home Video distribution system - in which distribution costs were very much proportional to the number of users potentially reached by the service - IP distribution has dramatically changed this paradigm. An online service

has very similar fixed costs whether the service is provided in one or all EU countries. The development of a digital single market may therefore play a critical role in the success of these new distribution models.

2. Barriers to the development of VOD services

Although in theory there is no formal legal provision which prevents the development of a unique continental marketplace for digital content and the launch of cross-border VOD services, the commercial practices currently put in place by rights-holders in licensing content rights, as well as the existing regulatory framework, make it very complex, if not impossible, to launch such cross border services.

As a legacy from the brick-and-mortar Home Video rental business, licensing of content by right holders (major studios, independent producers, broadcasters) is, in fact, still managed at national level based on the concept of the "territorial exclusivity". This means that, after licensing the content in a given country, the VOD operator can only make it available locally and has to apply DRM measures (such as geo-filtering of IP addresses) to prevent EU citizens living in different countries from accessing that content. A provider willing to put together a cross-national EU VOD service, thus exploiting the low distribution costs of digital distribution, would therefore need to negotiate and sign a specific contract in each specific territory. This has very much to do with the fact that online rights are still managed in many cases in bundle with other forms of distribution (traditional linear broadcasting for instance) for which the territorial dimension still makes more sense than the European one.

Besides the complexity and the huge transaction costs entailed, this mechanism makes it extremely difficult to build a homogenous offer as in many countries rights for online distribution are dealt by the right holders on an exclusive basis and under very different terms. This has two different negative impact:

1. Many titles may simply be not available in some territories, as they have been licensed exclusively to one distribution platform. In countries where traditional broadcasters enjoy for historical reason a high bargaining power, the number of "current" movies potentially made unavailable for VOD is very high, as traditional broadcaster license a bundle of exclusive rights, often including free-to-air, pay and online distribution [1].
2. VOD has, in fact, been perceived by traditional broadcasters as a threat as it may lead to the establishment of alternative and powerful distribution models for video, in direct competition with broadcasting. As a consequence, whereas rights for traditional Home Video have never been dealt on "exclusive" basis, broadcasters ask in many cases to acquire exclusive rights for online VOD rights in bundle with traditional broadcasting rights. This reduces enormously the capability of emerging VOD players to build attractive legal offers.

   The need to negotiate and acquire right on a country by country basis does not entail simply having different libraries for each territory, but also different economic conditions, retail prices, availability dates, usage limitations, as again the conditions at which the rights are negotiated depends by the local branch dealing it. This creates another huge barrier for a would-be pan European VOD service, as it makes extremely difficult for the VOD operator to explain to its users why a specific title is available on a specific date for its French audience and only few

weeks later for the Italian users, or why a different price is applied in different countries or why the usage conditions attached to the transaction (how many hours the user has to watch the movie after the transaction, how many devices can be connected to the same account, etc.) vary from country to country.
Beside the above issues, the impact of the collective right management system on the digital single market is also relevant, creating additional complexities.
Fact is, even when rights are acquired by VOD platform operators for each country, a further territory-by territory clearance has to be gained through the national based Collective Management Organizations (CMOs). The relevance of the behaviour of collecting societies was confirmed by the European Commission in the antitrust decision of 2008 [2].
As a result, audio-visual content that could easily be distributed through one online VOD platform to the potential audience of the entire continent is instead subject to several deals and to clearance 27 times through 27 different CMOs. All such deals involve transaction costs and potential restrictions, which dramatically hamper the rollout of cross-border services.
The situation described seriously frustrates the possibility to develop EU-wide VOD platforms and puts Europe at serious disadvantage compared to the USA, where VOD/online rights are licensed in a one-stop shop approach for the whole territory and in a non-exclusive way, allowing several players to compete on quality of service and business models. The artificial fragmentation of digital distribution in Europe instead, used by the right holders to extract the highest monopoly rent in each country, is possibly the biggest reason for the low level of development and penetration of VOD and other digital distribution platforms in Europe.
Territorial segmentations of rights and the artificial partitioning of the single market.

3. Territorial segmentations of rights and the artificial partitioning of the single market

Having set the problem, we want to explore more in depth whether this artificial partitioning of the single market is an inherent and inevitable effect of the exclusive rights granted under the intellectual property system and whether and to what extent it is compatible with the Treaty.
As it is well known, intellectual property rights such as copyright are monopoly privileges granted to creators and owners of works that are results of human intellectual creativity which provide their owners the right to exclude others from accessing to or using such works without the authorization of the right holders for a limited period of time [3].
By creating and protecting such right to exploit exclusively the creative work and exclude others from using their ideas or forms of expression, IPRs provide economic agents the incentives for innovation and for the creation of new forms of artistic expression.
So the ultimate rationale of IPRs is to encourage firms to innovate and thus engage in a competition based on increasing quality and diversity of goods and services, which is also the objective of competition policy.
As both IPRs and competition policy are essential to promote innovation, it is critical to strike the right balance and ensure a competitive exploitation of the legal

monopoly granted to the innovators by IPRs. It is therefore necessary to guarantee their co-existence by ensuring that IPRs are not abused [4].
When exploiting such rights in the European Union though, there is a further limitation to the way in which the legal monopoly created by Intellectual Property rights may be exploited, and that is represented by the Single Market.
As well known the creation of a single market based on the free movement of goods, people and services and the capability of EU citizens to get goods and services everywhere in the EU territory is the cornerstones of the EU Treaty.
The restrictions to competition imposed by the exploitation of exclusive IP right are therefore compatible with the Treaty only if they do not arbitrarily discriminate or contain a disguised restriction on trade between Member States. The European Court of Justice (ECJ) has the power to further fine-tune the relationship between the freedom of circulation of audio-visual goods on the one hand, and the effects of the exclusivity of intellectual property rights on the other.
Nevertheless, although efforts have been made during the past twenty years to harmonize some aspects of copyright law in the European Union, the current copyright system is still based on the principle of territoriality.
This means that the scope of the copyright protection is determined “per territory” and rights can be exploited on a territorial basis. As stressed above, from the perspective of media platforms willing to distribute audio-visual works, this means that in order to be able to operate on a pan-European basis they must obtain from the right holders a specific licence per each territory of the EU in which the work is to be made available, so as to avoid liability for copyright infringement
It is evident how this practice made a lot of sense in the traditional broadcasting environment, where television had, for inherent linguistic and cultural barriers, a specific national dimension. Broadcasters were national entities, interested in reaching their national audiences, hence acquiring rights that were limited to the territory in which they were operating (and on an exclusive basis) was the logical consequence. Even the emergence of satellite DTH distribution did not challenge the local nature of broadcasting: although from a technical point of view TV signals could reach continental dimension, broadcasting – i.e. the editorial organization of a line-up of programs by a broadcaster - remained a strictly local rather than a continental business.
IP based distribution of non-linear services introduces, instead, a new concept which, for the first time, can have a continental dimension and thrive in the Single Market. Creating a library of on demand content - which can have different language soundtracks and vary considerably so to cater to audiences with diversified tastes - is a venture that can and should be built having in mind a European dimension. Still, even rights for IP distribution such as for VOD platforms are dealt by local branches of international majors and independent producers on a territory by territory basis. Therefore, unless the VOD player acquires rights for every single territory in the EU, although technically it may potentially make its VOD library accessible to any EU citizen, it will have to artificially block potential customers living in a different country from accessing it.

4. The European Court of Justice Decision on Football Association Premier League case

So far, this artificial segmentation had never been challenged as potentially in contrast with the Treaty, as the right of the IPR holder to negotiate and license content on a territorial basis and through territorial exclusivity was considered key to achieve a far remuneration.
Nevertheless, in a recent decision [5] concerning the use of foreign satellite decoder cards for broadcasts of Football Association Premier League matches, the ECJ has taken a different - and potentially disrupting -approach in identifying the right balance between copyrights in the broadcast of football matches and the principle of the freedom to provide services, as well as the interface with EU competition law.
The above decision provides interesting elements that can shed light also on the more general issue on whether the artificial fragmentation of the market in the exploitation of audio-visual rights can be deemed to be compatible with the Treaty.
With specific regard to relationship between freedom of service and exclusive right of digital transmission, the ECJ confirmed that any restriction of a fundamental freedom can be justified only if it pursues a legitimate objective or by overriding reasons of public interest, and in any case if it does not go beyond what is necessary to achieve the objective or interest in question. The ECJ held therefore that, although IPRs are intended to protect the holder's right to exploit commercially the content in return for remuneration, only appropriate and reasonable remuneration should be protected.
With regard this point the Court observed that: *"It is clear from settled case-law that the specific subject-matter of the intellectual property is intended in particular to ensure for the right holders concerned protection of the right to exploit commercially the marketing or the making available of the protected subject-matter, by the grant of licences in return for payment of remuneration (…) However, the specific subject-matter of the intellectual property does not guarantee the right holders concerned the opportunity to demand the highest possible remuneration. Consistently with its specific subject-matter, they are ensured – as recital 10 in the preamble to the Copyright Directive and recital 5 in the preamble to the Related Rights Directive envisage – only appropriate remuneration for each use of the protected subject-matter. In order to be appropriate, such remuneration must be reasonable in relation to the economic value of the service provided. In particular, it must be reasonable in relation to the actual or potential number of persons who enjoy or wish to enjoy the service (…) Thus, with regard to television broadcasting, such remuneration must in particular – as recital 17 in the preamble to the Satellite Broadcasting Directive confirms – be reasonable in relation to parameters of the broadcasts concerned, such as their actual audience, their potential audience and the language version (…)" [6].*
The principle of territorial exclusivity provides the right holder the capability to get a premium price from a broadcaster in each territory, in exchange for the possibility granted to the broadcaster to become the only distributor of that specific content. Nevertheless, with regard to such premium price, the ECJ held that if such exclusivity has the effect of partitioning markets and creating artificial

price differences between Member States, then this approach to licensing content is to be considered in contrast with the single market objectives of the Treaty.
With regard this point the Court has observed that: 114 – "*Finally, as regards the premium paid by broadcasters in order to be granted territorial exclusivity, it admittedly cannot be ruled out that the amount of the appropriate remuneration also reflects the particular character of the broadcasts concerned, that is to say, their territorial exclusivity, so that a premium may be paid on that basis. None the less, here such a premium is paid to the right holders concerned in order to guarantee absolute territorial exclusivity which is such as to result in artificial price differences between the partitioned national markets. Such partitioning and such an artificial price difference to which it gives rise are irreconcilable with the fundamental aim of the Treaty, which is completion of the internal market. In those circumstances that premium cannot be regarded as forming part of the appropriate remuneration which the right holders concerned must be ensured.*"
Consequently, as observed by the ECJ, such a premium goes beyond what is necessary to ensure appropriate remuneration for those right-holders and therefore territorial exclusivity - and the restriction to trade it entails - are not justified.

5. The implications of the ECJ Decision for VOD and the relevance of Guidelines on Vertical Restraints 2010/C130/01

The ECJ arguments are particularly relevant for licensing mechanisms currently applied to VOD rights: the territory by territory licensing and the territorial exclusivity seem even less justified in the commercialization of VOD right, as through the so called "revenue sharing" mechanism the right holder gets a remuneration that is directly proportional to the amount of transactions, normally based on a percentage of the price paid by each user that rents or buys the single title.
Based on this mechanism, should the VOD operator make the content available also to users outside its territory this would immediately and automatically grant the right holders additional and proportional revenues. Therefore limiting the capability of the VOD operator to provide the content to users living outside the Member State where the VOD operator is established (and for which it has acquired the rights) may not be necessary to guarantee the right holders a fair remuneration.
It is obvious then that the only rationale beyond the fragmentation of the market is that it leaves the right holder the capability to license the content exclusively in each country to a single distributor, hence getting a "premium" fee associated to such exclusivity. But this premium is exactly what the ECJ deemed not justified or in any case not defendable when it jeopardises the principle of the single market limiting the free circulation of goods and services.
It should also be noted how such premium price is in most cases paid by dominant players (generally pay broadcasters operating on traditional platforms) to acquire rights for new platforms, often in a defensive approach, i.e. for pre-emption or in general anticompetitive purposes, to prevent the entrance in the market of new players and the development of innovative on demand services.
Not only the behaviour described harms the development of the single market, but also directly the consumers, as in many cases the broadcaster that acquires the

VOD right has no intention to make such a service available but is primarily interested in preventing others to do so.
The dilemma between the legitimate right of an IPR owner to exploit commercially its good or service on one hand and the superior common interest represented by the implementation of the single market has been faced by the Commission already and it has, in fact, led to imposing limits and constraints to the way other kinds of IPR rights can be exploited.
Specifically, the capability of an IPR holder to organise an exclusive distribution agreement - i.e. to arrange for a single distributor in each territory and prevent potential customers to acquire that service/product from a different distributor established in a foreign country (even via IP based platforms) - is strongly limited in the new Guidelines on Vertical Restraints 2010/C 130/01 ("Guidelines").
In drafting the new Guidelines the Commission acknowledges that the Internet is a powerful tool to reach a greater number and variety of customers compared to more traditional sales methods and could represent a powerful enabler to implement the single market at a whole new level. The capability of a distributor to use a website may have effects that extend beyond the distributor's own territory and customer group because the technology allows easy access from everywhere.
Such features of Internet has induced the EU Commission to limit use of territorial exclusivities on the Internet environment in the market of goods and services and to modify existing guidelines to stress that a customer must be allowed to access the web site of a distributor in a different country and contact such distributor to acquire the product or service.
Consequently, the same Guidelines provide that a commercial agreement between the owner or producer of goods and services and a distributor in a given Member State which prevents customers located in a different Member State from accessing the website of the distributor must be considered unlawful.
To reinforce such a concept the ECJ, in a recent decision on e-commerce for goods [7], has judged unlawful any contractual clause which de facto prohibits the Internet as a method of marketing or limits the capability of the distributor to engage in so called "passive sales" to end users wishing to purchase online and located outside the physical trading area of the member of the selective distribution system.
It should also be noted that only under very specific and exceptional circumstances and, in any case, for a very limited time the Guidelines allow the introduction of clauses preventing distributors from passive internet sales: *"§65 A distributor which will be the first to sell a new brand or the first to sell an existing brand on a new market, thereby ensuring a genuine entry on the relevant market, may have to commit substantial investments where there was previously no demand for that type of product (…). Such expenses may often be sunk and in such circumstances the distributor may not enter into the distribution agreement without protection for a certain period of time against (active and) passive sales into its territory or to its customer group by other distributors. (…). Where substantial investments by the distributor to start up and/or develop the new market are necessary, restrictions of passive sales by other distributors into such a territory or to such a customer group which are necessary for the distributor to recoup those investments generally fall outside the scope of Article 101(1) during the first two years that the distributor is selling the contract goods or services in that territory*

or to that customer group, even though such hardcore restrictions are in general presumed to fall within the scope of Article 101(1)" .
The provisions above clearly show how the possibility, under specific circumstances, for the IPR holder to prevent distributors to sell via Internet a product/service to customers established in a territory covered by a different member of the selective distribution system is justified by the need to protect the distributor, rather than to guarantee a fair remuneration for the IPR holder.
In any case, it appears even less evident why holders of different kinds of IPRs – such as copyright related to audiovisual content - should be entitled to a higher degree of protection, and excluded by the balance between different interests identified by the Guidelines. Such a higher degree of protection and the absolute capability to apply the territorial exclusivity seems rather a legacy from the traditional approach to audiovisual content distribution than the consequence of specificities of the audiovisual industry. Economic analysis of intellectual property has, in fact, already clarified the exercise of copyrights should balance incentives to innovation with the effort to limit any contractual clause aimed at restricting access [8], so any rhetoric suggestion about exclusivities in IP can't be considered as a valid argument.
On the other hand, it could be argued that should IPR holders of audiovisual content keep being granted this special protection, the same principle may be eventually be extended to holders of IPR for different products and services, hence slowly jeopardizing even in other sectors the very concept of the single market.
Alternatively, identifying tools that prevent the right holders from applying the territorial exclusivity – at least for a temporary period and for those rights that are strictly related to Internet - could prove to be key in unleashing the potential of online content distribution, ultimately generating huge benefits for authors, European citizens and the same right holders, as well as putting a stop to anticompetitive behavior of traditional broadcasters that appear to be the only players in the value chain benefiting from the existing framework.
There is no doubt, in fact, that the worries expressed by the recent case law by the ECJ indicate how the exploitation of IP rights on territorial exclusivity, besides not being compatible whit the new technological end economic framework of e-content distribution, is not deemed compliant with the Treaty and needs to be reformed based on what expressed in whereas 17 of Directive 93/83/EC that provides that "in arriving at the amount of the payment to be made for the rights acquired, (…) should take account of all aspects of the broadcast, such as the actual audience, the potential audience and the language version".
To this respect, the Guidelines then seem to offer a reasonable point of balance between the reason of different categories of stakeholders. Introducing the "passive sale" concept in the VOD market and allowing EU citizen to access content made available in any territory in the EU would prove the sound approach to allow the Internet to play a key role as a distributing platform, reinforce the digital single market, while not disrupting the existing structure of the market. The language fragmentation in the continent would, in fact, still largely protect the territory and audience of the distributors.
It would then be sufficient for the Commission, in interpreting the indication of the ECJ, to simply extend the Guidelines to the licensing of online content so to introduce a clear prohibition for right holders to prevent a VOD provider from limiting access to its service to any European citizen living in any of the EU

member states, irrespective of how and where the VOD operator has acquired the rights. This would allow a VOD operator that has acquired rights for a library and agreed to remunerate the right holder based on the number of transactions, to provide that service throughout the single market, not preventing potential users living in other countries to access its service. By acquiring content in multiple languages, the would-be pan-european VOD player would extend its potential reach, while at the same time guaranteeing a proportional and coherent stream of revenues to the right holders.
By making content, no matter where licensed, legally available to any potential user in Europe would ultimately provide advantages for right holders, as it would put several providers in competition, therefore leading to those operators competing not only on price but on features of the service and maximise the exposure of the work and the possibility of a higher number of end users to access it.

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Notes:
[1] Due to exclusivity deals for content rights signed by several Major Studios with traditional platforms (i.e. satellite/cable/ broadcasters), it is very complex for new players to develop offers including a complete range of titles. Broadcasters usually acquire online rights in a bundle with linear free-to-air or pay-tv rights having in mind, as a primary concern, the protection of their traditional revenues rather than the development of a new business. As a result, in many cases the acquisition of these rights does not lead to the creation of online marketplaces. The rights are bought and not used, thus hindering the development of online market and harming consumers. Major studios are reluctant to abandon such tying practices because they prefer to favour the consolidated relationships with the broadcasters.
[2] Commission Decision of 16 July 2008 (Case COMP/C2/38.698 – CISAC), C (2008) 3435 final, Brussels, 16 Jul. 2008, available online at: http://ec.europa.eu/competition/antitrust/cases/decisions/38698/en.pdf
[3] HURT, SCHUCHMAN, (1966), The Economic Rationale for Copyright, in American Econ. Rev., vol. 56, p. 421-432; KITCH E., The Law and Economics of Rights in Valuable Information, (1980), in J. Leg. Stud., vol. 9, p. 683-723; LANDES, POSNER, An Economic Analysis of Copyright Law, (1989), in J. Leg. Stud., vol. 18, p. 325-366; ID, The Economic Structure of Intellectual Property Law, Cambridge, Harvard University Press, 2003; MACKAAY E., An Economic View of Information Law, (1992) in KORTHALS ALTES et al., Information Law Towards the 21st Century, Deventer, Kluwer, p.. 43-65; PALMER T G, Intellectual Property: A Non-Posnerian Law and Economics Approach, (1989) ,in Hamline L. Rev., vol. 12, p. 261-304; PLANT A, (1934), The Economic Aspects of Copyright in Books, in Economica, vol. 1, p. 167-195.
[4] The TRIPS Agreement allows WTO members to apply national competition law to IPR-related anti-competitive practices. In the TRIPs agreement, the general considerations in paragraph 1 of the Preamble, read with Article 8(2), allows Members to take appropriate measures to prevent the abuse of intellectual property rights by rights holders. See Reductionist Competition Rules: A TRIPS Perspective", in Keith E. Markus, & Jerome H. Reichman, (eds.), International Public Goods and Transfer of Technology under a Globalized Intellectual Property Regime, Cambridge University Press, 2005, pp. 730-731; Pedro Roffe, "Control of Anti-competitive Practices in Contractual Licences under the TRIPS Agreement", in

Carlos M. Correa & Abdulqawi A. Yusuf (eds.), Intellectual Property and International Trade: The TRIPS Agreement, Kluwer Law International, 1998, pp. 279-280.

[5] European Court of Justice Decision in Cases C-403/08 and C-429/08 Football Association Premier League and Others v QC Leisure and Others Karen Murphy v Media Protection Services Ltd available on line at http://curia.europa.eu/jurisp/cgi-bin/gettext.pl?where=&lang=en&num=79888995C19080403&doc=T&ouvert=T&seance=ARRET

[6] Par 107 Judgment in Cases C-403/08 and C-429/08.

[7] European Court of Justice Decision in Case C-439/09 Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la Concurrence and Others available on line at http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62009CJ0439:EN:HTML

[8] See Richard A. Posner "Intellectual Property: The Law and Economics Approach" in Journal of Economic Perspectives—Volume 19, Number 2—Spring 2005—Pages 57–73; Ullrich (2001), Intellectual Property, Access to Information, and Antitrust: Harmony, Disharmony,and International harmonisation, p.366, published in Dreyfuss, Zimmerman and First (ed.), "Expanding the Boundaries of Intellectual Property", Oxford University Press, 2001 2 US Federal Trade Commission (2003), To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy, Chapter 1, p.2