

WIPO Guide

on the
Licensing
of Copyright
and Related
Rights

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Preface

The subject of licensing of intellectual property rights has always been of critical importance at WIPO. Considering only the area of Copyright and Related Rights, licensing is the most frequent, and often the most important activity which will take place in the life of a Copyright work or an object of Related Rights—those works and objects are licensed, and the products of those licenses are enjoyed globally, exponentially many times more often than the other activities which affect works and objects, such as sales, purchases, transfers, adaptations, and even their creation.

When you, the reader, see a film on television or at the theatres, hear music on the radio, purchase a book, a poster, a computer software program, a CD or DVD, etc., you are participating in the benefits and products which are the result of the licensing of Copyright and Related Rights. Millions of times a day, around the globe, the benefits of Copyright and Related Rights are experienced, as a result of the licensing of such rights.

But the world situation has become much more complicated, even dangerous of late, with the evolution and unprecedented growth and use of the Internet. In less than a second, a valuable work or object can be uploaded without authorization, distributed globally, and a creator or rightholder's entire market dissipated... with just a mouse click.

Conversely, millions more people every day gain the benefits of the Internet, through which works, objects, information and access, never before experienced or even available to them, legally come right into their homes or work. Life is enriched, knowledge is spread, education and learning are enhanced, businesses are supported, and the world has the ability to become a better place. This picture requires, however, that certain rules be established and followed, and in the context of this volume, those rules necessarily include relevant international laws and treaties (such as the WCT and the WPPT) within the mandate and competence of WIPO.

As this volume ably points out, licensing of Copyright and Related Rights is based on roughly equal portions in Copyright and Related Rights laws; contract laws; and industry practices. In order to analyze to the fullest possible extent the vertical and horizontal licensing process, and its many beneficial results, WIPO identified and engaged the services of individuals who have been recognized as experts in their respective fields, and who were not only active in their field, but who were in a very real sense pushing the contours of their industry through their work, their writings and their activities. On behalf of WIPO, I thank these individuals: I. Fred Koenigsberg, Lois F. Wasoff, Bert Sugayan, Howard M. Frumes, Tomohiro Tohyama, Pravin Anand, Mihaly Ficsor and Nils Bortloff. They are identified more fully in their chapters, and their outstanding work speaks for itself. I also thank all of those staff members of WIPO who worked on this volume.

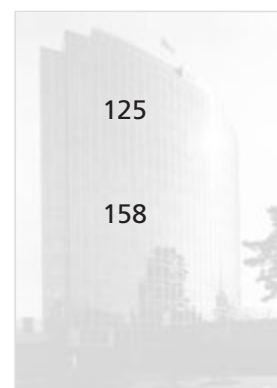
I take the opportunity offered by the publication of this volume to re-confirm to WIPO's various constituencies, including its Member States, industry, public consumers and civil society, that WIPO will continue to provide relevant, useful information, such as this volume, in all areas of intellectual property; that WIPO will strive to provide the essential global forum of choice for all intellectual property issues; and that WIPO will do everything in its power, and within its resources, to promote economic, social and cultural development in all countries of the world.

Geneva 2004
Kamil Idris
Director General
World Intellectual Property Organization



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Chapter I

An overview of the general business and legal principles involved in the licensing of copyrights and related rights

Today's global economy is increasingly driven by technology and technological change. That change has resulted in an ever-increasing number of outlets for creative works; without those creative works, those outlets have no content. Hence, ownership or control of creative works increasingly means economic power. The proof is everywhere. The Internet (like telephone, radio and television before it) exemplifies the role of communications technology in forging economic and social change and in creating economic wealth. Equally, the Internet exemplifies the role of ownership of creative works—that is, ownership of the copyrights which are the intellectual property in those creative works—in shaping the economy, rendering physical and geographic boundaries less relevant to accessing consumer markets or interacting with other businesses. Thus, much of the graphic, textual and audio content of the Internet is protected under copyright¹.

Understanding the basic mechanisms by which copyrights are owned, transferred and licensed is necessary to an understanding of the workings of the new, information-based global economy. This introductory chapter will first identify and define key attributes of copyrights, identifying the manner in which rights come into being and are maintained. Limits on such rights, derived from other areas of substantive law, such as antitrust, competition and bankruptcy principles are explained. This chapter will then generally examine copyright licensing: from due diligence that is appropriate or necessary to establish the value of what one seeks, to the key terms that are part of most, if not all, copyright licenses. Subsequent chapters will examine specific individual areas of copyright licensing.

This chapter does not purport to provide a thorough analysis of copyright law or a comprehensive catalog of all contract issues bearing on copyright licensing. Some issues, such as, for example, the once-feared Y2K computer bug, appear from time to time and become vitally important to vast numbers of license arrangements, only to fade when the ephemeral events that give rise to such concerns themselves pass.

More importantly, as copyright laws are national in scope, this overview will deal with the common principles that underlie national copyright laws. The reader is cautioned that, in every case without exception, knowledge of appropriate national law is vital for a thorough understanding of licensing issues and procedures. Further, that national law knowledge must extend beyond copyright law to other relevant areas, such as contract, antitrust or competition, and bankruptcy law.

Creation, Character and Scope of Copyright Rights

Virtually without exception, in virtually all countries, copyrights are creatures of legislation. As a general matter, copyright subsists in "original" works of authorship as soon as the work is fixed in some tangible medium of expression.

Copyright laws generally provide not only the right to exclude others from using the copyright work, but also the right to authorize others to make such uses, such as through licensing. In a classic and most basic formulation, copyright is said to protect the *expression* of ideas, but not the ideas themselves. The types of original expressions of authorship that are protected include (but are not limited to) literary works; musical works; dramatic works; pantomimes and choreographic works; pictorial, graphic and sculptural works; computer software; motion pictures and other audiovisual works; sound recordings; and architectural works.



Although different countries' laws use different terms to describe the rights which are encompassed by copyright protection, one can say generally that these include the rights to reproduce the copyright work in copies or phonorecords; to prepare derivative works based upon the copyright work; to distribute copies or phonorecords to the public; and to perform and display publicly the copyright work. These rights are virtually infinitely divisible and assignable in whole or in part; therefore, making explicit the scope of rights granted is essential in drafting, or entering into, any licensing arrangement.

Because parties to a copyright license often do not consult their attorneys until the essential business goals have been outlined in principle, the parties' knowledge of the substantive law and the extent to which rights may be challenged or enhanced can be a vitally important part of the license negotiation. Thus, for example, for a party to assess whether it needs a license to make use of a copyright work, that party should be aware of the limitations on the copyright holder's rights. By way of illustration, the copyright laws of several countries following the common-law tradition allow for the "fair use" of, or "fair dealing" in, copyright works, for purposes such as criticism, comment, news reporting, scholarship or research. Whether a particular use is "fair," and hence outside of the copyright owner's control, calls for a particularly fact-intensive inquiry. The analysis must weigh facts such as the purpose and character of the use; the nature of the copyright work; the amount and substantiality of the portion used; and the effect of the use on the value of, or potential market for, the copyright work. Copyrights may also be challenged on various grounds going to the validity and enforceability of the underlying rights themselves. While a detailed explanation of the various limitations of these rights is beyond the scope of this chapter, such knowledge is obviously vital to the making of a proper license agreement and may form an essential part of the due diligence investigation that should be conducted.

Due Diligence

Copyright licenses vary in scope and complexity, and may be seen as a continuum, ranging from a simple consent to use a photograph, to a license to base a major motion picture on a novel. In all such instances, it is essential to identify all relevant intellectual property and secure (and/or protect) appropriate rights to permit full exploitation of the business opportunity. This requires assessing and contracting for the use of existing rights, identifying the possible need to secure future rights, and obtaining commitments to secure a license or assignment of such not-yet-existing rights.

Part of the due diligence process should include tracing the chain of title of existing copyright rights. The licensing party (i.e., the party granting rights, the "licensor") may have acquired the subject copyright rights from a third party, in which case further assignment of such rights may require review of the prior transfers to confirm that all relevant rights were conveyed and that there are no breaks in the chain of title. Where the licensing party is not the sole author of a copyright work, it may be proper, depending on local law, to confirm as well that the licensing party has secured rights from all co-authors. The licensing party may also have granted security interests that have been recorded against the intellectual property as required by local law. The validity and enforceability of the copyrights should also be considered, as should the age of the copyrights, for such rights endure for only limited terms and may be in their waning years.

License Formation

Although there is no "standard" method of license formation, the general outlines of the steps leading to license formation are clear. A prospective licensee will usually solicit a license from the copyright owner, and negotiations in the form of offers and counteroffers will follow. Business people, legal counsel, or both may conduct these negotiations. In some cases, the license offered

by the copyright owner will be in the copyright owner's prescribed form, with little or no possibility of modification. In others, especially those involving significant license fees, the terms will be heavily negotiated.

Once the parties have agreed on license terms, it has been the usual practice to reduce the agreement to a written instrument. Indeed, many local laws require license agreements – or at least exclusive licenses – to be in writing to be valid. From both the licensor's and licensee's perspectives, it is always advisable to enter into a written agreement, so the chance of a dispute over the license terms (or, indeed, over the license's very existence) is minimized. And, although this rule is often observed more in the breach than in the observance, it is highly advisable to execute the written license agreement before the licensee's use of the copyright work begins.

New technologies, such as computer software and the Internet, have important implications for when and how licenses are formed. Many software companies do not actually "sell" copies of software, but rather license them. Most interactive Internet websites and providers similarly license access and use. The practice of licensing, instead of sale, originated in the early years of computer use when the software industry licensed expensive, often customized programs for use on a single computer (such as a mainframe terminal).

Even though hardware and software have become far more affordable and widely available in recent years, the practice of licensing software persists. In most situations, there is no practical way for the software company or Internet website, and the prospective licensee, to negotiate a license agreement because the transaction costs of doing so would be prohibitively expensive. As a result, several new forms of licenses have been devised. For example, software companies often package their product with express provisions which advise that the purchaser is subject to the license terms contained on the outside of, or even inside, the package. This "shrink-wrap" license is formed once the user removes the container or wrapper. Another example is the "click-wrap" license, which is formed once an Internet user is required to affirmatively click a button or icon that indicates acceptance of the license terms before downloading a program or accessing a website.

Such licenses raise questions as to what actions are sufficient to form a license. What happens, for example, when a person unwraps a software package or clicks to download a program but is simply not aware that he or she is entering into a license agreement? How does that satisfy the legal requirement that a party must accept all of the terms and conditions offered in the agreement in order for the license to be formed? These problems can be fatal in the context of "browse-wrap" licenses. In such situations, an Internet webpage displays a notice of contractual terms; a user may click to view the full text of an agreement, but that user is not required to click an acceptance of the terms in order to download the program. Courts have been hesitant to find that these actions form a license because there is nothing to show that the user actually agreed to the terms of the license or even understood that a contract was being formed.

Courts (as this is an emerging area of law, it should be noted that many courts have not yet dealt with any of these issues) may uphold both shrink-wrap and click-wrap licenses when they require a user to take affirmative steps that unambiguously show agreement before he or she can use the software. Some courts have found shrink-wrap licenses valid and enforceable, even when not all the terms of the contract are communicated on the outside of the packaging. Likewise, courts have tended to uphold click-wrap agreements, reasoning that there is agreement when a user must affirmatively accept the contract terms before downloading. Local law should be consulted to determine what actions are sufficient to form valid licenses in the on-line environment for the use of copyright works.



Antitrust and Competition Issues in License Agreements

In broad economic terms, copyrights are protected by the law because doing so encourages creativity and promotes fair competition. However, copyrights may more narrowly be viewed as limited and legally sanctioned monopolies. Consequently, licensing copyright rights requires some consideration of antitrust and competition law restraints. Although it is not possible in a work of this scope to address systemically or to summarize the manifold antitrust and competition law concerns relevant to intellectual property licensing, some of the most significant issues can be and are here noted. Of course, where the licensing party enjoys market power, if it seeks to include in a license terms dictating a price maintenance scheme, uses the licensing arrangement in a discriminatory manner, or engages in other traditionally suspect conduct, greater attention to antitrust and competition issues is warranted. However, in more commonplace licensing circumstances, consideration may be confined to the types of licensing practices that are likely to pose the greatest risk of antitrust or competition law scrutiny. Unquestionably, use of the license to broaden the physical or temporal scope of the exclusive rights conferred by law activates the warning light. Some laws have condemned as copyright misuse the practice of seeking to extend the *limited term* of a copyright grant, particularly by collecting royalties for use of the work after expiration of the copyright term. Most courts recognize that the “monopoly” embodied in a copyright is no different from the “monopoly” – in the sense of an exclusive right – in the ownership of any property. Hence, claims of antitrust or competition law violation in the licensing of copyright works are usually dismissed. One should note, however, the special considerations involved in the *collective* licensing of copyright works because of possible concern that such arrangements could constitute combinations in restraint of trade.

Future Rights Under a Pre-Existing Agreement

It is quite commonplace in copyright licensing to license not only new uses which may be later developed, but also works which are not yet created. It is important to consult local law to determine whether words in a license which are broad enough to cover new uses permitted by subsequently-developed technology will be presumed to cover such new uses. If local law is that they are, the burden is thus on the licensor to limit or reserve rights in new uses. Licenses should be as specific as possible so as to avoid future doubt.

Formalities: Is a License or an Assignment Intended

Before even addressing the substance of license agreements, procedural formalities and requirements should be known and examined. These vary, depending largely on whether the agreement is considered to be a license or an assignment, a distinction considered below in greater detail.

A copyright assignment is an immediate and irrevocable transfer of the owner’s entire interest in all or some part of the copyright property. A transfer of something less than that interest is a license. An assignment may arise from the immediate and irrevocable transfer of only *some* of the copyright owner’s rights, or all rights in a specified geographical region. There can be very significant ramifications when distinguishing between the two under various local laws. Examples of such ramifications include the following: (i) the standing of the assignee/licensee to sue for infringement, for local law may not give a licensee general standing to sue for infringement in its own name; and (ii) the rights of the parties in the event of bankruptcy may vary, as the licensed property may be governed by unique provisions of the applicable local bankruptcy law. Whether a transfer of a particular right or interest is an assignment or a license is a substantive issue; it is not determined simply by the name the contracting parties select for the transaction. There may be

local law requirements regarding the necessity for reducing transfers or licenses to writing, and for recording security interests in copyrights.

Basic Elements of the License

Effective copyright licenses all share certain common features. At a minimum, it is necessary to define the copyright works and rights subject to the license, the territories in which the license applies, the term of the license and the consideration (such as a royalty) for the license.

Subject Matter of the License

The most difficult issue in copyright licenses is defining the copyright property that is the subject of the license. Questions to be considered are: how broad a scope of rights the licensor owns; what rights does the licensee require; what rights should it seek; and what rights is the licensor prepared to grant? The parties' economic bargaining positions frequently determine who gets what, and who controls the drafting of the agreement. Simply identifying and describing the licensed property and understanding the legal limitations, strengths and weaknesses of the parties' respective positions vis-a-vis such properties can be daunting.

Copyrights are also limited by external factors and substantive law. Indeed, licensing copyrights is most effectively accomplished with an understanding of what rights are needed to achieve the intended business goal. Depending on local law, copyright may be treated as being virtually infinitely divisible. It is therefore imperative that the precise boundaries of the rights being licensed be defined. Failure to do so could result in disaster—either an interpretation that more rights have been conveyed than was intended (in the extreme case, the entire copyright), or that fewer rights were conveyed than intended.

The determination of what rights to convey necessarily involves an assessment of what rights are needed. What uses of the copyright work will be made? To offer a perhaps oversimplified example, in a license to market videocassettes of a motion picture, it will not be enough from the licensee's viewpoint to obtain the right of reproduction, for the ability to manufacture the videocassettes is for practical purposes useless without the right of distribution of the copies to the public. Further, as the aspect ratio of a television screen is different from that of a wide-screen movie theater, the right to modify the motion picture (e.g., by cutting off the "ends" of the wider screen aspect ratio) may also be necessary, thus involving a grant of the right to produce a derivative work. Such a right may also be necessary to conform the copyright work to the local cultural environment (e.g., by excising scenes which would offend in the local culture). Concomitantly, in this example, from the licensor's viewpoint, the license should not convey a general right of reproduction, but rather should be limited to reproduction only in videocassettes (perhaps by specifying the precise technical standards.) Similarly, if the motion picture is to be edited or modified, the licensor may want control over or approval of the editing process, or of the final result. Indeed, the licensor's existing agreements with "talent," such as the director, may require approval of those parties to any changes as a condition to the contract.

A vitally important consideration for both parties to the license is the necessity to account for future, as yet unknown, technological developments. Much litigation has been concerned with the use of a licensed copyright work in a medium unknown when the license was executed. To the degree that the future can be anticipated, it should be taken into account. In the above example, as videocassettes are intended for playback in homes, a provision encompassing not only videocassette technology but also any playback medium intended primarily for use in private homes might be included. Licenses very frequently resort to catchall phrases such as "in any medium now



known or later developed.” Again, it is up to the parties to define such terms as precisely as possible to avoid future controversy over what was intended, and to know how local law interprets such provisions.

Parties often wonder whether permission is required at all to excerpt copyright material. For example, as already noted, certain uses of copyright works might fall within the scope of limitations on the rights of the copyright holder, e.g., “fair” use, for which there is no copyright liability. Obviously, a cost-risk analysis should be undertaken to determine whether to take a license or rely on a claim of “fair” use. One should keep in mind two points in undertaking that analysis. First, “fair” use is the *exception* rather than the rule. Second, whether, in local law, merely asking for a license, but failing to come to terms, prejudices a later “fair” use claim.

The license agreement can expressly identify the rights granted or conveyed and include catchalls to capture other related rights. For example, in the case of software licenses, concern that the licensee be able to use the technology may require that the licensor provide appropriate new versions, product upgrades or improvements. Access to the source code (to allow the licensee to resolve future technical problems) may also be necessary, particularly if the licensor should become bankrupt or face other substantial business problems that interfere with its ability to perform.

Territory/Geographic Scope

Copyright rights are, with a few qualifications, strictly territorial in scope. There are separate national copyright laws in each country. However, bilateral and multilateral international treaties facilitate protecting copyrights worldwide by establishing minimum levels of protection in member countries and by facilitating extensions of rights from one country to other member countries. As such, copyrights may be protected internationally, for example, through the *Berne Convention for the Protection of Literary and Artistic Works*, the *WIPO Copyright Treaty*, and the *WIPO Performances and Phonograms Treaty*.

Generally, the licensor is free to set the terms under which the licensee can use the licensed property in any foreign jurisdiction where the licensor owns rights. However, competition laws in the European Union may limit to some extent the licensor’s right to circumscribe use of the licensed property to specific member States of the European Union. It may be unlawful for the licensor to attempt to control use of its claimed copyright property in jurisdictions where it does not own the copyrights. Within the United States, for example, the general rule is that absent other anticompetitive efforts, territorial restrictions do not violate antitrust law.

Although it may be thought a daunting task, it is wise to consider the differences in the national copyright laws of all the countries which are covered by the license – at the very least, those of the major markets in which the license will be utilized. For example, certain countries may have stringent “moral rights” provisions which may preclude even a use licensed by the copyright *owner* without the consent of the *author*, such as a radical editing of a copyright work. As in all agreements, be they license agreements or otherwise, an ounce of prevention is worth a pound of cure.

Exclusivity

The obvious practical concern regarding exclusivity in a license agreement is economic: to the extent copyright ownership can be deemed a lawful legal monopoly, the benefits of that monopoly are best enjoyed without competition from other licensees. The greater the number of licensees among whom the pie must be divided, the less for each. Compensation paid for the license should reflect such potential competition (whether from the licensor or other licensees), and it may be

useful for the licensees to undertake due diligence to assess the number and significance of potential or actual competitors.

There are degrees of exclusivity. At one end of the spectrum, the licensee may have the right, if specified in the contract, to exclude even the licensor from use of the licensed property in the relevant region and for the stated time period. Less restrictively, the license may simply prevent the licensor from licensing *other* parties in the geographic region and during the license term. Various degrees of non-exclusivity may also be negotiated, including for instance a right of first refusal should the licensor elect to offer further licenses to third parties. Exclusive rights will not typically be inferred absent compelling evidence. However, if a license agreement does not specify that it is exclusive, it may nonetheless be deemed exclusive if the language of the contract and surrounding circumstances support such a construction.

One key aspect of assessing exclusivity is the standing the licensee has to bring suit in its own name to protect the copyright property. Where the licensor retains substantial rights, even an agreement denominated an “exclusive license” may not be sufficiently exclusive to convey “all substantial rights” or the right of the licensee to sue in its own name. Where there are no meaningful limits on the rights of the transferee, the transfer agreement may be deemed an assignment rather than a license. The substance of the agreement, rather than talismanic phrases, will control, as will, of course, local law, which may authorize suit by the legal or beneficial owner of any of the exclusive rights conferred by copyright. Thus, for example, local law may treat an author who has transferred ownership of the copyright work in exchange for stated royalties as a beneficial owner and allow the author to sue for infringement. And, the owner of any exclusive right, including an exclusive licensee, may be deemed to be the “copyright owner” of that particular right and be authorized to bring suit. As discussed below, it is wise to specify in the license agreement as many of the possible scenarios for litigation as can be agreed.

Term

The term of a copyright license cannot exceed the term of the copyright. The copyright owner that seeks to license its rights beyond the term of the underlying copyright risks a suit for copyright misuse. However, as the laws of different countries provide for different terms of copyright, the licensee should be aware of those differences and their effects. A grant of a license for the full term of the copyright covering more than one territory may mean a longer period of license in one or another territory. Local law should also be consulted as to the effect of the absence of an express limitation as to the term of a license; a common view is that the agreement will be deemed terminable at will.

Payment

The manner and amount of payment typically raises more practical issues than legal ones. Varying with the parties’ needs and interests, the inherent value of the licensed property, and the respective bargaining power of the parties, the contract may specify a flat fee, periodic payments based on sales of licensed products, or both. A royalty may be structured, for example, as a percentage of sales or as a stepped up or down percentage of sales (e.g., 5% of sales up to 50,000 units, 2.5% of sales in excess thereof). Uses of copyrights that may require payment of royalties need not be limited to sales of products. The triggering event for payments thus may be simply the number of “hits” on (*i.e.*, views of) an Internet web page. Considerable creativity is possible in accommodating the parties’ needs and capabilities. Minimum royalty payments may be appropriate to create an incentive for the licensee to market and sell the licensed products. A royalty arrangement may combine these elements, such as in a minimum up-front payment



which is then recouped against a percentage of sales. That up-front payment may be expressed as being non-refundable if sales royalties do not reach the amount of the payment. Conversely, from the licensee's perspective, maximum royalties may be useful to ensure that the agreement does not become unduly onerous. In some cases, a license based on use is impractical for the licensee – an example would be a radio station which publicly performs thousands of copyright musical works over the course of a year, and has no practical way of identifying the copyright owners of each work. In such cases, a so-called "blanket" or "collective" license is used. The copyright owners of the musical works, through a collective performing rights licensing organization, issue a single license to the user, which allows the public performances of all the musical works in the organization's "repertory" for a stated annual license fee. The key characteristic of the "blanket" or "collective" license is that the fee is *not* keyed to actual music use, but rather simply grants access to the entire repertory, and allows use of whatever the licensee wishes to use. Timing of payment must also be considered, whether quarterly, monthly, semi-annually, or annually. Other methods of payment may be appropriate depending on the parties' needs and the nature of the licensed product or service at issue.

Accounting

Although there is no requirement that licenses be income producing, and often they are not, a formula for determining what is owed is essential. The license should specify that formula with precision. Further, it is very common that the license requires the licensee to furnish periodic statements to the licensor showing exactly how the license fee for that period has been computed (e.g., the number of, and revenues from, sales, if the fee is a percentage of revenue).

If money is to change hands, the licensor will also want to retain a right to audit the books and records of the licensee to verify the accuracy of the statements and accountings the licensee has submitted. Generally, it is sufficient to require that the licensee comply with generally accepted accounting standards, retain records and permit access to them for an appropriate period after the accounting period or term of the license. Although the licensor should have the right to audit the licensee's books and records after any accounting period, such audits may be an intrusive and needless burden to both parties. It is in both parties' interests to adopt reasonable auditing requirements. Frequently, therefore, audit provisions will limit audits to normal business hours, on reasonable notice, and with a maximum frequency (e.g., no more than once a year). Audit provisions also will almost always require confidentiality. Audits may be barred after a contractual "statute of limitations" – e.g., statements are deemed final one year after receipt. Finally, the costs of the audit may be borne by the licensee if the audit discloses an under-payment which exceeds a certain amount (e.g., some percentage of the amount ultimately determined to be due). The agreement may provide in such cases for interest on the under-payment as well. Arbitration to resolve disputes may also be the least costly and most prudent way of resolving such issues. If so, an appropriate arbitration provision should be included in the agreement.

A realistic concern the licensor must face is the licensee who produces excess product that is not accounted for. Such products may be dumped or sold in undesired trade channels. Negotiation of appropriate language to manage such potential breaches of trust can be difficult, to say the least, if it is to be accomplished without undermining the fundamental trust that is necessary in any commercial relationship. However, special provision can be made for willful breaches, including immediate termination without a right to cure and without a right to arbitrate. The licensee who refuses to accede to reasonable provisions to prevent or remedy bad faith may warrant suspicion as a potential business partner.

Marketing Duties

The contract may specify the marketing duties of the licensee (e.g., best efforts, reasonable efforts or good faith) to market and promote the copyright work. Where the licensed property has established value and the licensor has available a range of potential licensees, the licensor may insist on a higher standard to insure the greatest possible return on its property. The simplest method to maximize sales may be to provide for minimum royalties. The license may also require reasonable efforts or require the licensee to use its best efforts to market and sell the work and so generate royalties. Standard practices in any given industry will often define the actual duties that accompany such contractual requirements.

Termination and Recapture of Rights

There is little question that license agreements should be made terminable for serious breaches or defaults. There are, however, many variations on that theme. Certainly, the most common cause for termination is failure to pay the requisite license fee. But any breach of a licensee's obligation can be expressed as grounds for termination.

A termination provision should first deal with technical requirements. Very frequently, licensees will insist that termination be allowed only for *material* breach or default. It is relatively rare to attempt to specify the standard of materiality (perhaps because of the difficulty in finding common ground for such a definition). It is common, however, to provide for notice and a possibility of cure – e.g., termination must be preceded by notice (thirty, sixty or ninety days are common notice periods), during which, if the breach or default is curable, the licensee may cure. Termination is sometimes self-effectuating (e.g., the termination occurs automatically after the given time period, without further notice); sometimes it requires a separate notice confirming that the time period has run without an intervening cure.

The termination provision should also address the “mopping up” of matters (e.g., what is to be done with inventory after termination). If the licensee is permitted to sell off inventory, the licensee may be required to furnish an accounting of its inventory at the time of termination, to allow the licensor better to monitor permissible sales after termination. Whatever the concerns which are brought about by the specific license agreement, it is wise to specify these matters in the license agreement at the outset because the parties will not likely be on the most cordial of terms after termination or if termination for breach or default is imminent.

In copyright licenses, the recapture of rights before expiration of the license is also very common, both under the terms of the license and because of local law provisions. It is, for example, quite common to provide in literary publishing agreements that if the publisher allows a book to go out of print during the term of the license, the author may recapture the rights before the license would otherwise expire. In many circumstances, local law permits a license or transfer of copyright ownership to be terminated, and the rights to be recaptured, by the author or by certain specified heirs. Obviously, those acquiring rights should be aware of this possibility: a licensee may believe he is acquiring rights for the full term of copyright only to see those rights terminated long before the term ends.

Representations and Warranties

Key express warranties often fall into two categories: a purely formal warranty as to the parties' authority to enter the contract; and a substantive warranty by the licensor that it owns all rights subject to the agreement. The formal warranty of authority may have substantive implications,



as where the licensor has already entered into an exclusive agreement with a third party. A representation or warranty of ownership of rights may lead the parties in drafting an agreement to specify further related duties, such as a duty to indemnify the licensee from any third party claims of infringement if the licensor's claimed rights prove dubious or incorrect, and a duty to defend any such claims.

A licensor's duty to defend may also be broadened into an affirmative duty to police for infringements. This duty is often required to be shared by language obliging the licensee, if it learns of infringements by third parties, to give notice to the licensor and to provide appropriate assistance in any enforcement action. The contract can specify that the costs of such assistance will be borne by either or both parties as appropriate.

Certain other representations and warranties are quite common in copyright licenses: for example, that the work was previously registered with a governmental authority; that it was published on a given date; that it is or is not a revised edition of an earlier work. In addition to obtaining a warranty of ownership, a licensee may be well served to search the governmental or other records for verification of those warranties. It is also very common for a copyright licensor to warrant that the work is original with its author (who may be the licensor) and does not infringe upon the rights of any third party.

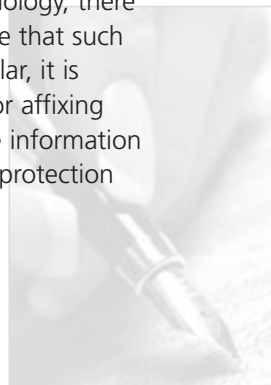
Very frequently, the licensee will want the licensor to support its warranties and representations through an indemnification, undertaking to defend any claims which arise from warranted issues. If such an indemnification is provided, the indemnitor generally will want to control any litigation (including the right to make a settlement), and the indemnified party will want the right to participate with its own counsel, at its own expense. If the licensor has the bargaining power, such indemnifications also may limit the amount recoverable by the licensee/indemnitee to the license fee and no more.

Copyright Notice

No copyright notice is *required* to protect or preserve copyright rights. But to suggest that copyright notice should be ignored would be irresponsible. Local law may provide for enhanced remedies in infringement suits if notice is present. It is quite common for copyright owners to affix notices, for their prophylactic effect, and to require licensees to do so as well. It is good practice to require in all license agreements that licensees include appropriate notices.

Confidentiality

It is common for copyright licenses that convey the right of first publication to require confidentiality of the copyright work until that event. Especially in copyright licensing involving technology, there is frequently sharing of confidential information. The license agreement should provide that such information be identified as confidential with as much precision as possible. In particular, it is recommended that documents be specifically designated as confidential by stamping or affixing a "confidential" designation on the page or pages of documents that include sensitive information exchanged during the course of performing the agreement. The license providing for protection of confidential information will likely require that the duty to preserve confidentiality survive termination.



Escrow Provisions

Although copyrights are by definition intangible, their effective use often requires access to physical copies. Thus, to produce copies of a movie, sound recording or software, may require access to a master copy suitable for reproduction. To ensure that the licensee has not only the right but the ability to continue producing copies in the event of a default by the licensor or perhaps the licensor's bankruptcy (with an accompanying loss of control by the bankrupt party over its own operations), the parties may agree that master copies of copyright works, source code of computer software, or the like, be held in escrow. A neutral escrow agent holds such materials until such time, if any, as the occurrence of a releasing event (defined by the escrow agreement), at which time the licensee becomes entitled to obtain the master copy for its own continued use.

If use of an escrow agreement is appropriate, the parties will typically agree, in the license agreement itself or in a separate escrow agreement among themselves and the escrow agent: what is to be deposited in escrow; whether the deposit materials need to be updated at any times; what constitutes a releasing event; and what are the responsibilities of the escrow agent, both in maintaining the deposit materials and upon the occurrence of the conditions precedent to a release. The parties must also agree, of course, on an acceptable allocation of costs for the services of the escrow agent and any expenses incurred by the agent.

Bankruptcy

Local bankruptcy law may contain unique provisions regarding copyrights, and should be consulted. There are great practical difficulties anticipating the likelihood of bankruptcy, its timing or possible effects. Where bankruptcy can be foreseen with sufficient clarity to permit definite planning at the contracting stage, the prudent course may, of course, be to forego the license agreement altogether.

More common as a means to protect the licensee in the event of the licensor's bankruptcy is to place in escrow key tangible assets that are essential to the licensee's continued operation under the agreement. These may include source code for software, or master recordings or films for music or movies, access to which would be required to continue operating under a license or to enjoy the full benefits of the agreement. For independent but related reasons, escrow arrangements are not uncommon in copyright licenses because they serve as a form of insurance against default. Where the "default" is bankruptcy, escrow arrangements similarly protect the licensee's interest. However, because the licensor in bankruptcy may have no duty to maintain the copyrights, the licensee may also want to insist on the right to prepare upgrades or modifications which, in the case of computer software for instance, would entail creation of derivative works, rights for which must be expressly granted.

The licensor may want to take special precaution in drafting the agreement against the possibility that the license will become bankrupt. In a worst-case scenario, the unprotected licensor could find its copyright rights assigned in bankruptcy to a direct competitor. A surer ground for the licensor to maintain control over the licensed property is to provide by contract that it is relieved of the obligation of performance in the event of an assignment or other event leading to an unwanted loss of control.

Successors and Assigns

License agreements generally are considered personal and hence non-assignable unless expressly permitted, although local law may vary and should be consulted. However, it is common to specify



under what circumstances, if any, a license may be assigned. It is equally common (and prudent) to address whether, if at all, a license can be assigned to a competitor. Often, the safest course is to require written approval from the licensor before rights under a license can be assigned. If appropriate, the contract can provide that such consent may not be unreasonably denied.

Merger/Modification

As in any contract, the parties should define what is or is not part of the agreement. This may (and often does) include various annexes or schedules of copyright works. It may include other related agreements or documents, such as an agreement with an escrow agent. Given the many uncertainties in negotiating and ultimately interpreting contracts, it is wise to avoid needless uncertainty as to the elements of the contract itself.

Duties after License Expiration

As is the case with termination for breach and default, license agreements should make explicit the parties' rights and obligations after expiration. Thus, although the license may have expired, there may be a continuing duty to pay royalties for sales of the licensed work which occurred during the license term. Audit rights may continue. There may be a "cooling down" period after the license expires for the licensee to sell-off remaining inventory. There may be a continuing duty to provide support for users of licensed software. Confidential information acquired during the term of the agreement will likely need to be preserved in confidence. All such duties should be specified as precisely as possible.

Ownership Agreements

Because copyright systems are particularly designed to protect authors (in the broadest sense of any creators of original works), the author may have certain presumed rights under local law. Agreements specifying ownership thus may be essential, sometimes even when the author is an employee.

A second significant aspect of copyright ownership is that, not unlike other forms of property, copyrights may be jointly owned. The most common way for such rights to arise in copyright works is in the creation of a "joint work" by two or more authors. Local law should be consulted as to rules for joint ownership, such as whether joint owners may individually and independently issue licenses.

Assignments

Copyrights may be bought and sold much like other properties. Often such conveyances will be part of the sale of an entire business in connection with which the copyrights are owned and used and may include physical facilities, know-how, employee contracts and other associated assets and liabilities. Even where less than the entire business is sold, such transfers will often require assignment not merely of one copyright, but rather will require identification and acquisition of numerous related intellectual properties and perhaps other tangible assets.

It is essential in such cases to conduct appropriate due diligence to be certain the acquiring entity obtains all that is necessary to carry on the relevant business and assess whether the rights transferred are adequate to the party's needs. For example, acquiring the right to manufacture

and sell a valuable computer program will be considerably less valuable if it does not include the most recent version.

Security Interests

It is not uncommon that copyrights are used as collateral to secure a loan or are otherwise securitized as part of a license agreement. Local law should be consulted to determine the proper means for perfecting those security interests

Compulsory Licenses

Local copyright law may provide for compulsory licenses of copyright works for certain specified uses. In many such cases, the remuneration fixed by local law may only be the starting point for a negotiation (if necessary, downward) of a different license fee. Such a negotiated license within the parameters of a compulsory license may incorporate the compulsory license's other terms by reference, or may modify those terms.

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Chapter II

Literary Works

There was a time, within the memory of most people, when print on paper was the only format in which most text based copyright materials were distributed. In that context, while the grant of rights language in book contracts was typically very broad, in reality the only rights that had any significant economic value were rights to distribute the work in print.

While some might describe print as an antiquated medium, print formats for text works had, and still have, many advantages for creators and publishers. Although the rights to the content are legally separate from the rights to the physical object, when a work is distributed in print form, the “words” and the “paper” are inextricably linked. Copyright management information can be simply affixed—it can consist of the author’s name, the publisher’s identifying information and in some instances a copyright notice – and cannot be easily or conveniently separated from the work itself. There are inherent limitations on the amount of manipulation that a user can make of the content, at least without some degree of inconvenience. And, of course, duplication of the printed work is time-consuming, often expensive and generally produces a copy that is of lower quality than the original.

Technological developments have profoundly altered this state of affairs. Print is only one of many media in which literary content can be distributed. The new media and new means of distribution, particularly digital formats distributed over computer networks, have completely separated the content from its means of delivery. As a practical matter, the ability to exercise many of the exclusive rights of the copyright owner (i.e. reproduction, distribution, adaptation) are now easily within the grasp of users of the content. The impact of these changes cannot be overstated.

Authors and publishers are increasingly depending upon licensing agreements, not merely to define relationships between and among themselves, but to define their relationships with the users of their works. This chapter will discuss the nature of the publishing industry and its current business practices, then examine the impact that new technologies are having on the industry, particularly in the area of licensing.

An Overview of the Publishing Industry

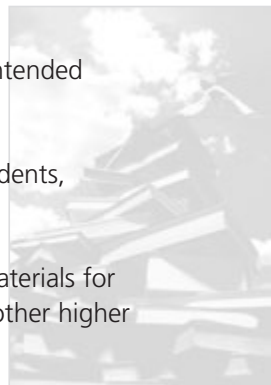
Types of Publishing

The “publishing industry” is composed of several distinct businesses, each having different practices with respect to the acquisition and licensing of rights to the works they publish. The major categories of publishing are the following:

Trade publishing (the books usually purchased in book stores: fiction and non-fiction intended for general audiences; general reference works; children’s books).

Educational publishing, including materials intended for elementary and secondary students, and for higher education (college and university students).

Scientific, technical and medical (“STM” or “Professional” publishing), consisting of materials for post-graduate education, scientists, researchers, doctors and other professionals, and other higher level applications, including academic journals and other periodicals as well as books.



A publishing company may specialize in one form of publishing, or may publish works in several of these markets. Large publishing companies are usually composed of separate divisions or subsidiaries that devote their energies to particular markets. However, business and licensing practices are determined by the type of publishing in which a publisher is engaged, and not by its corporate affiliation. So trade publishers, even when they are owned by companies that also publish educational materials, will acquire rights from authors, publish and distribute works and enter into license agreements with respect to those works, in accordance with the particular practices that characterize trade publishing.

Size of the Publishing Industry

Every country in the world has authors and publishers. Reliable estimates of the global size of the publishing industry are not readily available, but individual country statistics give some sense of the size of the industry. According to the Association of American Publishers (AAP), U.S. book sales totaled more than \$26 billion in 2002. The International Publishers Association (IPA) tracks information about publishing activities in almost 30 different countries. To choose a few examples from recent IPA statistics, Italy's publishers sold \$2.3 billion worth of books domestically in the year 2000, and generated an additional \$65 million in export sales. Germany's book sales were \$1.3 billion in 2000. The U.K., in the year 1999, generated more than \$4.4 billion on sales of 824 million copies. These are all countries in which publishing is being done in languages that are widely spoken. Even where that is not the case, publishing activities generate significant revenue. In Denmark, for example, the population of about 5 million probably accounts for most of the Danish speakers in the world. Danish publishers, in 2001, generated \$262 million, on sales of 28 million copies.

Important Stakeholders

The most obvious, important stakeholders in publishing are authors and publishers. However, the industry is much more complex than that simple model would suggest. Authors can be individual creative persons who are entirely responsible for the content of their works. But authorship is often a collaborative process, involving the efforts of writers, editors, illustrators and other creative artists. The rights to all or portions of a single work may be owned by any or all of these participants, depending on the circumstances surrounding the creation of the work and the contractual or legal relationships between and among the collaborators².

Often, the rights acquisition process occurs with the assistance of an agent, who represents the author in locating and negotiating with a publisher. The agent will often continue to represent the individual creator in connection with the licensing of those rights that are not licensed to the original publisher, such as foreign or translation rights if the author retained those rights. Agents also represent publishers in licensing rights outside their primary markets, such as the right to create dramatic works based on the original publication.

Like any other commercial endeavor, publishing has customers who are also important stakeholders. Libraries and educational institutions are among the most important users and, of course, purchasers of copies of literary works and of licenses to use those works. Both of those constituencies have special concerns related to the "fair use" (or "free uses," in Berne parlance) of literary works in connection with their performance of their core missions of archiving and making knowledge available to the public, and of education. One of the major issues in publishing now is the sometimes adversarial relationship between publishers and some of their most important customers, as publishers seek to maintain their revenues from the sales and licenses of their works, and as this group of customers seeks to expand the uses they can make of those works under exemptions or exceptions to copyright.



Special Characteristics of the Publishing Industry

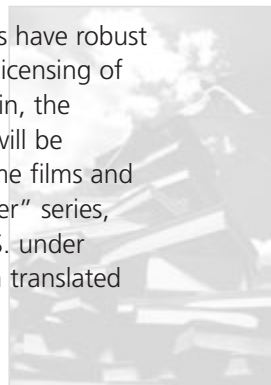
The publishing industry has been the subject of enormous consolidation in recent years. Smaller companies have been acquired and made part of large entities that are often in businesses other than publishing or, if they are primarily publishing entities, may have many diverse types of publishing under common ownership. And, although there is a widespread perception that publishing, like certain other copyright industries, is U.S. dominated, many of the largest publishing groups are headquartered in the European Union.

For example, Pearson, which is a British corporation, now owns a large publishing operation in the U.S. publishing for the school (elementary and secondary) market, as well as the largest U.S. college publisher. Reed Elsevier, which is based in the Netherlands and the U.K., purchased Harcourt Brace in 2000, becoming one of the three largest school publishers in the U.S. and an important force in publishing for the U.S. college market, while at the same time increasing its already significant presence in professional publishing. Bertelsmann, which is a German company, had for many years owned the U.S. trade publisher Bantam Doubleday Dell. Through its purchase several years ago of Random House, Bertelsmann became the largest publisher of trade books in the United States. All of these companies also, of course, have significant publishing activities in their home countries and elsewhere in the world. These developments have contributed to both the consolidation and the globalization of the publishing of literary works.

Despite the increasing “internationalization” of ownership, some aspects of publishing retain a profoundly local character. In some countries, like France and Canada, this is partly a function of the legal system, since both of those countries have laws that create “cultural exceptions” to free trade to encourage the creation and dissemination of domestic works. Even without such legal requirements, cultural differences will limit the use of, and market for, certain materials by territory. For example, materials created for the elementary education market in a particular area of the United States, designed as they necessarily are to meet the curriculum and pedagogy set for that state or region, may have little relevance to students and teachers in a school located in another U.S. state, let alone to students and teachers in any European country. Although language differences can be addressed through translation, cultural differences are much more profound. So Spanish language educational materials created for use in Spain will include references to history, current events, and other factors that are likely to make such materials of minimal use, unless they are heavily revised, for students in Argentina or Mexico.

Other types of works do have global markets, and the distribution of those works is often accomplished through licensing, both directly by publishers to users and between publishers in different geographic areas. Materials used in the scientific, technical and medical fields, less subject to the local cultural and taste differences, are commonly sold and licensed across national borders. Business and economics books published by U.S. publishers are often successful in foreign markets, either in English language versions or in translation.

Materials created for entertainment purposes, as many trade books are, will sometimes have robust international markets. Trade books are usually distributed internationally through the licensing of translation or reprint rights to foreign publishers rather than through direct sales. Again, the market for, and popularity of, a book, in either its original language or in translation, will be determined to a large extent by cultural considerations, although some books, like some films and recordings, seem to have an appeal that transcends national borders. The “Harry Potter” series, written by a British author, achieved unprecedented success when published in the U.S. under license from the original U.K. publisher, and has, as of the end of February 2003, been translated under license from the original publisher and author into 55 languages.



Finally, there are still some peculiar artifacts of prior business practices that influence licensing and distribution in the book publishing industry. The sun may have long ago set on the British Empire, but its successor, the British Commonwealth, continues to exercise an influence on the international licensing of reprinted versions of English language trade books. Traditionally, when U.S. publishers enter into reprint licenses for trade books with U.K. publishers, the U.K. publishers are granted English language rights not only for the U.K. itself, but for the entire British Commonwealth with the geographically logical exceptions of Canada and, in some recent licenses and with less geographic logic, Australia³.

Relevant Legal Instruments

With the exception of database publishers, authors and publishers are primarily concerned with works protected by copyright. Although trademark, trade secret, patent, right of publicity or privacy and defamation issues are certainly from time to time of concern to publishers, the most relevant legal instruments for publishers are those that regulate copyrights and to a lesser extent related rights⁴.

Therefore, the legal instruments of greatest concern to publishers and authors are:

- National copyright laws, and in particular the exceptions to copyright which are permitted by those laws, such as fair use and fair dealing, personal use exemptions, special provisions for the use of copyrighted works in education and by libraries, and provisions dealing with inter-library loan and document delivery;
- Multilateral and bilateral treaties that control the application of national copyright laws to foreign works (i.e. the Berne Convention, TRIPS and the WCT); and
- EU Directives, for those publishers either located in the EU or interested in doing business in the EU (which includes virtually all publishers), including the Software Directive (1991), the Rental Rights Directive (1993), the Copyright Duration Directive (1993), Database Directive (1996), and, in particular, the Copyright (Information Society) Directive (2001) (hereafter referred to as the “EU Copyright Directive”), which was intended to implement the WCT and WPPT treaties and also to create a degree of consistency in copyright laws in the EU with such issues as rights of reproduction and permitted exemptions from copyright.

Although the widespread adoption of international treaties creating minimum standards for intellectual property protection has created some consistency in the laws in this area, there are significant “gap” areas in international norms and publishers must be sensitive to the differences between and among legal regimes. “Moral rights” are particularly important in continental Europe, and the laws protecting them are different from those found in common law jurisdictions like the United States, the U.K., Canada and Australia⁵. Some countries have provisions in their domestic laws which, for example, vest copyright ownership for certain types of works in certain specified creators, and place limitations on the extent to which certain of those ownership rights may be transferred by contract. All of these differences can affect the ability of a publisher to enter into license agreements with respect to certain rights under copyright.

In addition, copyrights, like other forms of property, are managed through contracts. Publishers are thus concerned with relevant contracting practices within the countries in which they do business and in particular with limitations on the ability to contract which may be imposed by local laws.

Laws not directly related to copyright, like unfair competition laws, may have a profound and direct impact on licensing practices. For example, anti-competition law in the EU places restrictions on the ability of a licensor to grant exclusive rights to territories within the EU, because of the potential interference with the single market among the Member States⁶.



The licensing of literary works is also affected by privacy laws and by the differences between those laws. In particular, there are important differences between the E.U., where the standards are set by the E.U. Privacy Directive, and the laws and practices of the U.S., where privacy is not protected by a single set of laws but rather by a patchwork of industry-specific statutes and industry self-regulation.

Finally, the fact that the U.S.'s cherished "First Amendment" guarantee of freedom of speech and of the press is a "local ordinance" when considered in light of global commerce is an important factor in the licensing of literary works. The First Amendment makes it difficult and highly unusual for the distribution of a literary work to be impeded in the U.S. because of its content. This is not the case in many places outside the U.S. For example, Hitler's infamous "Mien Kampf" is still in print in the U.S. The sale or licensing of that work is, however, strictly prohibited in Germany.

Licensing Practices in the Publishing Industry

Except for those agreements in which a complete transfer of copyright ownership is made to the publisher through a "work-for-hire" agreement (or similar arrangement, as permitted by local law) or an outright assignment of rights⁷, "publishing agreements" are a form of license agreement. All of the considerations that are relevant in evaluating other types of licenses, such as clearly defining the subject matter of the license and the rights to be granted, the territory, the duration, exclusivity, payment issues, marketing responsibilities, and representations and warranties, must be considered. The discussion below is intended to briefly describe the business practices common for each type of publishing: first, when rights are being acquired from a creator; and second, when those rights are being further licensed to other publishers or directly to end users.

Rights Acquisition Agreements

The romantic notion of authorship and publishing is of an individual creator shaping an entire work, and then turning that work over to a publisher to reach the broadest audience. Certain types of trade publishing come close to this romantic ideal, in particular fiction and children's books. Many works are in fact collaborative efforts involving many individual creators whose work is being pooled and coordinated by a publishing company or other third party. But the model of a creative artist entering into an agreement with a distributor is the one upon which much licensing in the trade publishing area is based. Other types of publishing begin from a different starting point entirely⁸.

The common ground in rights acquisition agreements, across the different types of publishing, is that the grant to the initial publisher will be exclusive for those specific rights recited in the grant of rights clause of the agreement.

Copyright Ownership

In publishing agreements for trade books (with the exception of some reference books that are published for the trade market, such as dictionaries), the author almost always retains ownership of the underlying copyright. The grants made by the author to the publisher are specific and often narrow. Important rights, with significant economic value, are often retained by the author. It is in this type of publishing where literary agents typically play the most important role, negotiating the rights grant to the publisher and aiding the author in finding licensees for retained rights.

Rights acquisition practices for works to be published for the higher education (college) market are somewhat similar to those for trade books, in that the author often (although not always) retains ownership of the underlying copyright. Typically, however, the grant of rights to the publisher

will be much broader than in trade book contracts, and will almost always include the right for the publisher to do revisions and new editions of the work. STM/Professional publishing practices are similar to those in college publishing, at least for books. For professional journals, it is more usual to see outright transfers of copyright from the author, who is generally a scientist working in the relevant field, for whom the publication provides benefits in terms of professional status rather than direct remuneration from the journal publisher.

Scope of the Grant; "Primary" and "Subsidiary" Rights

Primary rights

Trade publishing agreements traditionally divide the rights granted into two categories. The "primary right" granted to the publisher is usually the right to publish the work in book form. This grant is not as simple as it might appear. First, what "book form" is has changed over the years, as "book form" can now be deemed (or, in better practice, specifically drafted) to include audio versions, e-books, and other non-print forms of the text. If a grant in a modern contract is intended to be limited to print formats, it should say so explicitly. Contract disputes, some of them ending in litigation, have arisen over the language of this basic grant, particularly in the case of older agreements that did not include or contemplate other forms of "books⁹."

Even if the grant specifies "print," further clarification is necessary to avoid misunderstandings. Grants of primary rights in trade book agreements usually specify the type of print publication covered by the grant. A grant may be for hard cover only; hard cover and soft cover trade editions (which are generally the same size and quality as hard cover books, but bound differently); mass market print or reprint rights (i.e. books that are smaller in size and usually of lower quality, sold in different channels at lower prices).

Subsidiary Rights

Other print rights are often included in the grant, including foreign reprint rights, translation rights, periodical or serial rights (through which excerpts or abridgements are licensed for publication either before the book is initially published, in which case they are called "first serial rights" or after initial publication, in which event they are called "second serial rights"), rights to do book club editions, anthology or collection rights, rights to do premium or special editions, etc. These print rights are usually considered to be "subsidiary rights" rather than "primary rights" and, typically, they are exploited by the publisher through licenses to third parties rather than through the publisher's own activities. In the U.S., a well-established, successful trade author, represented by a literary agent, will often retain the rights to first serialization, foreign reprints and translations of his work. If the author is retaining foreign reprint and translation rights, the license grant will be limited as to language and as to territory as well.

Other types of subsidiary rights include the many other, non-print, adapted, versions of a work that can be licensed by the author or the publisher to produce additional revenue. Among these rights are electronic rights (which are also increasingly being considered to be primary rights, as the market begins to develop for digital versions)¹⁰, audio rights (for products like books-on-tape which, again, may also be granted as primary rights), dramatic rights, motion picture rights, television and radio rights, and merchandising (also called "commercialization") rights. Primarily adaptive rights (such as dramatic and merchandising rights) are, at least in the case of a well-established author, most likely to be retained by the author.



Primary and Subsidiary Rights in College Publishing

The grant language in a college publishing agreement will include the primary and secondary rights discussed above (although, obviously, the economic value of, for example, the dramatization rights to a physics textbook is not very great). The author will generally retain few if any rights to the work. Among the most economically important subsidiary rights for college textbooks are the electronic rights and the right to do further licensing of excerpts for use in anthologies or in supplemental course materials. Higher education is an area in which the possibilities for digital dissemination of written materials are being realized. Most college courses in the U.S., for example, have accompanying web sites and make materials available to students online. Most college textbooks therefore either exist in digital forms, or have accompanying supplemental materials, intended for use with the textbook, which are made available on CD-ROM or over the Internet. It is important for college publishers, therefore, to acquire the rights to manipulate and adapt the content of the books they publish in digital media.

Also important to both the author and the publisher, particularly for college textbooks dealing with the “hard” sciences (e.g., physics, mathematics, chemistry, biology) and certain other subjects, is the ability to exploit the work internationally through reprint and translation licenses.

College textbooks have a revenue stream from the licensing of photocopy and other reproduction permissions to use excerpts in teaching materials such as custom publishing arrangements and “course packs,” which are compilations of materials created by a professor for use in connection with a particular course. These types of permissions are also relevant to other types of publishing, but college publishers are more concerned with these activities since they are not merely a source of licensing revenue, but may cause lost sales if the “custom” materials replace purchased textbooks.

Special Considerations related to “Electronic Rights”

“Electronic rights” have been a source of tremendous controversy in publishing. Even before any significant economic benefit was being realized through their exploitation, and perhaps because the economic benefits and the business models were unclear, publishers and authors have been arguing over which of them should control the dissemination of literary works in digital forms.

It is particularly important that “electronic rights” be clearly defined. Among the issues that should be addressed in any clause granting (or explicitly retaining) electronic rights are the following:

- (i) Does the grant of “electronic rights” include the right to reproduce the entire work only on tangible media like CD-ROMs, or does it also include the right to deliver the work on-line?
- (ii) Does the grant include the right to combine the work in its entirety with other works (i.e. in a database)?
- (iii) Does the grant include the rights to adapt portions of the work and to include additional materials, such as still or moving images, sounds, and spoken or performed text to create a new work?¹¹
- (iv) What is the territory for the grant of electronic rights? The best practice is to be certain that there is only one grantee for electronic rights for each language in which the work will be published, since digital dissemination does not respect national boundaries.

- (v) Does the grant include new media not yet developed at the time of the contract? In the U.S., it is common to include language that covers “all media now known or hereafter developed.” In some other countries, notably Germany, grants covering not-yet-existing technology are not permitted by law.
- (vi) How will the author be compensated for the electronic rights, and will the author’s compensation differ if the publisher exploits the right as a “primary” right (e.g. publishes the e-book itself) or as “subsidiary” right (e.g. licenses the right to a third party)?¹²
- (vii) Given the fact that business models in this area are still evolving, should the author have approvals over electronic products or sublicenses?¹³

Duration of Agreements and “Out of Print” clauses

Typically, publishing agreements grant the publisher rights for the term of the copyright in the licensed work. Trade publishing agreements generally have provisions that give the author the right to terminate the agreement if the work goes “out of print.” Definitions of “out of print” vary to some degree, although the most common language refers to the work no longer being “offered for sale.” In order to trigger an “out of print” clause, the author usually is required to give written notice to the publisher. The publisher then has the opportunity to put the book back into print during the notice period, which is typically at least six months and is often longer. If the notice period passes without the book having been put back into print, the rights will then revert to the author.

Agreements for educational works do not typically include rights reversion clauses. In the higher education area, among the most important rights granted to the publisher is the right to prepare new, revised editions of the work. A successful college textbook is often revised every several years, to keep it current and maintain sales. The original author may participate in revisions or may no longer be an active participant but may be continuing to receive a reduced royalty as the actual work on the revised version is done by a new author team. In either event, the publisher is not going to want to be obligated to revert rights on an earlier edition that has gone “out of print” because it has been replaced by a new edition of the same work.

Compensation

Although the scope of rights grant will vary, the method of calculating the author’s compensation in trade publishing agreements is, in U.S. based agreements at least, fairly consistent. The major area of variation is the amount of the advance against royalties paid to the author. Advances can range from nothing at all to a few thousand dollars paid to an unknown children’s book author to millions of dollars to established, famous authors of adult trade fiction books. On sales of hard cover books, the author will receive a royalty percentage (usually ranging from 10 - 15 percent) of the suggested retail price of the book. For sales of soft cover versions, the author will receive a lower percentage (ranging from 7-1/2 - 10) of suggested retail price. It is not unusual for there to be an “escalator clause,” where the royalty starts at the lower end of the range, then increases as the sales of the work increase.

Revenues from licenses of subsidiary rights are allocated between the author and the publisher. Revenues are usually shared at least equally and often on a basis that favors the author. In the case of licenses of first serial rights and adaptive rights (i.e. dramatic rights, motion picture rights, merchandising rights, etc) the proceeds are usually split on a basis that gives the largest share to the author. It is not unusual to see, for example, a sharing of dramatization rights revenues in which 90% of the proceeds go to the author and 10% go to the publisher.



Authors of college textbooks and books published for the professional market are also compensated through the payment of royalties (usually in the range of 10 to 20 percent of the net proceeds from sales of the work, often with provisions for the percentages to increase as sales increase) and a sharing (for most rights, on a 50/50 basis) of the proceeds from licenses of subsidiary rights. Net proceeds are the actual revenues received from sales of the work, less certain deductions (such as discounts and allowances) as permitted by the agreement. Author advances tend to be smaller than for trade books although they can, in the case of a relatively small number of “superstar” textbook authors, be substantial. Textbook authors are also sometimes given “grants” (outright payments not recouped against royalties) in addition to or in lieu of advances, to cover specified expenses like administrative assistance, payments to graduate students and permissions costs.

Satisfactory manuscript clauses, publisher’s discretion and author approvals

Agreements of all types will provide for the submission of a manuscript on a date specified (or for the submission of portions of the manuscript on an agreed schedule), and will give the publisher the right to accept or reject the submissions. Whether the publisher is obligated to give the author an opportunity to revise an unacceptable manuscript and the nature of the financial consequences of a rejection (i.e. whether the author will be required to return any advances) vary from contract to contract, but the underlying principle is that the publisher can refuse to publish a work after submission if it does not meet the publisher’s standards for acceptance.

When a work has been accepted for publication, the publisher generally has broad discretion about the form and format in which the work will be published, the timing of publication, and the setting of suggested retail prices and of wholesale discount schedules. There have certainly been disputes between publishers and authors about whether the publisher has done enough to market the work and to seek licensees for subsidiary rights, but the contract language in most publishing agreements gives the publisher broad discretion to make decisions about all of these matters.

The publisher’s discretion about the timing of publication is sometimes limited through a contractual requirement that publication take place within a fixed period of time (usually no less than 18 months, and sometimes longer) from acceptance. And well-established authors sometimes negotiate for and get certain approvals over, for example, the cover of the work, marketing materials or some types of subsidiary rights licenses.

Representations, warranties, indemnities and insurance

Publishing agreements include representations and warranties by the author that the work is original, not in the public domain, and does not contain material that would infringe on the rights of third parties. The author has to confirm that the rights granted to the publisher can be granted by the author, and that the author’s performance of the contract will not violate any other agreements to which the author is a party. The author will also agree to indemnify the publisher in the event that any of these warranties are breached.

Qualifying language stating that only a willful breach will give rise to an indemnity obligation is sometimes included. The author may only be obligated to indemnify the publisher with respect to a claim of copyright infringement or defamation if the claimant is ultimately successful, thereby transferring the risks associated with frivolous claims to the publisher. And the publisher may agree to give the author the benefit of any insurance that the publisher carries with respect to such claims, so that the author’s practical exposure is limited to the amount of the publishing company’s deductible under its insurance policy. The extent to which these provisions are negotiable varies,

based on the internal policies of the publisher, the prominence of the author and the effectiveness of the author's agent.

Licenses to Other Publishers

Foreign rights and translations

These "subsidiary rights" are exploited through license agreements between the original publisher (or, if the rights were retained by the author, the author or his agent) and another publisher or producer. The original publisher or the author is usually referred to as the "Proprietor" and the licensee as the "Publisher."

Rights to publish the work outside the country of origin are licensed by territory and by language, and are typically explicitly limited to print rights only. Given the ease with which content in digital forms can cross national borders through online distribution, it is important that only one publisher has the right to do "electronic versions" of a work in each language. Reprint and translation agreements also contain time limitations, so that the right to publish a translated version, for example, may last for a five or ten year period.¹⁴

Often, the publisher of the translated version will own the copyright in the translation, so that at the end of the term the original publisher has to either renew the agreement or enter into a new agreement with a different local publisher, who will then either do an entirely new translation to avoid infringing the rights of the first translator or license the rights to the translation.

For English language works in particular, there is an important international market for reprint rights. These are licenses that permit the local publisher to distribute the work in a specified territory in English. As mentioned above, licenses between English language publishers in the U.K. and in the U.S. are common and, in an exception to the usual rule, such agreements are usually for the term of copyright rather than for a specified term of years. Sometimes, depending upon the nature of the work in question, the reprint license will include the right to do some "localization" of the work; that is, for the local publisher to make changes in the text of the work to make it more suitable for the local market. "Harry Potter and the Sorcerer's Stone" (which has sold tens of millions of copies in the United States) is actually a "localized" version of the first book in the series, which was published in the U.K. under the title "Harry Potter and the Philosopher's Stone." Aside from the change of title, changes were made in the text ("jumpers" became "sweaters" and "lorries" became "trucks") to accommodate differences between British and American usage.

The compensation paid by the local publisher to the original publisher for both translation and reprint rights is usually a combination of advance payments and royalties. Sometimes, the originating publisher is also paid an "offset" fee if the original typography is being used (that is, if the book is not being "reset").

Other provisions in reprint and translation agreements include the following:

- (i) There are requirements that translations and any other permitted adaptations be "faithful and complete," sometimes with specific approvals by the original publisher.
- (ii) The territory is specified (in English language reprint agreements, specific countries or regions are mentioned; for translation agreements, the territory is often the world, in the translation language only).



- (iii) The agreement will address the question of who, as between the original and the local publisher, is required to clear permissions for any materials owned by third parties which were used in the work as originally published. This may include quoted materials, charts and graphs, artwork, photographs and illustrations, and sometimes cover art as well.
- (iv) Copyright notices and credit lines are specified.
- (v) Payment provisions and audit rights are set out in detail.
- (vi) The original publisher usually makes some representations and warranties about the content of the work, generally including at least a warranty of non-infringement.

The market in translation and reprint rights for trade books is a mature one, with well-established business practices and relationships. There are several major book fairs held every year, and a large number of smaller fairs, attended by publishers, book sellers, agents and others at which selling rights is a central activity. The largest book fair, held in Frankfurt, Germany each fall (which is also attended by publishers for the college and professional publishing markets), had, in 2002, 6,400 exhibitors from more than a 110 countries, 171,000 trade visitors from 106 countries and more than 240 literary agencies in attendance. Also important are the London Book Fair in March, Book Expo, held in various locations in the U.S. and sponsored by the American Booksellers Association each May, and, for the buying and selling of rights to children's books, the Bologna Book Fair in Italy each April.

Although direct sales outside of the original country of publication are more common for college textbooks and other higher-level educational materials than they are for trade books,¹⁵ licensing is an important source of international revenue for these types of works as well. College textbooks in particular are often distributed by local publishers through reprint and translation licenses, on terms (i.e. advances, royalty payments, limitations as to territory and term of years) that are not dissimilar to those found in the licensing of translated or reprinted trade books. "Localization" agreements are also common. For example, a business textbook might be revised by a local publisher to use examples drawn from that country's business community, instead of using U.S. companies and events, to illustrate points made in the text.

E-book licenses

More and more, the right to do "e-book" versions is being treated as a "primary" right by book publishers, who are themselves creating and selling "e-book" versions of the works they publish. There is also, however, a market for the licensing of the electronic version of books to third party aggregators, who then make the works available in digital form through licenses to end-users. Vendors such as netLibrary (www.netLibrary.com), ebrary (www.ebrary.com), and questia (www.questia.com), are commercial online library services offering tens of thousands of electronic texts to libraries and the public. These companies license the rights to either specific titles or a list of titles from the relevant rights holder (the publisher or the author), convert each title to the appropriate digital format, and incorporate each title into a database which is maintained by the company and made available over the Internet on either a sale or subscription basis. This is a relatively new area of business, and the licensing practices are not yet well established. There are a few common threads, however:

- (i) The online library service is responsible for doing the conversion, although the cost of the conversion is sometimes "charged back" to the publisher;

- (ii) The online library service agrees to maintain technological protections for the digital content;
- (iii) The publisher's compensation is on a royalty basis, calculated against either the licensee's overall revenues or the revenues attributable to the licensed titles.

Obviously, this business model is dependent upon the security protections provided by various Digital Rights Management (DRM) technologies and the legal protections in national legislation implementing the anti-circumvention provisions of the WCT, such as the Digital Millennium Copyright Act (DMCA) in the United States.

Licenses Directly to Users

Licenses of Online Academic Journals

Licensing revenue is particularly important for STM publishers, and in particular for journal publishers, for whom licensing directly to end-users has become a major source of revenue. As an example, according to a recent *New York Times* article, the journal *Science* is read in digital form by about 800,000 people, compared with 140,000 readers of the print version. Many of those electronic copies are downloaded at universities that buy "site licenses," giving access to the journal to members of the university community for a fee, as reported in the *New York Times*, of about \$5000 per year.¹⁶

Science is only one of hundreds of journals distributed to their readers through the licensing of digital access. All of the major publishers of scientific journals (i.e. Elsevier Science, Wolters Kluwers, John Wiley & Sons and others) distribute most, if not all, of their publications in digital form, both in CD-ROM format and through on-line distribution. For some journals, hard copy versions are virtually non-existent, and the vast bulk of the "sales" of the journal are made in the form of "licenses" to view, store, and print the digital version of the journal. For publishers in this field, their customers have become their licensees.

License terms vary from publisher to publisher. The most common model is the subscription model, through which an end user (an individual, a library, a corporation, an educational institution, etc) pays a monthly or annual fee for access to an entire database of journals published by a particular publisher (a so-called "repertory license") or, increasingly, a specific journal or group of journals. Materials in the database are often made available in a variety of formats, including at a minimum the "portable document format" (.pdf) and html.

These online licenses are designed to accommodate a wide variety of user needs. They may involve giving an institution a number of "seats" per license, so that multiple users can access the content; they may designate the levels of access permitted, so that it can be less expensive to see only an abstract of a work, with additional charges applying for access to the full text; or there may be access charges to see the work on the screen, with additional fees applying for the ability to print the work. Access controls may be password protection, or, in the case of institutional (corporate, university and library) licenses, access may be based on IP authentication through which a user will be given access to the database so long as she is using a workstation associated with the licensee institution.

Professional publishers, and in particular journal publishers, have web sites through which their products are offered in digital form. Licensing terms are often displayed or described in detail. A particularly good example of the scope, flexibility and terms of such licenses can be found at the web site for John Wiley & Sons InterScience service, <http://www.interscience.wiley.com>.



Collective Licensing, Compulsory Licensing and “RROs”

Copyright is subject to a number of important exemptions that vary from country to country. They may include personal use exemptions, special exemptions to facilitate certain educational or archival uses, and others. One of the most common ways for users to avail themselves of the exemptions has been, and remains, photocopying.

To facilitate payments to copyright proprietors, consistent with the requirement in Article 10 of the Berne Convention that uses made under most of these exemptions be “compatible with fair practice,” many countries have created forms of collective or compulsory licensing, under which the copiers pay a small fee (sometimes in the form of a per page levy, sometimes as a levy on the machines used to make the reproductions). The funds collected are administered and distributed by state mandated collecting societies (also known as reproduction rights organizations or “RROs”). These reprography “licenses” are a source of revenue for publishers, although not always as significant a source as the publishers would like, since the methods used to calculate the allocation of the proceeds are not always complete or accurate. Usually, a combination of voluntary reporting by the institutions making the copies and statistical sampling is used to determine what percentage of the revenues should be distributed to the various participants in the system, which may include (it varies from country to country) individual publishers and authors and/or RROs in other countries which then further distribute the revenue.¹⁷

In the U.S., there are no mandatory exemptions for such activities, although large numbers of photocopies are made in reliance on the “fair use” exception (meaning that there is no obligation for payment to, nor permission from, the copyright owner) or under individual permissions agreements (such as photocopying for use in course packs) or blanket licenses (typically used for corporations). The Copyright Clearance Center (CCC) is the U.S. RRO, and it administers licensing systems by registering publishers and lists of works, then granting licenses to users who choose to seek them from CCC. Participation in the CCC’s system of collecting and disbursing photocopy royalties is entirely voluntary for both publishers and users, and both are free to deal directly with each other in connection with these types of licenses.¹⁸

An emerging trend in this area is the attempt being made in some countries, such as, for example, Australia and Germany, to extend this system of centrally administering and collecting photocopying revenues to the making of digital copies. The publishers, who fear a further erosion of their revenues from the untrammled digital distribution of perfect copies of their works, are generally opposing these attempts.

Noteworthy Issues Between the Creative Community and Industry

Predictably, as the publishing industry is changing through the impact of technology, consolidation in the industry, globalization of the market place and many other factors, tensions have arisen between and among the participants in the industry.

“New Uses”

The duration of rights acquisition agreements in the publishing industry is typically co-extensive with the term of copyright, which means that many works are being exploited by publishers under contracts drafted many years ago. As new technological developments have created new potential uses for older content, questions have arisen over whether certain “new uses” can be said to be covered by these older grants. In the U.S., these issues are matters of contract interpretation, conducted under the guidance of sometimes apparently conflicting court decisions addressing



such questions as whether a 1939 license for motion picture rights included the rights to sell and rent video-cassettes and video discs, even though video-cassettes and video discs were not invented until decades later;¹⁹ whether a 1930 assignment of “motion picture rights” to a musical play included the right to broadcast the film on television, even though television was not commercially available until 1941;²⁰ whether a grant to develop a cartoon for television viewing included the right to distribute it on video cassette;²¹ and whether a grant in a publishing agreement to publish a book “in book form” included the right to publish it as an e-book.²²

In other countries, local laws may determine the outcome of the issue. In Germany, for example, there is a statute prohibiting creators from licensing uses not in existence at the time of the original contract. This has not been entirely successful in avoiding litigation, as evidenced by a recent case dealing with the question of whether a DVD version of a film was really a “new use” not covered by a grant that included a right to distribute a film on video.²³

Digital distribution and “out of print” clauses

Traditional contract language for “out of print” clauses will often contemplate a rights reversion to the author “when the publisher ceases to offer the work for sale.” But what if, for example, a work is maintained in a publisher’s digital database, available to be ordered for online delivery as an e-book, or for delivery to a vendor who is offering “print-on-demand” services to purchasers? Is the book still being “offered for sale?” Formerly, keeping a book “in print” meant maintaining an inventory of the work sufficient to meet customer demand. Now, a publisher can invest little or no effort in maintaining the availability of a work, and generate little or no revenue from the work, but still be technically “offering” the work for “sale,” thereby defeating the reversion to the author. In newer agreements, this issue is sometimes resolved through negotiation, by including a minimum dollar amount of sales that must be achieved to maintain the rights.

Direct distribution to the “end user” by the author

Just as the Internet empowers users, it empowers authors. Some authors are beginning to experiment with these new capabilities, and to question the continued viability of publishers as intermediaries between authors and readers.

The most well publicized example of this phenomenon was Stephen King’s direct distribution, over the Internet, of “The Plant,” beginning in July 2000. King had previously, with the cooperation of this publisher, released a novella entitled “Riding The Bullet” only as a downloaded e-book. That introduction, in March of 2000, was initially successful, but was then compromised, first because the publisher’s servers had trouble with the demand (400,000 copies were downloaded), then because (within 3 weeks of the novella’s release) the proprietary format of the release was “hacked.” King’s subsequent experiment with a new work, “The Plant,” was to offer the book in a non-proprietary format, directly to end-users over the Internet, without his publisher, one chapter at a time. He relied on the honor system, asking that he be paid \$1 per download per chapter. The experiment was halted after 7 months and 6 installments, as the percentage of voluntary payments went down.

Experiments with direct distribution are not limited to best-selling authors. Some scientists are looking into the possibility of doing their own, direct distribution of scientific articles, rather than relying on publishers of scientific journals, who conduct peer reviews of articles and handle their distribution in exchange for a transfer of rights to the articles. The “open access” movement has attracted a great deal of attention in the scientific community, and some financial support as well. The Public Library of Science, which intends to begin publication of “open access” journals in



various disciplines late in 2003, is using a \$9 million grant from a charitable foundation to fund its activities. Other “open access” journals are already available, as are archives of open access materials. The movement appears to be growing, although an ambitious attempt to get researchers to agree to refuse to submit articles to any journals that did not agree to provide “open access” has thus far been a failure. The materials involved are scientific research papers for which finality and accuracy are critically important, so the issues of proper attribution and integrity are of great concern.²⁴ The mechanism proposed by at least some of the “open access” advocates is that the individual scientist (or group of scientists) would retain ownership of the copyright, but would agree to the broad and free distribution of his work through the use of a license agreement. The extent to which open access journals will replace or compete with commercial journals remains to be seen, but the issues are important ones for the entire scientific and scholarly community.²⁵

The Impact of Technology

Development of standards and markets for e-books

The e-book market has, until very recently, been regularly described as “nascent.” According to recent filings made by the Association of American Publishers (“AAP”) with the U.S. Copyright Office, this situation is beginning to change dramatically.²⁶

The AAP filing described a report issued in July of 2002, by Open eBook Forum (“OeBF”), a nonprofit organization developing standards for e-books. The report showed a tremendous growth in the customer base for e-books. Publishers active in the field, including major trade publishers such as Random House, HarperCollins and Simon & Schuster, are reporting significant growth in sales, and e-book reader software downloads have increased dramatically (to cite a few examples, over 5 million copies of the MicroSoft Reader software had been distributed as of the date of the OeBF report, and Adobe Acrobat eBook Reader average monthly downloads increased by about 70% from 2001 to 2002). Improvements in standardizing formats, software features and title availability are all occurring. Several major trade publishers are offering new titles simultaneously in print and e-book formats. These changes and others will ultimately increase the importance of e-book formats to publishers, authors, libraries and consumers, which will in turn have a dramatic impact on how the “electronic rights” to text materials are licensed. As a further reflection of this development, AAP recently released figures showing that e-book sales by U.S. publishers for January 2003 were \$3.3 million, as compared to \$211,000 for January of 2002, an increase of more than 1,447%. Although these figures are very small compared to the overall U.S. book sales in January 2003 of \$557 million, the growth is still striking.

The development of reliable and “consumer friendly” Digital Rights Management (DRM) technology is obviously a key element in the continued growth of the market for e-books. DRM technology should, ideally, both protect the publisher from the unauthorized copying and redistribution of the e-book, and facilitate its use by the reader. Although the technology in this area is improving, the problems are far from resolved.²⁷

Increases in digital piracy

As text materials become more available and more widely used in digital form, they will also be more subject to the kind of digital piracy that has, to date, been aimed primarily at the recording and film industries. Text materials are particularly vulnerable to digital piracy through such common mechanisms as peer-to-peer networks, because of the relatively (as compared to music and films) small size of most text files. For those reasons, the WCT, as its anti-circumvention provisions are implemented in the national copyright laws of countries having ratified it, is of critical importance to publishers and authors.

Document delivery, inter-library loan and e-reserves

Technological developments have exacerbated an old tension between publishers and some of their most important customers, the libraries and educational institutions. Document delivery and inter-library loan are not new. It has long been a common practice for copies of certain types of materials to be provided by one library to another (i.e. a single journal article sent by a library that has a subscription to one that does not). U.S. copyright law has specific provisions that address, and permit, this practice, subject to certain limitations.²⁸ Although this has always been of concern to publishers (overly-broad use of such exchanges would have a dramatic negative impact on sales), when deliveries had to be accomplished through the mailing or personal delivery of actual hard copies, there were inherent practical limitations. Now, so much of the material used for these purposes is already in digital form (for example, online journal articles) that materials can be very conveniently shared and, absent legal and technological protections, the leak can easily become a flood.

Similarly, publishers have always been concerned with use of materials like “course packs” which are comprised of pieces of their works recombined by professors for specific course use. In the U.S., the fact that course packs do not fall within “fair use” exceptions was established through protracted and expensive litigation.²⁹ Now, the development of digital e-reserves may make course packs obsolete and create a new set of issues around fair use and fair dealing. Works and parts of works can be easily scanned and included in library databases, for use by students (and others, unless there are appropriate access controls) over the broadband networks maintained by colleges and universities. Widespread use of these technologies, particularly if these uses are claimed to be “fair use” or are made subject to specific statutory exemptions to copyright, threatens both sales and licensing revenue for authors and publishers.

Emerging Trends

Concern about “fair use” and similar exemptions, and the implementation of the WCT

The “fair use” factors of Section 107 of the U.S. Copyright Act are a kind of “catch-all” in which many of the “free uses” that are contemplated by the laws of other nations are encompassed. Section 107 is consistent with the provisions of Article 10 of the Berne Convention, which provides for certain “free uses” of copyrighted works for quotations for certain purposes, so long as the use is “compatible with fair practice.” However, the specific ways in which copyright limitations are expressed in national laws can vary enormously from jurisdiction to jurisdiction so long as they are consistent with this basic minimum standard. Certainly, the “fair use” doctrine’s cherished “four factor” analysis is an artifact of U.S. law.³⁰ In fact, copyright laws often specify the conduct which is to be permitted under “fair dealing” in a much more explicit and less open-ended way than Section 107 (e.g. in the U.K. there is a specific exemption for “research or private study” in section 29(1) of the U.K. Copyright, Designs and Patent Act).³¹

The implementation of the WCT is creating a concern in some circles that the ability of copyright owners to technologically protect their works will also result in limitations on “fair use” and its analogs in the laws of other nations. Therefore, the laws that create the protections contemplated by the WCT may also create additional exemptions or exceptions to copyright that could have a dramatic impact on the licensing activities of publishers and authors.



The U.S. and the DMCA

The DMCA is the U.S.'s implementation of the WCT. The provisions of the DMCA that prohibit circumvention of technological protections were, through negotiation and discussion, ultimately made subject to a number of exceptions. There is a substantial body of opinion that holds that the exceptions built into the DMCA did not go far enough, and that the ability that the DMCA and the WCT give to copyright holders to enforce technological protections for their works constitutes an erosion of "fair use." Therefore, there have been several legislative attempts to alter the DMCA, and a number of judicial challenges to its provisions. Thus far, those attempts have been unavailing, but it is clear that they will continue.

The drafters of the DMCA anticipated this issue. The statute defines two types of technological measures: those that prevent unauthorized ACCESS to a work, and those that prevent unauthorized COPYING. It also recognizes a difference between (i) the act of circumventing, and (ii) the creation and distribution of devices or services that permit circumvention. Since some copying may be privileged as "fair use," only the act of circumventing protections against access (not protections against copying) is prohibited. The making or selling of devices or services that circumvent is treated differently. The "anti-trafficking" provisions prohibit the making or selling of devices or services that circumvent EITHER access protections OR copying protections when the device or service is (i) primarily designed or produced to circumvent; (ii) has only limited other commercially significant purposes; or (iii) is marketed for use in circumventing. The DMCA provides for other, specified exceptions, and for the potential that additional exceptions will be created in the future.³²

Within days of the opening of the most recent Congressional session in January 2003, several bills were introduced to create a consumer "bill of rights" that would substantially diminish the copyright holder's ability to limit access to digital versions of works. Whether or not any of these bills actually becomes law in the U.S., the attempts to limit the scope and effectiveness of the anti-circumvention provisions in U.S. law will continue.

Special issues in the implementation of the EU Copyright Directive

The EU Council adopted the Copyright Directive on April 9, 2001 after more than four years of debate and negotiation. It had the ambitious goal of not merely permitting the compliance by EU members with the new WIPO Treaties, but of harmonizing rights of copyright and related rights, and of bringing consistency to the permitted exemptions. Arguably, the final product does not achieve those goals.

The Copyright Directive goes beyond merely requiring that all Member States provide for anti-circumvention of technological protection measures, which would have been the minimum necessary to permit ratification of the WCT. The Directive also requires that Member States harmonize their internal laws with respect to the basic copyright rights of reproduction and distribution. It recognizes a "right of communication to the public" which will encompass rights of display, public performance and broadcasting, but will apply to new technological means of exercising those rights, such as Internet distribution. This aspect of the communication right is the "making available" right provided in Article 8 of the WCT, which according to the Directive is the right to "make works available to the public in such a manner that members of the public may access them from a place and at a time individually chosen by them."

It is in the area of permitted exceptions to copyright protection where the Copyright Directive failed to create consistency between and among its member nations, and therefore, with respect to nations outside the EU as well. Instead of including a list of required exemptions, the Directive includes a single mandatory exemption for the temporary acts of reproduction "which are

transient or incidental [and] an integral and essential party of a technological process” when the sole purpose is to enable transmission in a network between third parties by an intermediary, or a “lawful use.”³³ That single mandatory exception is followed by a list of six exceptions to the “reproduction right,” and fifteen exceptions to the “reproduction right” and the “right of communication” which are optional, and which may be adopted or not, in whole or in part, by each of the EU Members.³⁴ The Directive also provides that any adopted exceptions to the reproduction and communication rights may also be applied to the distribution right “to the extent justified by the purpose of the authorized act of reproduction.”³⁵

Perhaps any attempt at truly harmonizing EU law in this was overly ambitious at the outset, given the patchwork of pre-existing exemptions to copyright which already existed in the laws of the Member countries. The Copyright Directive clearly gives enormous flexibility to each of the Member States in designing their national laws in this area, but it arguably does not help create the predictability and consistency that were its stated goal.

Expanded copyright exemptions for educational uses

Efforts to make materials more readily available for use by students and teachers are generally received with sympathy, since the goal of the proponents is an attractive one. In the U.S. and other countries, these attempts sometimes take the form of proposals for exemptions from copyright law that are directly related to educational activities but which, if not carefully crafted, may eliminate the financial ability of publishers and authors to create and disseminate the works to be used.

An example of a successful and balanced attempt to accomplish this goal is the “Technology, Education and Copyright Harmonization Act” (the “Teach Act”) which became law in the U.S. in December of 2002. The bill, which was supported by the academic and publishing communities, creates a limited and specific exception to copyright for materials used in digital distance education, if the use meets certain carefully specified criteria. Those criteria include the following:

- (i) Works produced or marketed primarily for use in mediated instructional activities via digital networks cannot be used under exemption;
- (ii) The exemption only applies to accredited, nonprofit educational institutions or government bodies;
- (iii) The portion of work used must be comparable to that which is typically displayed in the course of a live classroom session;
- (iv) The performance or display of the work must be made by or at direction of an instructor as an integral part of a class session offered as part of systematic mediated instructional activities;
- (v) Technological measures must limit (i) recipients to students enrolled in a course; (ii) retention of work beyond class session; and (iii) unauthorized further dissemination; and
- (vi) The institution taking advantage of the exemption must have policies regarding copyright and compliance, and must provide such information to students and faculty.

The TEACH Act represents a “middle ground” between broad educational use exemptions that could threaten the financial health of publishers, and licensing systems that could require permission and payment for virtually all uses, however inconsequential, to the detriment of educators. It is hoped that other attempts to create educational exemptions will be as carefully crafted.



Conclusion

Traditionally, literary works reach their readers through the sale of actual copies. Licenses were, until recently, primarily a tool that authors and publishers used to define their relationships with each other and, at times, with customers using portions of their works for certain purposes. But copyright law, not license terms, defined the rights and privileges of most readers.

As digital distribution of literary works is becoming more common, and more important economically, licensing has taken on a new and important role. Licenses now increasingly define the relationships between authors and publishers, on the one hand, and their customers, on the other. "Readers" are becoming "end users."

The prevalence and ease of digital distribution of literary works, and the impact that it is having on copyright law, is creating both opportunities and challenges for all of the participants in the publishing industry.

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Chapter III

Graphic and Pictorial Works

Pictorial and graphic works are typically protected by a combination of intellectual property and related rights. Like all intellectual property, these works may be licensed to multiple parties in whole or part, either exclusively or non-exclusively. Complicating the matter, in many cases, numerous parties often own different rights in the same work. Given that multiple competing rights, rights holders, and licensees may exist with respect to any particular pictorial or graphic work, sorting through the various parties' interests can quickly become a complex endeavor, and both owners and licensees of graphic and pictorial works often encounter challenges in understanding their respective rights. The emergence of digital technologies and the Internet in the creation, management, licensing and distribution of graphic and pictorial works has only magnified the complexities of these issues.

The Graphic and Pictorial Licensing Industry

Pictorial, graphic, and sculptural works include two-dimensional and three-dimensional works of fine, graphic, and applied art, photographs, prints and art reproductions, maps, globes, charts, diagrams, models, and technical drawings, including architectural plans.³⁶ Although some creators of graphic and pictorial works handle both the creation and distribution of their works directly, the vast majority of licensing transactions today are handled by authorized representatives. These representatives typically contract with photographers, artists and other creators of such works pursuant to a representation agreement, with the representative responsible for the commercial exploitation and distribution of the works. Although the majority of these representation agreements involve agreements to share royalties with creators, a significant portion of the market involves work-for-hire agreements with commissioned authors hired for a particular assignment, and staff authors under an employment agreement where there is no ongoing royalty obligations owed by the representative.

Historically, the licensing of graphic and pictorial works involved a highly manual and time-consuming process. Over the last decade, the emergence of digital technologies and the Internet have led to a transformation of this business. In the photography industry today, an image can be created by a photographer in the field using a digital camera, can be uploaded via satellite to a media-asset management system at the photographer's agency, and can be catalogued, licensed and downloaded for use by a licensee anywhere in the world in a matter of minutes. The emergence of the Internet has also opened up new markets and usages of images beyond the traditional markets serviced by representatives of graphic and pictorial works. It has also given rise to a plethora of new legal issues and risks to both licensors and licensees of these media assets.

The worldwide market for stock photography is estimated to be approximately \$2 billion, with 3% growth forecast for 2003. The creative segment of the market is comprised of advertising agencies, graphic designers, and corporate advertisers, and accounts for \$1.5 billion of the total. Editorial users, which include magazine, newspaper and book publishers, account for the remaining \$US 500 million.

Although the licensing of pictorial and graphic works ultimately involves the delivery of a media asset to a customer, the underlying economic transaction is the licensing of the rights of the copyright holder (the photographer, illustrator or graphic artist) under the terms of a representation agreement with their representative, which in turn provides a license specifying a particular use of the work to the licensee. The representative's role, in essence, is to manage the rights to the work to ensure that the rights ultimately granted to the licensee do not exceed the rights granted by the copyright holder to the representative.



Generally, the representative licenses only the author's copyright, leaving any additional clearances of any third party with an interest in the work (such as rights of depicted persons or property, underlying copyrights in fine art, or trademark owners) to be secured by the licensee. While licensees of pictorial and graphical works in the creative and editorial markets are generally aware of the underlying rights issues involved in the licensing of these media assets, the emergence of the Internet as a primary distribution channel has increased the need to inform less sophisticated consumers who might access and download these works and make unauthorized or unintended uses.

Legal Instruments, Laws, Treaties and Frameworks of Graphic and Pictorial Licensing

The licensing of graphic and pictorial works is governed by numerous statutes, international treaties, and laws that may vary from jurisdiction to jurisdiction. What follows is a brief overview of the international legal framework concentrating in the five key geographic markets for the licensing of pictorial and graphic works – the United States, Japan, the United Kingdom, France and Germany, which represent approximately 80% of the global market based on license revenue.

International Agreements

There is no *per se* international copyright law. Rather, protection of copyrights is available only from individual countries. Within each country, the substance of graphic and pictorial work protection varies, as do the methods required to acquire such protection. However, largely because of the increase in intellectual property trade (and subsequent treaties that arose from these market dynamics), copyright protection has found considerable common ground in many countries. Consequently, transnational licensing poses a considerably lesser threat than it once did, and most licensors agree that the benefits greatly outweigh potential infringement exposure.

It is important to note that these treaties mandate that signatory countries conform their copyright protection scheme to a minimum agreed standard. The five countries which make up the bulk of the market for the licensing of graphic and pictorial works are signatories to the following major treaties.

The Universal Copyright Convention (UCC)

The UCC extends the protection of literary, scientific and artistic works (including graphic and pictorial works) to all signatory nations, assuming the works bear the symbol required by the UCC and the name of the owner and year of publication. The UCC requires that the level of protection be the same as that which the particular country affords works that comply with its local requirements for copyright works. Practitioners should be aware that, without taking any additional action (other than including the required notice), they hold foreign copyrights which may be assigned or licensed.

The Berne Convention

The Berne Convention for the Protection of Literary and Artistic Works (Berne Convention)—understood to be the international intellectual property treaty with the largest impact—provides for nondiscrimination in the treatment of intellectual property. The Berne Convention prohibits signatory countries from requiring formal action as a prerequisite to copyright registration. Thus, US copyright law no longer requires registration or publication with notice as a prerequisite for copyright protection.



Members of the Berne Convention must treat graphic and pictorial works of a fellow signatory country in the same manner they do with respect to domestic works.³⁷ Therefore, an author that has published a work in a member country can enforce that copyright in other member countries without registration or other formalities. Creators of copyright works in countries that are not signatories to the Berne Convention may still enjoy copyright protection in member nations by simply having the work published first in a member nation. (This is commonly referred to as a “back door” to copyright protection.)

The Berne Convention established the minimum length of the copyright protection as the life of the author plus fifty years. (The UCC, by contrast, allows for life of the author plus 25 years.) While signatory nations may legislate for lengthier protection, the Berne Convention prohibits any shorter term of protection. The Berne Convention also grants authors the moral rights of “paternity” and “integrity,” allowing the author to claim ownership and object to distortion of his work which negatively affects his reputation. For most graphic and pictorial licensing practitioners, it is most important to note that the Berne Convention will apply to the vast majority of licensing scenarios.

General Agreement on Trade-Related Aspects of Intellectual Property

The World Trade Organization (WTO) was founded under a number of principles and conventions, including the Agreement on Trade-Related Aspects of Intellectual Property Rights, or “TRIPS Agreement,” and addresses intellectual property issues amongst members of the WTO. With little exception, the TRIPS Agreement generally requires that all members comply with the Berne Convention. Licensors of graphic and pictorial works should take particular note of the requirement that all WTO member nations comply with Article 18 of the Berne Convention. This article mandates that copyright protection be restored to works that have fallen into the public domain for reasons other than the expiration of their statutory term of protection. Further, moral rights were excluded from the TRIPS Agreement. Accordingly, graphic and pictorial licensors whose work was created in a WTO member country need only be concerned about moral right issues in the country in which the work was created, unless such protection follows from other instruments, such as the Berne Convention.

North American Free Trade Agreement³⁸

The North American Free Trade Agreement (NAFTA) applies to intellectual property agreements made within Canada, Mexico, and the United States. Having built on the foundation of the TRIPS Agreement, NAFTA caused Canada and Mexico to enact more stringent domestic legislation in order to ensure consistent protection to all member countries. Graphic and pictorial licensors should note that NAFTA is extended to graphic and pictorial work as well as all other “works embodying original expression.” Accordingly, emerging technology, such as multi-media works and “new media” (media that often incorporates “streaming” digital graphic and pictorial works), are protected, where the TRIPS Agreement does not allow for similar protection.

World Intellectual Property Organization Copyright Treaty

The World Intellectual Property Organization (“WIPO”) Copyright Treaty (WCT) was adopted in 1996, in an effort to clarify certain aspects of copyright law in view of the emerging communication and computer technologies. The agreement is intended to supplement the Berne Convention, and states clearly that nothing in the agreement “shall derogate from existing obligations that Contracting Parties have to each other under the Berne convention.”³⁹ Licensors of graphic and pictorial works should note that this treaty affirms their intellectual property rights in digital media across international borders.



Moral Rights and the Licensing of Graphic and Pictorial Works

As noted above, many countries recognize the moral rights (or “droit moral”) of the creators of graphic and pictorial works. This doctrine reflects the general ideal that the creator of the work has the ultimate and exclusive right to control the manner in which their creations are reproduced, modified, or displayed. Moral rights differ from other intellectual property rights in that they are personal rights of artists, above and beyond the right of economic exploitation.

Unlike the economic component of copyright, moral rights are not internationally uniform; the moral rights protected in the United States are not as expansive as in Europe. Moral rights may restrict the licensees’ ability to bargain for certain terms of a licensing agreement and impose maintenance obligations that might not otherwise have been contemplated. Moral rights enable the creators to claim authorship, prevent use of their name as the author of any work they did not create; prevent the use of their name as the author of the work if the work has been distorted, mutilated, or otherwise modified, so that the use would be prejudicial to their honor or reputation; prevent any intentional distortion, mutilation, or other modification of their work which would be prejudicial to their honor or reputation; and to prevent any intentional or grossly negligent destruction of the work, if the work is of recognized stature.

Business and Industry Practices

Licensing Considerations

Licensing graphic and pictorial works has become significantly more complicated in the digital age. In addition to the standard licensing considerations, practitioners must now contemplate multiple methods of access, use, and distribution, while taking care to address ownership considerations and the application of laws from each territory where use of such works will occur. Since rights to pictorial and graphic works are rarely exercised without reference to a form of media, such as photographs, illustrations, or motion footage, this chapter focuses on the supplemental rights surrounding the use of such media.

The Parties

A license to graphic and pictorial works will necessarily deal separately with all rights contained in a manifestation of the work, as well as access to the work itself. The preliminary inquiry, therefore, concerns the identity of the parties to the license and their respective rights. Identifying all relevant rights holders and the scope of all such holders’ right can be challenging. Focusing on some critical questions, therefore, is often helpful: Is the licensor authorized to grant the rights? Does the licensor own these rights, or are they merely authorized to license the rights being granted? Can they provide all rights contemplated by the licensee’s use? Can they insure access to or delivery of the manifestation of the work whose rights are being licensed? Does the licensee represent all potential licensed users of the rights? Is the licensee exercising the rights or acting as an agent for the final end user?

Failure to properly identify the rights and/or rights holders involved may lead to potentially devastating consequences. Thus, licensors as well as licensees are well-served to spend time identifying the relevant parties and rights, particularly given the nature of the graphic and pictorial work. They are also wise to consider the complicated intersection of the various layers of rights and multiple rights holders involved when licensing rights in such works.



The Scope of Rights Granted

Initially, the license must focus on the rights in the graphic or pictorial work owned or retained by the licensor. Primarily, these are the copyright in the licensed work. In most countries, the license must clearly specify the nature of the specific copyright being licensed. Topics to address include:

- (i) reproduction (size, placement, quantity, format);
- (ii) publication and distribution (media, territory, format, and circulation);
- (iii) public display (medium and territory);
- (iv) modification or creation of derivative works; and
- (v) attribution. As pictorial and graphic works are increasingly licensed for use in digital technologies, these topics must also anticipate applications in digital format and usage and across a broad and ever-increasing spectrum. For example, while “size” and “placement” in traditional media might have meant three inches by three inches and a quarter page advertisement, on-line use might speak in terms of pixel size, web banner advertisement, placement and unlimited distribution. The task of “translating” traditional applications of licensing terms into meaningful provisions, as applied to the usage of digitized works, raises several key considerations.

Exclusivity

Since copyright is a divisible right, the concept of exclusivity takes on added importance in licensing. Exclusivity is typically carved off by territory or format; for example, one may simultaneously grant exclusive print rights in France to one licensee while also granting non-exclusive worldwide digital rights to another licensee. With the emergence of new technologies, graphic and pictorial works rights holders may wish to consider limiting the license grant by industry or topic. While broad grants of exclusivity are not uncommon, such licenses amount to a buyout or practical assignment of all rights (in some countries, such a license is tantamount to a legal assignment of rights and may be recorded as such). Any exclusive license should be conditioned upon payment, and should contain provisions that terminate exclusivity upon material breach. Otherwise, the rights owner could be left with little more than a legal claim to pursue. Prior licenses should also be noted in the new exclusive license.

Describing the Licensed Use

With the rapid pace at which new technologies emerge, the description of the licensed use becomes critical. Publishing provides a great example: if an original license to one publisher permitted exclusive use of the work in all books, does the license include electronic books?⁴⁰ Does it include online archives?⁴¹ Does it include delivery of books to portable devices such as cellular phones and personal digital assistants (PDA)? Does it include collections of former publications on CD-ROM?

Practitioners frequently use the recital “all formats presently existing or hereafter invented” as a means of insuring that new technologies will not require future negotiation. However, the copyright laws in many countries may invalidate such broad grants and limit the extent of the licensed use. Therefore, practitioners should strive to contemplate and specify new technologies or include options to address future technologies.

Other factors to consider when describing the licensed use include:

- Bundled rights: Does the license include the right to bundle with other works, or license the derivative work containing the graphic and pictorial work to others?



- Usage: Does the license distinguish the use of the work in a product from advertising for the product, and price such uses separately?
- Territory and Language: When describing online use, does the license focus on country-specific domains and language?
- Reproduction: What is the permitted size and resolution of the reproduced work?
- Placement and Prominence: What is the location, circulation and permitted volume of the usage of the reproduced work?
- Term of use: Will the use be for a limited term? Certain uses, such as in films and television, may require a perpetual license (for the life of the film). Product uses, such as posters or calendars, are typically limited to a set number of years or allowed inventory.
- Archival/Survival Rights and Inventory disposal: When the licensed use ceases, will there be permitted a survival period, or will the licensee be permitted to retain the work in an archive? If product inventory remains, how can it be disposed?
- Re-use Fees: Will the license include reuse rates, or do these require additional negotiation?
- Limitations: Is use limited to specified equipment, seats/users, or network access?

Commercial versus Editorial Use

A consideration particular to the licensing of graphic and pictorial works relates to the distinction of whether the work will be used for commercial or editorial purposes. Commercial uses are generally those primarily associated with the advertising of a product or service, whereas editorial uses are those whose primary purpose is to inform or educate. In practice, commercial use license fees typically exceed those for editorial uses, and authors typically assert more control over commercial uses due to concerns about artistic integrity for their pictorial or graphic works. Commercial uses also require a more thorough evaluation of potential third-party permissions that may be required.

Rights to Sublicense

Every digital use of a graphic or pictorial work by licensees inherently requires a grant of rights for the licensee to authorize the use of the work by its customers. The sublicense should be drafted specifically and narrowly to reflect the actual use (*i.e.* “reproduce and display in a web browser located at a specific URL”), under the terms of an approved end user license agreement (“EULA”), but not otherwise to distribute or modify. The licensor may wish to set minimum licensing terms for the EULA used by the licensee with its end-users or approve the licensee’s EULA. In either case, the license should refer to the authorized EULA rather than being silent about the terms of the licensee’s EULA.

Reservation of Rights

One practice when setting out the scope of the rights granted is to reserve specific rights or restrict specific uses. This is most common when the scope of the license is undefined or capable of broad interpretation, or when the licensor wishes to reserve certain uses for later negotiation or for other licensees. This is the appropriate place to reserve rights concerning new markets or new technologies.

Prior Approvals

Notwithstanding the grant of rights, the use may still require additional review or approval by the licensor or by third parties. This occurs frequently where the author is not the licensor but is represented by the licensor. Additionally, this occurs where a third party may have contractual approval rights, even though they do not hold any intellectual property rights in the pictorial work. Pictures of celebrities typically fall into this category, with a photographer allowing the celebrity or her publicist to review or retouch the photographs or approve of any licensee. The license may need to specify who bears responsibility for obtaining third party approvals.

Restrictions for Specific Sensitive Uses

Given the wide variety of potential uses of pictorial and graphic works (particularly in a digital environment), combined with the fact that such works can and often are modified, combined and incorporated with other works, consideration should be made of whether restrictions should exist concerning the types of other works with which the licensed work may be used. For example, an artist-licensor who is personally opposed to war or violence may wish to restrict any use of the licensed work from being used in advertisements for guns. A wide range of “sensitive topics” may exist for which a licensor may wish to restrict use. If so, such restrictions should be expressly contained in any license.

Third Party Rights

It is the rare license of graphic or pictorial works that does not require contemplation of the rights owned by third parties. Footage or photographs depicting such works may have layers of intellectual property rights, not all of which will be owned or represented by licensors. Even the conversion of a work into another medium may result in derivative works or compilations, with emerging rights belonging to multiple parties. The license should contemplate third party rights, and allocate responsibility for clearing those rights.

Disclaimers/Warranties

Because of the potential complexity relating to rights and rights holders in any one particular graphic or pictorial work being licensed, disclaiming what is being licensed and any related liability is often important. Failure to include such disclaimers may expose the licensor and/or licensee to unconsidered liabilities. Typical considerations might include no grant of third-party rights (rights of publicity or privacy), no grant of copyright in subject matter depicted, no grant of trademark rights, no grant of moral rights, no warranty for errors and inability to use due to hardware/software conflicts/accuracy of caption information, no responsibility/liability for licensee’s use or addition of other material and no liability for an end user’s misuse. In addition to disclaiming certain rights, licensors should be careful to only contract for those rights which they own. The licensee should, in turn, insist on some type of warranty that the licensor can, in fact, provide the license granted.

Other considerations

Because pictorial and graphic works potentially incorporate such a wide variety of rights, the parties should be aware of numerous other considerations that may arise from time to time. For example, licensing parties should anticipate potential issues relating to lost/damaged media, third party rights and clearances, and issues relating to media in the public domain.



Noteworthy Issues

Pictorial and graphic works are typically protected by a combination of intellectual property and related rights, such as copyright, rights of publicity and trademarks, among others. Additionally, numerous parties often own different rights in the same work. Multiple parties may wish to license the use of parts or all of a work, either exclusively or simultaneously. Given that multiple competing rights, rights holders, and users may exist with respect to any particular pictorial or graphic work, sorting through the various parties' interests can quickly become complicated. Indeed, both owners and users of such works often encounter challenges in understanding their respective rights. Of course, the increasing movement into the digital world has only magnified the complexities of these issues. Having a fundamental understanding of the key issues affecting graphic and pictorial works when licensing such works will, therefore, help interested parties to understand their rights, as well as anticipate future likely issues.

Copyright

A Bundle of Rights

While other important intellectual property and related rights are often implicated in respect to pictorial and graphic works, copyright law is primary. Some countries require fixation of the work in a tangible medium in order for the work to be protected by the copyright laws; in the United States, registration of the work is optional, but is required in order to enforce these rights. Copyright law grants the rights holder a "bundle of rights," including: the right to reproduce the work, the right to create derivative works, the right to distribute the work, the right to perform the work and the right to display the work. Each of these rights are distinct and can be separately licensed to various users and for a variety of purposes.

Rights are Divisible

Because the exclusive rights granted to rights holders as articulated above are "divisible," rights holders have great power to define how their works are used. Because of the flexibility of the rights holder to divide up rights, it is important that both the rights holder and the receiver of the rights (be it licensee or assignee) understand exactly the scope of the rights granted in any rights arrangement. Failure to do so can either unintentionally restrict the rights granted or received, or, conversely, erroneously expand such rights.

Underlying Rights and Multiple Rights Holders

Ownership of a copyright does not necessarily guarantee that the copyright owner or licensee can actually use the work. For example, while the photographer of a picture may own the copyright in the photograph itself, he does not necessarily own the right to commercially exploit the subject matter depicted in that photograph. The user, therefore, must realize what rights it has licensed from the photographer. If the user has only licensed the copyright(s) in the *photograph* itself (as differentiated from the subject matter depicted in the photograph), the user may still be restricted from using the photograph in a commercial fashion; it may be required to first obtain permission from a rights holder of the subject matter depicted in order to commercially exploit the image. As is clearly apparent, therefore, keeping focus on what "underlying rights" exist in any particular work is necessary. Otherwise, one might only secure some, but not all, of the necessary rights to engage in an intended activity.

Similarly, an artist may grant rights to use an illustration (say, of a whale) in a collage poster. That collage poster is both a “derivative work” of the picture and a compilation and enjoys its own, separate copyright protection which can be exploited by the producer of the collage poster. However, if the collage poster producer were to license its rights in the copyrights of the poster (to be reproduced on a web site, for example), unless specifically allowed by the illustration artist, the web site owner must recognize that the illustration of the whale as contained in the collage poster cannot be used without permission from the artist (as opposed to the collage poster producer). That is, the rights in the illustration of the whale are still owned by the artist and the rights in the collage poster (minus the illustration of the whale) are owned by the collage poster producer. Therefore, when licensing the copyrights in a graphic or pictorial work, both the rights holder and particularly the licensee must appreciate the scope of the rights which the rights holder is capable of licensing, and which are in fact granted. Often, licenses from multiple rights holders may be required. From these basic examples, one can begin to understand the complexity that exists in the licensing of graphic and pictorial works. When multiple works are involved, the issues can multiply exponentially.

Not All Rights Are Equal – Special Issues

While all of the five rights granted to the owners of works are exclusive, the relative importance of each to the rights holder and the potential licensee (or assignee) will vary depending on the particular intended use of the work. For example, the web site owner in the above example may need the right to reproduce the illustration of the whale, as well as the right to create derivative works of it. However, the web site owner likely may not need the right of public performance, since illustrations are not “performed.” As one might expect from the examples above, identifying and securing the rights to the underlying copyrights can often be the most challenging. However, in many cases, there may be no further underlying right that needs attention. The collage poster producer above, for example, needed only a license from the illustrator to produce, distribute, and display the poster. A common area in which such issues arise in the pictorial rights licensing arena involves the licensing of digital images depicting “fine art.”

In general copyright protection is limited in duration. All copyright works, therefore, will eventually lose their copyright protection after a certain period of time has elapsed. Thus, while at one point in time a license might have been needed to reproduce a particular painting, after the passage of time, it might be the case that no such license is required. Accordingly, many classic “fine art” images, such as Leonardo da Vinci’s *Mona Lisa* or Rembrandt’s *Nightwatch*, have fallen out of copyright and into the “public domain” for all to use.

However, one must still be careful to consider whether any rights *other* than the “first” underlying copyright exist and require a license. For example, while one is not prohibited from reproducing the original *Mona Lisa* (i.e. taking a picture of the actual painting itself), one cannot without license reproduce another party’s reproduction of the *Mona Lisa*. For example, if a photographer takes a picture of the *Mona Lisa*, deciding to add special filtered lighting to alter or modify the appearance of the colors, creating an avant-garde picture, the photographer has now created a “derivate work” of the *Mona Lisa* and is entitled to copyright protection for the newly added material. Unlike the earlier example of the wall hanging manufacturer with the whale, the underlying work in the *photograph* of the *Mona Lisa* is not protected by copyright. However, while that photographer does not obviously own any exclusive rights in the ability to reproduce the *Mona Lisa*, he *does* have the ability to prevent others from reproducing his particular *photograph* of the *Mona Lisa*. Thus, the web site operator above would need permission to reproduce this particular *photograph* of the *Mona Lisa* on his web site.

Given the range of complexities in owning and licensing rights in graphic and pictorial works, it is critical for both right holders and potential licensees or assignees to always track and clarify what rights are at issue, and the relative scope of those rights.



Protecting One's Rights – Copyright Registration

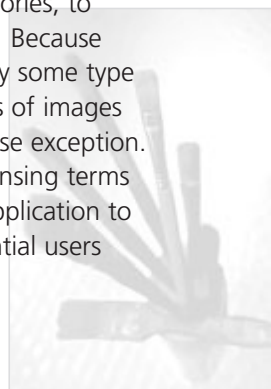
While under prior United States law, the failure to federally register one's copyright resulted in a total loss of all copyright protection, today, consistent with international law, works are protected even absent registration. However, this change in U.S. law does not mean that copyright registrations are unimportant. To the contrary, registration of copyrights still grants important protections to rights holders. Given the ease and frequency with which graphic works can be and are infringed in today's digital world in particular, taking steps to protect one's rights is critically important. Additionally, the value of any particular license may, at times, depend in part on the steps taken by rights holders to fully protect their rights.

Perhaps the biggest benefit to registering one's copyrights is the ability to recover statutory damages and attorney's fees under U.S. federal laws. Generally, if infringement of a work occurs when the work is unregistered, the rights holder will be unable to recover such amounts and would be limited to actual damages. As these are typically the most lucrative remedies available in copyright infringement actions, recovering money damages for copyright infringement can be difficult absent extraordinary circumstances. Accordingly, the failure to register a work can, at times, adversely affect the value of any particular work and, consequently, affect the terms of any particular licensing arrangement. Consequently, proof of registration is often requested by parties interested in licensing rights. As registration may be a pre-condition for filing a federal copyright infringement action in the United States, few good reasons exist for not registering. Finally, owners of copyrights of works formerly in the public domain in the United States, which were restored under applicable treaties, may still be required to register their intent to enforce copyright in order to recover damages.

Fair Use

Despite all of the rights afforded copyright owners, interested parties often claim that their use of a particular work is "fair," and therefore insulated from any infringement claim from and potential liability to the rights holder. The evaluation of whether a use is "fair" will be made in light of a variety of factors (some set forth in copyright statutes). These factors include: (1) the purpose and character of the defendant's use of the allegedly infringed work, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyright work; (3) the amount and substantiality of the portion used by the defendant in relation to the copyright work as a whole; and (4) the effect of the use upon the potential market for or value of the copyright work.⁴² Unfortunately for both rights holders and users of copyright works, whether a particular use is considered "fair," and therefore permissible without a license from the rights holder, is rarely clear or often highly debatable. Such uncertainty can be particularly true with graphic and pictorial works.

Images are used in almost every medium and channel of society, ranging from news stories, to advertisements, to magazine articles, to lunch boxes and countless others in between. Because images are somewhat unique in that they almost inherently can be perceived to convey some type of artistic message apart from any particular use of the image, rights holders and users of images often battle over whether a specific use of an image is subject to copyright law's fair use exception. To reduce such arguments, parties often agree to resolve such issues through clear licensing terms where possible. Therefore, an awareness of copyright law's fair use doctrine and its application to the rights in pictorial and graphic works is important for both rights holders and potential users when negotiating rights through licenses.



Right of Publicity/Privacy

As noted above, the right of publicity is a separate and distinct right from that of copyright. As opposed to the bundle of rights afforded under copyright law, the right of publicity is the personal right of every individual to control the commercial use of his or her identity. This right may be described in certain countries as a right of privacy or a right of integrity. However, as the earlier examples suggest, this right often co-exists along side copyright, particularly with respect to graphic and pictorial works.

While it is not often difficult to recognize that a “right of publicity” issue may be involved in any given situation (due to the fact that a work includes a recognizable picture or name of a person), resolving whether such uses are permissible can be quite difficult. This difficulty arises, in part, from the tension between two sides of the same coin: on one hand, the right of publicity originated in some respects from the protections afforded individuals not to have their private life commercially exploited; on the other hand, laws or constitutions may grant strong rights of free speech to those who might wish to comment on or inform the public on matters of interest, including those of people in the community. Because of these strong competing rights, resolving what constitutes a permissible use of an individual’s name or likeness can be difficult.

Given that people are a popular subject matter of pictures, debates over what might be allowable uses of an image of a person’s image are common. Most disputes in this area center on the type of medium on which a person’s name or likeness is used. That is, is it truly commercial (a coffee mug), truly non-commercial (a critical political news story), or somewhere in between? Licenses often attempt to recognize and specify the rights afforded to licensees and are one of the best methods for avoiding the uncertainty of such uses otherwise left to constitutional analysis. The benefit of such certainty is often quite high given that the rights holder in many rights of publicity disputes are highly recognized celebrities who tend to be vigilant and litigious in protecting the exploitation of their valuable publicity rights. Thoughtful licenses, therefore, are often valuable tools in mitigating the likelihood of costly disputes.

Trademark

In addition to copyright and rights of publicity, issues relating to trademark law are not uncommon in the use and licensing of pictorial and graphic works, particularly images. Trademark law is designed to protect consumers against being confused as to the source of particular goods and services. Thus, the law prevents one from using a symbol or designation (i.e., the trademark of another) in such a way as to mislead the public into believing that particular goods or services originate from, or are sponsored by, that other unrelated party. Because images may include other party’s trademarks, one must be mindful that the image is not used in such a way as to falsely associate the respective trademark owner with unrelated goods or services.

Other Issues

Pictorial and graphic arts can often incorporate a truly wide range of subject matter and artistic nuances. As a result, in addition to the above-noted rights, rights holders and potential users of pictorial and graphic works are also likely to encounter other related rights from time to time (e.g., moral rights, other property rights and the like). While the complexity of the intellectual property and other laws protecting images can be great, both rights holders and users should take comfort knowing that careful drafting of the terms of the license should provide the necessary protection to all interested parties and can significantly reduce the risk of a later dispute.



Technological Developments and Their Influence on Licensing

As consumers, content creators, content providers and technology providers continue to move toward an increasingly digital world, we can expect previously entrenched business and legal paradigms to change in order to keep pace. Just as the development of new digital technologies has recently challenged the established business practices and legal foundations of the music, motion picture and television industries, creative artists and content providers of pictorial and graphic arts can also expect further development in their respective business and legal landscapes. In particular, three distinct frontiers appear to be emerging as important focal points: (1) emerging distribution channels; (2) emerging secondary markets for the works; and (3) the challenges and uncertainties created by developing law as applied to pictorial and graphics works in the digital world. It is in light of these developing trends that interested parties must revise old licensing practices, and consider new and creative ones, for the involved rights.

Channels and Methods of Distribution

Technology has revolutionized the graphic and pictorial works industry by rapidly decreasing the time to create, process, catalogue, manage, and distribute visual products from weeks to minutes. Today, the quality of digital reproductions often matches, and in many cases, surpasses that of traditional media. The concurrent advancements of computer hardware and software makers in combination with the movement of analog based companies to digitally-based products and services are not only improving the quality of such digital products, but are also enabling new and innovative uses. Simultaneously, these advancements are lowering the barriers of entry to participating in the digital world. As growth continues, however, increased challenges to rights holders in both infringement and business methods can also be expected.

Future Expanding Uses

The ability to digitize traditional media has changed both demand and established methods of distribution, for such media in kind and scope. The development and widespread adoption of the MP3 format has forever changed expectations of consumers of music. Similarly, the development of digital video recorders, such as TiVo and ReplayTV, is altering how consumers watch television and movies. Increased demand by consumers for these extensions of traditional media into digitized formats has been met by increased innovations and new distribution methods by content providers and technology manufacturers. Music can now be downloaded in various formats onto portable devices, television programs can now be shared across subscriber networks and new licensing frameworks have been developed to manage digital distribution of music.⁴³ Technological advances are similarly expanding demand and distribution of images and graphic arts.

Of the many rapidly emerging technologies, one with potentially the greatest anticipated effect on pictorial and graphic works is that of “smart” devices – devices with the ability to access data regardless of location, type and number of devices used. As smart devices are increasingly integrated into daily life and consumer demand and use of them grows, content providers will increasingly seek image distribution to these new devices. Thus, while image distribution to devices such as cell phones, PDAs and the like might not have originally been contemplated by rights holders and content providers, the increased ability of such devices to display high quality images and graphics will require revised licensing arrangements to cover these new channels of distribution.

More fundamentally, increased integration of computing and entertainment is expected to grow as prices for new technologies decrease. Therefore, for example, where home entertainment systems have traditionally consisted of disconnected analog components, consumer demand is moving

towards integrated digital environments. Thus, as consumers' use of plasma screens, video telephones and other new image-based technologies becomes more common, demand for pictorial and graphic works driven to such devices will increase. Agreements covering the uses of the displayed images will, therefore, need to account for these evolving methods of distribution.

Decreased Barriers to Entry

In contrast to the broadening methods of distribution, the increased ability of the public at large to create and control distribution of fairly good quality digitized images with relatively little investment of time or money, and without serious degradation of quality, has decreased the barriers to entering the market of image publication and distribution. While the advantages of using established agencies to manage, publish and distribute works will in most cases always outweigh those of self-publication and distribution by a single artist or small group of artists, the fact that artists now have the ability to "do it themselves" is likely to alter how some rights are negotiated and licensed.

The recent change experienced by the music industry provides a good example. While most major recording artists still recognize the benefits of major record label representation, some less established acts are foregoing label representation and instead themselves distributing their music online. While an artist may prefer label representation to self-publication, the fact that self-distribution is an available alternative creates a new consideration for labels interested in signing the recording artist. Similarly, while authors of pictorial and graphic works may prefer the benefits of established agency representation, the ability to self-distribute potentially creates a new degree of leverage. Further, because of the increased ease of digital distribution, an artist may feel that while they prefer generalized representation, they would like to retain certain limited defined rights, which they feel they can just as easily exploit themselves. These new options available to creators may, therefore, inject new dynamics into some aspects of rights licensing of images.

Emerging Challenges to Rights Holders

With every new technological development comes new challenges to rights holders. Because of the increasing ability to make high-quality copies of digitized images, rights holders and content providers can expect continued attempts by others to avoid authorized licensing of content.

Like music and movies, digitized images can be copied with ease and without serious degradation in quality. At the most basic level, all that is needed to make copies of digital images is a computer and some simple software. With a little more investment, the combination of relatively inexpensive, but sophisticated software and hardware, combined with online access, can enable massive high-quality copying. The proliferation of peer-to-peer networks has almost overnight made it possible for unlicensed content to be shared with countless users instantaneously, mitigated only by the relatively high bandwidth needed to transmit such computer files. As computer file size continues to decrease, the speed at which digitized images can be shared unlawfully will undoubtedly increase.

Efforts by rights holders to fight piracy will also continue to grow on several fronts. License agreements by rights holders may be drafted to specifically contemplate increased responsibilities to protect against piracy. Such efforts may include increased coverage in agreements requiring digital watermarking, stronger encryption, and other copy preventing and usage tracking technologies. Resolution and file size of the images licensed are also likely to be further defined, as control of these features may be used to further deter mass piracy (e.g. lower resolution thumbnail versions of images used to index catalogs may be less likely to be mass pirated). Additionally, further reduced complexity in some form licensing agreements for more basic uses may reduce the deterrence of common consumers to lawfully license image use, thereby further reducing the compulsion for piracy.



Developing Secondary Markets

In addition to new systems of use driven by new technologies, a substantial area of emerging growth lies with the continued expansion of “bricks and mortar” businesses into the digital world. This expansion creates a market for secondary rights licensing not originally contemplated by the creator of the licensed work. For example, traditional art auction houses have quickly identified the benefit of online distribution of digital images of their collections. Originally unforeseen by artist or auction house, the derivative works rights in the digitized images have created a valuable secondary rights market. These rights must obviously be considered in future licensing arrangements as applied to all involved parties.⁴⁴ As sophisticated rights agencies promote the benefits of distribution of digitized images, the secondary licensing market for organizations such as museums, auction houses and the like is expected to grow.

Emerging Trends

As technology has evolved throughout history, legislatures and courts have amended the copyright laws in order to maintain a proper balance between protecting the copyright owners on the one hand, and protecting and fostering the benefits received by society from the creativity of authors on the other hand. Recent changes in copyright law relating to digitized content, made both by lawmakers and by the courts, particularly in the United States, make clear that copyright law will continue to evolve to keep stride with technological change. Several emerging areas appear likely to impact the future of licensing of graphic and pictorial works.

Fair Use

The doctrine of fair use often serves as a central battlefield between rights holders and alleged infringers when new technologies test the boundaries of copyright law. Fair use acts as the “safety valve” of copyright law’s strict liability scheme. Because it is grounded on a “rule of reason,” what is “reasonable” and considered a “fair” use will change as new, unforeseen uses of copyright works are made. Thus, where activities that were once clearly considered “fair uses” move online, the limits of lawful, unlicensed uses of graphic and pictorial works will be tested.

A quickly emerging and hotly debated concern centers on the increasingly popular use of the Internet and the World Wide Web by schools’ distance education courses. Rather than physically attending classroom lectures, students attend virtual classes online. In the past, certain express uses of copyright materials in classroom settings have been exempted from the exclusive rights of copyright holders. These exemptions as originally envisioned, however, do not clearly apply to cover these new online uses. Therefore, rights holders and end users must now further consider whether the use of graphic and pictorial works in certain circumstances traditionally believed to be “fair uses” are still “fair,” or whether licenses are required.

Another area sure to test the boundaries of fair use relates to where copyright law has historically bowed to policy considerations. Where use of graphic and pictorial works for purposes of commentary and criticism, news and the like often fall within the realm of “fair uses,” it cannot be assumed that the same will be true in the digital world. These areas require particular attention in the licensing agreement, as misjudgment in the scope of licensed rights (either broader or narrower) based on the implications of future fair use developments will certainly affect the value of the license and licensed content.

The practices of online linking and framing to and of graphic and pictorial works also present new issues. The recent decision in *Kelly v. Arriba Soft Corp.*⁴⁵ is perhaps the most striking reminder of

the importance of this emerging area for online images. There, the Ninth Circuit for the United States Federal Court held that the mere act of unauthorized online linking to or framing of copyright protected photographic images by the defendant's visual search engine web site infringed the copyright holder's public display right and did not constitute a fair use. The case is likely to lead to further refinements of the fair use doctrine, at least as applied to online use of digital images.

Digital Millennium Copyright Act (DMCA)

The 1998 DMCA in the United States created many important changes to its copyright law in response to developments created by the Internet. In addition to the application of existing doctrines to online activities, the DMCA also created new rules for the digital world. These new laws have already begun to affect the treatment of pictorial and graphic images in digital form, and therefore must be considered in licensing agreements. The new provisions with perhaps the greatest potential impact on digital rights holders of pictorial and graphic works are those governing circumvention of technological measures used to protect copyright works and copyright management information.

The DMCA, as required by the WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty, implemented several obligations relating to the circumvention of technological measures used to protect copyright works and the preservation and use of copyright management information. Both technological protection and copyright management information measures are used heavily to protect and manage digital rights in graphic and pictorial works. These provisions are certain, therefore, to become heavily negotiated issues in future agreements. Because the fair use defense may not be available to a party who has circumvented technological protections measures in order to make a fair use of the protected work,⁴⁶ licensing agreements may become even more important when encrypted and otherwise technologically protected images and other graphic and pictorial works are at issue.

Other Developing Laws

In addition to the DMCA, the WIPO Copyright Treaty, and the WIPO Performances and Phonograms Treaty, other laws continue to be implemented and modified to meet continuing changes in technology as applied to copyright works. For example, the European Copyright Directive similarly implements important rights and obligations for rights holders and end users, including those related to anti-circumvention prohibitions and copyright management information. As courts in implementing jurisdictions interpret these rules, licensors and licensees should consider the differences in laws as they apply to the licensed content.

Other applications of copyright law to the digital environment raise uncertainties for licensing rights in graphic and pictorial works. Two such important emerging areas relate to: (1) the first sale doctrine, and (2) implied licenses.

First Sale Doctrine

Copyright law's first sale doctrine entitles the owner of a particular work to sell or otherwise dispose of the possession of that particular copy.⁴⁷ Because the first sale doctrine was originally drafted before digital works existed, and therefore intended to apply to tangible copies, it is uncertain whether online transmissions of particular copies will be considered to be covered by the first sale doctrine. Though the application of the first sale doctrine may seem to apply to some sales in the digital environment, application of the doctrine may be less clear in others. Given that digitization



of works often requires multiple “copies” to be made (in computer RAM, cache copies, buffer copies, among others), careful thought must be given by the copyright holder to the potential applicability and effect of the first sale doctrine when selling rights in digital format in any particular “copy” of a graphic and pictorial work to third parties. Potentially slight differences in treatment of the distribution right and first sale doctrine by the WIPO Copyright Treaty, WIPO Performances and Phonograms Treaty and European Copyright Directive may also affect future treatment of rights in pictorial and graphic works.

Implied License

In certain circumstances, users of digitized content located online might claim that rights to certain uses, such as caching, have been granted under an implied license. Though courts might favor narrow construction of any such licenses, increased attention to specific contractual provisions on web site terms of use and elsewhere may help defeat the reliance on the implied license doctrine by alleged infringers, thereby avoiding conflict. At a minimum, rights holders in graphic and pictorial works should review current licensing arrangements in light of the potential argument that an implied license may be argued for in some limited cases.

Conclusion

It is clear that, as we move further into the digital world, the boundaries of copyright law will continue to be tested as it is applied to new technologies and activities. Because nearly every activity involving digitized images requires “copies” to be made, rights holders and parties interested in using copyright materials will need to consider the effect of copyright law. Indeed, traditional applications of copyright law applied to the pre-digital world may no longer make sense as applied to digital works.

Although licensors may potentially enjoy stronger rights in the developing online environment, emerging new business methods, unexpected interpretations of law and the increase of piracy in the digital age will increasingly test those rights. Greater attention to the treatment of the rights involved in agreements will surely be an important tool for addressing these changes.⁴⁸

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Chapter IV

Motion Pictures

Motion pictures are a unique combination of art and commerce, individual vision and cooperative action. Although new technology is making the creation of some films more accessible and less expensive, a vast majority of those films which are successfully licensed worldwide are expensive, substantial productions, and thus usually created by large companies financed and structured for that purpose. This has led to a consolidation of the film industry and the increasing power and influence of the United States-based (although not always United States-owned) major motion picture studios.

In the early days of filmmaking, it was not an overly difficult or expensive proposition to make a film once one had access to a camera, film and other rudimentary materials. Before the advent of sound brought spoken language to films, the medium easily transcended territorial borders and cultural boundaries. Since language did not interfere with the licensing of films, they could be created almost anywhere. In the early twentieth century, their value in the marketplace was primarily based on the appeal of the story and subject matter, quality of execution and marketing, and availability of theatres. At that time, French companies dominated the worldwide licensing of films, including imports into the United States of America: "In 1910, two-thirds of the movies shown in the world were made in France."⁴⁹

By 1919, however, following the devastation of Europe during the First World War, American films constituted 90 percent of all films shown in Europe.⁵⁰ The economic depression of the 1930s and another World War helped solidify the American studios' worldwide influence. Those studios were able to produce films without significant interference by war, while maintaining their substantial domestic market during a time when theatres, facilities and infrastructure in much of the world were being destroyed.

Despite serious economic problems during the 1960s and into the 1970s, the studios have been able to maintain dominance of worldwide production, distribution and licensing of motion pictures. Nevertheless, there has always been an important independent and international film industry presence. Local film industries have strong histories in many countries. Local films are often licensed on a country-by-country basis, at least regionally, depending upon political, cultural and language compatibility. Meanwhile, non-English language films accounted for a shrinking percentage of theatrical box office receipts in the United States of America. Only recently have a few such films gained major theatrical success in the United States of America, such as "Life Is Beautiful" and "Crouching Tiger, Hidden Dragon."

As a result, although independent and international companies also play a key role, any analysis of the structure of the motion picture industry should begin with the major studios.

The Structure of the Motion Picture Industry

The Major Studios

The studios have dominated the film industry for decades. Paramount Pictures was formed by the 1916 integration of Famous Players-Lasky and the Paramount Company. Universal was created in 1912, Fox in 1913 (the merger between 20th Century and Fox occurred in 1935), Columbia in 1920 and Warner Bros. in 1918. MGM (now inclusive of United Artists) was formed by the 1924 acquisition by Loew's Incorporated (which owned Metro Pictures) of Goldwyn Pictures and Louis B.



Mayer Productions. Disney was formed in 1923. Each of these studios has continued to exist, in one form or another through the present day.

Amazingly, only one other company formed in the past seventy-five years, DreamWorks, now considers itself to be a studio. However, DreamWorks distributes its pictures domestically through Universal, and does not directly distribute in any other countries; further, it owns no television networks, cable systems, or other significant media companies. Of the major studios, only MGM is primarily limited to the development, production, financing and distribution of motion pictures, relying primarily on its vast film library of thousands of titles.

The remaining major studios have purchased, developed or merged with various entertainment entities to create substantial media conglomerates in recent years. This protects but limits the significance of each company's film studio, as the larger company attempts to build itself into an increasingly significant international media company and extend its brands and trademarks beyond the individual films the studio produces and distributes.

- Warner Bros. is now a division of AOL/Time Warner, and thus part of a company that includes Internet giant AOL, substantial publishing interests (Time magazine), Warner Music Group, pay television network HBO, the WB network, cable networks such as CNN, TNT and TBS, a major cable provider, New Line, and numerous other media properties.
- Paramount holds a similar position in parent company Viacom as an affiliate with MTV, Nickelodeon, the Comedy Channel and other cable networks, pay television network Showtime, CBS and smaller United States network UPN, and other media entities.
- Fox is owned by NewsCorp. which owns the Fox television network, cable channels (for example, FX and Fox Sports Net), international satellite services including Star in Asia and BskyB in the United Kingdom, and extensive publishing, sports and other media holdings.
- Universal is currently in a state of uncertainty arising from its ownership by French conglomerate Vivendi (and its own problems with French pay television giant Canal Plus); however, it remains related to Universal Studios' theme parks, Universal Music Group (the largest music company), Focus Features, and cable channels USA Network, Trio and SciFi Channel.
- Disney includes its famous theme parks, ABC, a series of cable networks including The Disney Channel and ESPN, and Miramax.
- Columbia, with film divisions or affiliated companies TriStar, Sony Classics, Screen Gems and Columbia TriStar Home Entertainment, is owned by Japanese behemoth Sony, and thus affiliated with Sony's hardware company, Sony Music, and other Sony activities.

Each major studio is thus able to develop, finance and produce many motion pictures despite the inevitable ebbs and flows in the market. While independent and smaller companies cannot afford to commit to numerous high-budgeted films, the studios can commit to the development, production and marketing of an annual slate which includes highly budgeted pictures targeted for mass worldwide audiences.⁵¹ These pictures augment their existing film libraries and allow the studio to survive until the next "blockbuster" arrives to generate meaningful profits and long-term benefits, including increasing library value (and sometimes the value of affiliated companies). Studios thus can focus their attention on pictures such as "Jurassic Park," "Batman" and "Raiders of the Lost Ark" which generate sequels, television productions, theme park rides, stage productions, books, soundtracks, and merchandise of all kinds. More recent examples of such profit-generating franchises are "Harry Potter" and "The Matrix" at Warner Bros., "The Lord of the Rings" at New Line (owned by Warner Bros.), and "Spider-Man" at Sony.⁵²

Meanwhile, studios also combine more and more often to share the financial risk in numerous highly budgeted films or those perceived to be risky. For example, Fox and Paramount co-financed "Titanic," reportedly the most expensive and clearly largest revenue-generating motion picture of all time.

Studio-Owned Film Companies

The success of certain independent production and distribution companies prompted their acquisition by studios to augment and diversify the studios' film libraries. The most significant of these – Miramax, New Line, and most recently Focus Features (formerly Good Machine, which has been combined with USA Films) – provide the purchasing studios with an "independent" approach to development, production, marketing and distribution. These companies have proven themselves adept at discovering or at least working with talented filmmakers, and have dominated film festivals and Academy Award nominations in recent years.

Such companies can create films with smaller budgets, riskier subject matter, and international directors and actors. For example, it is perhaps not surprising that New Line and Miramax warred over building Jackie Chan's English-language audience in the United States. These three companies also continue to license their films internationally and often take the lead in finding co-financing or co-production partners.

Studio-Related Independent Companies

Although significantly successful films are most often created and distributed by the studios, some major successes have been produced by or with independent companies while being distributed in North America (and sometimes elsewhere) by studios. These production entities constitute a second strata of film companies. They are companies independently run and usually moderately well financed, but contractually tied to studios at least for domestic distribution and/or co-financing. Some of these companies have international investors and often license their films to their international financial partners. Examples of such companies include Spyglass, Mutual, New Regency, Revolution Studios, Village Roadshow and Morgan Creek. Many such companies have developed or co-financed studio-released successes, such as "The Sixth Sense," which Spyglass co-financed with Disney. These companies often utilize their independence to control some or all of the international rights and licenses for their pictures, while granting domestic rights to the studio.

A unique independent production company is LucasFilm, the source of the unbelievably successful "Star Wars" film series. While utilizing Fox's film distribution, LucasFilm has maintained the right to license its merchandise, books, and ancillary rights.

Independent Companies and AFMA

A final important category of relevant film companies are the truly "independent" companies (that is, companies with no ownership by or co-financing agreements with a studio), including many non-United States-based entertainment entities of various kinds which finance, produce and/or acquire films for their own territories or for worldwide license. These companies range from individual entities formed solely for the purpose of financing, producing and exploiting single pictures, to substantial theatre owners, television networks, and other media entities worldwide.

Many of these independent companies operate as sales representatives or international distributors. While some are also involved in film production, they are usually expert in international licensing and many are members of non-profit trade association AFMA (originally known as The American Film Marketing Association).⁵³



AFMA was formed in 1981 by a group of small international sales agents involved in worldwide licensing of English-language motion pictures, and determined to create a Los Angeles-based film market. The annual American Film Market has since grown to become the largest film market in the world and the trade association currently has over 170 members. Its membership includes studio-owned Miramax, New Line, Focus, and HBO, studio-related companies like Lakeshore, Morgan Creek and Village Roadshow, substantial independent companies such as Artisan and Summit, individually dominated sales companies like Roger Corman's New Concorde International, Mark Damon's MDP Worldwide and Kathy Morgan's Kathy Morgan International, and numerous international sales companies of all sizes. AFMA is no longer limited to distributors of English-language pictures, and now includes television companies and financial institution members. AFMA's members are based around the world, including London, Paris, Munich, Rome, Madrid, Toronto, Tokyo, Hong Kong and Sydney, among other locations.

AFMA members reported worldwide gross sales for the year ending December 31, 2000, of over US\$2.6 billion.⁵⁴ Thus, while they account for revenues far less than the studios' receipts,⁵⁵ AFMA members nevertheless are a significant factor in the international film industry.

International Film Markets and Festivals

Over the years, parties interested in licensing pictures outside of their local area have done so primarily at a few annual motion picture markets. These events, sometimes tied to concurrent film festivals, allow motion picture buyers and sellers from around the world to screen pictures, review trailers and other marketing material, discuss films (past, present and future), and negotiate licenses in person. One of the largest of these markets is tied to the Cannes Film Festival and takes place in May each year. The other two primary markets are MIFED, the fall market in Milan, and AFMA's American Film Market held in February/March in Santa Monica, California.

The use of such intense markets to license pictures has had an effect on the way in which films are licensed and the nature of license agreements. For example, time pressured market licenses have led to the common use of deal memos (short form license agreements) which may or may not then lead to subsequent long form agreements.

Meanwhile, film festivals have become increasingly important not just for the screening, review, and promotion of films, but also as a venue for film companies to engage in various business transactions (including film acquisition). The most important of these at present are probably the Toronto Film Festival, Sundance, and the major European festivals in Berlin and Venice. In addition to these well-known events, there are hundreds of other motion picture festivals and events worldwide, offering potential notoriety (and sometimes distribution) to non-English language pictures and independent films.

The growth in the number and significance of film festivals has paralleled the development and globalization of communications technologies. As a result, dozens of important festivals and markets now combine with mobile phones, e-mail, faxes, video-conferencing, and satellite transmissions to allow more international transactions to occur outside of the film markets. Thus, while the major film markets remain important as a means of developing and maintaining essential personal relationships and to market and publicize films—as well as hopefully to develop a fervor among film buyers sitting with an enthusiastic festival audience—films now can be and are licensed worldwide on a year-round basis.



Pre-sales of Future Films

Unlike some other forms of intellectual property, an anticipated *future* motion picture can hold substantial value, particularly for territorial distributors who do not have access to a constant flow of studio-level pictures. The acquisition of important pictures has been sufficiently important to many licensees to justify committing to their purchase before films are even completed. Scores of independent pictures have been sold on a what is referred to as a “pre-sale” basis.

The first regular use of this approach is often attributed to Dino Di Laurentiis, who used it to finance his large-scale independent productions.⁵⁶ Normally based upon a genre script, budget, and one or more major elements (usually director and/or lead actor), a producer entered into agreements in various territories to license a film which was yet to be completed. Although it has become difficult to do so in the present economic climate, for many years various European and United States banks loaned against these pre-sale contracts and the potential value of the picture’s unsold rights (which together with the underlying copyright formed the lender’s collateral). The bank funds were then utilized to finance the picture and, upon delivery of the completed picture (which was guaranteed by a completion guarantor, generally via a “completion bond”), licensees paid the bank directly. This process was implemented with larger or smaller ‘gaps’ between the amount borrowed and the pre-sale guarantees, depending on the perceived value of the picture in the future (particularly in unsold territories) and the strength of the marketplace.

The ability to pre-sell films usually depended upon one or more established film elements, financially strong buyers, willing banks, a completion bond, and a strong producer trusted by the other parties to complete the picture on budget, on schedule and consistent with the approved screenplay.

At times the number of such pre-sale transactions and gap financings have been substantial. For a number of years, commencing in the mid-1980s, the value of most films in the then-booming video market was such that many parties came to believe that very little else was required to assure profitability. While these perceived assurances were not always accurate, the perception allowed international sales agents, production lenders, completion bond companies, and independent producers to thrive. Such a market caused independent production companies to sometimes raise the salaries of major (and sometimes not so major) actors and directors in order to complete a film package for pre-sales. This boom period saw many independent film entities become public companies and raise millions of dollars of capital. One problem such a business model faces is that pre-sales usually protect the downside or risk for a particular film but reduce its potential upside profitability. Thus, if this model is tied to excess overhead, limited financing, uncertainty about the flow of future productions, license failures or non-payment, severe market changes, and/or any unpredictable loss, the licensor’s entire business can be jeopardized. The resultant, but predictable, bust substantially tightened the market.

After the video boom cooled, other market forces or financing mechanisms arose which allowed a continuing pre-sale market (for example, various territories’ television markets expanded and, for a short-lived period, insurance became available to protect production lenders, at least on paper).

The current market has changed dramatically into a much more conservative one. It is often difficult, if not impossible, to pre-sell significant territories. When it is possible, equity financing and often deferred compensation and/or additional collateral – is normally required before a production lender will put money into a picture which is not fully collateralized by existing distribution agreements.



The Primary Factors in Evaluating a Motion Picture

The copyright in a motion picture is not only legally divisible, but from a practical perspective is divided into numerous pieces. While certain production entities (such as the studios) may distribute a picture on their own in most territories and media, it is becoming less and less common to exploit (or even finance) a picture without multiple licenses. Any thorough analysis of worldwide film licensing would consider financial, cultural, artistic, political, legal and (of course) economic issues required for the successful creation and exploitation of motion pictures.

Set forth below are a number of separate subjects which should be evaluated together to determine how best to finance and/or exploit a motion picture.

Territory

Traditionally, motion picture licensees have been local distributors or sub-licensees based in their own country or territory. They may be theatrical distributors (and/or exhibitors), video companies, television networks, or even government-backed film organizations. Most licensors initially look to these local buyers in the largest licensing countries – the United States of America and Canada (usually licensed together), Germany, France, Italy, the United Kingdom, Spain, Scandinavia, Japan, Korea and Australia/New Zealand (also normally licensed together). Sometimes multiple territories or countries are licensed together, or a territorial buyer (for example, for all of Europe or Latin America) will license rights to distribute itself throughout its territory or do so through an established group of affiliated companies. This all seems fairly straightforward and is not particularly different from the geographical analysis which would have occurred many years ago. However, the closer one looks at individual territories and how to define and evaluate them, the more complicated matters become. There are a number of reasons for this.

First, countries have shown a remarkable instability in borders and a lack of longevity during the last twenty-five years. Anyone who has licensed a picture for exploitation in the Soviet Union, Yugoslavia, Czechoslovakia, or a number of other territories can vouch for such dramatic changes. New countries have emerged on a regular basis – there are now 191 countries recognized by the United Nations.

Second, the definition of any territory must be tied to questions regarding the language in which the picture was filmed and is to be exploited. For example, questions arise as to whether a license to a French company for exploitation in France also includes rights to French-speaking Switzerland, former French colonies in Africa, and a number of other French-speaking areas and islands.

Third, the analysis of any territory is entwined with the media being licensed. For example, DVDs are created on a regional basis for piracy and technological reasons, and the licensor must determine which DVD “region” is included in a licensee’s rights. This can have an effect not only on the value of the picture in that particular territory, but also in other territories.

Fourth, the value of a picture in any territory can be dependent on satellite footprints, the prevalence of parallel imports, overspill and widespread piracy (either into that territory from elsewhere or as a result of pirated exploitation in the territory). The best current example of this problem is the licensing of pictures in Asia. A release, for example, in China, Hong Kong, or Malaysia must be coordinated with that picture’s release in the other named countries as well as most of the rest of Asia to assure maximum value and reduce losses. Various contractual provisions can deal with some of this, but the licensor needs to be certain how and when licensees will exploit the picture – and in which media – to avoid interference from exploitation in neighboring countries.⁵⁷ Such piracy and parallel import problems can undermine worldwide exploitation in some cases.

Fifth, the territory being licensed must be defined in a manner consistent with other license agreements. For example, Latin American and North American pay television licenses each often include the Caribbean, Bermuda, Puerto Rico and/or neighboring islands and, as such, could conflict. This can be resolved by licensing North America and Latin America to the same licensee, by defining the territory clearly and/or by providing non-exclusive rights (which usually does not work) or limiting the available languages (which sometimes does work).

Sixth, geographical concerns and boundaries can also become confused with the license of so-called “Internet rights.” The question of whether and to what extent Internet streaming or downloading can be properly encrypted and restricted to one or more licensed territories is, at best, unsettled. Thus, for a number of years most licenses have defined and then “frozen” such Internet rights until industry-accepted technological and legal restraints can be effectively implemented.

Defining the licensed territories should be standardized to avoid lengthy, inconsistent negotiations between various parties. AFMA has attempted to accomplish this – with some success – by creating detailed definitions of all the territories licensed throughout the world, thus providing an existing structure for independent companies and others who utilize AFMA’s model license agreements or refer to such territorial definitions in their license agreements.⁵⁸

Media/Rights

Unlike many products, motion pictures can be licensed separately for numerous media. It is usually the licensor’s task in negotiating its licenses to define precisely which media and which rights are being licensed.

The initial part of this work commences upon acquisition of a picture or, if it is being licensed by its producer, in the producer’s documentation of the legal chain-of-title for the picture. Filmmakers and rightholders sometimes fail to understand the full consequences of using various elements in their pictures. The failure to obtain documented rights for any part of a motion picture’s development or production can, at best, increase the picture’s cost substantially and, at worst, make it impossible for the picture (or at least certain rights) to be licensed at all. Some of these problems, such as utilizing unlicensed music, may be resolved by removing the unlicensed material from the picture. Other clearance problems, for example scenes containing trademarked, copyright or otherwise protected product, can sometimes preclude a party from licensing or exploiting the picture at all.⁵⁹

Fortunately, some unlicensed materials now can be eliminated in post-production by utilizing computer technologies, but the cost in money and time can be high. Thus, any picture needs to be seen as a series of legal rights arising from various agreements and related documents pertaining to everyone providing services and everything appearing in or used for the picture. It can be a daunting task—and is particularly overwhelming when it is not done as part of the production process.

The rights in and to a picture also can be undermined by parties failing to understand all the contractual obligations owed to those providing goods or services, including those arising under applicable collective bargaining agreements. Such union or guild agreements can impose residuals payments tied to receipts, as well as other obligations. Any license, at minimum, needs to determine who is responsible for such residuals and other third party costs and obligations.

Determining which media and rights are to be licensed and which are to be reserved starts with the earliest stages of a picture. If, for example, a project is based upon an existing novel, comic book or video game, certain or all publishing and/or merchandising rights in that original work are often reserved by the original owner. The parties need to determine whether the film’s producer is to



share in subsequent publishing revenues (and for what period and which publications), what is to happen with subsequent novels, comic books or video games containing the same character(s), and what is to be done with related products. For example, even if a novelist is able to reserve publishing rights in the original novel, the parties must deal with questions about author-written sequel novels, novelizations by the production company, “making of” books, stage plays, and a myriad of other potential publishing products and rights.

Once the licensor determines which rights are available, the parties need to determine whether and to what extent those available rights *should* be licensed in any particular agreement. This normally includes decisions regarding theatrical or cinematic exploitation, home video (including DVD), non-theatrical, soundtrack, music publishing, literary publishing, stage plays, theme park attractions, merchandising (including toys, games, clothing, and the like), airlines, hotels, Internet and electronic media, video games, and a variety of ancillary and related rights. Such rights need to be defined clearly in any license, whether granted or reserved.

The parties must determine whether any rights will be granted to the licensee for subsequent film or television productions derived from the initial licensed picture. Sequels, prequels and remakes, television series, and similar productions can become the source of serious negotiations. Those rights are sometimes reserved, sometimes granted, and often are the subject of a variety of first negotiation, first refusal and last refusal provisions. The parties must know where they will stand when a sequel or other subsequent production becomes a reality.

The parties should negotiate the timing or scheduling of the licensee’s exploitation of the licensed rights. Thus, “holdbacks” are negotiated for certain rights. Traditional holdback periods have existed for various media (for example, between theatrical and video release and between video release and pay television exhibition). However, standard “windows” of release or holdback provisions are currently undergoing changes,⁶⁰ and serious reconsideration resulting from the rapid development of new or different media (or delivery mechanisms), including DVD, Internet streaming and downloading services, pay-per-view, video-on-demand, demand view, multiple related television networks or tiers, and other changes driven by new technologies.

Each studio has prepared its own definitions to determine how such rights should be defined and controlled within their standard agreements. Anyone licensing rights from (or to) a studio must carefully review its definitions to make sure they are clear and accurately reflect the applicable situation. Often, such studio-generated definitions are a combination of dated, historic terms and up-to-the-minute technical details.

In the independent world, AFMA’s model license agreements include definitions⁶¹ of all available (and some unavailable) rights and media in order to bring some order to the confusion of the independent marketplace. These definitions are often useful and many independent parties utilize AFMA’s definitions as part of the AFMA license agreements or in conjunction with their own agreements.

Censorship/Ratings Issues

Licensing a motion picture does not necessarily mean that the licensee can then actually or fully exploit it. In addition to making sure that a film is deliverable on a timely basis and negotiating all physical materials necessary for exploitation, the licensee and licensor must know what kind of censorship, ratings or registration limitations exist in the relevant territory.

Normally, an MPAA rating for theatrical release in the United States of America will be available, and many licensees include as part of their delivery schedule a required minimum MPAA rating



(for example, no more restrictive than “R”), to provide them some solace. While that rating does not officially apply outside the United States of America, it can be useful to lessen the licensee’s perceived (or real) risk. In a number of territories (for example, Italy, where the rating determines when a film can be aired on television), parties may negotiate the precise rating required as a condition for the licensor to be paid at all or to be paid some pre-negotiated portion of its license fee or advance. In any event, the parties need to determine which of them is to bear the risk that a picture may be censored or restricted.

Most countries with active censorship provisions have seen them used by local licensees to interfere in the way in which pictures are licensed. For example, if there is uncertainty as to which pictures will be censored, licensees may attempt to utilize (or influence) the censorship board in order to pay less money than contractually promised, or in some instances to avoid license agreements altogether if buyer’s remorse sets in or new information (e.g., piracy, changes in the market, etc.) arises after completing the license agreement.

There are also a number of countries with registration obligations for imported films. These include Korea, France and Spain. Licensors need to determine methods to avoid improper or premature registration in such countries or they may find themselves unable to sell (or re-sell) their pictures.

Term

Naturally, the parties need to negotiate the time period during which the licensee can exploit the picture. Essential provisions include the commencement date (often the date a picture is either able to be or is actually delivered and approved by the licensee), as well as conditions which can extend, suspend or renew the term.

Negotiating the term entails more than simply discussing the number of years a licensee can exploit acquired rights. The parties must negotiate an extension provision for defined *force majeure* events and should determine the effect of material breaches on their agreement and/or its term. They may provide cut-off dates if obligations are not met by the licensee (for example, the obligation to theatrically release the picture on a minimum number of screens) or an extension of the term if a specified level of subsequent royalties are paid or other delineated milestones are met by the licensee.

If a licensee is allowed to sub-license its rights within the territory, the license should reflect whether the licensee can sub-license for a period beyond licensee’s term.

It is also important to address what happens at the end of the term. Parties normally require that the licensee return or destroy existing prints and other materials (as well as returning all relevant documents and submitting a final accounting statement). There is often a “sell-off” period negotiated for a licensee to ship or release already existing product (usually videos or DVDs) for a specified number of months beyond the term.

Nature of the Licensee’s Market

Accurately evaluating a licensee’s market is as important for the licensor as it is for the licensee. Of course, often information is not as easily available to the licensor, although the Internet and growth in entertainment industry media coverage has made such information far more accessible in recent years. Experience and good research can be essential for a licensor to evaluate a picture’s worth in a particular market. Box office and other financial data is available through the MPAA and AFMA (especially to their members), the trade papers, and various Internet sites. The availability of such information is another reason that the traditional film markets (Cannes, MIFED, AFM, etc.) are useful, as many people in the film industry converge on one location and share current information.



The most obvious means of determining value is to review recent box office and video performance of similar pictures in the relevant market. Prior transactions between the parties often form the basis for determining an appropriate economic structure. Some predictions are too uncertain, thus usually leading to a financial transaction based on the licensee's results, such as a royalty-based license or one replete with performance bonuses and/or reversions for lack of success.

Other factors which may be relevant to evaluating the market are; the number of existing theatres and those in the process of being built, the number of video stores or other means of home delivery, potential television sub-licensees, exchange rates, political regulations and restrictions, and potential changes of a political, economic or cultural nature. A party may want to know about the financial strength, pending mergers, management changes, and stability of potential licensees and other local media companies. All these factors can affect the value of the picture, the stability of the license, the likelihood of future payments, the appropriate term, and other significant aspects of the license.

Negotiating the Financial Terms of Motion Picture Licenses

With such information regarding the value of a specific picture in a particular market, the parties can effectively negotiate financial terms. Traditionally, most international licenses for smaller territories or those where it may be difficult to obtain accurate and complete accountings have been on a "flat" basis. The licensee agrees to pay a fixed fee for specified rights in its territory for a specific term. The parties are usually aware of the price range paid for similar films in that territory and they negotiate the amount and timing of payment along with the relevant term and rights. In many instances, such flat deals are made because some licensees are so unlikely to live up to future payment obligations as to make any other transaction virtually meaningless. Also, some economically developing countries are so rife with piracy, currency restrictions or other problems that no other kind of agreement makes sense for the parties.

As the available means of exploiting films have expanded and the international business community has become more organized and sophisticated, parties have increasingly relied upon some form of participation by the licensor in licensee revenues. In larger territories, especially when major films are being licensed, licensors normally insist upon sharing such revenues.

For the financial terms to involve anything other than a flat license, parties must negotiate the method of determining a licensor's share of revenues. This usually involves the licensee deducting a distribution fee from all gross receipts derived from the picture (which may or may not be inclusive of sub-distributor fees), then deducting contractually defined distribution expenses (which include marketing costs which are often "capped" unless additional expenses are approved by licensor). In most cases, after deducting its distribution fees and recouping distribution expenses, a licensee deducts the advance or minimum guarantee it already paid from amounts otherwise payable to the licensor (sometimes with interest). Remaining revenues are then paid in full to the licensor or divided between the licensor and licensee.

This distribution fee arrangement is the standard structure when the licensee is not a theatre owner, television station/network or video distributor in its territory but, rather, sub-licenses its rights to third parties. In the event the licensee is a video distributor, for example, a royalty structure is usually negotiated whereby a share of each home video unit's wholesale price or actual revenues are payable directly to the licensor. If the licensee intends to utilize its own theatres or television network to exploit the licensed picture, the parties usually negotiate specific provisions to allow the licensor to share in the licensee's revenues or, for example, to offset that participation with a larger advance and/or smaller distribution fee.

Other financial terms include limitations on what items can be treated as distribution expenses (for example, if video revenues are treated on a royalty basis no video distribution or marketing expenses are normally deductible). A licensee is usually allowed to create physical materials for the picture (in its discretion) if dissatisfied with what is provided by the licensor or if the licensee needs to create undelivered or additional materials (for example, dubbing a picture into the local language). Those expenses are not part of any cap on recoupable distribution expenses.

As part of negotiating the financial deal, parties also often tie the licensee's financial results to the term. For example, if a licensee has not recouped the minimum guarantee plus its actual distribution expenses by a specified point in time (perhaps the end of the term), it may be allowed to extend the term automatically for a pre-negotiated period of time to recoup those costs. In addition, a licensee may negotiate an automatic extension of the term in the event it is able to meet certain goals concerning gross receipts, video units sold, box office grosses attained, or profits paid to the licensor. Some agreements provide that the term will automatically expire if specific figures are not reached by a particular point in time.

Material Provisions for Motion Picture License Agreements

Once the essential terms of the license are negotiated, the parties still need to address numerous other important points. These are often negotiated by each party's attorneys. If the parties have entered into prior licenses, the negotiation and documentation process is often made easier by referencing a prior agreement. However, every film is different and, as a result, most licenses require changes even to prior transactions between the same parties.

Credit/Billing

Any license must address the issue of existing obligations with respect to credits and billing on screen, in the billing block, and in paid advertising. A licensee should be contractually obligated to maintain existing onscreen credits provided by the licensor. In addition, the licensee should agree to abide by all credits and billing requirements and restrictions for marketing and paid advertising as presented in writing by the licensor. The licensor is likely to be obligated by existing agreements (with producers, directors, actors, writers, and others) to include in all third party licenses the obligation to only exploit the picture in a form which includes all promised contractual credits.

If the licensor is able to do so under its existing agreements, it can agree that the casual or inadvertent breach of such obligations by the licensee will not constitute a material breach of their license agreement sufficient to give rise to termination or cancellation. There is often a provision requiring only the *prospective* cure of any credit or billing failures, after written notice, thereby obviating the obligation to replace or change pre-existing prints, video units and advertisements. However, licensors must be careful to make certain that any such limiting language is consistent with the credit provisions already in place with all other parties.

Licensors must make certain that their licensees agree to abide by all guild or union credit and billing provisions. The Screen Actors Guild ("SAG"), Directors Guild of America ("DGA") and Writers Guild of America ("WGA") have detailed minimum credit and billing obligations for their members, which can relate to everything from the order of credits and size of credits on screen to the size of credits on paid advertising, marketing materials, billboards and other materials. These provisions include restrictions on the size of credits in paid advertising compared to the size of the film's title and to other credits. Thus, the licensor and licensee each need to make certain that the licensee receives a complete and accurate list of necessary credits and billing obligations, including applicable collective bargaining agreements.



Licensees usually negotiate the right to add their own introductory presentation credit (and often their logo) as the distributor of the licensed picture in their territory. The primary issue for the licensor here is again to make sure that the credit granted is consistent with all other contractual obligations on the picture.

Credits and billing also may need to be consistent with that element of moral rights which allows an “author” to claim paternity of his or her artistic work. “Article 6bis(l) of the Berne Paris text requires Contracting States to give authors the right to claim authorship of the work. The WIPO “Guide to the Berne Convention” calls this ‘first and foremost’ of the moral rights and underscores that the right may be exercised by the author as he wishes; it can even be used in a negative way, i.e., by publishing his work under a pseudonym or by keeping it anonymous, and he can, at any time, change his mind and reject a pseudonym or abandon his anonymity.”⁶²

For motion pictures, this right of paternity is normally dealt with through a combination of the author’s agreement(s) to provide services and/or to sell the property to the film’s producer, as well as applicable guild or union credit/billing rules. Moreover, presumably in part because of the substantial number of parties involved in creating motion pictures, moral rights do not usually become a problem with respect to “paternity.” Even on an overall basis, copyright expert Paul Goldstein has written that “(M)otion pictures provide a prominent example of how civil law countries extensively accommodate moral rights to the exigencies of the marketplace.”⁶³ Nevertheless, most agreements with anyone who might constitute an “author” include specific credit and billing provisions, a waiver of moral rights (unless the agreement is between companies based in countries which give strong protection to moral rights, such as France), and a waiver of injunctive relief as a potential remedy for breach.

Delivery Obligations

License agreements should include a standard or pre-negotiated delivery schedule delineating the specific physical materials and documents to be delivered to the licensee (or to which licensee is to be provided access) by a specific delivery date. Such delivery schedules can vary from, in a simple example, the delivery of prints (and/or a video master), trailers and basic marketing materials to, in a more complicated situation, extravagant, detailed, multi-page obligations. Increasingly, however, with the growth of digital media, delivery schedules have become extensive and thorough. Licensees no longer are simply looking for the ability to release a motion picture in theatres and license it for television use. Rather, licensees usually now request numerous home video materials, multiple versions, “making of” films, related documentaries and additional DVD materials. All of this has increased the cost and burden on producers and licensors.

Often delivery schedules are negotiated after the financial terms of a license have been reached, and can create significant problems for licensors as a result. It is essential that licensors know precisely what delivery materials are available and what items need to be delivered to any licensee, in addition to how and where they are to be delivered.

A fairly standard delivery schedule includes access to the basic underlying film materials (a negative and/or inter-positive), prints, video masters and related physical materials; all sound materials; trailer elements; photographs, slides, and other marketing materials; “making of” films and electronic press kits; biographies of, and filmed interviews with, key elements providing services on the picture; evidence of insurance; rights and chain-of-title documentation; production contracts; and often other materials such as additional prints and publicity materials necessary for multiple film festivals. While this is only a partial list, the items requested – particularly by the studios – can be seemingly impossible to meet for many independent and international producers. Moreover, the more rights licensed, the longer the term, and the larger the territory, the more materials will be demanded.

Certain territories are known to be particularly stringent in evaluating the technical standards to be met, particularly Germany and Australia. In any pre-sale situation, it is wise to determine as early as possible what technical standards will be utilized for delivery obligations.

Delivery schedules are often re-negotiated in the event a picture is licensed on a pre-sale basis and then a completion guarantor and production lender subsequently become involved in the production. The bonded delivery schedule is usually less substantial than that promised to the licensor by the film's producer or promised by the licensor to the territorial pre-sale licensees. Thus, the parties need to communicate about delivery issues and changes at an early date to make sure the picture can be delivered as required by all parties.

Chain of Title/Warranties and Representations

Essential to any license agreement are appropriate representations and warranties regarding the rights being granted and the lack of any existing litigation, claims, liens, restrictions or obligations which undermine or affect those rights. If any relevant claims or restrictions exist, they need to be disclosed to the licensee. Representations and warranties must be consistent with the licensed rights and media (as discussed above) and with the underlying chain-of-title.

A related and important provision is the indemnification provided by a party making representations in the event of their breach and resulting third party claims, losses or damages. Similarly, a licensee should indemnify the licensor for claims, expenses and obligations arising as a result of the licensee's breach of its promises, representations and warranties. For example, in the event a licensee were to release the picture without the appropriate credits or copyright notice, or to edit the picture in a manner inconsistent with the license agreement, the licensee would be required to indemnify the licensor for all resulting claims and damages. Usually the indemnification clauses also include a provision covering all legal fees and costs incurred as a result of the indemnified claims. It is common for such a legal fees provision to be restricted to "reasonable outside legal fees."

Insurance

The licensor often needs to deliver evidence of insurance. More and more territories require delivery of certificates evidencing that the licensee is named as an additional insured on the picture's errors and omissions insurance policy. There are even situations in which the licensee expects to be an additional insured on the picture's general liability insurance (and sometimes other policies).

In the event any licensees insist upon a director or, more often, lead actor as an "essential element" (that is, someone who cannot be replaced), the picture's producer must acquire so-called "essential elements insurance" to cover that person. This is often an unbudgeted (and material) expense, and thus requires either advance planning or changes to the budget.

Security Interests and Collection Accounts

Some licensees (for example, a studio acquiring territorial rights on a picture) often insist upon receiving a security interest in the picture, or at least in the rights being acquired for the territory licensed. While this is not particularly common outside of studio agreements, when parties do insist upon a security interest, the licensor must coordinate that security interest with prior and other security interests granted to the production lender, equity investors, completion guarantor and possibly other licensees and/or guilds.



In some instances, this is handled as part of the loan transaction by an inter-party agreement negotiated between the lender, guarantor, producer, licensor (if different from producer) and those licensees receiving security interests. A subsequent security interest will usually require approval by prior secured parties and/or a subordination/non-interference agreement so that other security interests will not be utilized to defeat the newly secured party's rights.

There are questions regarding the usefulness and enforceability of security interests when production companies, licensing entities and licensees are all based in different countries and the legal work involved in formalizing such interests can require many lawyers from various countries. Nevertheless, any production lender, completion guarantor or studio are likely to insist upon a security interest for all transactions.

On occasion, the licensor will request a security interest in its share of the licensee's gross receipts, although this is rare. Most licensors who are concerned about a licensee living up to contractual obligations are concerned with securing payment. To deal with this concern, a licensor may request one of a number of other options to secure payment. One option is to request a corporate guarantee where the licensee is owned by a larger company or a personal guarantee when the licensee is essentially an organization controlled by one individual. Personal guarantees are difficult to obtain in most cases, but where a licensee is a fairly new subsidiary or division of an established corporation, a corporate guarantee may be possible.

A more common method of securing payment is to request a letter of credit (or other bank instrument) from the licensee. Traditionally, any advance or minimum guarantee will be payable in part by a deposit due upon execution of an agreement (often between 20-30% of the total payable). Thereafter, the balance is due upon notice of delivery, delivery itself, or on the occurrence of one or more other milestones (perhaps including commencement of principle photography in a pre-sale situation or upon video release). A letter of credit is usually applicable to all future payments, i.e., everything but the deposit is secured in this fashion.

An increasingly common mechanism is to use a collection agent and collection account for all receipts. This is particularly common where a production loan is in place and the bank wants to make certain it receives all payments on pre-sale licenses when numerous other parties also have an interest in the picture's receipts. In that instance, the parties either allow the production lender to set up the account or select a third party escrow holder/collection agent whom they trust to administer revenues. The collection account agreement will specify the order of payments from the collection account. (The production lender may even request a security interest in that account.) The order of disbursement of such funds will probably include the collection agent's administrative fee (perhaps one percent), any distribution fees or commissions which the licensor/sales agent is allowed to take off-the-top, the full amount of the production loan, remaining or deferred distribution fees, recoupable distribution expenses, deferments, and disbursement of funds to investors and profit participants.

Another means of securing performance could be the inclusion of a "key man" clause, by which a license agreement terminates after one or more identified executives leave the licensee's employ. Usually the nature of the licensor's concern about receiving payment will dictate the best means to secure it.

Assignability/Transfer of Rights

Most license agreements include a provision which specifies whether the licensee may sub-license, assign or transfer the rights it is acquiring to third parties. Sometimes such transfers are limited to those pre-approved in writing by the licensor. In other instances, the licensor must be consulted. Often, the licensor must be provided with written notice and a copy of all such third party agreements.

The law governing whether a licensee may assign its rights without express written authorization depends upon applicable copyright law in the appropriate jurisdiction. However, this issue is sufficiently important to the contracting parties that it should be the subject of a separate and clear contractual provision.

Under United States copyright law, there has been a distinction between copyright assignments and licenses. Under the 1909 United States Copyright Act, a copyright license was not transferable, although an assignee could transfer its rights. Various federal districts have addressed this issue with respect to the 1976 United States Copyright Act, although not consistently. However, in a recent federal appellate court decision (in the district including California), the Court held that federal copyright law governs such cases and that, absent a contractual provision to the contrary with the copyright holder, “exclusive licenses are only assignable with the consent of the licensor.”⁶⁴ Other courts in different jurisdictions apply different standards on this issue; thus, the parties are best served by negotiating this point to a resolution and documenting their decision.

Restrictions on Uses/Editing

Sometimes a film’s producer will contractually commit to limitations on editing a completed film, agree to consultation rights before editing for certain purposes (for example, for television or censorship), or is subject to certain editing restrictions under applicable collective bargaining agreements (for example, the DGA agreement). The most common provisions deal with a film director’s right of consultation or first opportunity to edit for censorship, rating or other purposes. In such cases, it is essential that the license agreements deal with these requirements.

In addition, some directors or stars have sufficient bargaining power to obtain other contractual limitations on exploitation of their pictures. This may include restrictions such as not allowing a film to be exhibited on television with commercials or not allowing it to be released on a video containing commercials.

Accounting and Audit Provisions

Licensees usually agree to report regularly to the licensor by providing an accounting statement specifying gross receipts, distribution fees, distribution expenses and, if a royalty agreement exists, the number of units sold, the relevant price against which the royalty is calculated, and royalties payable. Often such provisions simply reflect that the licensee will provide a statement with “reasonable detail.” Other times the parties negotiate a list of specific items to be included in the statements. On occasion the parties will approve and attach a general format to be utilized for licensee’s participation statements.

Accounting statements are usually provided on a monthly, quarterly, semi-annual and/or annual basis. Often licensors attempt to obtain monthly accountings, although some companies refuse to issue statements more often than quarterly and some insist on semi-annual accountings. If monthly accountings are required, they are often for a limited number of months after the theatrical (and possibly video) release of the picture. Thereafter, quarterly statements may be required (perhaps for up to three years). Many agreements then require semi-annual statements for a specific time period and annual statements thereafter. Parties may negotiate a provision whereby no statements are required when no gross receipts are received (or, sometimes, when no amounts are payable to the licensor). The parties may also require the licensee to include copies of all newly signed license agreements with its statements.



The parties should negotiate the time period from the end of each accounting period that the licensee may utilize to complete and deliver statements. The agreed period is usually between thirty and ninety days for the licensee to provide reports.

Most licensors are contractually entitled to audit the picture's records on reasonable notice, at the licensee's place of business, once per year. The parties may agree that the auditor must be a certified public accountant or other "qualified" party. Audit provisions sometimes limit the amount of time the auditor may spend at a licensee's office or require "reasonable" cooperation in the audit by the licensee. The parties may also negotiate whether the resulting audit report must be provided to the licensee.

It has become fairly common for licensees to agree to pay reasonable audit costs in the event an audit establishes a material discrepancy in either revenues reported or amounts reported payable to the licensor. For example, if the audit establishes that the amount reflected payable under the audited reports is understated by at least 10%, the licensee may agree to pay the reasonable cost of the audit (and sometimes resulting legal fees).

The parties often negotiate a time period within which the licensor can object in reasonable detail in writing to any part of an accounting statement or, failing to do so, is deemed to have accepted the accuracy of that statement. Another common provision specifies a contractual statute of limitations period after an audit report is issued (or after an audit is completed) in which to initiate any related litigation to contest the audited statements.

Dispute Resolution

International film contracts have been similar to agreements in many other industries with respect to their dispute resolution provisions. That is, the party with substantially more bargaining power tends to impose the mechanism by which disputes are to be handled. This includes selection of the forum (traditionally courts based in the country of that party), applicable law in the same location, and various provisions to limit the kinds of claims which can be pursued and the remedies which can be granted. In such situations, there is usually no provision obligating the court to award attorneys fees and costs to the prevailing party. However, provisions are usually negotiated regarding breach, notice, cure and default.

Virtually all film licenses include non-injunctive relief provisions to make certain that the picture's production, marketing, and exploitation cannot be enjoined, limited or suspended in the event of breach. This is accomplished by waiving the right to injunctive relief and limiting the claimant to the pursuit of specified monetary damages. However, that provision is often conditioned on payment of the license fee or advance.

Recent years have seen the increased use of mandatory, binding arbitration in many industries as various jurisdictions look favorably on this alternative to expensive court time. The motion picture industry has followed this trend. Most production loan agreements, inter-party agreements and international license agreements, for example, contain arbitration provisions. In certain situations, the studios accept (or even insist upon) arbitration provisions. Organizations such as WIPO, AFMA, the American Arbitration Association and others have set up dispute resolution mechanisms which are used by parties in the film industry.

AFMA's arbitration tribunal has proven particularly effective in resolving licensing disputes. The AFMA arbitrator panel is composed of attorneys from around the world who are experts in the entertainment industry. AFMA has set up a streamlined and simple administrative system to expedite resolution of disputes using its rules. Thus, many disputes between licensing parties over

delivery issues, collection of advances or overages, and various other subjects have been resolved without recourse to normally more expensive and time-consuming court proceedings.⁶⁵ In addition, since many motion picture licenses involve parties from different countries, cultures and languages, using such a mechanism to resolve disputes allows a flexibility not usually found in court. Evidence can be presented at more convenient times, whether by telephone, in writing, or in other ways decided by the parties or arbitrator to get such disputes resolved without the more formal proceedings utilized in the courts of most countries.

Naturally, to the extent disputes involve copyright infringement or piracy, such matters are not resolved between private parties in arbitration, except in unusual circumstances. Since arbitration can only be imposed by the parties themselves through contract, any claims between parties who have no contractual relationship (such as motion picture copyright holders against pirates or infringers) would not be subject to arbitration unless the parties agree to arbitrate *after* the claim arises. Piracy cases and copyright infringement cases involving motion pictures are generally of the same nature and involve the same treaties, statutes and other regulations applied to other intellectual property disputes.

Mediation, through which parties voluntarily attempt to resolve their disputes with the assistance of a neutral, third-party mediator, has also become an increasingly common and useful method of resolving film industry disputes.

Exhibits and Ancillary Documents

There are usually additional documents beyond the license agreement required by a picture's licensee to assist it in exploiting the acquired picture. These can include documents required under the parties' delivery schedule or exhibits to the license agreement.

Among the more common documents needed are those required to import, register, or establish sufficient ownership of a picture for purposes of exploiting it or enforcing rights against infringers or pirates. These documents may include certificates of origin, transfers of rights, short form assignments or licenses, certificates of authorship, and insurance documentation. Security interests result in security agreements, mortgages of copyright, UCC-1 financing statements and other lien documents. Sometimes documents are required directly from a picture's producer or licensor to confirm credits, copyright ownership, a lack of existing security interests or litigation, and similar assurances.

If the parties agree to use a letter of credit or a collection account, of course, these also generate additional documentation.

International Copyright, Trade and the Film Industry

As part of a global industry, the licensing of films often depends on open markets and strong copyright protection and enforcement. The applicable copyright treaties and most national copyright laws covering films are no different than those applicable to other intellectual property. However, as reflected above, piracy is a major ongoing concern of the MPAA, AFMA, and other bodies representing film companies.

There are many trade barriers to producing and distributing motion pictures, such as levies, taxes, anti-piracy sticker programs and content quotas. These trade barriers often become the focus of trade discussions. In order to create an infrastructure for delivery of motion pictures in a digital environment, strong copyright protection and enforcement must be incorporated into local law and resources must be dedicated to enforcing those laws.



The negotiation of bilateral and regional free trade agreements is increasingly important in worldwide trade policy. These negotiations offer an important opportunity for trading partners to modernize copyright law so that the film industry may achieve maximum participation in the new digital and electronic environment and to improve enforcement procedures. Intellectual property protection and enforcement are keys to market access, as they can help regularize and organize the market, allow parties to predict the results of their efforts, and limit piracy losses.

International trade negotiations offer a vital tool for encouraging compliance with other evolving international trends in copyright standards (such as fully implementing WIPO treaty obligations and extending copyright protections beyond minimum levels negotiated into various treaties), as well as outlining specific enforcement provisions to aid countries in achieving effective criminal, civil and customs enforcement measures.

Future Trends

One obvious concern about the future is that the film industry, led by the major studios, must deal with the threat of increasing worldwide digital piracy which has already greatly weakened the music industry. While home use, whether paid for or not, is not likely to destroy the viability of theatrical exhibition, piracy could substantially alter the way in which films are exploited.

As discussed above, given the longevity of the major studios and the worldwide business trends toward centralization, it is easy to predict even further consolidation and worldwide media control by the major studios. However, there are many countervailing factors which should maintain an independent and local presence in the production, distribution and exploitation of motion pictures. Among the factors which will likely encourage non-studio film activities are the following:

- The increasing accessibility of filmmaking due to the development of digital cameras, computer graphics programs, and other technological developments.
- The increasing likelihood that the Internet, mobile phones and wireless technology will allow a more democratic and open exploitation of digital films worldwide, even if such exploitation does not directly compete with the theatrical, major studio film experience.
- Many individuals are driven to make films for artistic, rather than business, reasons and will find a way to do so despite the lack of monetary motivation.
- Despite their formerly independent subsidiaries and “classics” divisions, the studios simply are not structured to educate or encourage beginning filmmakers, who are thus driven to other places to produce risky, edgy, politically challenging, or experimental films.
- Local languages and cultures need expression despite the internationalization of communications and cultural products.
- Many governments are intent upon strengthening local filmmaking activities for political, cultural, economic or other reasons, such as Australia, Canada, France, and numerous other countries.
- There is a strong history of local filmmaking in India, France, Hong Kong, and elsewhere, which is unlikely to disappear.
- For whatever economic, personal and artistic reasons, there are currently thousands of films produced independently each year and the studios simply cannot and will not be involved in most such projects.



Thus, the film industry is likely to see both the continuing centralization and increasing power of the major studios, *and* the continuing growth of independent and local filmmaking activities.

While the studios dominate production of high budget, special-effects laden event pictures, the risks inherent in these productions are such that studios will likely continue to share that risk on at least some expensive projects. Even when studios do not minimize risk on large projects, they may be inclined to do so on more moderately budgeted films in order to limit their annual production investment. This should lead to more co-productions, co-financing arrangements and equity investments on studio pictures.

Meanwhile, independent or local filmmaking will continue to expand. In certain areas of the world, such productions are likely to become regionally powerful and could eventually vie with studio productions in much of the worldwide market. China and India appear to be two countries most likely to gain increasing importance in the international film industry given their economic potential, population, filmmaking traditions and unique cultures. It is also possible that the current cooperative economic, currency and political efforts in Europe could lead to one or more major European-wide production and distribution entities, although there are many language, cultural and historical issues to overcome before that can take place.

Many countries will utilize films and other forms of entertainment to develop their local economy and strengthen their ability to bring national cultural products to their citizens. Localization of television productions and the narrow targeting of Internet users and cable television viewers may lead the way in creating local productions for new media. As the development of local technological infrastructures (such as wireless communications) and the reduction or elimination of existing media windows and restrictions change the way in which people are entertained and educated, the licensing of films will similarly change. As a result, there is one thing of which we can be virtually certain: the worldwide licensing of motion pictures will continue to become more and more complicated.

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Chapter V

Interactive Digital Entertainment and Education Products (multimedia)

The breadth of works under the moniker “interactive multimedia” is very large. Multimedia works generally entail the integrated use of multiple forms of media. In its crudest form, for example, “multimedia” could refer to a children’s picture book containing the mediums of text and images. A more modern example of multimedia would be a videogame combining text, graphics, sound, animation, and images. Since videogames are one of the most popular examples of multimedia, this will be the main industry of focus in this chapter.

A quarter of a century has passed from the days when the videogames “Space Invader Game”⁶⁶ and “PacMan”⁶⁷ first attacked the Japanese market in the late seventies. Since then, numerous improvements have been made in relation to speed, sound and coloring of the games as well as three-dimensional visual presentations, all of which have enhanced the size of the global market for videogames.

In February 1996, the “Pokémon” videogame for Nintendo GameBoy was released for worldwide distribution. Subsequently, in the same year, the monthly comic book “Korokoro Comic” first introduced the story of the Pokémon to the print media. Thereafter, in April 1997, the Pokémon television series produced by Shogakukan Production Company Ltd. began broadcasting. In June 1997, a CD single of the popular theme song of Pokémon was released. In July 1998, the first theatrical motion picture of Pokémon was produced and released in Japan and achieved rental revenues of US\$40 million in Japan.⁶⁸ With the success of the Pokémon project, as utilized in a variety of media ranging from videogames, magazines, television, music and theatre, Nintendo of America then took it on. Nintendo of America has acquired the license to exploit the television programs, the theatrical motion pictures and the merchandizing rights in the United States, Europe and other non-Asian countries, and achieved unprecedented success on the basis of a single Japanese property. As of the end of June 2000, the total number of games of Pokémon sold for GameBoy was 460,000 for domestic Japanese sales and 21,890,000 for overseas sales. The number of Pokémon card games sold was 1.85 billion for the Japanese market and 2.4 billion card games sold worldwide. Theatrical revenues generated by the first Pokémon movie in the United States were US\$85 million, and US\$91 million in total for countries other than Japan.⁶⁹ The Pokémon success story clearly shows how videogames can be commercially exploited in multiple media and in any region of the world.

Size and Players in the Industry

The market for videogames has expanded since its inception with the evolution of technologies in making videogames. In 1999, the total revenue generated from the sale of videogames and hardware originating in Japan for both the domestic and overseas market was 1,017,413 million yen (US\$8.5 billion).⁷⁰ Of such amount, 562,788 million yen (US\$47 billion) was from software sales, while 454,625 million yen (US\$3.8 billion) was from hardware sales. In 2000, the corresponding amount was 1,117,751 million yen (US\$9.3 billion). The sum of 577,891 million yen (US\$4.8 billion) of the 2000 total amount was due to software sales and 539,860 million yen (US\$4.5 billion) was from hardware sales. Thereafter, the total amount of game shipments for the domestic and overseas market climbed to revenue of 1,457,458 million yen (US\$12.1 billion) in 2001. The sum of 517,387 million yen (US\$4.3 billion) was generated from software sales in 2001, while 940,071 million yen (US\$7.8 billion) was from hardware sales during the same year.⁷¹ It is interesting to note that through the years 1999 to 2001, videogame software sales remained at fairly similar sales levels while sales of hardware during the same periods increased yearly.

Concerning videogame hardware manufacturers, in 1999, the PlayStation had 46.8% of total shipments comprising the domestic Japanese market and shipments overseas. In comparison, in 1999, Nintendo 64 achieved 16.2% of market share while Dreamcast had 14% of the market. In 2001, the market picture changed dramatically, with PlayStation and PlayStation 2 owning 70.7% of domestic and overseas shipments, Nintendo GameCube and Nintendo 64 comprised 15.5%, and Dreamcast had only 0.8% of the market. Such figures, were expected to change again with the introduction of Microsoft's X-BOX console and the departure of Sega's Dreamcast in 2002.⁷²

The all-time top 5 videogame titles sold in Japan and their corresponding unit sales figures in the millions are as follows:

1. Super Mario Bros. by Nintendo (6.81)
2. Tetris by Nintendo (4.23)
3. Super Mario Land by Nintendo (4.18)
4. Dragon Warrior VII by ENIX (400)
5. Super Mario Bros. 3 by Nintendo (384).⁷³

The top five selling videogame software titles sold in the United States for 2001:

For PlayStation:

1. Harry Potter: Sorcerer (761,263)
2. Tony Hawk's Pro Skater 2 (982,850)
3. Tony Hawk's Pro Skater 3 (648,299)
4. Driver 2 (865,709)
5. Madden NFL 2002 (567,062)

For PlayStation 2:

1. Grand Theft Auto 3 (1,965,832)
2. Madden NFL 2002 (1,653,050)
3. Metal Gear Solid 2 (1,231,303)
4. Gran Turismo 3: A-Spec (1,172,322)
5. Tony Hawk's Pro Skater 3 (1,044,738)

For GameBoy:

1. Pokémon Crystal (1,400,887)
2. Pokémon Silver (880,753)
3. Pokémon Gold (846,019)
4. Zelda: Oracle Ages (628,649)
5. Zelda: Oracle Seasons (619,542).⁷⁴

In the United States, videogame software and edutainment titles sold in 2001 consisted of the following genres, with the corresponding number of units sold in parentheses: Action (43,118,000), Sports (28,908,000), Simulations (20,810,000), Strategy Role Playing (24,071,000) and Edutainment (383,000). It is interesting to note that the figures demonstrate that interactive multimedia for educational purposes are not as popular when compared to the other genres of interactive products sold.

Videogame hardware and software sales in the United States for 2001 totaled US\$9.4 billion.⁷⁵ As a result, the combined sales of videogame hardware and software sold in Japan and the United States in 2001 was approximately US\$13.4 billion. The total sales figures for videogame software and hardware sold is estimated to be even higher for 2002.



Relevant Laws, Treaties and Frameworks

Copyright Laws

Japan

In Japan, the Copyright Law was amended in 1985 to recognize “programs” i.e., computer software, as copyright works.⁷⁶ Before said codification, one had to review judicial decisions as to whether videogames could be protected under the Copyright Law of Japan.

Looking back to 1981, Namco Ltd., the manufacturer of a popular videogame called “PacMan,” brought suit against Suishin Kogyo Co. Ltd, et. al, companies operating coffee shops which purchased the illegally reproduced “PacMan” games and made them available for their customers’ use at their coffee shops. Namco went to court to stop the illegal exhibition of the videogame units. Namco claimed in its lawsuit that its videogame was protected under the Copyright Law of Japan as a “motion picture,” and therefore it should enjoy the right to “exhibit” the work, as such exhibition right was granted to motion pictures under Article 22-2. The Tokyo District Court affirmed Namco’s legal argument by ruling that the PacMan videogame did fall within the definition of “motion pictures” under Article 107, based on the reasoning that videogames in general consist of stories, visual images and sounds, and therefore Namco could demand cessation of such illegal exhibition of the videogame by the defendant.⁷⁷ As a result of this PacMan case, the general understanding arose that videogames are “motion pictures” under the Copyright Law of Japan. Ironically, such characterization of videogames resulted in judicial rulings which were regrettable for the videogame manufacturers, in the Tokyo High Court, Osaka High Court and the Supreme Court of Japan, with regard to certain suits brought by videogame manufacturers against a company engaged in distributing used videogames.

In 1998, a seller of used videogames brought suit in Tokyo District Court against Enix Corporation seeking a ruling from the Court that Enix did not possess legal grounds under the Copyright Law of Japan to seek an injunction preventing plaintiff’s sales of used videogames. At the same time in 1998, Capcom, Konami and other videogame manufacturers brought suit in Osaka District Court against two other companies dealing in the distribution of used videogames. In these two suits, the main issues were whether the used videogames could still fall under the definition of “motion pictures,” and whether used videogames could enjoy the right of distribution (*hanpu-ken*) accorded to “motion pictures” under Article 26, paragraph 1 of the Copyright Law of Japan. The rulings of the courts differed; the Tokyo District Court ruled that used videogames did not fall within the definition of “motion pictures,” and granted the affirmative judgment to the plaintiff,⁷⁸ while the Osaka District Court affirmed that videogames were “motion pictures,” and granted affirmative judgment to the plaintiff videogame manufacturers.⁷⁹ The cases were appealed by the parties to Tokyo High Court and Osaka High Court. Both High Courts ruled that videogames were “motion pictures.” However, the Tokyo High Court denied that videogames could enjoy distribution rights, and granted a favorable judgment to the used videogames distributor,⁸⁰ while the Osaka High Court affirmed that videogames could enjoy distribution rights, but such rights were exhausted upon first sale, and therefore videogame manufacturers could not seek an injunction against used videogame distributors.⁸¹ The videogame manufacturers in the Osaka case appealed to the Supreme Court of Japan, which ruled that videogames did fall within the definition of “motion pictures,” and thus could enjoy distribution rights, but that the copyright owners’ rights were exhausted with regards to videogames that were not publicly exhibited as in the case of theatrical motion pictures.⁸² This ruling confirms that used videogame distributors/sellers could continue their business, since their distribution/sales did not infringe the copyrights of the videogame manufacturer.

United States of America

In the United States, laws dealing with copyright works are founded on the constitutional right as provided in Article I, Section 8, clause 8 of the United States Constitution, the Patent and Copyright clause, which states "The Congress shall have power... To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." Interactive works such as videogames are subject to copyright protection under United States copyright laws.⁸³ Essentially, software or game code is subject to copyright protection as long as it is an original work of authorship and fixed in a tangible medium of expression (diskette, CD, ROM cartridge, etc.).⁸⁴ Software, whether written for an educational application or videogame, is protected under copyright to the extent that its application is not based on mere ideas, procedures, processes, a system, method of operation, concept, principle, or discovery.⁸⁵ Generally, there is a very low standard as to the level of creativity needed for a videogame to qualify for copyright protection. In *Atari Games Corp. v. Oman*⁸⁶ 979 F.2d 242 (1992), the Court indicated that a videogame is subject to the same criteria for creativity as any other work eligible for copyright protection. Quoting the Supreme Court, the Court held that "[T]he requisite level of creativity is extremely low; even a slight amount will suffice. The vast majority of works make the grade quite easily, as they possess some creative spark, 'no matter how crude, humble or obvious' it might be..."⁸⁷ Thus, a very low standard is required for obtaining copyright protection for a videogame, as for any other works.

Copyright protection accords its owner the exclusive right to the work as codified under 17 U.S.C. Section 106. Exclusive rights include the right to reproduce the copyright works, prepare derivative works based on the copyright work, distribute copies by sale, lease, rental, transfer of ownership or lending, and public performance or display.⁸⁸ A higher level of protection may be possible for multimedia works by obtaining patent rights for the works. Generally, this is more difficult to obtain than copyright protection, since the works must be novel, useful and not obvious. Merely marketing a videogame on a DVD or other media may not be sufficient for patent protection unless combined, for example, as part of a game system.⁸⁹

The process of registration of a game or computer software program involves completing and filing the appropriate form with the United States Copyright Office and paying a nominal filing fee.⁹⁰ Under the Copyright Act, it is possible for a software program to benefit from having its trade secrets protected, while still being able to assert its copyright by registration. Circular #61, "Copyright Registration for Computer Programs," allows various options for the protection of source code with trade secrets blocked out or only certain pages of the code submitted. Where portions of code are blocked out, the circular states that the following must be met: "(1) the blocked out portions must be proportionately less than the material remaining; and (2) the visible portion must represent an appreciable amount of original computer code." Other application requirements include, where applicable, special deposit requirements, such as the submission of a CD-ROM for a computer multimedia program.

Receiving a Certificate of Registration from the United States Copyright Office is *prima facie* evidence of copyright ownership. Section 410(c) of the Copyright Act specifically states that, "In any judicial proceedings the certificate of a registration made before or within five years after first publication of the work shall constitute *prima facie* evidence of the validity of the copyright and of the facts stated in the certificate." The Copyright Act of 1976 confers upon copyright holders the exclusive right to prepare, and authorize others to prepare, derivative works based on their copyright works.⁹¹

Perhaps the most common legal actions involving copyright licenses are infringement actions, where one party accuses another of having infringed its copyright in a work. In order for a videogame manufacturer to prevail in an infringement action, the copyright owner must prove "(1) ownership



of a valid copyright; and (2) unauthorized copying of original elements of the plaintiff's work."⁹² Unauthorized copying may be demonstrated by showing circumstantial evidence of access and substantial similarity of both the general ideas and expression between the copyright work and the allegedly infringing work.⁹³ Such infringement actions primarily address the question of originality as to who owns the disputed work.

Chapter 5 of the Copyright Act generally deals with copyright infringement and remedies. The Act provides a variety of remedies such as injunctive relief, impoundment and disposition, damages and profits, attorneys' fees and costs, criminal penalties and other remedies such as statutory damages, and is the basis for many judicial decisions.

Although copyright protection provides an owner with exclusive rights to works, there are limitations on such rights under United States law. Most significant of such limitations is the doctrine of "fair use" as seen, for example, in *Narell v. Freeman*,⁹⁴ where the Court held that "the doctrine of fair use allows a holder of the privilege to use copyrighted material in a reasonable manner without the consent of the copyright owner" as provided for in Section 107 of the Copyright Law.⁹⁵ An example of the fair use defense, as used in the videogame industry, is seen in the case of *Sony Entertainment v. Connectix Corp.*⁹⁶ The facts of this case involve Connectix Corporation copying Sony's proprietary basic input-output system (BIOS) for purposes of reverse engineering Sony's PlayStation console in order to create their product, which emulates the functions of the PlayStation on a personal computer. The Court held that the act of intermediate copying of computer software for purposes of creating non-infringing software is protected fair use as long as the infringing act of copying is a necessary requirement.⁹⁷

United Kingdom

The relevant legislation in the United Kingdom (UK) in relation to the protection of multimedia works is the Copyright, Designs and Patents Act 1988 ("CDPA") and amending secondary legislation which gives effect to European Union (EU) Directives, such as the Directive 91/250/EEC on the Legal Protection of Computer Software and the Directive on Copyright in the Information Society (herein the "Digital Copyright Directive," or "DCD").

The United Kingdom is a signatory to the Berne Convention, Rome Convention and Universal Copyright Convention. These conventions provide background to much of the United Kingdom's recent legislation in this area, and show how the United Kingdom is complying with its international obligations. The United Kingdom is also obliged to give effect to the World Trade Organization's TRIPS Agreement.

The United Kingdom will implement the provisions of the 1996 WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT) ("WIPO Internet Treaties"), not already part of its law, when the United Kingdom implements the DCD.

In the United Kingdom, copyright subsists in literary, musical and artistic works as well as sound recordings and films. Literary, dramatic, musical and artistic works must be 'original' in order to qualify for protection. The CDPA includes 'computer programs' as a form of literary work. As could be expected, however, the CDPA does not mention "multimedia" works, which were in the early stages of development during the late 1980s.

Currently, it is safe to assume that a multimedia work will be protected by copyright to the extent of its constituent parts. The implementation of the DCD should further help to harmonize the United Kingdom's digital copyright legislation with that of the rest of the EU. Copyright would therefore exist in:

- the underlying text, graphics, music and sound recordings;
- the underlying computer program; and
- screen displays.

As in Japan, under United Kingdom law, it is likely that film copyright subsists in the screen displays of a multimedia game. The definition of a film in the CDPA is “any medium from which a moving image may by any means be produced.” Although there is no court decision in the United Kingdom on this point, the Federal Court of Australia held that visual images created by playing a video game fell within the Australian equivalent statutory definition of ‘cinematographic film’ in *Electronics Pty Ltd v Sega Enterprises Ltd (1997)*.⁹⁸ Although Australian law is not binding with respect to United Kingdom law, it is persuasive; in other words, it may influence the United Kingdom courts to follow the decision of the Australian courts. If implemented, this would then give software owners greater protection against copying as software owners can rely on both literary and film copyright. It is easy to imagine a situation in which a piece of software is reverse engineered, and the program rewritten, with the same or substantially similar screen displays. Although it would be very difficult to prove that there had been an infringement of literary copyright in the underlying computer program, it would be possible to bring an action through infringement of film copyright of the screen displays. This is in line with the software industry’s attempt to protect the “look and feel” of a multimedia product as well as relying on the literal or non-literal copying of the underlying computer program.

In the United Kingdom, copyright in a work is infringed by a person who, without the license of the copyright owner, does, or authorizes another to do, any of the acts restricted by copyright. These “restricted acts” include: reproducing the work (copying, caching, loading, and storing are all covered, whether permanently or temporarily); translating or adapting it (decompilation of a program or translation into a different programming language are both covered); distributing it to the public; performing it in public; and renting, lending or broadcasting it.

There are many exceptions to these “restricted acts.” Some of the more important exceptions, currently in force in relation to digital products, are:

- The right to use the program for its intended purpose. This right cannot be abrogated by agreement to the contrary;
- The right to study or test the program in order to understand its operation. This right cannot be directly abrogated by contract, but any observation must take place while the licensee of the software is using the program within the terms of his licence;
- The right to copy in order to make a “back-up,” where it is necessary to use the program. This right cannot be abrogated by contract; and
- The right to decompile the software where such decompilation is necessary to achieve the compatibility of the program with other software. This right too, is not capable of abrogation by contract.

In the software industry, it is estimated that 37% of software in use is pirated (representing revenue losses of 2.9 billion euros). This increase in software piracy is mainly due to new technology (such as CD-RW drives) which enables large scale perfect copying of software at extremely low cost. This represents a very advantageous cost-benefit ratio for those looking to get the highest profit with the lowest investment, easy and wide distribution and low risk of detection and penalty.



In order to reduce software piracy, it has been argued that authors of digital works should seek to restrict infringement of their copyright by the use of stricter contractual provisions and improved digital rights management, such as encryption and electronic “watermarking,” as copyright law can no longer be relied upon.

However, relying on technological measures alone will not be sufficient, as hackers will always find ways of circumventing these measures. Therefore, a combination of appropriate legal and technical measures is needed.

In line with this, the European Commission published in January 2003, two proposals for EU law designed to combat counterfeiting and piracy. The first proposal is for a Regulation to combat counterfeiting and piracy in the EU; the second proposal is for a Directive on measures and procedures to ensure the enforcement of intellectual property rights. The proposed Regulation applies to seizure of suspected infringing goods at the EU’s external borders. The proposed Directive covers goods and services circulating within the EU.

In addition, United Kingdom copyright law protects technical measures designed to prevent unauthorized access to, or prevent the copying of digital works (e.g., copy-protection devices or access codes). In *Sony Computer Entertainment v Paul Owen & Ors (2002)*,⁹⁹ Sony obtained summary judgement against the third defendant for the importation and sale of a computer chip that was capable of circumventing the copy protection codes applied to computer games used on Sony’s Play Station 2 console. This was held to be a clear breach of Section 296 of the CDPA, which prohibits the manufacture, import or sale of devices or means which are specifically designed or adapted to circumvent copy protection technology. It did not matter that the computer chip had other functions than to infringe the claimant’s copyright.

Implementing the DCD will involve making many amendments to the CDPA and should further help to harmonize the UK’s digital copyright legislation with that of the rest of the EU. The most important changes are:

- A new ‘communication to the public’ right which will provide that uploading works onto a website is a right of the author. (This will give rightholders and performers clear authority to prevent uploading of their works in Napster-type scenarios);
- Temporary acts of reproduction (which occur in cache memory) will no longer infringe if their sole purpose is to allow lawful use of a work (or transmission by an intermediary in a network);
- Where copies are made for private use (currently allowed as an exception to infringement in the UK), a system for providing fair compensation to rightholders will have to be instituted;
- Protection against circumvention of means designed to prevent copying and viewing, such as encryption and digital watermarking; and
- Protection against the removal of digital rights management information.

Digitization, and increasing demand for access to works over the Internet, have led to a need for new legislation extending existing copyright laws (the adoption in 1996 in Geneva of the WCT and the WPPT was one important response to these developments). Encryption and digital rights management capabilities have developed in tandem to help meet the demand.

Advances in technology mean that the cost of publishing and distributing multimedia works is reduced. However, it also means that the unauthorized copying of works can be carried out with



relative ease and at very low cost. Copy protection technology can play a part in tackling software piracy, and will be a deterrent against most users from any unauthorized copying. However, advances in technology also mean that dedicated hackers will obtain faster and more advanced computer systems that will ultimately allow them to circumvent most forms of copy protection.

Legal measures are therefore needed as a further deterrent against the more dedicated hackers. Owners of multimedia products will have to rely on a combination of these technological and legal measures to effectively protect their works.

Anti-Trust and Competition Law

In dealing with interactive digital entertainment and educational multimedia products which are protected under copyright and/or patent, one needs to examine whether a contractual or non-contractual arrangement, including licensing, may violate anti-trust or competition laws of each applicable country. In April 1995, the United States published the "Anti-Trust Guidelines for the Licensing of Intellectual Property," which applies to patents, copyrights, trade secrets and know-how. The European Union published in January 1996 the Commission Regulation No.240/96, which applies to patents, know-how, combined licenses and copyrights and other intellectual property rights.¹⁰⁰ In Japan, the "Anti-Trust Guidelines for Patent Know-how Licensing Agreements," under the Anti-Monopoly Act, was published in December 1998, and applies to patent/know-how licensing agreements. Although the guidelines are not directly applicable to multimedia issues, as they are to the licensing of other forms of intellectual property rights, the views stated in the guidelines will be applied *mutatis mutandis* to the extent possible, depending on the nature of such other intellectual property rights, including copyrights. In March 2002, the Study Group on Anti-Trust Law and Software was mandated by the Japanese Fair Trade Commission to study the matter of software and anti-trust law. The study group published a report in which they stated that the application of the anti-trust law to the provisions of software license agreements (the restrictions against reproductions, revisions, modifications, and ownership issues of any modified work or exclusive licensing arrangement for modified work, prohibitions against reverse engineering and the restriction of tie-out sales and handling of competitive products) is principally the same as that which the Fair Trade Commission of Japan expressed in the above guidelines.

One of the points examined by the above study group was whether prohibition of reverse engineering violates the anti-trust law of Japan. In the United States, reverse engineering for the purpose of obtaining interface information is generally permissible under the doctrine of "fair use."¹⁰¹ In the EU, reverse engineering is permitted under the Software Directive (91/250/EEC, May 14, 1991) concerning the legal protection of computer programs. In Japan, the notion prevails that reverse engineering encourages the development of technology, and any prohibition by the licensor in a software licensing agreement of reverse engineering of said software could restrict research and development activities of the licensee, and furthermore could impede fair competition within the product and technology markets of the software. On the other hand, there are also cases where the algorithms in the software contain protected know-how, and thus the opposing view exists that when software is offered in the form of object code, prohibition of access is necessary from the licensor's point of view. Accordingly, this view holds that the prohibition of reverse engineering would then have the benefit of providing incentives for the licensor to carry out research and development. From the point of view of the Anti-Monopoly Act of Japan, it is important that the incentives of both software licensor and licensee to engage in research and development, and the development of new technology, are not impeded.

For example, as in the case of software which performs certain platform functions, in order for one to develop hardware and software which has interoperability with said software, interface information is necessary. If the licensor does not offer this interface information to the licensee,



reverse engineering then becomes a necessary means to develop software or hardware appropriate for the software. In such situations, even if reverse engineering is considered to be an exercise of a licensor's rights under the Copyright Law, it is no longer deemed an act recognizable under the Copyright Law, but is instead subject to the Anti-Monopoly Act.

In Europe, Nintendo and Sega had separate agreements with videogame manufacturers by which they reserved their rights to approve the sale of the videogames developed by licensees, and contractually required licensees to entrust Nintendo with manufacturing. These agreements provided for the maximum quantities of videogames any licensee could produce in any year. In response, the European Commission sent letters to the licensors indicating that the above contractual requirements may violate EU anti-trust law. Thereafter, both companies revised the restrictive provisions in their respective agreements.

In Japan, the Fair Trade Commission considered it a breach of antitrust law when ten "pachinko" game manufacturers agreed to make a patent pool of the various technologies for manufacturing pachinko game machines, and agreed not to license such technology to other pachinko manufacturers. These 10 companies comprised 90% of the pachinko game market in Japan. The Fair Trade Commission considered this practice akin to substantially restricting competition, and therefore a breach of anti-trust law in Japan. In another opinion of the Fair Trade Commission, Sony contractually required retailers of their game software to not be engaged in the purchase, sale or distribution of used videogames. The Fair Trade Commission considered such practice similar to a contractual restriction on retail price, and as a result, such practice on the part of Sony was determined to be illegal.

Impact of WCT on the On-line/Internet Distribution of Video Games

There is an increasing trend in the use of on-line/Internet devices for the distribution of videogames to users, and it has therefore become necessary for copyright owners of videogames to be protected in the use of these devices on a world-wide level.

In December 1996, a WIPO Diplomatic Conference adopted the WIPO Copyright Treaty ("WCT"). Article 8 of the WCT provides:

"Without prejudice to the provisions of Article 11(1)(ii), 11*bis*(1)(i), 11*ter*(1)(ii), 14(1)(ii) and 14*bis*(1) of the Berne Convention, authors of literary and artistic works shall enjoy the exclusive right of authorizing any communication to the public of their works, by wire or wireless means, including making available to the public of their works in such a way that members of the public may access these works from a place and at a time individually chosen by them."

Article 8 of the WCT clarifies a rightholder's exclusive right to authorize any communication to the public in regards to the work, including the right to make available to the public the work. The following is a discussion of the impact of this WCT Article on the on-line/Internet distribution of videogames in the United States, EU and Japan respectively.

United States

In 1995, a year before the adoption of the WCT, the report, "Intellectual Property and the National Information Infrastructure" (also known as the "White Paper") was published. The White Paper stated that the application of Section 106(3)¹⁰² of the Copyright Act for purposes of digital dissemination of copyright works appeared uncertain, and recommended that the Copyright Act be amended to expressly recognize that copies or phonorecords of works can be distributed to the

public by certain methods of transmission, and that such transmissions fall within the scope of the exclusive distribution right of the copyright owner. As a result, the White Paper recommendation was incorporated into a bill and submitted in the 104th Congress, but the bill was not enacted. In addition, other amendments to the Copyright Act were also attempted, but ultimately failed to introduce a provision expressly setting forth a copyright owner's exclusive right of communication to the public of works.

In the absence of legislative action, however, federal courts have ruled that making a work available through an electronic network for end-user downloading is within the scope of Section 106(3) of the Copyright Act. In *Playboy Enter. Inc., v. Frena*,¹⁰³ the Court held that when unauthorized photographs owned by Playboy Enterprises were downloaded to a bulletin board system by the defendant's subscribers, the plaintiff's exclusive right of distribution was infringed by customers of the defendant. Also, in *Marobie-Fl. Inc. v. National Ass'n of Fire Equip. Distibs.*,¹⁰⁴ the Court held that unauthorized copies of the plaintiff's electronic art files placed on the defendant's website constituted infringement of the plaintiff's exclusive right of distribution because the files were downloadable by Internet users. The same rationale with respect to the copyright owner's exclusive right of distribution would then be applicable to the on-line/Internet distribution of video games to the public without authorization of the copyright owner.

In the United States, the author's exclusive right of authorizing communication to the public of the works is not explicitly provided in the Copyright Act, but it is substantially protected under case law and therefore in compliance with the WCT.

European Union

Driven by the need for greater harmonization and the desire to implement the WCT, the Directive on Copyright in the Information Society (DCD) was adopted by the European Council on April 9, 2001.¹⁰⁵ The Directive was finally adopted three-and-a-half years after it was first debated in the European Parliament. The process was slowed by extensive lobbying on the proposal by a wide variety of industry and other interested sectors.

The DCD harmonizes three fundamental exclusive rights: the reproduction right, the distribution right and the right of communication to the public. Article 3 of the DCD (the wording of which originated from Article 8 of the WCT) covers communication to the public of copyright works via online means of distribution and stipulates the following:

"Member States shall provide authors with the exclusive right to authorize or prohibit any communication to the public of their works, by wire or wireless means, including the making available to the public of their works in such a way that members of the public may access them from a place and at a time individually chosen by them."

EU member States were required to implement the Copyright Directive into their own laws by the deadline date of 22 December 2002.¹⁰⁶

Japan

The Copyright Act of Japan was amended in response to the expressed desire of copyright owners and authors to protect their interests and those benefits obtainable from developing networked digital technology and various means of communication, such as the Internet and LAN, and taking into consideration Japan's adoption of the WCT, in 1997. The Copyright Act was amended to expressly provided for: (i) the definition of "the interactive transmission," which refers to a public



transmission made automatically in response to a request from the public; (ii) the definition of “the public transmission,” including interactive transmission, broadcasting and wire diffusion; and (iii) the right of the public transmission, which covers making transmittable the copyright work. The relevant provisions of the Copyright Act provide as follows:

Article 2

“(7) Public Transmission” means the transmission of radio communication or wire-telecommunication intended for direct reception by the public, excluding the transmission (other than that of works of computer programs) by wire-telecommunication installations where one part of which is located on the same premises where the other part is located or, if the premises are occupied by two or more persons, both parts of which are located within the area therein occupied by one person.

[...]

(9.4) Interactive Transmission” means the public transmission made automatically in response to a request from the public, excluding the public transmission falling within the term “broadcasting” or “wire diffusion.”

Article 23

“The author shall have the exclusive right to transmit his work publicly (including the right to make his work transmittable in the case of interactive transmission)

[...]

(1) The author shall have the exclusive right to communicate publicly, by means of a receiving apparatus, his work which has been transmitted publicly.”

In Japan, in accordance with Article 23 above, the copyright owner’s exclusive right of the public transmission should be expressly applied to the distribution of videogames via the Internet to the public. Therefore, if any person connects with a telecommunication network made for the use of the public via an interactive transmission server in order to play a videogame without permission of the copyright owner, such connection falls within the scope of the act of “making transmittable,” and constitutes a violation of the copyright owner’s right of public transmission.

Business and Industry Practices of Licensing

There are three dominant trends of licensing relating to videogames and edutainment software. These are: (1) an acquisition of a license by a manufacturer of videogames and “edutainment” software (programs for mixed purposes of education and entertainment) from authors or production companies or any other third parties who own books, motion pictures or any other type of works that a manufacturer wishes to use to create videogames and edutainment software based on such third party works; (2) licensing of videogames and edutainment software by a manufacturer/owner of the copyright to a local licensee for localization and distribution of the videogames and edutainment software in that local territory; and (3) licensing of videogames to producers of theatrical films and other non-videogame works. Type (1) licensing has become one of the customary arrangements with respect to certain types of motion pictures that achieve global distribution and are well suited for exploitation in videogames, e.g., “Harry Potter and the Chamber of Secrets” and “Lord of the Rings.” Type (3) licensing is also a possibility for videogame manufacturers in the exploitation of videogames in different kinds of works, e.g., “Street Fighter II” and “Bio Hazard” were licensed by Capcom to a

United States film production company and theatrically released by Sony Pictures in the United States in March 2002 under the title "Resident Evil."¹⁰⁷

Basic Terms and Conditions of a License Agreement

Type (1) Licensing

Type 1 licensing for videogames is commonly divided into licensing as applied to commercial arcade games and consumer videogames. The terms and conditions for these licensing agreements are basically similar to each other except for the amount of royalty to be charged for each commercial arcade game and consumer game sold. Basic terms and conditions used in these agreements are listed below, followed by an explanation of some terms of significance:

- Names of parties
- Properties to be licensed, e.g., game characters
- Systems/Format
- Scope of rights to be granted e.g., terms of exclusivity
- Royalty rate
- Minimum royalty
- Currency
- Accounting procedure
- Territory
- Marketing period
- Target introduction date
- Consumer introduction date
- Commencement date of agreement and expiration date
- Approval process
- Insurance
- Copyright and trademark notice
- Post expiration disposal date

Systems/Format

As explained below in the section covering the review of technological developments, various types of systems/format are made available in the market place, for example, Sega Dreamcast, Sony PlayStation2, Nintendo Game Cube and Microsoft X-BOX and therefore, agreements should accurately identify the particular systems/format on which the properties will be used under the licensing arrangement.

Scope of Licenses

Frequently, in videogame licensing disputes, the parties may disagree on the scope of the license granted. Where the license fails to explicitly authorize the use of a particular media, especially in the case of a new technology, a court would then have to determine the intent of the parties since intent controls. In *Bloom v. Hearst Entertainment, Inc.*,¹⁰⁸ the Court stated that the main issue covering a new use of a work is whether such use was known and could have been contemplated when the parties made their agreement. Furthermore, in the Second Circuit case of *Bourne Co. v. Walt Disney Co.*,¹⁰⁹ the Court held that "if the disputed use was not invented when the parties signed their agreement, that use is not permitted under the contract." Based on these and other cases, it is important for the parties to a license agreement to carefully draft the scope of the license



intended. If a broad scope of use is intended to be granted, especially as to future uses, then wording such as “methods of exhibition [distribution, etc.], now known or hereafter to become known” should be inserted in the license agreement.¹¹⁰

Grant of License

In most licensing arrangements, a licensee wishes to acquire the rights on an exclusive basis, and on a worldwide basis. This enables the licensee alone to produce and distribute videogames utilizing the properties acquired under the license on a worldwide basis. On the other hand, the licensor desires to limit the period for exploitation of the properties in videogame products by setting the marketing period from the consumer introduction date to the post expiration disposal date, so that the licensor can find another potential licensee following the expiration of the exclusive terms of the agreement. One should therefore make certain to ascertain whether an exclusive license is granted. In regard to most videogames, it is practical for the licensee to require the right of modification or reformatting of the properties to utilize them in digital format for videogames; therefore, it is important that such rights be provided for in the agreement.

Royalties

There are certainly various ways for both a licensor and a licensee to agree on the formula for compensation payable by the licensee. In general, the licensor usually asks for a minimum guarantee, and further requests that a portion, or the entire sum of such guarantee, be payable as an advance payment prior to production or distribution of the videogames. Furthermore, the parties may determine the royalty as a percentage of revenues, or simply agree to a certain flat sum amount for each type of videogame, i.e., commercial arcade type games and consumer videogames. As an example, the licensor may charge US\$35.00 for each unit of arcade games sold, and US\$2.50 for each unit of consumer games sold.¹¹¹ With regard to percentage arrangements, the parties may agree to certain percentages based on the retail price or wholesale price of the videogames. The parties may sometimes also agree to the payment of royalties on certain “breakpoint” percentages corresponding to the number of videogame units sold. A “breakpoint” in this context refers to an escalating number of units, e.g., 200,000 units, 300,000 units, 400,000, etc., to which the corresponding royalty rates increase as, for example, 1.5%, 2.0%, 2.5%, etc.

There are certain types of videogames featuring sports, such as baseball games that involve a baseball league, players associations, baseball stadiums and, on occasion, former baseball players. So long as videogame manufacturers wish to use names, likenesses, designs and any other intellectual or personal property rights of such parties, appropriate licenses must be obtained from these parties.

In a recent incident in 1999, Nippon Professional Baseball, comprising all professional baseball teams in Japan, granted a license to Konami, whereby Konami was allowed to use the names of the baseball teams and players, logo marks of the teams and the uniforms of the teams, etc., to manufacture the baseball videogames. The Japan Professional Baseball Players Association, consisting of baseball players belonging to the teams, objected to this grant of license to Konami, alleging that the right of publicity with regard to the players’ names and likenesses belonged to the players. This dispute was not settled by the parties, and on August 26, 2002, suit was filed by the Japan Professional Baseball Players Association against Konami and Nippon Professional Baseball. This indicates that unless a videogame manufacturer obtains appropriate licenses and/or consents from any and all parties concerned, the development and production of the videogames may be at stake. Another example which also took place in Japan in 1998, involved a videogame manufacturer of horse racing games who was sued by a group of owners of racehorses.¹¹² Nagoya

District Court ruled that the owners of the famous racehorses owned the right of publicity with regard to the names and likenesses of the horses, and granted favorable judgment in the form of damages to the plaintiffs, the owners of the racehorses. This also indicates that a videogame manufacturer must obtain proper licenses from any party who owns applicable rights.

The amount of royalties in consideration of obtaining licenses from owners of characters, sports players, and various other potential licensors, may differ in each deal depending upon the level of fame, strength of characters and other commercially exploitable elements. However, videogame manufacturers wish to limit the aggregate amount of royalties payable to all parties concerned to below 10% of the retail price to assure that the videogame manufacturers will be able to make an adequate profit.¹¹³

Properties to be licensed

A licensee should ensure that it receives the legal rights to all properties such as names, nicknames, abbreviated names, titles, depictions, likenesses, poses, costumes, emblems, powers, characteristic concepts, themes, settings, personalities, modes of expression, phrases, pictorial and written graphics and other characteristic elements, concepts and themes which may be embodied in the final product.

Approval Process

As explained above, the properties are modified in virtually all videogame licensing agreements of this type. A licensor customarily asks for approval rights with regards to the manner of utilization, especially with respect to the modification of the concepts or story setting for each property. This approval system sometimes creates hardship between licensor and licensee in finding solutions in a timely manner. When a licensor suggests changes to the concept or story setting, or gives detailed comments with regard to any idea proposed by the licensee, frequently the schedule for completing the videogames in time for launch on the targeted market introduction date will be delayed. In such situations, the licensee tends to suffer negative consequences from such delay. For example, if a licensee wishes to produce a videogame of the World Cup Soccer 2002, the licensee surely wishes to complete production well in advance of the games, and it becomes vitally important for the licensee to satisfy any approval procedure in such time as shall not hinder its production schedule.

Commencement Date and Term

In order for the licensee to protect its exclusive rights to optimize the sales of the videogames during the license period, the licensee customarily asks the licensor to refrain from granting similar rights to third parties, even before the consumer introduction date. For example, six months prior to the market introduction date may be set as an exclusive period to ensure that no videogames using the same properties are offered for sale in the market place. The licensee may further wish to obtain an exclusive sales period following the market introduction date for the same purposes. From the licensor's point of view, the licensor may wish to limit an actual marketing period from six months to one year so that the licensor can utilize the same properties for other licensees or renew the agreement with the current licensee for an additional period. All arrangements with regards to exclusivity periods will depend upon the various needs of both licensors and licensees, and the actual period may differ in each transaction.



Type (2) Licensing

Essentially, localization serves to accommodate the local language requirement, and therefore, these types of license agreements are simple documents for the licensee to reproduce the games with the changes of language in the territory as permitted in the agreement.

The license may be granted for certain territories, or may be based on specific languages without limiting the geographical areas. This type of licensing is a distribution arrangement in essence, whereby the original videogame manufacturer optimizes its revenues by setting up distribution arrangements of the original videogames outside the main market, where the original videogame manufacturer does not have strong distribution channels.

The current customary royalty rate that the licensor may ask of the licensee is around 15%, but can be as high 20% or as low as 10%, depending upon the strength of the videogame properties.¹¹⁴ Note that these figures are negotiable.

One of the concerns that the licensor has in granting a license for localization is that of “parallel imports” of the same videogames directly or indirectly from the local licensee to the market which the licensor controls. This issue becomes serious from the licensor’s point of view in cases where the market place in which the licensee is permitted to distribute the videogames sustains the games at a very low price and then the game, when imported back to the licensor’s market, has more competitive price positioning. Parallel imports are permitted in most countries, consequently, the licensor would have difficulty trying to prohibit distribution of such cheaply priced videogames back to its own territory. This is one of the reasons why the owner of the copyright of the videogames may be hesitant in loosely arranging the licensing deal for localization.

During the 1980s, the typical videogame cost several hundred thousand dollars to develop, and took several months until conception. Today, the average videogame requires two years of development and costs US\$10 million.¹¹⁵

Type (3) Licensing

Traditionally it has been common to see videogames based on blockbuster Hollywood movies such as *Star Wars* and the multitude of games it inspired. Recently however, there has been a growing trend in the other direction. Hollywood movies accounted for US\$9 billion in revenue in 2002,¹¹⁶ while in comparison, videogames sold during the same period and in the same United States market generated US\$10.3 billion.¹¹⁷ It was therefore inevitable for such a trend to develop, whereby movie studios in larger numbers are beginning to notice and tap into the large market of videogame enthusiasts.

As a new trend in the videogame industry, videogame manufacturers have been concluding transactions with film studios to obtain licenses to produce videogames based on theatrically released films, such as “Harry Potter and the Chamber of Secrets” and “Lord of the Rings.” The prices for the acquisition of such rights have been booming and, therefore, unless the videogame manufacturers can greatly maximize the number of copies of videogames sold, there is always a risk of making inadequate profit. In view of these current developments in the industry, and with the hope of limiting the purchase price that one may be required to pay at later stages, certain videogame manufacturers have entered negotiations with film production companies at early stages of development. Such negotiations deal with making a commitment for investment in the development phases and, at the same time, securing the future opportunity that allows videogame manufacturers to obtain licenses to manufacture videogames based on a vested interest in such films. Obviously, the amount of investment for each project may differ.

Technological Developments, and the Impact of Technology on the Videogames Industry and its Influence on Licensing

Historically, technological development of multimedia devices has kept abreast of, and often develops as quickly as, computer technologies. Devices that realize multimedia entertainment environments are similar in many respects to computers. Accordingly, issues concerning computer software—e.g., piracy and the making of illegal copies—are generally applicable to those in the multimedia industry.

Whenever a software program or videogame program is successful in the market place, it is likely to raise copyright problems for its owner. Almost all videogames are now available to run on computers, but we should keep in mind the differences between computers or consoles designed for videogames, and personal computers. Videogame consoles are generally created for the sole execution and enjoyment of videogames, whereas ordinary personal computers are designed for multipurpose business or home usage. Regardless of whether a software program runs on a personal computer designed for multipurpose use or on a videogame console, however, the program may be regarded as copyright protected computer software.

The first videogame was created in a laboratory. In 1958, William A. Higinbotham at Brookhaven National Laboratory conceived an idea of the first interactive entertainment, “Tennis for Two,” using an oscilloscope for display.¹¹⁸ Soon after the first mini-computer DEC PDP-1 was developed, a student in a masters course at MIT, Stephen Russell, along with several others created the first version of the “Spacewar!” videogame fully utilizing the capacities of the new computer in 1961. You can still see the image of this videogame at their website.¹¹⁹ The software program was widely distributed in the United States via magnetic tape or through network mediums, although only a limited number of people, students or researchers accessible to PDP-1, could play the videogame. Mr. Russell did not claim copyright in the software.

Engineers who had been involved in the playing of Spacewar! then proceeded to change the progression of technology by introducing videogames into the home arena. In the Fall of 1966, Ralph H. Baer conceived the first home videogame system utilizing a television set as a display. He created the “Brown Box” prototype.¹²⁰ The original videogame matured in 1971 as the first commercial interactive home videogame “Magnavox Odyssey.” Odyssey had the original form in which a TV set and a game machine are used in combination. In the same year, as an Ampex engineer, Nolan Bushnell designed the first coin-operated arcade videogame “Computer Space,” which is the first commercial arcade type videogame. The videogame technology turned into an industry. Bushnell continued to develop videogames and established his company Atari. Its first and successful product was the arcade videogame “Pong,”¹²¹ released in 1972. The electronic guts were entirely solid-state and hardwired. No ROMs or microprocessors were present. This machine was made to do one thing and one thing only: play Pong. The hot sales of Pong made the videogame industry popular. Steve Jobs, the founder of Apple Computer, was an engineer at Atari and contributed to its next hit of “Breakout.” These videogames in the earlier age were fully solid-state. Their functionally simple hardwires and ICs allowed followers to sell pirated copies that realized functions similar to the original.

In the 1970's, small ICs run by the sequence of machine codes, i.e., microprocessors, inherited the primary role for videogames. Intel initiated sales of the first 4-bit microprocessor, the “i4040,” in 1971 and then, the 8-bit microprocessor, the “i8080,” was released in 1974. Videogames were composed of a microprocessor and related ICs—ROM, RAM, other gate ICs. They are called computers. Taito Western Gun comprised i8080, and Atari Tank 8 used Motorola's 8-bit microprocessor 6800. Computer software programs began to be utilized in both consumer and arcade type videogames. As an arcade game using a microprocessor, “Exidy Circus” was the first big hit in 1977 in the United States, and “Taito Space Invader” was one of the mega hits in Japan.¹²²



The inseparable combination of the software program with videogame machines is vital to these commercialized successes. To attract people, low quality of software products would cause a disaster in the industry. After the videogame industry was recognized as a lucrative business, Atari began implanting their arcade videogames into home videogames to create the Atari Video Computer System.¹²³ The system was designed to run videogame software programs in a single machine by means of exchangeable game cartridges. So many third parties provided game software with low quality that the videogame business fell into deflation. Atari's share price dropped sharply and the game fad burst at the end of 1982.

High performance level hardware incorporating strong graphical functions in imaging speed and high density resolution, is also vital to interactive multimedia entertainment, but only arcade type videogame machines satisfied the requirements in those early days. Although Microsoft started providing their operational system for IBM personal computers in 1980, these personal systems had poor performance for videogame machines. The makers of home videogame machines adjusted to the demands by utilizing a variety of technologies. Nintendo's Family Computer, released in 1985, is one of them. Graphical segments controlled by players are separated from background image and displayed as "sprite," i.e., moving image. The digital circuits automatically recognize their display priority and set images of characters having higher priority in the foreground, and the other images in the background. The hardware executing scroll functions increase the realistic environment of videogames. The developments of high performance CPU, ASICs and digital signal processors have escalated graphical ability and better enable three-dimensional images. The development of videogame machines and software programs continues including, for example: Nintendo Family Computer, NEC PC Engine, Sega Megadrive, Nintendo Game Boy and Super Family Computer, and Sony PlayStation.

The Internet penetrated into the base of computer users after Microsoft released "Windows 95" in 1995. Before then, videogames had evolved as standalone computers specialized to perform videogames. The breakthrough of information technologies added a new aspect to their basic features. Nintendo Super Family computer and Sony PlayStation were connected to the Internet through interfaces that enabled the exchange of data through the network. Videogames became an open-ended platform. The network communication not only allows us to download software programs, but it also enables us to exchange information to play the game, such as data-defining player characters. The development of videogames continues—Sega Dreamcast, Sony PlayStation 2, Nintendo 64 and Game Cube, and Microsoft X-BOX. The more complex technology becomes, the less likely it is that people can copy the hardware technology.

Emerging Trends and Possible Future Impact on Licensing

The market size per videogame title has certain limits and, therefore, videogame manufacturers must create exciting games which attract the public's attention by using new technologies and creating attractive game concepts. Such needs are common to other entertainment products and will persist. However, as also applies to other industries, one must make certain the cost of production of videogames is kept at a level that ensures adequate profit. One way to seek expansion of the videogame industry is to seek new market niches. For example, a novel licensing approach has been identified that may be the next wave of licensing agreements. The combining of popular music with videogames is especially beneficial to the embattled music industry which has experienced poor sales of late.¹²⁴ Another example of new markets for the videogame industry is expansion into new media such as mobile phones. In Japan alone, 446 million units of software for games such as Nintendo GameBoy were sold; while in the rest of Asia, corresponding figures were 102 million.¹²⁵

At the same time as this potential expansion of videogame licensing formats, the basic concepts of licensing, as discussed in this Chapter, will persist, even while financial arrangements, i.e., royalties and other types of compensation, may be differentiated for each new deal.¹²⁶

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Chapter VI

Computer Software

"I think there is a world market for maybe five computers."

Thomas John Watson, Sr. (1874-1956), President, IBM

That a businessman of Mr. Watson's stature was willing to still take a risk and set up a company to cater to the manufacturing needs of a market of *five* was our good fortune! And when in 1981 IBM launched the IBM Personal Computer (PC) upon the unsuspecting world, the industry giant had to turn to Mr. William H. Gates, whose company Micro-soft had developed a simple program called the Disk Operating System, which when installed into the IBM PC allowed the user to launch other programs. Mr. Gates at the time prophetically remarked (and has presumably never been allowed to forget to this day) that *"640k should be enough for anybody!"*¹²⁷

And yet, neither did the requirement for computers stop at five, nor did a memory of 640k succeed in keeping pace with the boom in information and the need to contain it.

The man who taught us to look at our *windows* in a whole new light, claimed that he was 'tantalized' when he first heard of the term 'Information Age'. He humorously talks of his wonderment as to the tools of this period in time, *a la* its historical predecessors like the Iron Age and the Bronze Age.¹²⁸ That he went on to give us most of the tools, which we use to define the so-called Information Age today, is a different story altogether.

The so-called tools of the Information Age, are mostly software programs, which keep our systems linked and running. A computer with its myriad hardware is similar to a train with compartments, passengers, and goods all in their proper place. Yet without an engine, the train cannot run. The function of an engine in a computer is played by software.

Having established the pivotal role of software in our times, what flows naturally is a discussion on the legal regime governing software. While the chameleon-like nature of software brings it under the scope of both patent and copyright regimes, the present focus is largely limited to the latter. The reason is that the subject matter of this chapter is not software *per se* or as it exists but software as it is used or applied. In other words, this chapter will attempt, over the next few pages, to locate software in a legal regime *after* it has been created, from the time period of its distribution to its end-use.

From an Indian perspective, the software sector is a key driver of the overall information technology (IT) market in the country. The Indian IT sector, enlarging from Rs. 5,450 crore (US\$1.73 billion) in 1994-95 to a Rs. 64,200 crore (US\$13.5 billion) industry in 2001-02 has depended heavily on software and services exports for its healthy year on year growth and for a larger and larger stake of the Indian GDP pie. In terms of share of GDP, the IT industry figures have risen from 0.59 percent in 1994-95 to 2.87 percent in 2001-02. India's software and services exports have jumped from Rs. 1,535 crore (US\$489 million) in 1994-95 to touch Rs. 28,350 crore (US\$6217 million) in 2001-02, consistently recording over 50% growth rates during this time frame.¹²⁹

Software – Why "licensed" and not "sold"

Less than a decade ago, the techno-legal world was in the throes of a debate, the results of which promised to bring a structural change in the traditional approach to software. Some revolutionary thinkers of our times were clamoring for the incorporation of computer software within the

realm of copyright law, only to be vociferously challenged by the traditionalists, who justified their skepticism by illustrating the many differences between software and other copyright works such as books, films or music. Although the debate is now largely extinct, the distinctions remain. And these distinctions necessitate the creation of a unique subset of laws and policies that must govern software even within the broad framework of copyright laws. One such subset is the licensing regime that applies uniquely to software, in lieu of “sale” which governs other copyright works. In other words, software in general is never “sold” – it is merely licensed to the end-user. That is, when you buy Microsoft Word, you are buying a non-exclusive license to use it – you are not buying the copyright to the software – that ownership remains with Microsoft.

Several reasons are advanced for why software is “licensed.” The central point to keep in mind regarding software is that using software, and distributing it to more people, *increases* its value, as there is no depreciation in the quality of the original product with each successive use. Hence, the more people use a given piece of software, the more of a standard it becomes and more people are encouraged to use it. The fallout from this is that each use necessarily involves storing software in the RAM or temporary memory of a computer. Unlike most other products whose value lies in their rarity and exclusivity, software can be distributed and copied digitally at zero cost. This fact necessitates the development of a means to prevent the *user* from transferring the software to others and this is where a license secures a regular stream of revenues for the owner of the software. In other words, for a user to ensure that his activity is legitimate, he needs the owner’s permission to temporarily create copies of substantial portions of the computer program while using it.

Another reason that is often advanced is that in most jurisdictions, reverse engineering of the computer program through decompilation may be a permissible activity. Hence to prohibit reverse engineering, owners rely upon restrictions in license agreements.

What is a software license

At its very basic level, a software license is the right granted by the copyright owner of a software program to a person, permitting him to use the said software,¹³⁰ and possibly also to modify, distribute, publish, translate or in any other similar way, deal with it.¹³¹ The party granting the authorization is the licensor while the party receiving it is the licensee.

If the software in question is protected by patent, copyright, or trade secret law, the license agreement allows the licensee to deal with the software without infringing the licensor’s copyright or patent rights and/ or without misappropriating the licensor’s trade secrets.¹³²

Factors such as the number of copies being licensed, the nature of the software itself, the manner in which it is to be used, the number of primary and secondary rights vested in the software which is the subject-matter of the license, the relationship between the individual rights-holders, all go towards determining the individual nature of the license being entered into. However, the basic features of a contract hold true for all software licenses, and hence obligations under a license, conditions for its breach, etc. follow the broad principles of contract law.

Types of software licenses

For greater clarity of understanding it is useful to first classify software licenses on the basis of the profiles of the licensor and the licensee, and then sub-divide each broad profile according to some typical licenses that characterize it.



Profile 1: User License Agreement

User license agreements are the most elementary class of licenses which are as widespread as they are limited in scope, in giving, as the name suggests, individual/ collective user(s) a mere right of *use* with no real title.

User license agreements can be broadly subdivided under the following headings:

- Signed license agreements – A typical feature of mainframe computer¹³³ software licenses, signed license agreements are as the name suggests a form of license entered into by both parties physically as differentiated from shrink-wrap or web-wrap licenses. A typical instance of a signed license agreement is that entered into by database developers with manufacturers for resource planning.
- Shrink-wrap license agreements – The shrink-wrap agreement gets its name from packages (usually of retail software) covered in plastic or cellophane wrapping. Such agreements are characterized by written licenses, mostly unsigned, which state that the acceptance on the part of the user of the terms of the license is indicated either by opening the shrink-wrap packaging or other packaging of the software, or by use of the software or by some other specified means.¹³⁴ The license is entered into by the end-user and the software manufacturer. However, due to the importance of the software license and its adherence, the recent trend has been to display the license in electronic form on the computer before installation of the software so that the buyer is completely aware of the terms and conditions and is bound by them. This form of licensing has been judicially recognized in *PRO CD Inc. v. Zeidenberg*¹³⁵ and *Beta Computers (Europe) Ltd. v. Adobe System (Europe) Ltd.*¹³⁶ Software for games like Doom, engineering software such as AutoCAD, productivity software such as CorelDraw, and desktop operating systems like Windows XP Home Edition all contain licenses of the shrinkwrap variety.
- Web-wrap/ Click-wrap license agreements – Over the last few years, technology growth has been driven by the Internet. Click-wrap or web-wrap licenses are licenses entered into electronically over the Internet. The entire process takes place over the Internet, with the licensor displaying the terms and conditions of the license before the software is downloaded or paid for. The end-user simply needs to click on the 'Accept' or 'Don't Accept' buttons provided for at the end of the license. However, with the growing importance of electronic commerce and the acceptance of digital signatures, web-wrap/click-wrap licenses are clearly the future of software licensing. This category of licenses has also been accepted as valid and binding in the *PRO CD Inc Case*¹³⁷ and the *Beta Computers Case*.¹³⁸ Yahoo and MSN Messenger, Real Player, Google Toolbar, Music Jukebox are all examples of software licensed through the click-wrap method. Currently, most updates to shrink-wrap software are made available through click-wrap. An example of this would be Microsoft Office XP.
- Site/ Enterprise license – This type of license usually gives the user a collective right to use the software at a specified site (location) or within a specific enterprise (company).¹³⁹ This form of software licensing is seen in companies and corporations where typically a large number of licenses are required for particular software. The benefits of this form of license are manifold both for the user as well as licensor. The user benefits from the lower costs of equipment and training. The license cost is comparatively lower as the licenses are procured in large quantities resulting in substantial savings. The licensor, by providing a site/enterprise license, develops a market for his software. A typical network operating system software like Novell NetWare would fall into this class.

- **Conditional Use/Access license** – This type of license is dependent upon either the number of records being maintained using the software or access to the existing publisher-provided database (i.e. a web-published database like Delphion for patents). The revenue model in this type of license agreement is based upon recurrent use of the software, having been necessitated by the higher maintenance cost for larger or frequently used databases.

Profile 2: Developer-Publisher license agreements

These licenses are entered into by companies who do not want to maintain a permanent developer workforce or cannot afford skill-specific high-maintenance employees. One instance of such a license is that between publishers and individual developers where all the work done by the latter is licensed permanently to the publisher at a one-time cost. Thereafter the publisher uses the code as he deems fit. Another instance of this is the agreement between a highly domain specific developer which licenses portions of its software to be included in other publishers' software. The revenue model can be one of royalty payments in the second instance, where the royalties would be based on the number of copies produced or the time frame of the license agreement, for example KAI Power Tools, an image manipulation and enhancing software which is embedded and bundled into Adobe PhotoShop.

**Profile 3: Publisher-Distributor license agreement –
These types of agreements can be broadly classified
into two types:**

- **Publisher-OEM¹⁴⁰ Agreements** – In these agreements publishers license the right to replicate an operating system on electronic devices. For e.g. Toshiba manufactures PDAs¹⁴¹ which have a pre-loaded embedded operating system manufactured by Palm Inc.
- **Publisher-VAR¹⁴² Agreements** – These agreements are necessitated in situations in which the publisher's software is not available off the shelf and turnkey projects have to be undertaken to deploy the software. Thus the publisher enters into agreements with distributors and trains them to deploy the software on his behalf, for example SAP AG GmbH has appointed Siemens Information Systems Ltd. in India as one of its VARs.

Profile 4: Run time/ Developer license agreements

Run time license agreements typically arise in the context of a software developer or publisher developing a new program that incorporates a component or elements from another developer's program.¹⁴³ For example a chemist may use Microsoft Visual Basic to develop an inventory-control system for in-house use or sale to other chemists.

Profile 5: Manufacturing/ Replication license agreements

A manufacturing license agreement gives the licensee the right to create multiple copies of the software. However, this license usually provides for creating copies of the software and not selling or distributing them, depending upon the terms of the license. Actual ownership of the software continues to remain with the licensor. These agreements are typically entered into by parent companies with their subsidiaries in various countries as the cost of replication gets lowered.



Profile 6: Cross-license agreements

Often a situation arises in the context of Patent Law where two patent holders require the respective patented goods of one another and enter into a reciprocal arrangement, whereby each party gives the other the right to utilize its patent. Software copyrights are often licensed on this model of reciprocity. This form of licensing is usually seen where the market for software, though mutually exclusive, cannot be adequately exploited commercially due to existing copyrights of both the parties. Parties may also enter into a cross-license to enhance their products and make them more marketable. The most celebrated example of a cross-license was that entered into between Sun Microsystems and Microsoft, under which Sun licensed JAVA to Microsoft in order to make Microsoft Internet applications compatible with JAVA. In return, Microsoft made available the know-how of their Windows Operating Systems to Sun in order for the latter to tailor its Netscape Navigator and make it more Windows-compatible. That the license turned sour and resulted in a high-profile antitrust litigation is a matter that will find mention in its appropriate place in a later segment.

Profile 7: Collaborative license agreements

This form of license agreement is entered into by parties when one party has the resources for manufacturing the software while the other has the technology and know-how for it. This is differentiated from a cross license wherein the arrangement is a reciprocal one. An example of this type of license is the collaboration between Sony and Ericsson for the manufacture of cell phones-cum- PDAs where Sony has the technology and know-how in optics and computing, and Ericsson has the know-how in mobile phone technology.

Profile 8: Escrow and TTP¹⁴⁴ license agreements

When in an agreement between a software publisher and the end-user, the stake of the end-user is very high, then both parties agree to appoint an Escrow agent or a TTP who holds the source code in safe custody for disclosure to the end-user if the publisher defaults in any way.

Profile 9: Outsourcing license agreements

These agreements are entered into when one publisher-developer contracts to have certain portions of a given software developed by another. The difference between this class of license agreements and collaborative license agreements is that in this the ownership over the software remains entirely with the licensor and the licensee may not use the same know-how in any other project. For example the mushrooming software industry in India owes its growth to outsourcing projects from high-cost countries like Japan, the EU and the USA.

Profile 10: Open Source license agreements¹⁴⁵

The core difference between open and closed source software is the terms of the license under which the software is distributed, and the fact that open source software is distributed with source code, to enable it to be modified.

The basic characteristics of an open source license are that it allows:

- Free modification,



- Free redistribution,
- Commercial use – that is, you are allowed to sell, or take commercial advantage of free software.¹⁴⁶

There are many different open source licenses, applicable to different products. As long as they meet the above requirements, they can be called open source.¹⁴⁷ The most popular open source license under which the vast majority of open source software is released is known as the GNU GPL or General Public License.¹⁴⁸ The GPL conforms to all the requirements of the Open Source Definition with one key addition: the GPL prevents “tainting” of open source software, by insisting that if you redistribute it, or use some open source code in another project, then you *must distribute the new product as open source too*. This is a key requirement that prevents the co-option of open source code into proprietary products, which are then the subject of a claim to copyright protection, and distributed on restrictive terms, thus blocking access to that particular set of open source code forever.

Standard terms of a software license

The operative terms of a software license depend upon the profile of the parties and the subject-matter of the license itself; but at the very core, they are contracts and need to conform to the standard requirements under contract law. Hence software licenses are characterized by the following standard terms:

Terms pertaining to procedural requirements:

- Identities of the various rights holders of the licensed product
- The identities of the parties involved in the license
- Modes of delivery and acceptance
- Forum Selection Clause¹⁴⁹
- Term of the license
- Method of revenue collection/ initial payment
- Maintenance, supports and upgrades

Terms pertaining to substantive content:

A description of the subject-matter being licensed – this is an important clause and its content can be further subdivided under the following headings:¹⁵⁰

- The program’s published name
- Whether the source code or object code is included
- What documentation is included
- Whether all material is licensed or only that over which the licensor has a legitimate claim of proprietary rights
- Whether any other rights are included or limited (e.g. can the licensee use the software to process data for third parties?)
- Whether concepts and ideas embodied in the software are licensed or just the expression of these concepts and ideas
- The nature of rights vesting in each party as a result of the license
- Warranties as to performance
- Scope of use and restrictions upon use of the software¹⁵¹
- Rights upon termination of the license



- Effect of termination of the license
- Restrictions (if any) on relicensing, selling, distributing or in any way commercially exploiting the licensed product
- Right to enhance/modify the subject-matter of the license and the ownership of the modified/enhanced software
- Access to source code
- Indemnities
- Taxation issues

Validity of software licenses and the grounds for breach

The determination of what amounts to breach of a license is essentially subject to judicial interpretation of the terms of the license. However, as a software license is, at the basic level, a contract, all the standard determinants of breach in a contract law sense will apply to software licenses. In other words, non-performance of obligations under the license by either party, misuse of the software by the end-user, contracting out of the scope of the license by the end-user, instances that could lead to a ruling of breach by the courts.

The validity of clickwrap¹⁵² and shrink-wrap¹⁵³ licenses have come up time and again before the courts whenever there have been allegations of misuse by the licensee leading to an action for breach by the licensor. Although the courts have today unanimously upheld the validity of such contracts *per se*, the issue of what constitutes breach in a given instance is determined by the interpretation of the impugned clauses on a case to case basis.

Termination of a software license

Apart from rare instances of perpetuity,¹⁵⁴ most software licenses are for a fixed term, which is indicated in the license itself. Such a termination could be termed as 'natural termination' of the license. However, in certain instances, an 'unnatural termination' may also occur at the instance of one of the parties or due to other extraneous factors, some of which are listed below:

- Termination upon breach
- Termination due to expiry of the term of intellectual property law protection for the licensed technology
- Termination at will or without cause – some contracts specifically provide for this type of termination at the instance of either party and with sufficient notice to the other party and the same is usually accompanied by a phase out period to clear out the existing stock in the licensee's possession.

Product liability under a software license

The two most common complaints that give rise to questions on product liability under a software license are non-performance of the software (e.g. hanging of a computer while the licensed software is being used) and the loss of data created under it or stored in it. The test that is usually applied in ascertaining whether the licensor is liable for either of the two defects or not is one of a qualitative assessment of the 'defect.' If it is one that is inherent in the software and peculiar to it, like a fault in the specific program, the liability would automatically vest with the licensor. If the licensor is not the developer, the resultant chain of causation would enable him to eventually sue the developer. According to the UCC, liability would also accrue to the seller if there has been any warranty made by him as to the nature, quality, etc., of the goods and the goods do not conform

to the said yardstick.¹⁵⁵ In *Redmac, Inc. v. Computerland of Peoria*,¹⁵⁶ the court held that statements regarding computer hardware and software that it would be “free from defect upon delivery” and would “work for a reasonable period of time” were not salesman’s puffing but constituted an express warranty.¹⁵⁷

There can also be an implied warranty by the licensor, if at the time of licensing, he is aware of the specific purpose for which the software is going to be used; there is then a burden upon him to ensure that the said software is at the barest minimum level able to fulfil the said purpose.

Derivative works

A derivative work is one which is based so substantially on an existing work, that *it would be considered an infringing work if the material which it has derived from a prior work had been taken without the consent of a copyright proprietor of such prior work*.¹⁵⁸ Thus, insofar as the original material (i.e. software) is concerned, the owner of the copyright in the same may claim infringement for the use of his software if the creation of the derivative work was based on his work in an unauthorized manner, but no property rights will accrue to him for the ‘new’ work.

Derivative works are now permitted in most Copyright statutes through express legislative incorporation. For example, United States Copyright Act Section 117, which was introduced into the U.S. Copyright Act through a 1980 amendment, provides:

“it is not an infringement for the owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner, or,...for archival purposes only and that all archival copies are destroyed in the event that the continued possession of the computer program should cease to be rightful. Adaptations so prepared should be transferred only with the authorization of the copyright owner.”¹⁵⁹

An interesting case on the determination of what constitutes a “derivative work” is *Midway Manufacturing Co. v. Arctic International Inc.*¹⁶⁰ where the Plaintiff claimed that the Defendant’s “speed-up kit” which when plugged into the Plaintiff’s video game made it run twice as fast constituted an infringement of its exclusive right of adaptation. The trial judge held that if the said kit was usable only with the Plaintiff’s machines, it would be an infringing adaptation, but if it could be used generally, then it would be an improvement in technology and not an infringement of the aforesaid right.

In other words, the right over derivative works that are created by the mere *use* of a licensed software vests with the licensee. However, if the said work owes its existence to the licensed software and cannot thrive independently on any other software, then such a derivative work would be an infringement of the right of adaptation that is vested in a copyright owner of the software.

Most software licenses contain clauses setting out the permissible limits for the creation of derivative works. Licenses of the Open Source variety are more liberal in this regard and only require that the licensor be given the necessary credit by the creator of the derivative work. For example, the Open Map Software, a Geographical Information System (GIS) software manufactured by BBN Technology is licensed with specific provisions as to derivative works in the following terms:

- In the definitions clause, “Derivative Work(s)” are defined as:



“any revision, enhancement, modification, translation, abridgement, condensation or expansion created by Licensee or BBN (Licensor) that is based upon the Software or a portion thereof that would be a copyright infringement if prepared without the authorization of the copyright owners of the Software or portion thereof.”

- Licensee’s right to create Derivative Works in the Software is subject to :

“Licensee agreement to insert a prominent notice in each changed file stating how and when you changed that file, and provided that you do at least ONE of the following:

- a) place your modifications in the Public Domain or otherwise make them Freely Available, such as by posting said modifications to Usenet or an equivalent medium, or placing the modifications on a major archive site and by providing your modifications to the Copyright Holder;*
- b) use the modified Package only within your corporation or organization;*
- c) rename any non-standard executables so the names do not conflict with standard executables, which must also be provided, and provide a separate manual page for each non-standard executable that clearly documents how it differs from OpenMap; or*
- d) make other distribution arrangements with the Copyright Holder.”*

Antitrust Issues

The following activities¹⁶¹ give rise to antitrust claims in the context of software licenses:

- Vertically imposed price restrictions (price fixing)
- Vertically imposed non-price restrictions (i.e. geographic, customer and sales method restrictions)
- Choosing and terminating distributors and dealers
- Tying arrangements
- Price discrimination

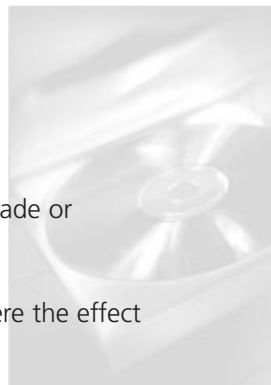
Several U.S. federal statutes deal with the issue of antitrust. Of these the Sherman Act “rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic, political and social institutions.”¹⁶²

Section 2 of the Sherman Act prohibits the following:

1. A monopoly
2. An attempt to a monopoly
3. A combination or conspiracy for monopoly

The said monopoly is defined in the aforesaid provision in relation to any part of the trade or commerce among several states, or with foreign nations.

The Clayton Act prohibits tying arrangements and exclusive dealing arrangements where the effect would be to substantially lessen competition or tend to create a monopoly.



Violations of the Sherman and Clayton Acts are subject to civil action.¹⁶³

The Robinson-Patman Act prohibits discrimination in price, services, or facilities furnished unless the price differential or furnishing of services and facilities was made in good faith to meet the price, services or facilities furnished by a competitor.¹⁶⁴

Microsoft, with its technical monopoly over operating systems in relation to PCs, has been on the receiving end of antitrust suits for quite a while. In the recent past much publicity was accorded to the suit filed by the United States acting under the direction of the Attorney General, where Microsoft was accused of having entered into *“unlawful contracts and combinations in violation of the Sherman Act.”* After several rounds of appeal, the said case was decided by the District Court of the District of Columbia on 12th of November 2002, when the Court prohibited Microsoft from indulging in discriminatory pricing and ordered it to observe uniform trade practices with all its licensees.¹⁶⁵

Antitrust litigation has for long been an effective business tool among software giants to seek a legal vehicle to piggy-back upon each other's software. The celebrated cases filed by Sun Microsystems against Microsoft essentially sought to compel Microsoft to distribute JAVA as a part of its Windows Operating System software. Sun Microsystems claimed in its private antitrust suit against Microsoft that the latter violated antitrust law by tying several products to its various operating systems: the Internet Explorer browser to Windows OS; the Windows workgroup server operating systems (Windows 2000 Professional and Windows XP Professional) to its PC operating systems; its IIS Web server to its server operating systems (Windows NT 4.0 and Windows 2000 Server); and the Net framework to its PC and workgroup server operating systems.

The preliminary injunction sought by Sun was one requiring Microsoft to include the most current Java plug-in with Windows XP and Internet Explorer. Additionally, Sun also asked the court to require Microsoft to “disclose and license proprietary interfaces, protocols and formats,” and to “unbundle” products such as Internet Explorer, IIS and .Net Framework.¹⁶⁶ Although Sun won the preliminary injunction in the District Court of Baltimore before Judge Fredrick Motz and Microsoft was required to carry JAVA, Microsoft has now gone on appeal and the order of the Appeal Court is awaited.¹⁶⁷ The conclusion of this case will have far-reaching ramifications in terms of balancing trade interests and the law.

The UCITA¹⁶⁸ – a specific legislation on software licenses

The UCITA began as a proposed Amendment to the UCC¹⁶⁹ to bring software licenses into its scope. The drafting of UCITA has been described as a “ten-year war between the software industry, consumer representatives, the entertainment industry and other stakeholders over the fundamental rules for electronic contracts, software licensing, and Internet contracts.”¹⁷⁰ The settings for this “war” were “well-attended drafting meetings, website, and e-mail lists, and ... seminars and symposia.”¹⁷¹ The central theme, emphasized throughout the drafting process, is that the UCITA is a commercial code focussing on the computer information industry.¹⁷² The UCITA has nine parts: (1) general provisions; (2) formation and terms; (3) construction; (4) warranties; (5) transfer of interests and rights; (6) performance; (7) breach of contract; (8) remedies; and (9) miscellaneous provisions. The 1999 Prefatory Note posits five themes in which UCITA's terms are to be interpreted: (1) “the paradigm transaction is a license of computer information, rather than a sale of goods”; (2) “innovation and competitiveness have come from small entrepreneurial companies as well as larger companies”; (3) “computer information transactions engage free speech issues”; (4) “a commercial law statute should support contractual freedom and interpretation of agreements in light of the practical commercial context”; and, (5) “a substantive framework for Internet contracting is needed to facilitate commerce in computer information.”¹⁷³ The UCITA is meant to cover computer information transactions.¹⁷⁴ The only transactions covered,



though, are agreements to create, modify, transfer, or license computer information.¹⁷⁵ Drafters Nimmer and Ring explain that if a contract involves both computer information and something else, the UCITA applies only to that part of the contract that involves computer information, except where obtaining the computer information is the primary purpose of the contract.¹⁷⁶ The UCITA is also the first legislation which accords recognition to shrink-wrap licenses.¹⁷⁷ Although the approach of the UCITA is novel and its subject-matter one which merited specific legislation, its real effectiveness can be commented upon only after it stands the test of judicial scrutiny.

Open Source Software

Traditionally, source code is kept secret and the object code for any program is distributed under a restrictive license, which allows only use of the program, but no copying, no distribution, and no modification. Consumers pay for the privilege of using the software. Exclusivity and secrecy of source code means that people pay to license usage – this money is the incentive to employ programmers, who work for money directly paid as a result of their code writing. However, with the development of a market for computer software in the 1970s and early 1980s resulting in the greater penetration of computers among the general populace, software and software development became increasingly commercialized, and secret, and any free sharing of source code and modifications to programs, extinct. This is because the value of such software, developed in secret, depended upon the secrecy and exclusivity of the source code – otherwise, your competitors would be able to sell the same, or derivative code at a lower price without the R&D costs.

Open Source means that the source code (and object code) is free for everyone to read, modify and distribute. People who want to improve it can do so themselves – there is no restriction on what you can do with it or on commercial use and resale of the software. Since the source code is freely available, anybody can modify the code, and hence program it to his own needs, and even resell it commercially if he wishes. Most open source software projects usually start with “one programmer’s itch”¹⁷⁸ and develops into a project – one programmer starts writing something to satisfy a personal requirement, and it expands from there.

A key requirement of open source software is that authorship must be attributed strictly (including authorship of minor modifications)– without it, many of the benefits of OSS fail.¹⁷⁹

OSS is protected by copyright so that its essential features are preserved – it is NOT in the Public Domain – copyright is not renounced – rather it is licensed on explicit terms. It uses the strength of the copyright system, intended to keep intellectual property exclusive, to restrict it, in the opposite way – it uses the power given by the system to the copyright holder, to ensure that software is kept free, and continues to be distributed on open terms.

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Chapter VII

Collective Management of Copyright and Related Rights

The model – or at least the basic structure – of *individual licensing* of copyright and related rights is relatively simple. The owner of rights authorizes the use of the work or object of related rights against the remuneration and under the conditions fixed by himself. It is another matter that the authorization may involve quite complex stipulations, since the rights covered by copyright and related rights may be divided territorially or with respect to the languages used, the sequence of uses may be fixed, the number of copies to be made and their subsequent use may also be regulated; and sublicenses, representation agreements, and the like may also complicate what is referred to in a general way as “individual licensing.”

Collective management of copyright and related rights is justified where individual licensing is impossible or highly impracticable. In such a case, owners of rights trust collective management organizations (authors’ societies, performers’ unions, professional associations of producers, etc.) with exercising their rights on their behalf. The collective management organization monitors and authorizes uses, collects remuneration and distributes it among the owners of rights to whom it is due. This determines the basic structure of licensing in the field of collective management organizations: there is an “*upstream*” phase, in which the collective management organization, through membership agreements, representation contracts or by other means – obtains the legal basis on which it may then grant licenses to users, and a “*downstream*” phase, where the licensing of uses of works and/or objects of related rights takes place. Since, however, genuine collective management requires that collective management organizations be in a position to grant blanket licenses for the use of practically the entire world repertoire of works or objects of related rights covered by the rights managed by them, there is a need also for an *inter-organization phase* where a given organization may receive authorization from other (typically foreign) organizations and may, thus, get into the position to be able to grant this kind of blanket license.

Fully fledged collective management was established for the first time for the exercise of *performing rights*,¹⁸⁰ in respect of “non-dramatic” uses of musical works, which are also frequently referred to as the category of “*small rights*.”¹⁸¹ It is in this field where all the above-mentioned elements have been most fully developed and applied for a long time in many countries. Therefore, in this chapter, the collective management of these rights is used as a model. Following its presentation, also some other forms of collective management are mentioned, indicating in what aspects they are similar to, and in what aspects they differ from, the above-mentioned basic collective management model. Finally, the impact that digital technology and the Internet may have on collective management of copyright and related rights is briefly reviewed and, in particular, the licensing techniques that may be used concerning the use of works and objects of related rights in the global information network.

In this chapter, mainly the collective management of exclusive rights is dealt with, since it is only in the case of such rights that it is appropriate at all to speak about full licensing mechanisms. It is to be noted, however, that, with the emergence of new massive – and partly “secondary” – ways of using works and objects of related rights, the limitation of copyright and related rights to a mere right to remuneration has become more frequent. These rights, in general, can only be exercised through collective systems. In certain cases, it is possible that the remuneration to be paid is set in the form of negotiations between the collective management organizations and the professional bodies representing the users. Nevertheless, this is not a genuine licensing process. Thus, only brief references are made to the collective management of rights to remuneration.



The Basic Model: Collective Management of Musical Performing Rights

“Upstream” phase: entrusting organizations with collective management of rights

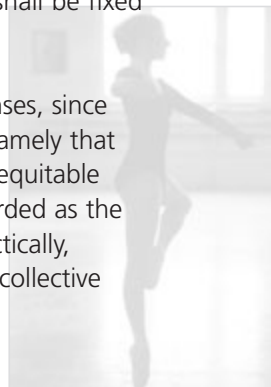
Preliminary question: voluntary, obligatory or extended collective management?

The exclusive rights of authors to exploit their works or authorize others to do so form a basic element of copyright, and, where recognized, such rights are also important for the beneficiaries of related rights. The exclusive nature of a right means that its owner –and its owner alone– is in a position to decide whether he authorizes or prohibits any act covered by the right. An exclusive right may be enjoyed to the fullest possible extent if it is exercised individually by the owner of the right himself. In such a case, the owner maintains his control over the exploitation and dissemination of his work, he can personally decide under what conditions, and against what remuneration, his work¹⁸² may be used, and he may more or less closely monitor whether his rights are duly respected. It follows from the very nature of exclusive rights that the owner of such a right should have the freedom to choose how he wishes to exercise and exploit it: he himself, individually; transferring it to somebody else; trusting it to an agent; or including it into a collective management system. Any provision under which owners of exclusive rights are deprived of the possibility of freely choosing the cases, and conditions, and the kinds of remuneration against the payment of which they authorize or not the use of their works, is a limitation of such a right, and it – as any other limitation – may only be prescribed if the relevant international norms permit to do so.

The Berne Convention contains provisions – namely Article 11*bis*(2) and Article 13(1) – under which it is a matter for legislation in the countries of the Berne Union to determine the *conditions* under which certain exclusive rights may be exercised. Those articles read as follows (emphasis added):

- Article 11*bis*(2): “It shall be a matter for legislation in the countries of the Union to *determine the conditions under which the rights mentioned in the preceding paragraph¹⁸³ may be exercised*, but these conditions shall apply only in the countries where they have been prescribed. They shall not in any circumstances be prejudicial to the moral rights of the author, nor to his right to obtain equitable remuneration which, in the absence of agreement, shall be fixed by competent authority.”
- Article 13(1): “Each country of the Union may *impose* for itself reservations and *conditions on the exclusive right granted to the author* of a musical work and to the author of any words, the recording of which together with the musical work has already been authorized by the latter, to authorize the sound recording of that musical work, together with such words, if any; but all such reservations and conditions shall apply only in the countries which have imposed them and shall not, in any circumstances, be prejudicial to the rights of these authors to obtain equitable remuneration which, in the absence of agreement, shall be fixed by competent authority.”

These provisions are regarded as a legal basis for the application of non-voluntary licenses, since they define the minimum requirements to be set when such conditions are applied; namely that they must not, under any circumstances, be prejudicial to authors’ rights to obtain an equitable remuneration. This does not mean, however, that non-voluntary licenses may be regarded as the only possible “conditions” mentioned in those provisions; also other conditions – practically, restrictions – of exercise of the exclusive rights concerned may be applied. Obligatory collective management is also such a condition, since it is clearly a *condition* that:



- although the owners of these rights are in the position of enjoying the exclusive right of authorizing the acts in question, it is provided that they can only do so in a certain way;
- although they own such exclusive rights, it is provided that they can only exercise them in a certain manner; and
- although they are granted such rights, it is provided that they can only exercise their rights through a certain system (namely, collective management).

Since the possibilities of “determining/imposing conditions” are provided in the Convention in an exhaustive way, on the basis of the *a contrario* principle, obligatory collective management of *exclusive rights* may only be prescribed in the same cases as non-voluntary licenses (which result in mere rights to remuneration).

In the preceding paragraph, the words “exclusive rights” are emphasized. This is to highlight that what is discussed above should not be interpreted to mean that obligatory collective management may only be prescribed in cases where, in the provisions of the Berne Convention – or other international norms on copyright and related rights – the expression “determine/impose conditions” (under which the rights concerned may be exercised) is used. Obligatory collective management is obviously also permissible in cases where (i) a right is not provided as an exclusive right of authorization but rather a mere right to remuneration (as in the case of the resale right under Article 14*ter* of the Convention, or the so-called “Article 12 rights”¹⁸⁴ of performers and producers of phonograms); (ii) where restriction of an exclusive right to a mere right to remuneration is allowed on the basis of some other wording (as is the case in respect of Article 9(2) concerning the right of reproduction¹⁸⁵); or (iii) where what is concerned is a “residual right;”¹⁸⁶ that is, a right to remuneration (usually of authors and performers) which “survives” the transfer of certain exclusive rights (such a residual right “by definition” cannot be in conflict with the exclusive nature of the right concerned, since it is only applicable *after* the latter has been duly exercised.)

While obligatory collective management, in the case of exclusive rights, such as the public performance right, is not allowed under the Berne Convention, some commentators believe that extended collective management may be in accordance with the Convention and other international copyright norms (e.g., those provided for in the TRIPS Agreement and in the WCT and the WPPT). Extended collective management is applied where a collective management organization has obtained a sufficiently representative repertoire, which means that at least the majority of domestic owners of rights have authorized the organization to manage their rights. In such a case, statutory law may provide that the organization may grant blanket licenses extending to all works covered by the right collectively managed by it. Without any further measures, this, however, would be a kind of obligatory collective management from the viewpoint of those who have not authorized the organization to manage their rights. To avoid this effect, there is at least a need for the possibility, provided by in statutory law, of “opting out” from the collective management system in a way that is relatively simple and does not discourage owners of rights from doing so if they prefer individual exercise of their rights.

Legal forms of authorization by owners of rights

Collective management organizations have to obtain a broad repertoire of works to be managed collectively in order to grant *blanket licenses* to users. In a few countries, the law provides for a monopolistic position for collective management organizations in order to facilitate concentration of repertoire; that is, only one organization may be established for the management of a given right in favor of a given category of owners of rights. Even in such a situation, however, as regards exclusive rights, a collective management organization normally needs the authorization of owners



of rights to manage their rights (in the case of extended collective management, at least to the extent that its repertoire may already be recognized as being sufficiently representative).

The authorization given by owners of rights, in general, takes the form of *transfer* of the rights to be managed collectively (however, the nature and form of the contract depends on the national law of the country concerned – meaning not only copyright law, but also civil law on contracts). There are some countries where authorization is based on some other concept – such as *legal representation* or *fiduciary management*; in such cases, however, there may be undesirable complications in respect of collective management organizations' ability to represent owners of rights in their own name, and this may undermine efficiency of the management system. Through transfer of rights, these problems may be avoided, placing the organization in a strong position to be used in favor of all owners of rights.

Such a transfer of rights, as a rule, is part of an *association, membership or management agreement* which contains quite complex stipulations and description of the collective system, which the owner of rights has to accept if he joins the collective management organization. The transfer is limited in time; at least, when membership in the organization terminates, the owners of rights recover their rights. It is also possible to limit the authorization for a certain – renewable – time period.

Taking the example selected to illustrate the functioning of a fully fledged collective management system – the management of musical performing rights – the assignment or transfer of rights, in general, extends to *all musical works of the given owner of rights*. It may happen, however, that the owner of rights has transferred the rights in some of his works to a third party. The owner of rights should declare this, and the collective management organization should respect that its management does not extend to such works.

It is quite a general practice that authors and other owners of rights transfer their rights to the collective management organization also in respect of *future works*. There are, however, certain countries where the transfer of rights in future works is not valid; in such countries, each time that the author declares to the organization a newly-created work, he must transfer his rights in it separately.

The transfer of rights to the organization, in general, extends to use of the works concerned *anywhere in the world*. This enables the collective management organization of each country to conclude mutual representation contracts with its foreign counterparts and through this it may be achieved that, in principle, each organization may grant blanket licenses for the use of practically the entire world repertoire. It is possible, nevertheless, that an owner of rights becomes a member of different societies in different countries. In such a case, of course, the entire world territory cannot be covered by the authorization granted to the organizations concerned. There is a *territorial division* between the organizations; this, however, does not create problem in operation of the collective management system, since there is no parallel management in any country.

It is to be noted that, in the case of musical performing rights, not only composers and text writers and their successors-in-title have rights that are relevant from the viewpoint of collective management. In general, *music publishers* also have rights. Technically, the basic subject matter of a publishing contract is the reproduction and distribution of the musical work in sheet music format. Nevertheless, publication of the work may contribute to more frequent performances. In addition, music publishers also actively promote the use of the works published by them. As a counterpart, music publishing contracts normally provide for a publishers' share in the remuneration collected for performing rights. Thus, any collective management system of musical performing rights may only be complete and efficient if music publishers also transfer these rights (although, in the case of exclusive rights, they cannot be obligated to do so). Music publishers are, in general, members of performing rights organizations, and play an active role in them.

Inter-organization phase: ensuring world repertoire for each collective management organization

It is not sufficient that the various national organizations obtain the repertoire of domestic owners of rights for the entire world, since they would hardly be able to exercise the rights concerned in all the other countries. In addition to the practical difficulties, it is also an obstacle that, in certain countries, only national collective management organizations enjoying a *de jure* monopolistic position may operate. Therefore, collective management organizations may be in a position to offer blanket licenses – also for the use of foreign works – if they conclude *bilateral contracts of mutual representation* with each other.

Although these contracts are essentially bilateral, they fit into a framework of *multilateral cooperation system*. Musical performing rights societies and other collective management organizations representing authors are members of the International Confederation of Societies of Authors and Composers (CISAC). CISAC organizes legal and technical cooperation among its members and, as part of this cooperation, model contracts have also been adopted. One of them is the *“Model Contract of Reciprocal Representation between Public Performance Rights Societies.”* The basic version of this model contract was adopted a long time ago, but since then it has been updated several times to incorporate new forms of using works.

The nature of the Model Contract is duly characterized in its introductory notes which read as follows:

“The Model Contract of Reciprocal Representation meets the need to ensure in the international field, in a practical way, the best possible protection of authors’ rights and interests through harmonizing the conditions in which the Authors’ Societies represent each other in their respective territories.

“In this context, it is a model recommended to the Societies for their use whenever that is possible, but obviously it is subject to such adjustments as may be necessary.

“However, when the terms of the Model Contract of Reciprocal Representation cannot be employed in relations between two national Societies it is recommended to the Societies that they adopt as far as possible in the agreements they are called upon to conclude the essential general principles contained in the Model Contract.”

The contents of the Model Contract reveal that it is a *fully fledged licensing agreement* serving as a basis for subsequent licensing of users (which, from the viewpoint of foreign societies, may also be regarded as a special form of sub-licensing).

By virtue of the Model Contract, “[Society A] confers on [Society B] the exclusive right, in the territories in which this latter Society operates to grant the necessary authorizations for all public performances (as defined [in the model contract]) of musical works, with or without lyrics, which are protected under the terms of national laws, bilateral treaties and multilateral international conventions related to the author’s right (copyright, intellectual property, etc...) now in existence or which may come into existence and enter into effect while the present contract is in force.”

The exclusive right referred to in the preceding paragraph is conferred so far as the public performance right in the works concerned has been, or will be, during the period when the contract is in force, transferred or granted by whatever means, for the purpose of its administration to Society A by its members, in accordance with its Articles of Association and Rules (these works constitute collectively the repertoire of the Society A).



Society B transfers the rights in its repertoire to Society A in the same way.

Under Article 2 of the Model Contract, “[t]he exclusive right to authorise performances as referred to in Art. 1 entitles each of the contracting Societies, within the limits of the powers pertaining to it by virtue of the present contract, and of its own Articles of Association and Rules, and of the national legislation of the country or countries in which it operates:

(a) to permit or prohibit... public performances of works in the repertoire of the other Society and to grant the necessary authorisations for such performances; (b) to collect all royalties required in return for the authorisations granted by it...; to receive all sums due as indemnification or damages for unauthorized performances of the works in question; (c) to commence and pursue...any legal action against any person or corporate body and any administrative or -other authority responsible for illegal performances of the works in question; to transact, compromise, submit to arbitration, refer to any Court of Law, special or administrative tribunal; (d) to take any other action for the purpose of ensuring the protection of the public performance right in the works covered by the present contract.”

The Model Contract also regulates such issues as equal treatment for the works and rights of the societies concerned, exchange of documentation, the obligation of granting mutual information about the tariffs and documents serving as a basis for collection and distribution of royalties, certain standard distribution rules, etc. Each society has the right to consult the other society's records concerning collection and distribution of remuneration to enable it to check the management of its repertoire by the other society.

By virtue of the provisions in the Model Contract, each society is entitled to deduct from the sums it collects on behalf of the other society the percentage necessary to cover its effective administration expenses. Furthermore, up to 10% may be deducted for social purposes of the members of the society concerned and/or for the promotion of national creativity and culture.

It is to be noted, however, that this is only a *model contract*. When two societies negotiate and conclude a *concrete bilateral contract*, they are not obligated to apply all the provisions in the Model Contract. For example, the level of the above-mentioned social and cultural deductions is an issue frequently subject to complex negotiations.

“Downstream” phase: licensing to uses of works

Desirable licensing form: blanket license

The usual instruments of licensing musical “performing rights” are *blanket licenses* which, as a general rule, authorize users to use any musical work in the repertoire of the collective management organization (which, on the basis of the legal techniques supporting such licenses may mean more or less the entire world repertoire) for the purposes, and within the period, indicated in the license. The transfer of rights in the national repertoire – or the authorization on some other legal basis to represent those rights – and the network of bilateral agreements enable national organizations to grant such licenses.

There are, however, some cases where certain protected works do not belong to the repertoire managed by the organization (since, in some countries, there are no appropriate partner organizations to conclude reciprocal representation agreements, or because certain authors withhold their works from the collective system). In such cases, various legal techniques exist which can guarantee the operation of the blanket license system without creating legal insecurity for users or unreasonably restricting the freedom of rights of the authors concerned. In the regulation and application of these techniques, it is taken into account that, in many cases, the whole system of

collective management would be undermined if collective management organizations were not allowed to grant blanket licenses and were obliged to identify, work by work, and rights owner by rights owner, their actual repertoire and – what would be even worse – to prove the legal basis on which they are authorized to manage the rights in respect of each individual work and individual right owners. Therefore, if there is an organization that represents a sufficiently wide repertoire of works in respect of which the best way of exercising a certain right is collective management, *it is desirable to ensure that such an organization may grant blanket licenses.*

There are two basic legal techniques for this.

The first legal technique is the application of a *presumption* – either provided for in statutory law or based on case law – according to which, until the contrary is proved, a given musical work forms part of the authors’ society repertoire and, thus, it may be the object of blanket licenses. Such a presumption normally includes a *guarantee* by the collective management organization that individual rights owners will not claim anything from users to whom blanket licenses are granted or, if they do, that such claims will be settled by the organization, and, that any user will be indemnified for any prejudice and expense caused to him by possible individual owners of rights. The organization also should guarantee that it treats, in a reasonable way, those owners of rights who have not delegated their rights for collective management, taking into account the nature of the rights involved.

The other legal technique for ensuring the conditions for blanket licenses is what is called the system of *extended collective management*. The essence of such a system is that, if there is an organization authorized to manage a certain right of a large number of owners of rights and, thus, it is sufficiently representative in the given field, the effect of such collective management is extended by law also to the rights of those owners of rights who have not entrusted the organization to manage their rights.

In an extended collective management system, there should be special provisions for protection of the interests of owners of rights who are not members of the organization. They should have the possibility of claiming individual remuneration and/or “opting out” (that is, declaring that they do not want to be represented by the organization). Of course, in the case of “opting out” from the collective system, a reasonable deadline should be given to the organization in order that it may exclude the works or objects of related rights concerned from its repertoire.

In certain countries – mainly in those where this follows as an obligation from the application of anti-trust laws (such as in the United States of America) – performing rights organizations also offer *licenses other than blanket licenses*; for example “per program licenses” which are, as their name indicates, licenses for particular programs. Furthermore, users may decide to operate outside the collective management scheme and try to obtain *direct licenses from authors*. It shows the obvious advantages of blanket licenses that, even where such alternative licensing forms are available, in general, neither owners of rights nor users tend to make use of this possibility, and they prefer blanket licenses.

Tariffs and other licensing conditions; guarantees against possible misuse of monopolistic position

Since collective management organizations, in general, are in a *de facto* – sometimes even in a *de jure* – monopolistic position, their contractual freedom is more limited than that of individual owners of rights. An individual owner of an exclusive right, as a rule, is free to authorize or not to authorize the use of his work for a given user, and, in general, he is even not obligated to indicate



any specific reason for which he may not wish to grant authorization in a given case. A collective management organization normally is not allowed to do so; if a user is ready to pay the tariff and accepts the conditions established by the society for the given type of use of works, it is *obligated to grant a license* to that user – *without discrimination* among users. This contractual obligation follows from the monopolistic position of the society (and a logical corollary of another obligation following from the same position, namely that the society *must undertake the management of the rights* of any owner of rights in the field of its operation provided that that owner of rights is ready to accept the uniform conditions set for the given category of owners of rights).

The *tariffs and other licensing conditions* set by the collective management organization should be reasonable, and should not involve any misuse of the monopolistic position of the society.

There are two kinds of *guarantees* for this: first, before establishing the remuneration to be paid and other conditions, there are, in general, *negotiations* with the representatives of users; and, second, there are *legal procedures available in case of disputes*, including the case of any alleged misuse of the monopolistic position of the collective management organization. In certain countries, specific *copyright tribunals or mediation/arbitration bodies* deal with such disputes, while in other countries, the settlement thereof is left to *ordinary courts*. In general, courts may also be involved where the disputes between collective management organizations and users are submitted to obligatory or voluntary mediation/arbitration, and one of the parties is not satisfied with the outcome of the mediation or the arbitration award, respectively.

The *negotiations* may take place *with some major users*, such as broadcasting organizations, on a one by one basis – in the sense that “*tailor-made*” licenses are granted to them. In respect of the *majority of users*, however, a *standard tariff system* is applied, where the same tariff is used for the same kind of users for the same kind of use to the same extent. The collective management organization *may establish the tariffs in a “unilateral” manner* without previous consultations or negotiations with the representatives of the users concerned; and it may be considered that this is in accordance with the exclusive nature of the rights collectively managed. It is to be noted that it is not in the interest of the organization to set unreasonably high tariffs, since in that way it may discourage users to ask for licenses, and thus the result may be just the opposite of the one the organization wishes to achieve: the overall amount of remuneration may decrease rather than increase, or, at least, it may not reach the desirable level. In this field too, it is not advisable to undermine the balance between offer and demand. Where users consider that the remuneration they are supposed to pay is unreasonably high and, in particular, where this may be regarded as a result of misuse of the organization’s monopolistic position, they can use the above-mentioned dispute settlement procedures.

The question emerges, in such a case, whether the user may refuse to pay the remuneration he alleges to be excessive and may, nevertheless, use the organization’s repertoire during the procedure (which, with the appeal or appeals, may take quite a long while). If this were accepted, users may misuse the procedures offering guarantees against possible misuse of the monopolistic position of the collective management organization. Should then users be obligated to pay the disputed remuneration to the society in spite of the dispute between them? This would mean that the user would have to pay the disputed amount in spite of the dispute brought by him to the court or the mediation/arbitration forum. Or during the procedure, should the user be precluded from using the repertoire of the organization, which, from the viewpoint of the very objective of the system would hardly be regarded a desirable effect? The solution to this complex problem is either a *conditional payment* or an *escrow deposit* of the remuneration requested by the collective management organization (and it seems that the best basis for this may be a provision in the statutory law itself). In such a case, the user can use the repertoire of the organization and cannot be subject to any inappropriate pressure. At the same time, the user cannot use the dispute as an excuse for not paying remuneration. If the court or the mediation/arbitration body finds that the remuneration

requested by the organization is too high, it orders the organization to pay back the amount that is regarded to be above a reasonable level.

It is to be noted that, although the remuneration to be paid is the decisive issue of a license (in general, blanket license) granted by a collective management organization, it may, and as a rule does, cover some *other issues*; such as the possibility of monitoring uses, making available documents necessary for the calculation of the remuneration to be paid or for the distribution of the remuneration collected, etc.

Standard tariffs and conditions

In the field of collective management of musical performing rights, it is more typical that authors' societies establish *standard tariffs*. Such tariffs guarantee equal treatment to users wishing to use the collective management organization's repertoire in certain cases for certain purposes under certain conditions. They offer the great advantage to both the organization and users that they do not have to be engaged in lengthy, costly and time-consuming negotiations before the conclusion of each concrete licensing contract.

The establishment of such tariffs is frequently preceded by *collective negotiations* with representative organizations of users (such as associations of concert bureaus, restaurant owners, hotels, retail shops). The conclusion of a *framework agreement* between the collective management organization and such an association does not necessarily mean that the members of the association can automatically use the organization's repertoire. Depending on the underlying legal regulation and the conditions of the agreement, *individual contracts* may still be needed with each member of the users' association; the conclusion of individual contracts is simpler since the standard tariffs and other standard conditions are applied. The collective agreement between the collective management organization and a users' association, however, may also provide for an *automatic application* of the agreement for all members of the association (meaning that they are allowed to use the organization's repertoire without any separate authorization, provided that they pay to the society the pre-established tariffs and that they also fulfil the other conditions of the framework agreement (for example, concerning the obligation of offering appropriate information necessary for the organization to monitor the use of its repertoire and/or identify the works used)).

Where the negotiations do not lead to agreement or where the collective management organization sets standard tariffs without consulting and negotiating with the interested users, different forums and legal procedures are available in the various countries to settle possible *disputes between the organization and the association of users (or individual users)* and to *review the tariffs proposed or established* by the collective management organization; this process is practically the same as those mentioned above concerning individual licenses against specific remuneration.

In the case of standard tariffs, it is also quite common, that they are submitted to *administrative review or approval* (by such bodies as, for example, the Intellectual Property Office or the Ministry of Culture). Frequently, collective management organizations themselves prefer such a review and approval system, since the approval and publication of the standard tariffs prevent subsequent disputes and strengthen their legal position.

Methods of calculation of remuneration and standard tariffs

It has been an age-old basic principle of calculating remuneration and standard tariffs that the *financial or other economic benefit* of the user should be taken into account as the most important criterion. It has also been accepted as a part of this principle that users should pay *around 10%* of



their income derived from the use of works (for example, both the German Patent Office and the Swiss Federal Court have found that 10% of such income is to be considered a fair remuneration; and the Swiss Copyright Act itself provides that, in general, such a percentage is to be regarded as an upper limit of the remuneration).

The 10% rule is fine-tuned by the *pro rata temporis* principle. It means that the 10% share is only applicable if all the works used in the program are protected and are parts of the repertoire of the organization concerned. The remuneration should be reduced in proportion to the works not protected or not covered by the organization's repertoire (more precisely, in proportion to the proportion of the performances of such works in relation to the entire duration of the program).

However, this 10% principle has always been easily applicable only where there has been a *close relationship between the income and the use of the organization's repertoire*. For example, in the case of a concert, the remuneration may be calculated on the basis of the income derived from admission fees. A percentage-based remuneration may also be established in the case of broadcasting organizations –although through a more complex calculation system – taking into account the subscription fees, the advertising income and/or the subsidies, as well as the amount and nature of the use of works within the entire program of the broadcasting organization. Where the calculation of the financial or other economic benefit is difficult, or even completely impracticable, due to the fact that there is no direct relationship between the income of the establishment and the use of musical works – such as, in the case of shops, supermarkets, hotels and other places with “background music” – the percentage system is not suitable. In such cases, *lump sum tariffs* are set based on various criteria related to the user establishment and the nature and foreseeable impact of the use of the repertoire of the collective management organization.

With the advent of ever newer technologies facilitating the use of works and bringing down the costs of production and distribution of copies and communication of works to the public, *the general applicability of the above-mentioned 10% principle is questioned ever more frequently*, and it seems that, in the era of digital technology and global information networks, *it may be becoming out of date*. There are two important reasons for this. First, with the decrease of the manufacturing and service costs, the value of the works protected by copyright within the overall value of the products or services proportionally increases. Second, the possibility of normal exploitation of works through certain distribution or communication channels may be undermined or, at least, dramatically reduced irrespective of the income of the users. Creators, publishers and producers will not be consoled by the information that they lose the opportunity to get a reasonable counter-value of their creative efforts and financial investments as a result of activities of those who also gain nothing from this. They have sufficient reasons to insist that only those should be allowed to engage in copyright-related activities (in cases other than those covered by exceptions – such as those for specific educational or informational purposes – allowed in accordance with the “three-step test”¹⁸⁷) who are able to guarantee such a counter-value.

In view of this, it is foreseeable that, in many cases, lump sum tariffs will have to take over the role from the application of the 10% principle or from any other percentage-based system.

The *bases for the calculation of lump sums as standard tariffs* for the use of the repertoire of organizations managing musical performing rights include such criteria as whether live music or recorded music is used; whether music plays a decisive role in the establishment (such as in a discotheque or in a karaoke bar) or is just “background” music (such as in hotels, shops, restaurants, etc.); the place where the establishment may be found (whether in a holiday resort, in a big city, in a smaller town or in a village); the nature and size of the establishment; the quality and corresponding price-category of the establishment; in the case of events without admission fee where music is used (that is where the percentage-based system cannot be applied), the number of participants, etc.

Standard tariffs normally only apply where the use of works in the repertoire of the collective management organization takes place in a lawful way (on the basis of an appropriate contract, or where it is sufficient to announce the use of the repertoire and the payment of the corresponding remuneration, on the basis of such announcement and payment). If the use of the repertoire of a collective management organization does not take place in such a way, in certain countries at least, the organization may demand and collect an amount higher than the remuneration calculated according to the standard tariffs (for example, the double of that amount). This right of the organization is based either on statutory law or on case law, and its justification is that the detection of such unlawful uses requires extra efforts and costs for the organization which are not taken into consideration when the normal standard tariffs are fixed.

Other Typical Forms of Collective Management

The limits of this chapter do not allow a full presentation of the various other forms – other than the management of musical performing rights – of collective management. What follows is a brief review of such other forms, drawing attention to their similar and differing aspects in comparison with the collective management of musical performing rights, and identifying those elements, if any, where licensing may play a role.

“Mechanical rights”

The expression “mechanical rights” is generally understood to mean the rights to authorize the reproduction of works in the form of recordings (phonograms or audiovisual fixations) produced “mechanically” in the widest sense of the word, including electro-acoustic and electronic procedures. The most typical and arguably the economically most important “mechanical right” is *the right of composers of musical works – and authors of accompanying words – to authorize the sound recording of such works.*

Certain collective management *organizations managing musical performing rights also deal with “mechanical rights”* in musical works. In other countries, *separate organizations* have been set up for the management of “mechanical rights”; for example, AUSTRO-MECHANA in Austria or NCB for the Nordic countries are societies administering the rights of both authors and music publishers, and the Harry Fox Agency in the United States of America is the agency of music publishers. These separate organizations *cooperate very closely with musical performing rights organizations.* In some countries, performing rights societies and mechanical rights organizations form close alliances and share certain elements of management; for example, SACEM and SDRM in France, PRS and MCPS in the United Kingdom and BUMA and STEMRA in the Netherlands.

The legal status and structure of mechanical rights organizations as well as the way in which they obtain the right to license national and international repertoires are *similar to what is described above in respect of musical performing rights*; there are also a number of similar features in the methods and techniques used in the management of these two groups of organizations. At the same time, *there are significant differences.*

One of the differences follows from the relevant provisions of the Berne Convention itself. While in the case of the so-called performing rights, it is only in respect of one category of such rights – namely, the right of broadcasting and simultaneous and unchanged retransmission of broadcast works – that the Berne Convention allows non-voluntary licenses, whereas *in the case of “mechanical rights,”* the possibility of *such licenses plays a much more essential role.* Article 13(1) of the Berne Convention reads as follows: “Each country of the [Berne] Union may impose for itself reservations and conditions on the exclusive right granted to the author of a musical work and to



the author of any words, the recording of which together with the musical work has already been authorized by the latter, to authorize the sound recording of that musical work, together with such words, if any; but all such reservations and conditions shall apply only in the countries which have imposed them and shall not, in any circumstances, be prejudicial to the rights of these authors to obtain an equitable remuneration which, in the absence of agreement, shall be fixed by the competent authority.”

Various countries apply non-voluntary licenses along the lines of the above-quoted provision of the Berne Convention (for example, Australia, China, Germany, India, Ireland, Japan, Switzerland and United States of America). In those countries, as a rule, *the law itself or a competent authority fixes the royalties* to be paid for such recordings. In certain other countries, however, *there is room for negotiating some elements of the royalty system in the case of “mechanical rights”, and to license this kind of reproduction accordingly.*

A further important difference – in relation to the collective management of “performing rights” – can be seen in the *specific role* of the International Bureau of Societies Administering the Rights of Mechanical Recording and Reproduction (BIEM) this acronym derives from the original French name of the organization: *Bureau international des sociétés gérant les droits d’enregistrement et de reproduction mécanique*) which is an international non-governmental organization with mechanical rights organizations as its members. BIEM negotiates *standard contracts with the representatives of the phonographic industry* fixing the conditions and tariffs for use of the repertoire of its member organizations by local producers of phonograms. These standard contracts are then applied by the member organizations in their relationship with individual producers, provided there is no non-voluntary licensing system in the countries concerned.

The *main negotiating partner* of BIEM is the International Federation of the Phonographic Industry (IFPI). The standard contract has been revised several times between BIEM and IFPI, but its future is, for the time being, unclear, and views differ concerning the status and role of the last expired version.

The standard contract, with the subsequent amendments, has become quite complex. Now it amounts to 24 pages and in addition to this, it also has several annexes. It covers, inter alia, the following issues: authorization to use the BIEM repertoire; precise identification of the rights granted and the exceptions thereto; royalty rates and methods of their calculation; mutual obligations of information; place and time-schedule of payments of royalties; conditions of exportation; and monitoring of the copies reproduced. The rules of the calculation of royalties extend also to such details as to remuneration in case of “mixed repertoires,” or to the influence of the number of works and fragments on the same disc, tape or cassette on the amount of royalties, and also to the issues of returns, bargain sales, minimum royalties, etc.

Rights in dramatic works

Collective management of rights in dramatic works is the most typical – and most traditional – example of partial collective management, namely, an agency-type collective management system. This form of collective management was originally developed by SACD, the French authors’ society, which, in fact, was the first ever authors’ society in the world dealing with collective management.

It was as early as in 1791 in the year when, with the adoption of the law on authors’ rights, Beaumarchais and other French playwrights succeeded in the fight for recognition of their rights that their *Bureau de législation dramatique* was transformed into the *Bureau de perception des droits d’auteurs et compositeurs*, that is, into an organization to collect royalties. It was then only a matter of formal transformation when, in 1829, the organization got its final name: *Société des auteurs et compositeurs dramatiques* (SACD). Within SACD, a General Agency was set up in

Paris with representatives in major provincial centers. The authors informed the society, and, through it, the theaters, of the *general conditions* (including, particularly, royalty rates) on the basis of which they were ready to negotiate about the authorization of the use of their dramatic (or dramatico-musical) works. Then, following those general contractual conditions, *individual contracts* were concluded, and the General Agency of SACD collected and after the deduction of the costs distributed the royalties to the authors. Although there are certain new elements in its activities, the structure of the collective management system of SACD – in the field of the rights in dramatic and dramatico-musical works – has remained more or less the same. This system contains three main elements: general contracts, individual contracts and the actual collection and distribution of royalties on the basis of the individual contracts.

General contracts are negotiated between the society and the organizations representing theaters. Such contracts include certain minimum conditions, in particular, the basic royalty rate. In individual contracts, no conditions may be stipulated that are less favorable to authors, but better conditions may be agreed upon.

Individual contracts are concluded on a theater-by-theater and work-by-work-basis based on the minimum conditions of the applicable general contract (with possible more favorable conditions). Unlike musical performing rights organizations, to which authors' rights are transferred or which otherwise are in a position to exercise the rights in their repertoire, and, thus, to authorize the use of the works without separate consultation with their authors, SACD has to obtain the authors' agreement to all individual contracts. *The society acts only as a representative.*

For *amateur theaters*, there is a simpler system. Here, the costs of individual elements of exercising rights would be fairly heavy. Therefore, authors are invited to *transfer to the society* – with some restrictions, and under certain conditions – *the right to authorize performances* in the framework of a general contract concluded with the Federation of Amateur Theaters.

The representatives of SACD regularly monitor theater performances in the areas for which they are responsible, and collect the royalties. The royalties are distributed directly to the authors – without any specific distribution pools or point systems similar to the ones existing in the field of musical “performing rights” – who own the rights in the works for the performance of which they have been paid.

The society deducts from the royalties an established commission rate, depending on geographic areas to be covered, and a social security contribution. When the financial results of a current accounting period become known, a part of the amount deducted may be paid back to the authors concerned because SACD follows the principle that only the actual administration costs should be deducted.

SACD also administers rights in works broadcast on radio and television and in audiovisual works. In this field, in general, full collective management applies. Authors give full authorization to SACD to exercise their exclusive rights. SACD negotiates general representation agreements with broadcasters and with audiovisual producers, collects royalties and distributes them to individual owners of rights.

As mentioned above, collective management of rights in dramatic works may not be regarded as full collective management: it is an agency-type management. In harmony with this fact, in many countries it is not authors' societies or other copyright organizations that manage such rights but rather real agencies (in many cases, several agencies with their own repertoires in the same country). Still, there are a number of countries where collective management organizations deal with the said rights. Those organizations, however, in the majority of cases, are not so specialized as SACD is; most of them have a wider repertoire, often also covering musical “performing rights” and “mechanical rights” (such as SIAE in Italy or SGAE in Spain).



Resale right (“droit de suite”)

Under paragraph (1) of Article 14^{ter} of the Berne Convention, “[t]he author, or after his death the persons or institutions authorized by national legislation, shall, with respect to original works of art and original manuscripts of writers and composers, enjoy the inalienable right to an interest in any sale of the work subsequent to the first transfer by the author of the work.” Paragraphs (2) and (3) of the same Article, however, leave broad liberty to countries party to the Convention in respect of the recognition and regulation of such a right. They are free to decide whether or not they introduce it and whether or not they subject its enjoyment to reciprocity. It is also provided that the procedure for collection and the amounts to be paid are matters for regulation by national legislation.

In spite of the non-obligatory nature of Article 14^{ter}(1) of the Berne Convention (as other substantive provisions of the Convention, it has also been incorporated by reference into the TRIPS Agreement and the WCT), a number of countries recognize this right. Granting such a right has become *obligatory for all member countries of the European Union* with the adoption of “Directive 2001/84/EC of the European Parliament and of the Council of 27 September 2001 on the resale right for the benefit of the author of an official work of art” (the “Resale Right Directive”).

One of the reasons for which the resale right is not recognized in other countries is that there is a *fear of possible practical problems* that may emerge in the exercise and enforcement of this right. The example of several countries where such a right exists shows, however, that they *may be avoided or solved by means of appropriate regulation of the exercise thereof and, in particular, through application of an appropriate collective management system.*

One of the key issues of the exercise of the resale right is the “*right of information*,” and it is particularly relevant from the viewpoint of collective management of this right. This is understandable since, without information about the resale of works of art, it would be simply impossible for authors to exercise their right. In order that the “right of information” may be respected, art galleries and art dealers must register the necessary data; as a minimum, the name of the author, the title of the work and the resale price. It is, however, not irrelevant how and by whom such information is requested. If this is left to individual owners of rights, at least, two problems may emerge: first, they will be unable to monitor all the possible places where the resale of their works may take place; and, second, this creates quite a great burden for art galleries and dealers since they have to fulfill several sporadic and differing requests for information. It is obvious that these negative effects may be quite easily eliminated if a collective management organization is connected in some way to the art galleries and dealers.

It is certainly due to this recognition that, for example, Article 26(5) of the Copyright Law of Germany provides that requests for information may only be presented through a collective management organization. The Resale Right Directive does not contain a similar provision, but its Article 6(2) allows member states to provide for compulsory or optional collective management.

Collective management may increase the efficiency of the exercise of the resale right even domestically; *in the international context*, however, it is *practically indispensable*. Collective management organizations, through a well-established bilateral and multilateral cooperation between them, may guarantee to owners of rights that their rights prevail also in foreign countries. It should also be taken into account that works of art are sold ever more frequently through Internet auctions, and, in such a case, the intervention of collective management organizations is even more necessary; without their monitoring capacity and legal machinery, rights owners would not have a realistic chance to enforce their rights.

The resale right is a *mere right to remuneration*. Therefore, *neither the “upstream” phase nor the “downstream” phase of the licensing chain exist in the way discussed in respect of collective management of musical performing rights.*

Reprographic reproduction rights

While in the case of the rights in respect of which collective management has been discussed or at least mentioned so far (“performing rights” and “mechanical rights” in musical works, rights in dramatic works, the resale right), it is fairly clear and practically undisputed to what extent and under what conditions they had to be recognized under the Berne Convention. *In respect of reprography, there have been certain questions raised as to the actual rights to be recognized and to the possible legal nature of such rights.* It depends on the answers to those questions in which cases and under what conditions collective management may be applied in this field.

From the viewpoint of the legal situation in respect of reprography, the first and most important fact is that the right of reproduction is an exclusive right under Article 9(1) of the Berne Convention which cannot be restricted – either by allowing free use or in the form of non-voluntary licenses – except in cases that correspond to the “three-step test” under Article 9(2) of the Convention. It has never been questioned that reprographic reproduction (photocopying, etc.) is a form of reproduction which is covered by the said exclusive right. Therefore, the question is not what rights authors should have in respect of reprographic reproduction of their works, but rather which are the cases where exceptions or limitations may be allowed.

In certain cases – such as reprographic reproduction for limited specific educational and research uses – *exceptions* may be applied. In some other cases, the exclusive right of reproduction, with a due application of the “three-step test,” may be reduced to a *mere right to remuneration* (for example, in the form of a levy on reproduction equipment and/or an operator fee to be paid by certain operators of photocopying machines, such as copy shops). It is *inevitable that the exercise of such a right to remuneration takes place through collective management organizations.* In such a case, however, *no real “upstream” and/or “downstream” licensing takes place.* What may be a similarity to the collective management of musical performing rights, *where it is not the statutory law itself which provides for the remuneration to be paid, but this is left to the collective management organization to establish it, is that normally negotiations take place with the associations representing equipment manufacturers, importers and distributors, operator organizations and certain user groups, along with the possibility of submitting possible disputes to a court or to a mediation/arbitration body, or, irrespective of any dispute, with the condition of administrative approval.*

The example of the United States of America shows, however, that reprographic reproduction rights *in the form of genuine exclusive rights may also be workable*, if they are managed through a centralized licensing system which applies, at least, certain elements of collective management.

The Copyright Act of the United States of America provides for various exceptions to the right of reproduction in respect of reprography (fair use for purposes such as teaching, scholarship or research, free photocopying by libraries and archives in certain cases which, however, must not amount to related or concerted reproduction of multiple copies of the same material or to systematic reproduction or distribution). Along with such exceptions, the exclusive right to authorize reproduction still applies as a general rule. Individual exercise of this right is, however, impossible in general, and joint management is the only workable way. In the United States of America, the *Copyright Clearance Center (CCC)* has been set up in order to take care of the management of such reprographic reproduction rights.

The CCC was established following a recommendation by the Congress that an appropriate clearance and licensing mechanism be developed with the support of bodies representing authors and other rights owners. The goal of the CCC was to ensure that the publishers of scientific, technical and medical journals receive compensation for copies reproduced by colleges, universities, libraries, private corporations, etc. The CCC represents, on a non-exclusive basis, in addition to the rights owners of journals, also those of magazines, newsletters, books and newspapers.



The original system for licensing, collection and distribution was established in the following way: publishers fixed photocopying fees which were printed in journals, and it was stated that copies could be made – for personal or internal use – if the indicated fees were paid to the CCC. Each user had to keep a record of photocopies or send in a copy of the first page of each article indicating the number of copies made. CCC billed users on the basis of those records and copies which were sent in.

This system (the so-called *Transactional Reporting Service*) was found to be too burdensome for certain users. Therefore, the CCC introduced a new plan, the *Annual Authorization Service*. The licenses granted in the framework of that service were based upon industry-wide statistical coefficients having taken into account estimated copying levels of various classes of employees. The copying coefficients were derived from 60-day surveys of photocopying conducted at sample locations for each licensee. They were applied in order to estimate total annual copying for each licensee taking into consideration their “employee population.” Distribution to rights owners was based upon the survey information.

A specific feature of the joint exercise of rights through the CCC is that each publisher establishes his own fees for the licensing of the photocopying of his works. Therefore, the licenses offered by the CCC are *not real blanket licenses* with unified license fees, but *individualized licenses granted through an agency-type clearing house system*. The CCC only deducts administrative expenses and distributes fees to the publishers who then further distribute them to their authors in accordance with underlining contractual arrangements.

Other organizations, for example the United Kingdom Copyright Licensing Agency (CLA) representing authors and publishers also manage reprographic reproduction rights, in certain cases and in certain aspects, based on similar licensing techniques.

Rights of performers and producers of phonograms

Some basic rights that are recognized in the Rome Convention, the TRIPS Agreement and the WPPT and in national laws for the owners of related rights (the rights of performers, producers of phonograms and broadcasting organizations) may be, and actually are, exercised on an individual basis without the need for specific collective management systems (although, for example, the conditions of employment contracts of performers are frequently the subject of collective negotiations between unions representing them and the representatives of their employers). There is, however, one *specific area of related rights where collective management is indispensable, namely the rights of performers and phonogram producers in respect of broadcasting and communication to the public of phonograms – the so-called “Article 12 rights.”*¹⁸⁸ The word “specific” is to be emphasized because there are also some other rights where collective management is applied and where performers and/or producers of phonograms have interests (such as the rights in respect of cable retransmissions and “private copying” mentioned above); but, in those cases, as discussed below, authors and other owners of copyright (and, as regards cable retransmissions, broadcasting organizations) have interests.

The WPPT has introduced several changes. The most important one is that, under its Article 15(1), Contracting Parties must grant the right to a single remuneration both to performers and producers of phonograms (for the direct or indirect use of phonograms published for commercial purposes for broadcasting or for any communication to the public). That is, Contracting Parties are not allowed to grant such a right only to one of the two categories as under Article 12 of the Rome Convention. It is another matter that Article 15(2) provides that Contracting Parties may establish in their national legislation that the single equitable remuneration may be claimed from users by the performer, by the producer of phonograms or by both. If only one of the two groups claims

the remuneration, it is obliged to share it with the other. The same paragraph also provides that Contracting Parties may enact national legislation that, in the absence of agreement between performers and producers of phonograms, sets the terms according to which performers and producers of phonograms must share the single equitable remuneration. (It is to be added that Article 15(3) of the treaty allows practically the same kinds of reservations to the obligation to grant such a right as Article 16 of the Rome Convention).

Since what is involved is a *mere right to remuneration*, it may only be exercised through an appropriate collective management system. In this system, following from the nature of the right, *there is no real “upstream” or “downstream” licensing, and the bilateral contracts concluded between organizations managing these rights cannot be characterized either as a kind of licensing agreement.* These contracts only regulate the order of transfer of payments, if any,¹⁸⁹ due to the owners of rights represented by the partner organizations.

Rights in respect of cable retransmission of broadcast programs

There are two basic categories of cable programs. The first category is that of *cable-originated programs*; that is, programs initiated by the cable operators themselves. The second category of programs is that of *simultaneous and unchanged transmissions of broadcast programs*. It is mainly in respect of the second category of cable programs that certain legal and practical problems emerge that, in principle, may only be solved either by means of non-voluntary licenses or by means of a collective management system.

In respect of authors' rights, simultaneous and unchanged transmission of broadcast works is covered by Article 11*bis*(1)(ii) of the *Berne Convention* (included by reference also into the TRIPS Agreement and the WCT), under which “[a]uthors ... enjoy the exclusive right of authorizing ... any communication to the public by wire ... of the broadcast of the work when this communication is made by an organization other than the original one.” It is clear under this provision that such a right exists in all cases where an organization other than the original broadcaster transmits the broadcast program simultaneously and without change. In such cases, however, under Article 11*bis*(2), non-voluntary licenses may replace the exclusive right of authorization. (In respect of cable-originated programs, Berne Articles 11(1)(ii), 11*ter*(1)(ii), 14(1)(ii) and 14*bis*(1) apply, which provide for exclusive rights of communication to the public – by wire – and thus, in the case of such programs, non-voluntary licenses are not allowed.)

The Rome Convention provides for rights of the beneficiaries of related rights only in respect of cable-originated programs which are covered by the general concept of direct communication to the public, and not in respect of cable retransmissions of broadcast programs. However, national laws may, and in many countries do, grant some rights (at least a right to remuneration) to the beneficiaries of related rights also for such retransmissions.

The European Community's Council Directive 93/83/EEC of 27 September 1993 on the coordination of certain rules concerning copyright and rights related to copyright applicable to satellite broadcasting and cable retransmission (hereinafter: Satellites and Cable Directive) contains detailed regulations on cable retransmissions which also include specific provisions on collective management. Article 8(1) of the directive provides, in general, that member states must ensure that, when programs from other member states are retransmitted by cable in their territory, the applicable copyright and related rights are observed and that such retransmission takes place on the basis of *individual or collective contractual agreements* between copyright owners, holders of related rights and cable operators. Under Article 9(1) of the directive, member states must ensure that *the right of copyright owners and holders of related rights to grant or refuse authorization to a cable operator for a cable retransmission may be exercised only through a collecting society.*



Paragraphs (2) and (3) of the same article contain rules on what is actually *an extended collective management system*. At the same time, Article 10 of the directive provides for an exception to obligatory joint management of cable retransmission rights. Under this article, member states must ensure that Article 9 of the directive does not apply to the rights exercised by a broadcasting organization in respect of its own transmission, irrespective of whether the rights concerned are its own or have been transferred to it by other copyright owners and/or holders of related rights (which means that cable retransmission rights of broadcasting organizations may be exercised on an individual basis).

Original broadcasters of programs are, in general, in a position to obtain authorization for their programs from owners of copyright and related rights in due time. Cable operators who transmit broadcast programs simultaneously – and usually, not only one program – cannot obtain authorizations in the same way. Although, in respect of certain categories of works, authors' organizations are ready to offer appropriate blanket licenses, other categories of works, particularly audiovisual works, are not covered by such licensing systems. In addition, the rights of original broadcasters and other related rights should also be taken into account.

In some countries, governments and legislators have come to the conclusion that the operation of cable systems can only be guaranteed by means of *non-voluntary licenses*. However, owners of copyright and related rights have proved that non-voluntary licenses are *not the only solution*; they are not the optimum solution either. There is another workable option which better corresponds to the objectives of the protection of copyright and related rights namely, the *collective management* of such rights. The Satellites and Cable Directive also reflects this recognition.

It was recognized that such a system could only be implemented in practice if an important link in the chain of collective management systems which was still missing was established namely an appropriate *collective management network for rights in audiovisual works*. The rights holders (not necessarily the original owners but the actual holders of rights) of such works – although on the basis of differing legal solutions – are, in general, the producers. Producers, however, did not have collective management organizations. The way towards workable collective management of rights in respect of cable retransmissions of broadcast programs has been opened by establishment of the Association for the International Collective Management of Audiovisual Works (AGICOA). The members of AGICOA are national associations and societies of producers of audiovisual works for management of rights in such works. The Association has essentially two main tasks: *negotiations* (in cooperation with its national member organizations) in respect of cable retransmission of audiovisual works represented by it, and the *distribution* to right holders of the sums collected.

The first contract, concerning the authorization of cable retransmission of programs on the basis of a general collective management system covering all rights involved, was concluded in *Belgium* between SABAM (the authors' organization which already had a collective management agreement with cable operators in respect of its own repertoire), AGICOA with its Belgian member organization at that time (BELFITEL), and the broadcasting organizations concerned (individually represented), on the one hand, and the Professional Union of Radio and Teledistribution (RTD), on the other. In the contract, it was provided that cable operators would pay remuneration for the use of the repertoire represented by the rights owners' organizations, and the latter would undertake guarantees against possible third party claims. (It is to be noted that, in 1993, SABAM left the agreement, and, from that moment, cable operators reduced their payments. This has led to litigation between AGICOA, on the one hand, and the RTD and individual operators, on the other hand.)

After the success in Belgium, there was a breakthrough in the *Netherlands* where a general contract was agreed upon between BUMA (an authors' organization), AGICOA with its Dutch member organization (SEKAM), and the broadcasting organizations concerned, on the one hand,

and the organizations of cable distributors, on the other hand. In *Germany* also, contracts were concluded between the interested rights owners and the *Deutsche Bundespost* for the cable retransmission of broadcast programs, where right owners were represented by GEMA. (In the meantime, *Deutsche Bundespost* has become *Deutsche Telekom*, and that organization has terminated the general contract. This may lead to a situation similar to what has emerged in Belgium.) At the same time, collective management agreements have also been concluded in *other countries* (such as in the Baltic states, Bulgaria, Hungary or Slovenia).

As regards *distribution* of the remuneration collected within the three categories, in the case of broadcasting organizations, it did not raise any practical difficulties because of their limited number. Authors' organizations already had their established distribution system which they were also able to use for this purpose, although it was necessary to extend and adapt that system to certain categories of authors (scriptwriters, film directors, etc.). AGICOA, however, had to establish its own system. Such a system – with a computer network and an international register of titles – started functioning as early as 1984. AGICOA has become a widely recognized organization since then with producers' organizations in many countries as partners. It makes use of the experience of musical performing societies in the field of the collection and distribution of the remuneration due from cable operators.

Within the basic categories of owners of rights interested in cable retransmission of programs (authors, performers, producers of phonograms, producers of audiovisual works, broadcasting organizations), there is a need for further distribution either directly or through the societies or associations of the various groups of owners of rights.

Rights in respect of private copying of phonograms and audiovisual works

Reproduction of works for private purposes is not recognized by Article 9(2) of the Berne Convention as a case where exceptions to the right of reproduction would be allowed without any further conditions. Any exception may only be allowed if the conditions of the "three-step test" set out in that provision of the Convention are met; namely, if the exception only concerns a specific case, does not conflict with a normal exploitation of the works concerned and does not unreasonably prejudice the legitimate interests of authors.

Studies have proved, beyond any reasonable doubt, that wide-spread domestic reproduction of sound recordings for private purposes ("home taping" or, in a broader sense, "private copying") does seriously prejudice the legitimate interests of authors. In respect of widespread domestic reproduction of audiovisual works for private purposes, similar, although less evident and, therefore, more disputed, prejudices have been identified.

Reproduction which causes such a prejudice must not be allowed under the national laws of countries party to the Berne Convention (and/or to the TRIPS Agreement and/or the WCT) unless the prejudice is eliminated, or at least mitigated so as to render it reasonable, by a *right to remuneration*.

It was Germany which, for the first time introduced such a right to remuneration in 1965. The second country, Austria, followed suit in 1980, and the third, Hungary, in 1982, and since then several other countries have taken similar steps.

The Rome Convention does not contain similar obligations concerning "private copying" in respect of related rights as the Berne Convention does in respect of copyright. It is, however, considered to be justified to extend this right to remuneration also to performers and producers of phonograms who suffer similar prejudice. The WPPT has changed the situation. Its Articles 7, 11 and 16 have assimilated the right of reproduction of performers and producers of phonograms to such a right of authors under Article 9 of the Berne Convention (also incorporated into the TRIPS Agreement and the WCT by reference).



The national laws that have introduced royalties for “private copying” provide that *claims to such a royalty may only be made through collective management organizations*. It follows from the very nature of this right to remuneration that it cannot be managed individually.

From the viewpoint of licensing, the same may be noted as in the case of the rights to remuneration for reprographic reproduction; namely that, in such a case, *no real “upstream” and/or “downstream” licensing takes place*. What may be a similarity to the collective management of musical mechanical rights is that, where it is not the statutory law itself which provides for the remuneration to be paid, but this is left to the collective management organization to establish it, normally *negotiations* take place with the associations representing equipment manufacturers, importers and distributors and certain user groups, along *with the possibility of submitting possible disputes to a court or to a mediation/arbitration body, or irrespective of any dispute, with the condition of administrative approval*.

It is to be noted that, *in the context of “private copying” through the Internet, a mere right to remuneration does not seem to be sufficient to satisfy the conditions of the “three-step test.”* Free “private” use through the Internet would undermine any possible normal exploitation of the works concerned. The solution is the application of appropriate *technological protection measures* and electronic *rights management information*, through which owners of rights may control access to and reproduction of their works. The WCT and the WPPT provide that their Contracting Parties must provide adequate legal protection and effective legal remedies against the acts of unauthorized circumvention of such protection measures (including the “preparatory acts” making circumvention possible) and of unauthorized removal or alteration of such information.

“Private copying levies,” and technological protection measures, may be applied together side by side, although obviously not for the same scope of reproductions. In harmony with this, Article 5.2(b) of the Directive 2001/629/EC of the European Parliament and of the Council “on the harmonization of certain aspects of copyright and related rights in the information society” (the “Information Society Directive”) provides that, in granting “fair compensation” (i.e., a right to remuneration) for private reproduction, “the application or non-application of technological measures” must be taken into account.

The Impact of Digital Technology and the Internet on Collective Management of Rights; “Global Licensing”

General remarks about the impact of digital technology and the Internet on the exercise of rights

The conditions of creation, production and exploitation of literary and artistic works and other cultural and information productions – and the requirements for the protection, exercise and enforcement of copyright and related rights – have gone through spectacular changes during the last decade. This is due to a great extent to the advent of new technologies, first of all to the new advanced applications of digital technology and telecommunication systems, with their “merger” in the global information network, the Internet.

The *WIPO “Internet treaties”* (the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT)), adopted in December 1996 and which entered into force in March 2002 and May 2002, respectively, offer adequate responses to the challenges raised by these new technological developments. The level of protection required by them practically corresponds to that of the Berne and Rome Conventions *plus* (at least as regards the substantive norms on rights and exceptions to and limitations thereon) to that of the TRIPS Agreement *plus* to what was added on the basis of the so-called “digital agenda” of preparatory work and the 1996 Diplomatic

Conference itself. This last *plus* level consists of: (i) the clarification of how the existing international norms should be applied in the digital environment (in particular, those on the right of reproduction and on exceptions and limitations); (ii) some adaptation of existing norms to the new conditions (in particular, in extending the right of (first) distribution and the right of communication to the public to all categories of works, along with the recognition of appropriate rights for interactive “making available” of works, recorded performances and phonograms); and (iii) the introduction of some truly new obligations (in particular, concerning the protection of technological measures and rights management information).

During the preparatory work leading to the diplomatic conference which adopted the two treaties, and also after their adoption, it was extensively debated in which way copyright and related rights may be exercised in practice. One of the issues discussed was *the impact of digital technology and the Internet on collective management*. As a result of these discussions – including at the WIPO Seville Forum¹⁹⁰ which was dedicated to this issue – the following basic findings have been made.

First, *the role of collective management will not necessarily decrease – rather the opposite, it will probably increase – in the digital world*. There are some new fields where collective management may, and certainly will, have an important role, such as the licensing of “multimedia productions” (which quite frequently are created from a great number of pre-existing works and contributions of different categories), and regarding the authorization of use of at least certain categories of protected material on the Internet.

Second, owners of rights have *greater freedom to choose between individual exercise and management of rights*, since they may exercise their rights directly on the Internet (through using technological measures and electronic rights management systems). This does not mean, however, that it is necessarily in the interest of owners of rights to make use of this opportunity. The reasons for which, in certain fields –such as the exercise of “performing rights”– collective management is the best solution in the analog world, also exist in the digital environment. It is, in principle, possible for well-known and popular authors and performers to choose individual licensing (and, in the case of exclusive rights, their freedom to do must be guaranteed). Experience shows, however, that, at least in the case of the traditional forms of collective management, this kind of “dissidence” and repudiation of the principle of solidarity may backfire and may be counter-productive not only for the community of creators but, in the long run, also for such “individualists.”

Third, *new forms of exercise of rights are emerging which combine individual and collective elements of exercising rights*, such as copyright clearance centers (the same form in which some reprographic rights organizations have been established) which serve as a centralized source of licensing, but which apply different tariffs and licensing conditions individually fixed by owners of rights.

Fourth, digital technology and the Internet both pose *serious challenges and offer new and promising opportunities for “traditional” collective management organizations* (such as “performing rights” societies with “collectivized” licensing conditions, tariff systems and distribution rules). On the one hand, the new possibilities for individual licensing and the above-mentioned new alternative options of collective exercise of rights, in principle, may undermine the monopolistic position of such organizations also in those fields where their system used to be the only feasible option. On the other hand, on the basis of the technology that may create such problems for them, they may make their operation more efficient and more attractive both for owners of rights and for users. As a result of this, “traditional” collective management organizations may, and hopefully will, become stronger and more efficient in this period of development.

Fifth, due to the phenomenon of “multimedia” – both in the form of off-line productions and in the way the different categories of works and objects of related rights are used together in the global digital network – there is a *growing need for establishing “coalitions” of various collective*



management organizations to offer a collective source of authorization (“one-stop shops”) or participating in an even more general co-operation which may also extend to individual owners of rights joining the “coalition,” either by including their licensing information or through also authorizing the “coalition,” as an agent to issue authorizations on their behalf in harmony with their individual licensing conditions and tariffs. This does not mean that in such a “coalition,” all the various licensing sources merge together. “Traditional” authors’ societies may, and certainly will, preserve their autonomy.

The framework of this chapter is not sufficient to deal with all aspects of the impact of digital technology and the Internet on collective management of copyright and related rights. Therefore, only the techniques that may be applied for “global licensing” for use of works on the Internet are discussed in detail.

Licensing exploitation of copyright and related rights in the Global Information Network

In the past, collective management organizations normally worked as *national organizations* and were able to *grant licenses for the use of the repertoires represented by them* (national and international) *in their own territories* (with some well-known exceptions, such as BIEM in the first period of its operation or NCB, the joint mechanical rights organization of the Nordic countries).

In this respect, the first dramatic changes were brought about by *direct broadcasting satellites*, many of which started transmitting programs to several countries. Irrespective of the sometimes religious-war-type debates about some opposing “theories” (“emission theory,” “communication theory,” etc.), it was inevitable to recognize that, in the case of such broadcasting, although the process of communication to the public (broadcasting being communication to the public by wireless means) starts in the country of emission, it is only completed in the countries of the “footprint” of the direct broadcasting satellite. It is in the latter countries where the public may be found to which the communication is made (the program is made available for reception, actual reception not being a condition for completion of the act of broadcasting), where the actual impact on the possibility of further exploitations of the works and objects of related rights concerned may be felt, and where the interests of certain rights owners – in particular, in those cases where rights are territorially divided and the owner of rights in a country of footprint is not the same as in the country of emission – may truly be prejudiced. CISAC took this into account in the so-called Sydney principles, which are included in the “Addendum [to the Model Contract of Reciprocal Representation between Public Performance Rights Societies of CISAC] concerning direct broadcasting satellites (DBS)” adopted in Sydney in 1987 at a session of the CISAC Administrative Council.¹⁹¹

The *Sydney addendum* reflects two not easily reconcilable, but equally important objectives of performing rights societies: first, offering a reasonable and workable licensing system to users; and second, duly taking into account the interests of, and the rights represented by, all the interested societies. When the societies found themselves faced with the phenomenon of the Internet, it was clear that, if they wanted to achieve the same objectives – and they certainly did, since this was inevitable from the very *raison d’être* of collective management – they needed an even more comprehensive contractual system. This was so, since no less than global, world-wide licenses were needed (in the sense that the works transmitted through the Internet are made available to all those who are connected to the global network all over the world).

In a way, *the Sydney addendum was used as a model* by those societies which proposed that the society of the country where the Internet service provider is located, and where the transmission emanates from, should be authorized to grant global licenses. *Other societies, however, wanted to take into account some other criteria* which they regarded as better reflecting the actual place and impact of exploitation of works through the Internet. The possibility of easy dislocation of uses

was also emphasized by the latter societies. Due to the differing positions of the member societies of CISAC, it has not been possible to reach general agreement about a Sydney-type amendment to the Model Contract. Since, however, it became evident that the absence of a sufficiently simple licensing system for Internet transmissions might lead to the proliferation of unauthorized uses and to growing disrespect for copyright, five societies with big repertoires decided to work out and apply a new licensing model.

Since the new licensing model (technically an “amendment” to the existing contracts based on the CISAC Model Contract) was adopted at the 2000 Santiago de Chile congress of CISAC by the five societies – BMI (United States of America), BUMA (Netherlands), GEMA (Germany), PRS (United Kingdom) and SACEM (France) – the agreements concluded using this model are called “*Santiago agreements*.” Due to the complex practical and legal problems involved, these agreements are regarded to be experimental for a trial period (with the possibility, however, of renewal). The model of the “*Santiago agreements*” was the basic *example*¹⁹² for the ability of collective management organizations to adapt their licensing methods even to such a complex environment as the Internet; thus, it is useful to present it in the form it was worked out, irrespective of how it may evolve in future.

The model for “*Santiago agreements*,” first of all contains a number of *definitions* of terms employed in the context of using works in global networks, such as “content provider,” “service provider,” “online exploitation,” “webcasting,” “streaming,” “on demand uses,” “website,” etc.

From these definitions, a broad concept of “performing rights” (and more specifically, that of one such right, the right of “communication to the public”) emerges. Under this broad concept (which seems to have been based on the text of Article 8 of the WCT, since it extends the concept of “communication to the public” to interactive, online “making available” of works), downloading (for example, in compressed format) without the possibility of listening to recordings of performances of musical works, or of watching audiovisual works, is also regarded as covered by “performing rights.”¹⁹³

The Santiago model identifies *the society authorized to grant a global license* in the following way:

- (i) if (a) the content provider uses the relevant country-code top level domain name (for example, “.fr” if the contracting society is SACEM, “.de” if the contracting society is GEMA, etc.), or, in the case of the United States of America, the “.com” or “.net” generic top level domain name, and, (b) the primary language used at the site of the content provider is the primary language of the country indicated by the national identifier, then the license shall be granted by the society operating in that country;
- (ii) in all other cases, the license shall be granted to the content provider by the society of the country among those mentioned in item (i) above where the content provider is incorporated;
- (iii) notwithstanding anything to the contrary set forth in items (i) and (ii) above, if the economic residence of the content provider in a country among those mentioned in item (i) above is different from the country set forth in items (i) or (ii) above, the society of that country may license the content provider (the economic residence of the content provider is deemed to be in a country if any two out of the following criteria are in one and the same country: (a) the country in which the main office of the content provider is situated; (b) the country where the content provider employs the majority of its employees; (c) the country where the audit of the annual accounts of the content provider is regulated);



- (iv) however, if the content provider is situated in a country without proper copyright legislation and/or without proper procedures for the administration of copyright in place, the parties must consult and agree on the most appropriate actions to take in the relevant circumstances, including the grant of any appropriate license to any party involved in the process of online exploitation;
- (v) in the case of private and personal websites, the license is to be granted by the society operating in the country where the access and hosting service provider has its place of incorporation and may be granted either to the content provider directly or (to the extent permitted by law) to the access and hosting service provider for their benefit.

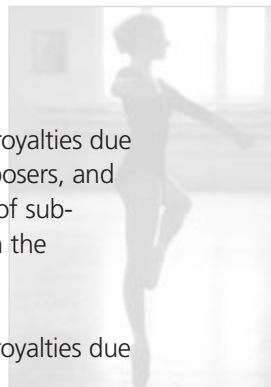
The license granted on the basis of a Santiago agreement is *for online exploitation in the entire world*. This, however, is only possible if there are appropriate arrangements and guarantees for taking into account the legitimate interests of partner societies. It seems that the model worked out corresponds to these requirements.

The Santiago model provides that *each party which has been granted a license for an online exploitation is required by the licensing society to provide* the following details with respect to the musical works which are contained in the respective online exploitations: the titles of the works and the names of the owners of rights concerned, as well as any electronic identifier of the works (for example, ISWC, ISAN), if available; furthermore, where relevant and where available, the gross price which has been charged to the end user, and, in relation to on-demand content transmissions, the country where the end-user has received such transmissions. Also, each society must, when accounting to the other society, supply a list of the names, addresses and website domain names of each party to whom it has granted licenses since the end of the previous accounting period.

These kinds of obligations to grant information are only valuable and meaningful if they are coupled with appropriate *distribution rules*. Such rules are included in the model contract. With respect to webcasting/streaming and on-demand content transmissions without payment by end users, royalties are to be distributed to the same rights owners and in the same manner as would be the case for terrestrial radio or television broadcasting in the territory of the licensing society, irrespective of the location of the ultimate listener/viewer.

With respect to royalties for on-demand transmissions against which payment is made, the following rules apply between two societies (in the example, society A and society B, from the viewpoint of society A):

- (a) if the demand was from an end user within the territory of society A, then society A's distribution to society B is to be made for the same rights owners as would be the case in relation to terrestrial radio or television broadcasting in society A's territory;
- (b) if the demand was from an end user within the territory of society B, then:
 - (i) with respect to the use of society A's repertoire, society A must pay the royalties due to society A's authors and composers directly to these authors and composers, and must pay the royalties due to the publishers to society B for the benefit of sub-publishers, to the extent that these sub-publishers represent the rights in the respective works in society A's repertoire;
 - (ii) with respect to the use of society B's repertoire, society A must pay the royalties due society B's authors, composers and publishers to society B;



- (c) if the demand was from an end user in a country other than the territory of society A or society B (a “the third country”), then:
- (i) with respect to the use of society B’s repertoire, society A must pay the royalties payable to society B’s authors and composers to society B and the royalties due to the publishers of society B to the society in “the third country” for the benefit of the sub-publishers in that country, to the extent that these sub-publishers represent the rights in the respective works in the society B repertoire;
 - (ii) with respect to the use of society A’s repertoire, society A must pay the royalties payable to society A’s authors and composers directly to them and the royalties due to the publishers of society A to the society in “the third country” for the benefit of the sub-publishers in that country, to the extent these sub-publishers represent rights in the respective works in the society A repertoire.

Of course, the distribution rules are the same if, in the example of the preceding paragraph, the positions of society A and society B are reversed and the distributions rules are applied from the viewpoint of society B.

The Santiago model notes that, notwithstanding what is set out above, the parties accept that the present system may not yet allow the payment for the benefit of *sub-publishers* to be applied in practice, and states that the parties “will agree to pragmatic arrangements in the interim.” It is also clarified that “in determining whether a sub-publisher represents the relevant rights in a particular work or works which are in another society’s repertoire, the distributing society shall follow the directions of that other society, except where it has no such directions, and except where the sub-publishing agreement is clearly in contradiction with these directions” (it is added, however, that application of this principle is also subject to the above-mentioned reservation concerning the payment of the benefit of sub-publishers).

In the model contract, it is declared that “[t]he parties will continue to examine the rules set out above with the object of trying to ensure that systems and procedures result in authors and composers and publishers/sub-publishers being paid their royalties in the most timely manner appropriate.”

This chapter was authored by Dr. Mihály Ficsor. Dr. Ficsor was formerly Assistant Director General in charge of Copyright at WIPO and currently speaks and writes on copyright issues around the world.



Chapter VIII

Music

Music – one of the most in demand “commodities” these days – faces navigating through a bumpy but at the same time exciting environment: Whereas on the one hand more and more people get their music for free from mainly unlicensed sources such as peer-to-peer services on the Internet, on the other hand various industry players implement rules for bringing the business back into a secure environment where all right owners are remunerated for the effort and investment put into a music production. Widespread use of illegal sites, made easier with the growth of broadband access in major markets, is affecting an industry that also has to compete with increased sales of other entertainment formats such as DVD films and new video game consoles, a shift in music tastes, age, gender and preferred point of purchase. The adaptation of creative and innovative rules – meaning licensing models – plays the same major role as it has always played in the area of legal exploitation of music. Licensing still follows the same rules as before: what kind of use is licensed, for how long, on an exclusive basis or non-exclusive and against what kind of remuneration? This chapter describes the main stakeholders and the environment in which music license agreements are concluded by the main players: namely, publishers and record companies. It then introduces business practices applied in the music industry – focusing on the terms in standard license agreements. Assuming that readers possess basic knowledge of the conventional rules, this chapter investigates new business models and their licensing rules in the new economy.

Overview on the Music Licensing Industry, the Main Stakeholders, and Opportunities and Challenges

The stakeholders

Any production of music usually involves the *composer or songwriter* who creates the composition and delivers the musical score and—where applicable—the *lyricist* who provides the text. The composer’s and lyricist’s (hereafter jointly called “authors”) works are usually administered by *publishers*. The work is performed by the *performing artists* and recorded by the *record producer* who then sells the recording – mostly embodied on physical sound carriers – to *retailers* who sell these to end consumers. Other players are *collecting societies* that administer and license the author’s commercial rights, especially to record companies, for the production and sale of sound carriers. There are also collecting societies administering record producers’ and performers’ public performance and broadcasting rights.

This is of course a very simplified description and usually requires sorting out complex creative and financial issues. The common denominator is that any outcome, whether sold on physical carriers such as CDs or online, broadcast or performed, is based on *license agreements* between the various parties. The negotiations can range from fierce battles to cooperative discussions in the effort to strike the deal.

The role of the respective stakeholders in the music industry can be described as follows:

Composer and lyricist

The composer creates the musical score and the lyricist writes the text of the words accompanying the music. Both are authors and creators of “works,” meaning personal intellectual creations, that can only be created by human beings. Their input consists of an intellectual expression that – as soon as it is fixed in a tangible medium of expression – is copyright and protected.

Publisher

The music publisher stands at the crossroads of musical creation and the music market. He accompanies the author and his work throughout its term of protection by ensuring its continued exploitation. The author usually concludes a license agreement with a publisher transferring all rights that the author did not transfer to a collecting society. Currently, the largest publisher in the world is EMI Music Publishing followed by Warner Chappell and the Universal Music Publishing Group. Independent publishers are, for instance, the mid-sized companies Carlin, Chrysalis, Famous and peermusic.

Collecting societies administering authors' rights

Usually, authors are members of collecting societies that administer and license collectively their exploitation rights (i.e., mechanical rights involved in CD manufacturing and distribution as well as rights of broadcasting and public performance). The societies are usually private entities controlled and organized by the right owners themselves based on membership. Collective licensing is based on the fact that it is nearly impossible for the individual author to check whether, where, when and how often his work has been exploited (e.g., reproduced and distributed on CD, broadcast, publicly performed) and to negotiate the respective license agreements with the exploiting parties or their respective trade associations. The collecting societies rely on a set tariff-structure; they claim the remuneration from the exploiters and distribute the royalties locally according to a distribution scheme to their members and internationally via a network of reciprocal agreements.¹⁹⁴

The featured artist and studio artist as performer

The featured artist is the main performer of the musical work/text incorporated in the audio/audio-visual recording. His or her rights are the subject matter of Exclusive Artist Agreements concluded between him and a record producer. Studio artists are only hired for a particular performance supporting the featured artist's performance. They often transfer their rights to the producer via a Session Player Agreement containing pre-formulated terms and conditions, and simply receive a lump sum. This also often applies to performers of classical music.

The record producer

The WPPT¹⁹⁵ (Article 2) defines the "producer of a phonogram" as the person, or the legal entity, who or which takes the initiative and has the responsibility for the first fixation of the sounds of a performance or other sounds, or the representations of sounds. In practice the latter is the person or entity, who or which carries the organizational and economic responsibility for the first fixation. In case of doubt, it is the entrepreneur who concludes the important contracts for materials and personal services. Consequently, the mere manufacturer is not a "record producer." In some cases the term "producer" is also used for the producer who influences the making of the recording artistically (creative producer). The producer usually is a record company with its own distribution apparatus. It might also be a production unit that licenses a finished master tape to another record company (e.g., via a master license agreement (described below)).

The "record company" can best be described as the organizational unit that receives licenses to exploit audio/audio-visual recordings. Besides discovering and developing new recording artists and repertoire, recording the actual music, organizing the manufacture and sale of record releases and the organization of the appropriate royalty payments to artists and other licensors, a record company has to carry out the following main tasks in the field of licensing:

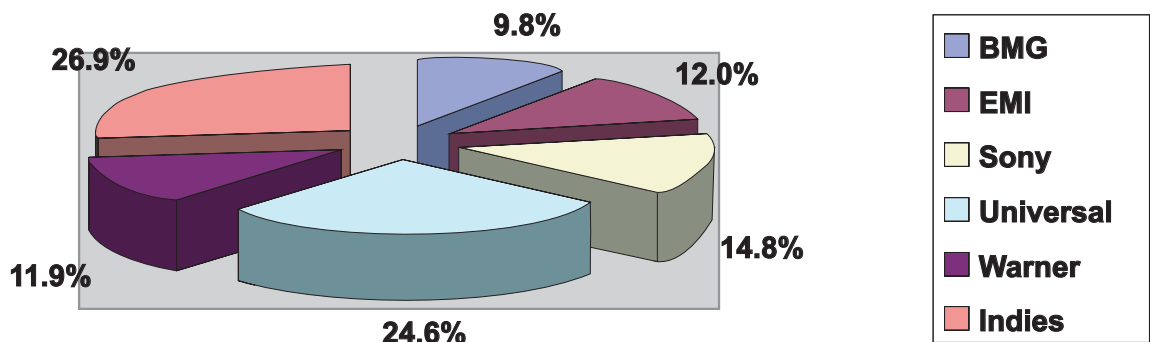


- conclusion of license agreements with other right owners in order to acquire the respective rights;
- licensing (whether directly or through collective management societies) the use of sound recordings in radio and TV broadcasting, advertisements and other formats such as the Internet;
- promoting the licensing of recordings for strategic or special marketing (e.g., in compilation albums or through record clubs); and
- selling, licensing and promoting the release of locally produced recordings in international markets. It has to be noted that music rights can be assigned to different companies for different parts of the world. For example, different companies in Europe and the US distribute the recordings of artist Pink Floyd.

Major record companies (“majors”) are characterized by their international music development and distribution networks. Their national affiliates usually license-in local repertoire that is then licensed out to the other national affiliates in other territories (so called “intra-company agreements”).

Independent companies (“indies”) tend to specialize in a certain genre of music. While they are usually oriented towards their domestic markets, they also export their artists abroad. Some indies deal with distribution, while others arrange for promotion or distribution of their artists abroad through distribution and licensing agreements with one of the majors, or with independent distribution networks.

Majors’ and indies’ global market share in 2002



Source: IFPI, *Music & Copyright*

Record companies are the principal organization that invest in the development of national music and sound recordings. For instance, in 2000 the industry invested 1.2 billion in the development of artists and repertoire in Europe alone. In general and on a world-wide basis, record companies invest up to 15% of their annual turnover in new licensed artists and repertoire. This level of investment is considerably high compared to other industries. The cost of making a record (including the artist’s advance (see below)) and producing a music video can be significant. A large number of copies need to be sold before a record company will recover or recoup its investment. Only one in 10 new releases make a profit.

In some cases one individual might play several roles at the same time: especially in dance music, the performing artist is also the creative producer as well as the phonogram producer and might even run his own record company. If he has created the underlying musical work by himself, he is also the author and enjoys the copyright in the song.

Collecting societies administering performers' and record companies' rights

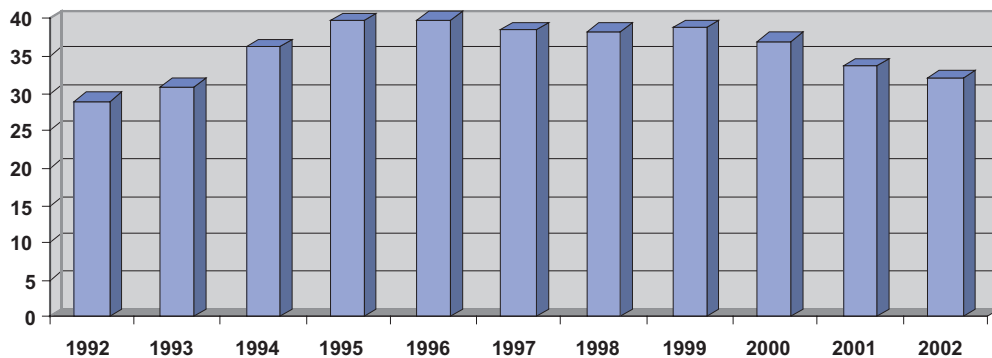
By contrast to the licensing of authors' rights, record producers tend to license their main rights individually to third parties. Their rights of broadcast and public performance of commercially released sound carriers ("secondary exploitation"), are for the main part licensed collectively by neighboring rights collecting societies.

Characteristics of the changing environment in the music industry

Focus: Record companies

The environment in which license agreements are concluded today has changed considerably – especially for the record companies. Based on world sales, the United States of America is the world's largest market, followed by Japan, the United Kingdom, France and Germany. However, the recorded business has experienced falling sales for several consecutive years – about 10% in 2002 alone.

World soundcarrier market growth/decline (retail value in current and constant US\$bn)



Source: IFPI

IFPI has stated: "World sales of recorded music fell by 7% in value and by 8% in units in 2002. Mass downloading from unauthorized file sharing on the internet and the massive proliferation of CD burning continues to be a major cause of the fall in CD sales globally, combined with competition from other entertainment sectors and economic uncertainty on consumer spending. Recorded music sales worldwide fell to US\$32 billion in 2002. Compared to 2001, sales of CD albums fell globally by 6%, and there were continued declines in sales of singles (-16%) and cassettes (-36%)." ¹⁹⁶



Focus: The music publishing business

While record companies are suffering from decreasing sales, music publishers are still doing well. Global publishing revenues in 2000 rose by 6.7% to US\$6.87 billion. Performances posted a 2.7% gain to nearly US\$3.08 billion, with mechanical income up 4.1% to US\$2.74 billion. The combined total mechanical revenues collected in 2001 fell by 11.13% to the equivalent of US\$1.93 billion compared with 2000. This is partly compensated for by the 2.55% rise in performance revenues to US\$3.27 billion.¹⁹⁷

The publishers' additional income streams, apart from income from mechanical and performance licenses, can be summarized as follows:

- licenses from TV, film and advertising synchronization licensing;
- growth in revenue from licensing exploitation of works on the Internet, cable and satellite performances;
- toy and videogame licenses; and
- fees for ring tones.

Nevertheless the new economy of publishing deals stem from the shrinking of the business in general, and mechanical royalties in particular. For new authors, most initial publishing income is derived from the mechanical royalties on records sold. But, as demonstrated above, sales are declining. Despite multiple income streams, publishers are not immune to the domestic and global decline in record sales.

New "music" for the business-positive trends

While the recorded music business faces the threat of new technologies on the one hand, for instance unauthorized music file sharing and CD burning, on the other hand, technology is creating various licensing opportunities to be embraced both by publishers and record companies. Such opportunities are:

- New physical carrier formats such as DVD and SACD;
- E-Commerce – Internet exploitation via legal download and streaming platforms; and
- M-Commerce: mobile phone exploitation of artists' logos, e-greeting cards, ring tones etc.

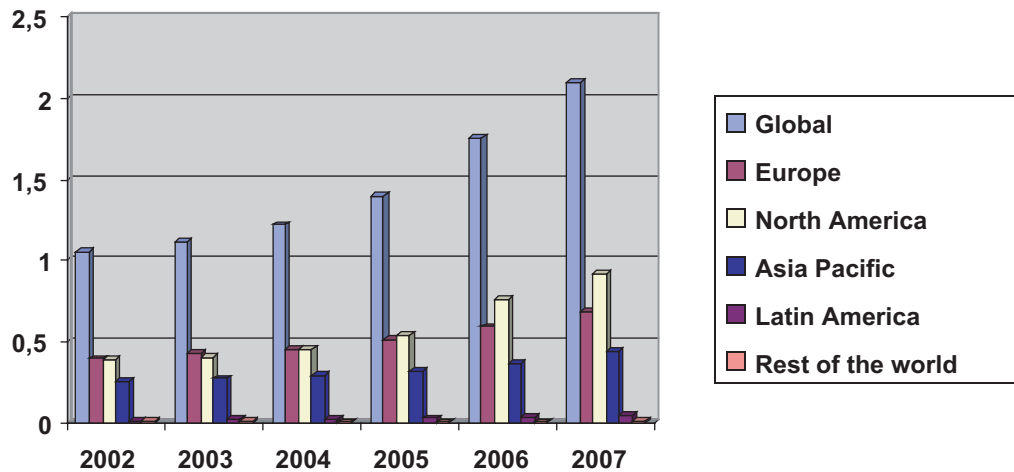
The *new physical formats* offer multi-channel surround sound, and can include videos, computer software and compressed files for portable playback. They also have one additional key advantage: copy management technologies were designed into the disc format and the respective players from the outset. In 2002, the sale of music videos saw a 12% rise in units sold. Growth worldwide is attributed to the increase in sales of DVDs overall and DVD players; DVD music videos rose by 58% compared to a 42% decline in VHS. With the release of over 1,300 new titles by record companies in 2002, DVD music videos are expected to become a growing contributor to music sales.

New formats such as DVD Audio and SACD also did well. Music companies have launched new CD titles simultaneously on DVD Audio or SACD. Since 2001, unit sales of both DVD Audio and SACD combined more than trebled, with each format selling over one million each in 2002.¹⁹⁸

Internet delivery of sound recordings offers vast marketing possibilities for publishers and record companies, and enables the latter to establish direct contacts with end consumers, a link that did not exist before.¹⁹⁹ Online portals can play a valuable role for companies and fans to communicate or even sell an artist's new product directly. Subject to data protection laws, record companies are able to collect customers' data in order to improve and tailor their customer service (a practice

known as “datamining”). The fact that Apple sold 1 million downloads of 200,000 songs initially available to Macintosh computer users in the United States of America within the first week after its launch of its iTunes Music Store in April 2003, boosted both expectations and trust in online sales significantly. It remains to be seen whether the planned Windows version will comprehensively demonstrate the viability of downloading online music services, as there are more hackers of Windows systems than of Apple.²⁰⁰

Online music sales: Forecast by region (US\$ m)



Source: Informa Media Group

Finally, of all forms of *M-Commerce*, the sale of ring tones is by far the most important one. It is estimated that in 2002, authors’ societies collected US\$71m in respective revenues, up 58% from US\$45m in 2001,²⁰¹ a significant share coming from Japan, where mobile phones are very popular among teenagers.²⁰² Besides Japan, Europe is the main *M-Commerce* market. There are an estimated 70 million mobile phone users aged between 12 and 24 years. It has been predicted that in 2003, Europeans will download 150 million ring tones and 110 e-greetings and dedications.²⁰³ To date, mainly monophonic ring tones have been traded and, accordingly, they have only generated revenue for songwriters and publishers. However, when digitized versions of the tunes of popular songs become available as “ring sounds” – which is expected shortly – record companies will also benefit from this fast growing market.

Of course, the digital revolution is reflected in today’s license agreements with legal and financial consequences. While the former contracts mainly dealt with the physical exploitation more and more “new media clauses” are introduced or re-negotiated into the licensing agreements.

Legal instruments, laws, treaties and frameworks of music licensing

National laws – authors’ and related (neighboring) rights

Any negotiation about music licensing takes place on the basis, for example, of rights provided by the national legislation to the respective right owners. In Europe, the national laws are often influenced by the European Directives implemented into national law (as described below). As far as the legal protection of the above-mentioned players is concerned one has to distinguish between authors’ and related or neighboring rights. Continental European countries in particular provide for such a distinction: authors are those who are involved in the personal intellectual creation or a work



(composition/lyrics in the field of music) that can only be created by human beings. Their input consists of an intellectual performance that is copyright and protected. Artists and record producers do not perform such an “intellectual creation”: the artist is “simply” performing the work and the record company is “simply” investing in and organizing the record production. Those who do not create a work, benefit from a so-called related or neighboring right in many countries.²⁰⁴

The general level of protection of these rights does not differ significantly from country to country as it did several years ago. This is based on the fact that – also due to international property trade and the tendency to conclude transnational license agreements with international partners – copyright laws have been harmonized or are going to be harmonized in particular areas. Consequently, the negotiation and conclusion of such license agreements now takes place on a more solid basis and establishes a much more transparent and predictable licensing environment.

International treaties and frameworks

The international agreements covering copyrights and/or neighboring rights oblige the signatory countries to provide a minimum standard of protection. One has to distinguish between conventions/treaties that cover either authors’ rights or neighboring rights or even both.

The five top sound carrier countries (France, Germany, Japan, United Kingdom and United States of America) have adhered to or are intending to adhere the following agreements:

The Universal Copyright Convention (UCC)²⁰⁵

This Convention, signed in 1952 and revised in 1971, protects authors and other copyright proprietors against unauthorized reproduction, public performance and broadcasting, subject to certain exceptions. It extends the protection of literary, scientific and artistic works (including musical works) to all signatory countries (including the United States of America that had not adhered to the Berne Convention at the time). Since the United States of America joined the Berne Convention in 1989, the UCC plays a less significant role.

The Berne Convention for the Protection of Literary and Artistic Works (BC)²⁰⁶

The BC, signed in 1886, is the oldest international agreement in the area of copyright. With the United States of America’s adherence more than one hundred years later, this Convention is also the most important one for the protection of authors. It provides a list of rights enjoyed by these authors – such as the right to authorize or prohibit reproduction, public communication, or adaptation of these works. It also allows Convention countries to provide certain exceptions to protection. Some countries also protect producers of sound recordings as “authors” with Berne-type protections. The BC is based on national treatment, e.g., signatories must treat authors of another signatory country in the same manner they do with respect to domestic authors. This applies not only to the catalogue of rights granted, but also to the enforcement of the latter. Authors of works in countries that are not part of the BC can nevertheless rely on its protection by having the work published first in a member country (often neighbor countries, for instance when the United States of America had not signed the BC, U.S., works could be first published in Canada or Mexico in order to benefit from the protection offered by the BC).

***The International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations (Rome Convention, RC)*²⁰⁷**

This is one of the most important Conventions covering the related or neighboring rights of performers, producers of phonograms and broadcasting organizations. The protection provided under this Convention differs, according to whether it is granted to artists or to producers of phonograms and broadcasting organizations. Producers and performers in Convention countries are protected against unauthorized copying of their recordings, and have a right to payment for broadcast of their recordings, subject to certain exceptions. The term of such protection lasts at least 20 years. The Convention makes provision for a full system of reservations and options. Countries can only join the RC if they have also signed either the BC or UCC. This requirement prevents countries from only protecting neighboring but not authors' rights. Furthermore, the RC provides for national treatment subject to the protection specifically guaranteed, and the limitations specifically provided for, in the convention.

It should be noted that the United States of America has not joined the other 77 States adhering to the RC. This gap in international neighboring rights protection has now been filled as the US has ratified the WIPO Performances and Phonograms Treaty.

***Convention for the Protection of Producers of Phonograms against unauthorized duplication of their phonograms (Geneva Convention)*²⁰⁸**

This Convention can be generally described as an "Anti-Piracy Convention," focusing on the widespread and increasing unauthorized duplication of phonograms and the damage this occasions to the interests of authors, performers and producers of phonograms.

***General Agreement on Tariffs and Trade (GATT)/Trade-related Aspects of Intellectual Property (TRIPS Agreement)*²⁰⁹**

The TRIPS Agreement is one of the agreements governed by the World Trade Organization (WTO) that deals with IP issues of the Member States of the WTO. Basically, the Agreement incorporates by reference the substantive requirements of the BC. It also provides to artists and record companies a term of protection of 50 years, whereas the RC only grants 20 years. Most importantly, for the first time in an international convention the TRIPS Agreement contains rules for the enforcement of IP rights.

***General Agreement on Trade in Services (GATS)*²¹⁰**

This Agreement – also governed by the WTO – provides for the elimination of trade barriers between Member States and for further liberalization of services. The Agreement has importance for the activities of the above-mentioned stakeholders in respect to their business operations abroad, such as distributing music and signing/licensing of foreign recording artists. Achieving a higher degree of liberalization of the online music market will also enable the development of new business models with global reach.

WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty

These two "Internet Treaties" basically aim at:



- Confirmation of the protection of traditional copyright materials and distribution mechanisms;
- Clarification of how copyright and related rights apply in the online environment; and
- Protection against hacking of technical protection applied to copyright products.

The Treaties incorporate the BC obligations by reference and contain RC compatible rules for phonograms and, finally, require enforcement procedures that permit TRIPS-level “deterrence.”

Whereas – as of April 2004 – the the United States of America and Japan, have already ratified the Treaties, the European Union, respectively the European Union countries (and therefore the United Kingdom, French and German sound carrier markets), have not yet ratified the Treaties.

WIPO Copyright Treaty (WCT)²¹¹

The WCT focuses on copyright owners (authors, composers and other creators of literature, art, music, films, software and other such creative works). It is a special agreement within the meaning of BC (Art. 20) and does not have any connection with treaties other than the BC, nor does it prejudice any rights and obligations under any other treaties. Nothing in this Treaty derogates from existing obligations that Contracting Parties have to each other under the BC.

WIPO Performances and Phonograms Treaty (WPPT)

The WPPT provides protection against unauthorized reproduction, distribution, and rental of recorded music. Making sound recordings available and communicating them interactively over the Internet also requires the producer’s and performer’s consent. And technical measures applied to recordings to prevent unauthorized copying or use are protected against hacking – a major concern for any right owner who licenses his repertoire online (see below).

Directives in the European Union (EU)/European Economic Area (EEA)

Whereas the above-mentioned international treaties and conventions provide for any international harmonization of rights on an almost worldwide level, various directives in the European Union (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom) – also applicable to countries in the EEA (EU countries plus Iceland, Liechtenstein and Norway) – provide for a similar set of protection standards. The directives are not self-executing pieces of legislation but have to be implemented into national law.

- (a) Directive of the European Parliament and of the Council on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (E-Commerce Directive)²¹²

The E-Commerce Directive ensures that Information Society services benefit from the Internal Market principles of free movement of services and freedom of establishment, and that they can be provided throughout the EU/EEA if they comply with the law in their home Member State. This principle of country-of-origin however, does not, apply to IP rights. Furthermore, the Directive establishes specific harmonized rules only where strictly necessary to ensure that businesses and citizens can supply and receive Information Society services throughout the EU, irrespective of frontiers. These areas include definition of where operators are established, transparency obligations for operators, transparency requirements for commercial communications,

conclusion and validity of electronic contracts, liability of Internet intermediaries, on-line dispute settlement and the role of national authorities. In other areas, the Directive builds on existing EU instruments which provide for harmonization or mutual recognition of national laws.

- (b) Directive of the European Parliament and of the Council on the harmonization of certain aspects of copyright and related rights in the information society (Copyright Directive)²¹³

The Copyright Directive is seen as the most important recent measure to have been adopted by Europe in the copyright field, providing European right owners with updated protection in the digital economy. The directive's goal is the preparation of the EU-countries' copyright regimes for the joint ratification of the WIPO Internet Treaties. It ensures that all material protected by copyright, including books, films and music are adequately protected by copyright. It provides a secure environment for cross-border trade in copyright protected goods and services, and will facilitate the development of electronic commerce in the field of new and multimedia products and services (both on-line and off-line via for example CDs).

In line with the above-mentioned WIPO Internet Treaties, the Directive harmonizes the rights of reproduction, distribution, communication to the public, the legal protection of anti-copying devices and rights management systems. Particular novel features of the Directive include a mandatory exception for technical copies on the net for network operators in certain circumstances, an exhaustive, optional list of exceptions to copyright which includes private copying, the introduction of the concept of fair compensation for rightholders and, finally, a mechanism to secure the benefit for users for certain exceptions where anti-copying devices are in place. Adoption and implementation of the Directive will enable the Community and its Member States to ratify the WIPO Internet Treaties.

Main rights covered by licensing agreements

In order to present the various rules governing license agreements, the main rights subject to negotiation between licensors and licensees are identified below:²¹⁴

Authors and music publishers

Composer and lyricist

- (i) Right of communication to the public

Authors benefit from a right of communication to the public of their works by wire or wireless means, including the making available to the public of their works in such a way that members of the public may access these works from a place and at a time individually chosen by them (see WCT, Art. 8).

This right especially refers to the traditional performance of their works, communication by broadcasting of radio and/or TV signals either terrestrially or via satellite and cable networks and, finally, also to the individual download of works via networks such as the Internet and the transmission via mobile phone networks and Wireless Local Area Networks (WLANs).

- (ii) Right of reproduction

Authors enjoy the exclusive right of authorizing the reproduction of their works in any manner or form (see BC, Art. 9(1)).



This right refers especially to conventional audio/audio-visual carrier production and printing of musical scores, but also to digital copying on the Internet and to digital sampling – although only fragments of the works are used.

There are various exceptions to this right determined by national legislation (e.g., private copying, fair use, quotation, schools, disabled etc.). These limitations shall not cause any conflict with a normal exploitation of the work and shall not unreasonably prejudice the legitimate interests of the author (see BC, Art. 9(2)).

(iii) Right of distribution

Authors enjoy the exclusive right of authorizing the making available to the public of the original and copies of their works through sale or other transfer of ownership (see WCT, Art. 6).

This right refers especially to the sale of their works on audio/audio-visual carriers in their physical form and not in electronic form (e.g., via the Internet).

In the EU/EEA this right is exhausted when the original or a copy thereof is first sold, or when its ownership is otherwise transferred with the authorization of the author, in a country of the EU/EEA. This principle reflects the freedom of movement of goods in the European internal market.

(iv) Right of adaptation

Authors shall enjoy the exclusive right of authorizing adaptations, arrangements and other alterations of their works (see BC, Art. 12 and 14).

This right is important where the work is translated, or arranged for various orchestrations.

Transfer of rights to publishers

In the Anglo-American copyright acts, authors' rights are subject to the notion of "copyright" and reflect the economic value of their creation. The author holds a property right in his creations that can be traded on the basis of economic principles. Consequently, a work can be created and transferred completely to another person for a flat fee. No royalties for exploitation might be required to be paid, and the right to the work belongs to the other party ("work for hire"). According to the Continental-European tradition, the focus is more on the intellectual input by the author. His rights are protected on the basis of a *droit d'auteur*. This is founded on the idea that a work is intimately linked to its creator, and the work cannot be separated from its author. Therefore, in some countries, the author only transfers his exclusive rights to the third party (e.g., a publisher) but remains the original right owner.

Performing artists and record producers

Main rights of performers

(i) Broadcasting/fixation right

The WPPT (Art. 6) grants performers the exclusive right to authorize the broadcast and communication of their unfixed performances, except where the latter is already a broadcast performance. Additionally, performers may authorize the fixation of their unfixed performance.



(ii) Right of reproduction

Performers also authorize the direct or indirect reproduction of their performances fixed in phonograms, in any manner or form (see WPPT, Art. 7).

(iii) Right of distribution

Performers enjoy the exclusive right of authorizing the making available to the public of the original and copies of their performances fixed in phonograms through sale or other transfer of ownership (see WPPT, Art. 8). This right only applies to the physical exploitation and is subject to the EEA-wide exhaustion in the same way as the above-mentioned respective author's right.

(iv) Right of making available of fixed performances

Performer also have the right to authorize the making available to the public of their performances fixed in phonograms, by wire or wireless means, in such a way that members of the public may access them from a place and at a time individually chosen by them (see WPPT, Art. 10). This right, therefore, encompasses in particular the on-demand exploitation of their performances on the Internet.

(v) Moral rights

Finally, performers benefit from various claims emerging from their moral rights regarding the use of their performance (see WPPT, Art. 5): a claim to be identified as the performer on phonograms, a right to object to any distortion, mutilation or other modification of his performances that would be prejudicial to this reputation.

Main rights of record producers

The producer benefits from the exclusive rights to authorize the reproduction (WPPT, Art. 11), the physical distribution (WPPT, Art. 12) with the possibility of exhaustion and the making available of the phonograms, especially covering on-demand use on the Internet. It is notable that sound technicians or recording directors and the above-mentioned "creative producers" do not benefit from these rights, as the legal protection reflects the financial and organizational investment by the entrepreneur "phonogram producer."

Common provisions in the case of secondary exploitation

With respect to the secondary exploitation of performances fixed on phonograms neither performers nor producers are granted an exclusive right by the WPPT, although some national legislations provide for the latter. According to the WPPT (Art. 15) they enjoy the right to a single equitable remuneration for the direct or indirect use of those phonograms published for commercial purposes for broadcasting or for any communication to the public. These claims are often administered by neighboring rights collecting societies.²¹⁵ According to national legislation, the single remuneration can be claimed from the user by the performer or by the producer – i.e., their respective collecting society – or by both.

The above-mentioned limitations (fair use, private copying etc.) also apply to performers' and producers' respective rights (see WPPT, Art. 16).



Relevant industry music licensing practices

The business and industry practices for licensing repertoire are very much based on standard licensing contracts – both in the area of publishing and recorded music.

Certain basic questions and requirements must be taken into account by the negotiating parties in negotiation of these agreements:

- Does the licensor actually own the rights and does the licensee need to include an indemnification clause in case the licensor does not?
- Are the rights and the way the rights are to be exploited described in a sufficiently detailed manner?
- Are moral rights of the licensor addressed?
- Has the licensor transferred all rights or has he carved out certain forms of exploitation?
- Can the licensor deliver on time?
- What is the licensor's share and license fee, and when does he receive his royalties/advances?
- How is the financial risk in any music production being shared (i.e., who bears the production costs, marketing etc.)?
- What is the contract term? When can the licensor re-negotiate the terms?
- Can the licensor also offer someone else his rights (exclusivity)?

In the following section, the main license agreements are introduced briefly.

Business and industry practices in the music publishing industry

The variety of contracts in the publishing industry

There are several varieties of standard music publishing deals:

- Song-by-song publishing agreement;
- Exclusive songwriter agreement;
- Co-publishing agreement;
- Joint administration agreement;
- Sub-publishing agreement;
- Synch-license agreement.

Song-by-song (or single song) publishing agreement

This agreement deals with the licensing of rights between an author and a publisher for a particular composition. It largely follows the rules of the exclusive songwriter agreement.



Exclusive songwriter agreement

This agreement is the most important license agreement in the publishing industry. It may last for a fixed period of years with options to extend the term. These publishing deals may cover all songs written by an artist, or just those songs commercially released during the term of the agreement. This agreement will be presented in more detail later.

Co-publishing agreement

This agreement is similar to other above-mentioned standard songwriters agreements, except that the author (or the author's publishing entity) co-owns a percentage of the copyright along with the publisher. It is common for both parties to each own 50% of the copyright, though percentages can vary from deal to deal. In a co-publishing deal, the songwriter's publishing entity also receives a percentage of the "publisher's share" of income. The main items to agree on are:

- minimum amount of works to be delivered;
- term;
- share; and
- what happens to the works after the deal has been terminated?

Joint administration agreement

In a joint administration agreement the publishing administrator collects income and also assists in promoting the songwriter's catalogue. An administration deal may last for a specific period of time or for one year with several options to renew. When the term is over, all rights revert to the artist. A publishing administrator is usually paid based on a deduction of a percentage of the income he collects on behalf of the artist. After deducting this administration fee, the administrator distributes 100% of the remaining net income to the songwriter.

Sub-publishing agreement

Sub-publishing plays an important role in the area of licensing Anglo-American works, and 70% of the worldwide record productions depend on those works. So far as the author's "mechanical rights" are concerned, the following is of high importance: usually these rights have been fully transferred to the original main publisher and are therefore owned by the latter on a worldwide basis unless the rights transfer has been territorially restricted in the first place. The main publisher relies on a worldwide network of sub-publishers who are usually granted the non-exclusive right to exploit the work in its territory. Additionally, the sub-publisher is exclusively authorized to collect the respective remuneration. The sub-publisher provides the collecting society in his territory with a mandate to administer the works and pay any royalties (his and the author's share) directly to him. The author, as he has transferred his copyright completely to his original publisher, does not receive any remuneration from the society. Instead, the sub-publisher pays a share to the original right owner via the main publisher located in the United States of America or United Kingdom. The respective author's share is accounted by these original main publishers.

A sub-publishing contract therefore contains two basic regulations:

- Which rights are represented, where?
- What is the share between sub-publisher and author?



Synch-license agreement

Music publishers issue synch-licenses to television advertisers, motion picture companies, video manufacturers and CD-ROM companies. Other more recent examples are: e-greeting cards, computer and console games. This right is usually administered individually or, in some cases, by the collecting society. The synch-right is closely linked to the above-mentioned *droit moral* of the author, as his work is supposed to appear in a new environment which might change the original work's character completely (e.g., *Also sprach Zarathustra* in Kubrick's movie "2001–Space Odyssey"). Synchronization generates significant income for publishers. In the first six months of the financial year 2001 to 2002, for EMI, the world's largest publisher, synchronization accounted for 14% of its revenues, compared to 9% in 1997 to 1998.²¹⁶ Tony Braxton's recording of "Unbreak my heart" generated nearly US\$1.2m in the United States of America alone for the first 18 months of the song's life – US\$695,000 in radio, TV and live performance fees and US\$504,000 in recording royalties.²¹⁷

The exclusive songwriter agreement in detail

The following examination of the most important clauses in nearly any standard songwriter agreement demonstrates the business practices applied in the publishing industry.

Subject matter of the agreement

The parties agree on a sort of framework deal that provides the publisher either with the obligation to accept any individual work by the author, or to benefit from a first-option right according to which the author has to offer the work first to the publisher. If the parties cannot agree on terms to include the work in the contract, the author might offer it to a third party. In this case, the parties might also consider the inclusion of a matching-offer right, meaning that the publisher can match the third party's offer and take over the work.

The long-term agreements between publisher and author (especially if he also is the performing artist) usually contain the obligation to deliver a minimum quantity of works. This obligation has an immediate effect on the advances (see discussion below). The parties need to agree on the term for the exclusivity as well as a right to terminate the agreement. Some national copyright acts provide for a maximum term of such exclusive licenses granted to a publisher.

Categories of rights transferred to the publisher

Performance and mechanical rights licensed by collecting societies

Standard agreements usually contain a clause by which the author transfers his public performance and mechanical rights to the publisher. In more recent agreements "Internet rights" are covered. Although these rights basically stand for the major stake in publishing income (see above) they have usually been transferred to the author's collecting society at the time the publishing deal is concluded.²¹⁸ Consequently, such a transfer clause in a publishing agreement has no effect as the rights are with the collecting society already. The publisher usually negotiates a share in the respective income from the collecting society's licensing activities.

Print right

In the past, the administration of the right to produce musical scores was the core business of music publishers. With the appearance of music on sound carriers, radio and TV, this kind of exploitation lost some of its importance. Nevertheless it should be noted that the current multi-media and Internet environment provides for various ways for the exploitation of musical scores outside the traditional use of the print right: composer software for keyboards and PCs contains scores of already existing musical works, Internet sites facilitate the making available of such scores to the global community, songbooks combined with pictures and biographies of artists for keyboards/PCs are also available. The traditional share is often between 10 to 15% of the net consumer price.

The synch-right

Whenever a song is used with a visual image it is necessary to obtain a “synchronization” (or “synch”) license permitting the use of that song. It should be pointed out that the synch-right is an additional source of income for the right owner besides royalties from broadcasting/publicly performing the (combined) movie. A portion of this money, usually 1/2 the net proceeds, is paid to the songwriter. In the publishing agreement the publisher sometimes deducts an administration fee from the author’s share. The remaining income could be shared equally.

Rights involved in advertisement

A particular “right of advertisement” does not exist but the author’s moral right is usually involved if the work is used for advertising purposes. The author usually determines, in his agreement with the publisher, the scope of the ability to combine his work with other advertisement productions. The split of any income from licensing such use remains to be negotiated. Sometimes songwriters are able to negotiate provisions in their publishing contract preventing their songs from use in certain contexts, such as ads for alcohol, tobacco, political campaigns or other uses the songwriter may find offensive.

Rights for merchandising

The term “merchandising” refers to the commercial exploitation of the author’s *droit moral*. This right becomes even more important and is of a higher economic value where the author is also the “visible” performing artist. Based on this legal position, he can authorize or prohibit the use of his image and name on T-shirts, mugs, puppets etc. The parties agree on whether the author, publisher or both should bear the cost risk. In the latter case, the parties usually split the income from merchandising. Where the publisher bears the risk, the author often receives a license fee taken off the net retail price of the particular merchandise.

Adaptation right

Usually the author allows the publisher to produce score editions and arrangements in order to exploit the work. Such an authorization is usually limited to adaptations that do not infringe the author’s *droit moral*. The respective clause in a publisher’s agreement covers in particular the following:

- Are foreign versions prohibited?
- Does the adaptation right apply to the main publisher or also to sub-publishers in other countries?



- Does the author have to authorize any adaptation/some adaptation (define which ones)?
- What are the accepted reasons for refusal of the authorization?

Due to rapid changes in the way music can be exploited, it is essential to carefully define and determine the transfer of rights and the forms of acceptable use. Very broad clauses such as “all formats today known and hereinafter invented” are invalid in some countries.

Rights transfer to publisher and restrictions

Based on the above-mentioned understanding of the notion of copyright and *droit d'auteur* the copyright can be completely transferred, e.g., to a publisher (for instance “work made for hire”) whereas this is impossible, with some exceptions, in some *droit d'auteur* countries. In such countries, the publisher is usually granted an exclusive right to administer and exploit the author’s work. In any case, the author provides the publisher with such rights that enable the latter to exploit his work in the most efficient way.

The following restrictions on the transfer of rights could be negotiated:

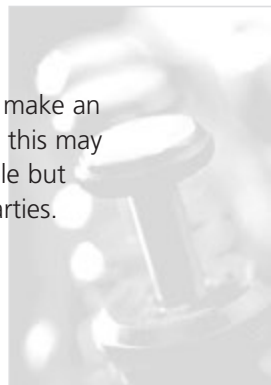
- Temporary restriction: usually the contracts contain the term “Life of the copyright.” One might consider a shorter term with a fallback of rights after the expiry;
- Geographic restriction: publishers usually prefer a world-wide transfer. This is useful if the publisher relies on an international network of (sub-) publishers in foreign territories. Otherwise, the transfer might be restricted to the exploitation in certain regions (e.g., the German-speaking region of Germany, Austria and Switzerland). It should be noted that the inclusion of a territorial restriction with respect to Internet exploitation is rather questionable and will rarely be accepted by the licensor;
- Restriction of the contents: transfer of rights for traditional exploitation (performing and mechanical rights) with the exclusion of any “online rights” or “film synch-rights.”

Financial considerations in a publishing deal

The basic principle in publishing agreements is that, in exchange for the transfer of rights, the publisher may pay the author an advance based upon the potential value of the compositions. Subsequent income generated from these songs is then divided. After the publisher recovers its advance, the artist is paid the “writer’s share” of net income received, while the publisher retains its publisher’s share.

Advances

The publisher pays the author an advance on the expected income. Publishers usually make an offer based on 50% to 70% of what they anticipate the record sales will be, although this may change as publishers tend to pay less advances.²¹⁹ This advance may be non-refundable but recoupable (fully or up to a certain limit) depending on the agreement between the parties.



Refunds

Where a collecting society administers the author's rights, the author depends on the strict distribution scheme as implemented by that collecting society. Should the author and publisher wish to agree on a different split than "ordered" by that scheme, the publisher could agree *inter partes* that the author participate in his "mechanical share income" from the society. Such an agreement *inter partes* would increase the author's income from the collective administration.

Controlled composition clause

Such a clause comes into play where the singer is also the songwriter, and applies to contracts between artists and record companies in the United States of America. According to the United States copyright law, Congress established a statutory mechanical royalty rate for songwriters and their publishers based on an upward-sliding scale tied to a cost-of-living index on a per song per record basis. The controlled composition clause, one of the royalty-reducing provisions in many United States record contracts, contractually reduces the mechanical rate for a songwriter/recording artist and its publisher on songs written or otherwise "controlled" by the artist. Most such clauses reduce the payment per song, but may also limit the total number of songs on which payment will be made and may fix the point in time at which the calculation will be made. This clause is also often called the "3/4 rate" as it typically reduces the amount to 75% of the above-mentioned statutory rate. Such a clause in the recording contract therefore has implications for the songwriter's mechanical license income.

Share in case of several authors

Where the work has been created by several authors, the authors themselves will conclude an agreement that regulates their share. If the authors are part of a band, a respective agreement in the corporate group agreement might be considered. Furthermore, they will have to reflect their co-authorship in the publisher's agreement.

Termination of the publishing agreement

Depending on the author's negotiating position and on the applicable national copyright law, the author might be able to revoke his works and to terminate the agreement accordingly. There might be various reasons for the author to take this step. For instance, if the publisher has been reluctant to exploit the work for a long time, or the author is no longer convinced that his work actually reflects his genius. As this possibility implies a high risk for the publisher, the contracts usually contain a clause according to which the parties agree on a time frame that regulates the publication of the work (e.g., 12 months upon delivery of the work).

Business and industry practices in the recording industry

In the recording industry, business and industry practices to license repertoire is similarly based on standard licensing agreements.

License agreements in the recording industry are becoming more complex. Whereas in the past sample forms were simply filled out (with name, address, remuneration, term), today's contracts can easily consist of up to 30 pages in Europe and often double in Anglo-American countries. The reasons for this are as follows:



- (a) New forms of exploitation are emerging: CD, CD-ROM, CD-e, DVD, SACD, online etc., and are often explicitly mentioned in the license agreement.
- (b) Costly advertising and marketing campaigns such as TV and radio campaigns, production of promotional videos and cooperation with TV stations require special conditions, in order to agree on the cost risk for both parties. Marketing and promotion costs are perhaps the most expensive part of the music business today, including increasingly expensive music video clips, public relations, tour support, marketing campaigns, and promotion to ensure the songs are played on the radio.
- (c) National productions are increasingly exploited abroad and therefore have to follow international, often Anglo-American, contractual standards.
- (d) Various national laws provide for the clear and transparent formulation of the terms and conditions as used, for instance, in the industry's sample contracts.

Main agreements used by the recording industry

The following are the main agreements entered by the above-mentioned players in the recording industry in order to produce and exploit a recording:

- Exclusive artist agreement;
- Producer and music video production agreements;
- Master license agreement;
- Label agreement;
- Sales and distribution agreement;
- Remix agreement;
- Sampling agreement;
- Licensing agreements with third parties: e.g., compilation and TV-cooperation agreements.

Exclusive artist agreement

In entering an artist agreement, the artist signs a contract directly with a record company. Such an agreement can refer to all performances recorded during the contract's terms or simply to a single production (called exclusive single title agreement).

Producer agreement

The record company then has to find a creative producer who records the artist's performance based on a so-called producer agreement. The producer usually grants all his unlimited rights to the company and receives a flat-fee or an override on each recording sold. For music videos, the record company also concludes a music video production agreement.

Master license agreement

Under a master license agreement, another record producer delivers a finished tape to a record company. The producer has already concluded an artist agreement in order to produce the tape. While he has paid all recording costs, he does not have his own distribution apparatus. In this case, he transfers his and the artist's rights as well as all contributors' rights to the record producer, who replicates and sells the recording as incorporated on the tape.

Before concluding an artist or master license agreement the following should be taken into account: in the latter, the producer bears the production risk but usually receives a higher share from the record company. In the former, the record company fully bears the production risk but the artist receives a lower share. Newcomers who expect significant sales often consider bearing the production risk (i.e., they pay the production costs) but expect to benefit from a higher share in the master license agreement with the record company.

Label agreement

The label agreement can be described as a sequence of master license agreements. The parties usually agree to found or select a label under which they intend to sell the recordings. This kind of contract involves a great deal of tight cooperation between the label owner – who is often also is the producer – and the record company. The label owner has concluded many artist agreements with various artists, often performing in a particular artistic style that distinguishes the label from others.²²⁰ The label partner does not necessarily have to deliver tapes only to the record company as his licensee. The latter often benefits from a first-option right, meaning that before the label partner offers the tape to any third party he has to first offer it to the record company, which has an agreed time frame in which it is allowed to decide whether to take the tape or not. If not, the label partner can offer it to third parties. Should the parties have agreed on a so-called “matching-offer right,” the record company can still strike the deal by matching the offer the label partner has received from that third party.

Under a label agreement, the record company usually relies on the creative know-how and the experience in A&R of the label partner. Therefore, the company pays marketing expenditures and label support in order to promote the sales of the artists’ recordings under the label’s name.

Sales and distribution agreement

Under sales and distribution agreements, the record company only fulfils administrative tasks. Such agreements are concluded where the producer of the finished product is not able to commercially distribute the recordings. He also concludes a separate manufacturing agreement with a pressing plant and has to pay the copyright fees to the authors’ collecting society.

Under a distribution agreement, the record company has the least influence on the making of the recording. For instance, even the cover layout and video production are controlled by the producer/artist. Even major record companies themselves sometimes conclude distribution agreements with other record companies that are highly experienced and specialized in sales in niche markets (e.g., heavy metal music, vinyls) and in a better position to serve these local niche markets. The main difference to the above-mentioned master license and label agreement, is that the producer usually does not receive a share in form of a license fee but receives the partner’s income from sale of the recordings from which is deducted a commission fee and other variable costs.

Common basic terms in exclusive artist and master license agreements

The parties often fix the contractual key terms in so-called “Heads of Agreement”: Such heads lay out the main economic terms – often in form of a table rather than in a full text – before concluding the “longform” of the license agreement.

In the final version of the longform the following most important and essential key terms are agreed on namely:



Product range

The parties agree on the (minimum) number of recordings the licensor (artist in case of artist agreement, producer in case of master license agreement) has to deliver during the contractual term and any further optional terms. The parties might distinguish between single or longplay productions and agree on the production of music videos in order to better promote the recordings. Not only the audio recording is subject matter of such license agreements, but also the right to exploit a respective audio-visual recording as “music video” in order mainly to promote the audio recording. But with the above-mentioned release of new highly sophisticated carriers such as DVDs the commercial exploitation of such music videos becomes more and more important. The significant costs of a music video production usually starting with US\$ 50,000 might be borne by the record company and are (partly) recoupable. Finally, the record companies also release TV and live concert recordings of the artist on DVD.

Under current license agreements, the parties agree on the production of a sound recording which is then subject to all forms of exploitation – be they physical (CD, DVD and other carriers) or non-physical (broadcast, Internet, M-Commerce).

Transfer of rights and restrictions

As with authors' rights contracts, the record company usually seeks to receive all unlimited rights for any form of exploitation. Included in the bundle of rights are also the right to make the sound recording available via the Internet and mobile networks. The licensee, though, may prefer a restricted transfer of rights. Such restrictions could be temporary, geographic (except for exploitation via the Internet) or in relation to the contents (see above).

Exclusivity of licensee's position

In nearly all artist or master license agreements, there are three types of exclusivity.

Exclusivity in the actual recording

This implies that the exploitation rights in the particular recordings are only granted for the agreed term of exploitation on an exclusive basis. Within that term the licensor is not permitted to grant any rights in these recordings to any third party.

Personal exclusivity and sideman's clause

This provides that for the term of the contract, the licensor is not allowed to provide any third party with any recordings performed by the artist. For a dance music project, concerts for welfare purposes and the artist's participation as a studio musician (sideman), the exclusive licensee often agrees to release the licensor from that strict exclusivity (the so-called “sideman's clause”). In return for the release, the licensee often receives an override from the exploiting third party and makes sure that a respective credit is stated on the final product. While the personal exclusivity of the artist is normally guaranteed, this is different in today's dance music productions, in which it is the creative producer rather than the artist who guarantees the success of a recording and who benefits from a valuable reputation in the dance music scene. The artists are often exchangeable. In these cases, the parties ensure that the personal exclusivity refers to the creative producer and not to the artist.

Re-recording restriction

This requires the licensor to warrant and guarantee that neither he nor the artist will re-record any contractual title contained in the master recordings during the contractual term and the exploitation period. This implies that neither the licensor (for instance, the producer in case of a master license agreement) nor the artist or any individual member of a group of artists may re-record or have re-recorded by third parties and/or exploit or have exploited by third parties the titles as incorporated in the master recording.

Merchandising, tour support, media training

If the record company provides any merchandising facilities to sell any products promoting the artist's name or image, the parties need to agree whether the company enjoys the exclusive or the non-exclusive right for merchandising. Furthermore, the parties need to agree on how to share the respective income from merchandising.

Live concerts are essential in order "to break" an artist, i.e., to make his name and performance well known in public and to trigger sales. Such live tours often lead to losses or the artists can only be placed as costly support acts of famous bands, in which case the parties again need to agree on the share of such expenses.

For the same reasons the record company (recognizing the artist's potential) may encourage him to take dance lessons, media training etc. These costs are also subject to further agreement on sharing and/or recoupment.

A new business model is emerging in this area: Joint-ventures between artists and record companies in order to share any income. An example was the agreement between EMI and Robbie Williams in October 2002.²²¹ As the record company has invested in the establishment of the artist and his reputation and therefore laid out the basis for his success, such new ventures might serve the purpose to share the artist's income from touring, merchandising and publishing earning to cover the company's costs.

License fee

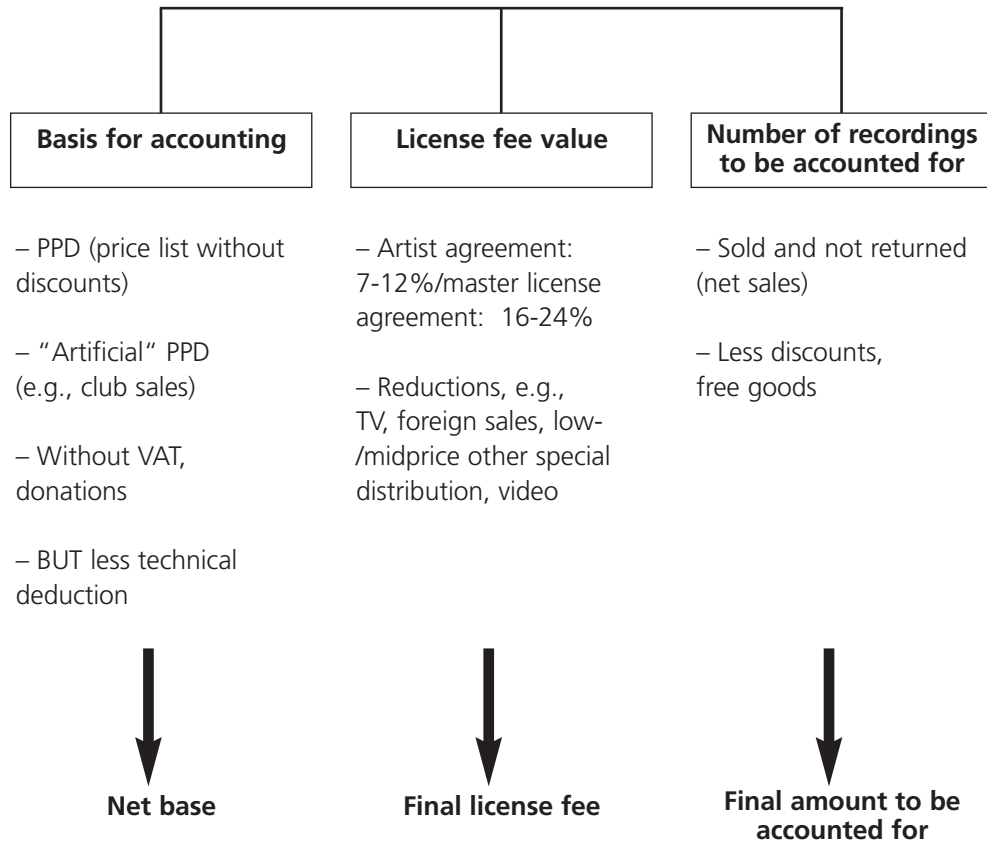
One of the most crucial parts in the negotiations is the licensor's participation in the licensee's income from exploiting his rights/repertoire. A producer who has concluded a master license agreement with the record company has to pay all the individuals who have contributed to the making of the recording, i.e., featured artists, creative producers, studio musicians etc. This has to be kept in mind during the negotiations with the record company. In order to determine the applicable license fee, there are three main factors to agree in licensing agreements:

- Basis for the calculation of the license fee;
- Actual nominal value; and
- What triggers the license fee?

These factors can be graphically summarized in the following chart:



Simplified means of calculating royalties in recording contracts



Basis for the license fee

Usually the published price to dealer (PPD) determines the basis for the calculation of the license fee.²²² This is the price stated in the record company’s price list according to which the wholesaler purchases the recordings from the company in order to sell them to the end consumer. VAT and donations are not taken into account. The same is valid for rebates and discounts. Where there is no PPD (e.g., in case of special manufacturing for clubs (only the price paid by the club member applies) or in case of B2C sales, such as in some of the online business models an “artificial PPD” is created. The latter is usually agreed as the net price paid by the consumer reduced by a certain percentage, or the value of the license fee is reduced. This net price paid by the end consumer becomes more important in the case of online sales where record companies sell directly to these end consumers.

This basis is then reduced by so-called “technical deductions.” This reflects the record company’s expenses for CD covers and plastic boxes etc., but also their payments for “cyberlopes” in order to let the artist benefit from the secure exploitation of his recordings in the online environment. The parties might also consider sharing the costs for the use of copy protection software, which could be paid as a fixed fee per recording sold and not returned.

The result after all deductions is called the “net base for accounting.”



Nominal value of the license fee

Usually the parties agree on a certain percentage calculated from the above-mentioned basis. This is all subject to negotiation. The artist's share in artist agreements often varies between 7 to 12%, the producer's share in master license agreements is higher, between 16 to 24%, but he also has to pay the production costs in order to deliver the finished master tape. This involves the payment of the respective artist and producer royalties. The parties might also agree on fee escalations linked to the economic success of the product.

The license fee is reduced to take account of additional expenses where the recording is exploited via a particular trade channel, such as advertised product, foreign sales, mail order, mid/low price, or as an audio-visual product.

Number of recordings to be accounted for

The licensor is intended to participate in any economic exploitation, and therefore he receives his royalties for sales of recordings through regular trade channels. Royalty-free are often: promotional records, free or bonus records as well as excerpts from master recordings used by the licensee for publicity and advertising purposes, records sold out at sell-out prices after deletion from the licensee's catalogue as well as records given to radio or TV stations as samples. The same applies to records returned to the record company by their wholesalers. Accordingly, the company is entitled to establish reasonable reserves for expected returns in the relevant accounting period. The actual amount of recordings subject to royalty accounting is called "net sales."

Advance payments

Advance payments on royalties are the second important item to negotiate. For the licensor, these payments are an important and immediate source of income as they are non-returnable. New artists in particular depend on such payments in order to survive. "Non-returnable" means that the licensor does not have to return the advance, but that the company tries to fully recoup this payment against the licensor's royalty income. In the end, this means that the licensor does not have to return the advance payment even if it has not been recouped.

Advance payments can be agreed as fixed annual payments or triggered by the delivery of a single/album, or they can depend on the accomplishment of the obligation to deliver a minimum amount of albums in a certain period of time. Advances are often paid in two installments: for instance, 50% after signature of the license agreement and 50% upon approved delivery of the master recording. Finally, the parties might negotiate whether the advance payments shall be cross-collateralizable against all royalties from all products under the contract. The latter is highly important in label agreements covering various artists.

Remix and sampling agreements

There are also established contract forms for remixes and digital sampling productions. Both uses imply an adaptation of the underlying musical work and also of the artist's performance on the master recording. Whereas the structure of the respective agreement is very much in line with the above-mentioned contractual structure of the master license agreement, the following additional issues need to be addressed:



Remix agreement

This agreement is similar to an agreement concluded between a creative producer and a record company. The following issues in particular need to be agreed upon:

- Date of delivery of the remix;
- Production costs;
- Exclusive rights transfer and indemnification by producer;
- Remuneration: flat fee/override license payments; and
- Credit “remixed by....”

Sampling licence agreement

- Indemnification of licensee by licensor regarding all claims raised by third parties whose rights might be infringed by the adaptation via sampling;
- Full documentation on whose contributions have been used/sampled (publishers, authors, artists, record companies);
- Importance of the sample (length, continuous use in the new recording or just from time to time, used as hook-line that identifies the new recording etc.); and
- Flat fee/one-time-only fee/bonus payments in case of increased sales.

Further industry license agreements

Compilation agreement/cross-licensing

Record companies also license tracks from other companies in order to put them on a compilation album. As with a master licenses, such inter-company license agreements basically determine the term of the license to use the track on that particular album and the remuneration based on sales of that compilation. Such agreements appear in a different context as well, namely, Internet exploitation. The majors involved, for example, in Pressplay (a joint venture between Sony and Universal, now sold to the United States based CD burning software company Roxio²²³) and MusicNet (joint venture between Real Networks, AOL Time Warner, EMI and BMG) cross-licensed their repertoire in order to be able to offer all repertoire out of one hand, meaning from their respective single platforms.

TV-advertising cooperation agreement

Such agreements regulate the use of a particular recording in a TV-series or advertisement. Often the record company is allowed by the broadcaster to use its logos on the advertised sound carriers. With respect to the sale of advertised albums, the TV station receives a share in the respective revenues.



Noteworthy issues between the creative community and the industry/rightsholders

Recording companies versus music publishers

The publishing and the recording industry is now in a period of particular tension. This is mainly focused on Universal Music's complaint with the European Commission. This move followed a two year stand-off between the International Federation of the Phonographic Industry (IFPI) and the umbrella organization for mechanical rights collecting societies, BIEM, over the negotiation of continental Europe's standard rate for the publishing royalty paid on manufacturing and sales of records. Universal argued that the publishers – through BIEM – had been operating a cartel, forcing companies to pay a royalty it believed was too high and did not reflect the reality of the recording market.

Artists versus record companies

Artists, particularly in the United States of America, are speaking up against record companies, criticizing deductions from royalties (see above, e.g., recording, marketing, promotion, and video costs). They are also concerned about the "work for hire" clauses in their contracts. Furthermore, they question the contracts' standard term which, provided minimum funds have been paid annually to the artist, runs for seven years.

The current trend is that record companies are rethinking the way they contract with artists in order to provide more transparency in contracts and accounting. There is a tendency to simplify business practices and to create greater transparency, to enhance margins and/or to participate in new or different income streams and, finally, to reduce overhead costs or manpower time on contract administration and royalty accounting. BMG, for instance, announced in November 2002 an overhaul of its world-wide royalty accounting policy in order to create "a simpler, more transparent accounting process by eliminating certain standard deductions applied to contracts both in the United States and other territories and by moving to a wholesale model in the United States instead of the current model based on the suggested retail price."²²⁴ This also applies to the company's online royalty accounting. These royalties will no longer be subjected to deductions and will be calculated on the artist's album rate rather than the lower singles royalty rate. The reason for this move is "to encourage artists to value the company's participation in legitimate online services and in the industry's continued efforts against online piracy." For the time being BMG's overall policy can be summarized as follows:

- contracts are limited to a maximum number of four albums;
- non-recoupable recording costs for each album are fixed;
- advances are spread through the contractual period; and
- to maintain a long-term/perpetual copyright ownership, BMG intends to pay additional advances at certain points in the future.

It is also understood that BMG will terminate application of a 25% reduction to North American royalty rates. It will scrap the practice of container/packing deductions and rely on one royalty rate applicable to all territories and all formats, or share income from non-traditional sales on a 50/50 split of the net basis. Furthermore, the company will scrap all reduced royalty categories and intends to report on a monthly as opposed to a semi-annual basis. In exchange, BMG will reduce the royalty rate. The latter is supposed to be 15% of the dealer price that equals a royalty rate under the conventional system of 20%, with a 25% container charge.

In North America, Universal Music intends to apply the higher album license fee to downloads rather than the lower single fee. Additionally, the company also would scrap the technical



deduction. At the same time, Universal Music has initiated a new royalty accounting and auditing system for physical sales,²²⁵ under which it will allow artists' representatives to see manufacturing information. Universal Music will also double the size of its audit support staff. Royalty workshops will be held for interested artists to help them better understand the royalty statements.

Warner Music Group has also announced its intention to streamline its license agreements.²²⁶ The company went further by implementing a self-penalty for undercredited royalties and, in certain case, offering to help to cover some costs of an independent audit.

Users calling for statutory licensing schemes

In view of the potential for global exploitation of music, exploiters are questioning rights owners' ability to provide for license mechanisms that reflect this new way of exploitation via global networks.²²⁷ They are calling for statutory licenses to avoid having to negotiate with any right owner at all. Following similar calls, the "Music Online Competition Act of 2001"²²⁸ was introduced by members of the United States Congress. Under the bill, any record producer would be obliged to grant a license to any third party for the exploitation of a sound recording that has already been offered for license. In Canada, the issue of inclusion of Internet exploitation in the statutory license scheme for cable transmissions has been raised.²²⁹

Who sells online—competition between sellers?

The big question now is who will sell music online. All players on the sales front are involved, and competition is growing.

The record company

In some cases, the record companies themselves sell directly to end consumers and follow a B2C (business-to-consumer) model. The advantage is that the right owner has the most direct contact with his customer and benefits from direct control over how he sells his repertoire. In this case, a non-exclusive license agreement is concluded directly between the record company and the consumer regulating the use of the recording enabled by DRM (by allowing/preventing the making of further copies, superdistribution, passwords etc). An example for this model is Universal Germany's portal Popfile.de. Apple's successful iTunes Music Store (licensed by the record companies) demonstrated that, similar to the off-line world, record companies need not necessarily own the highway music is sold on, but might concentrate on its core area of activity, i.e., the content business.

Sale via agents and brick-and-mortar retailers

A record company can sell its repertoire via agents from their website, or it could sell its repertoire to third parties (such as brick-and-mortar retailers) who then sell the recordings to end consumers. The latter model follows the conventional record sale. Some examples are the cyber store, *hmv.co.uk*, run by the United Kingdom-based retailer HMV, or *hotvision.de*, run by MediaMarkt in Germany. The United States portal Pressplay is marketed to consumers through relationships with, for instance, Yahoo, *mp3.com* and MSN.

United Kingdom-based OD2's business model relies on a link between record companies and retailers. When it sells recordings to the latter it acts as a wholesaler. The record company sets a dealer price for each track and OD2 supplies the track for sale on an "etailer" website, such as

hotvision in the above-mentioned example. The retailers are then free to set the final end consumer price.

In addition, classic retailers are now considering benefiting from their experience in end consumer sales as so-called “e-tailers.” On January 27, 2003, major United States retailers such as Best Buy, Tower Records and Virgin Entertainment announced the creation of a retailer-driven consortium called Echo, aimed at “bridging the gap between brick and mortar and digital music distribution.”²³⁰ Once licenses are obtained, the members will be able to deliver digital products and services through individually branded, or Echo co-branded partners. Under the terms of the venture, each retailer independently markets and prices the products. Wal-Mart’s recent purchase of online pioneer, Liquid Audio, is a move in the same direction.

Sale via well-known cyber stores

In addition, cyber stores with major reputations in the online community are discovering new online possibilities: Amazon and CDNow are examples of such companies that had already established reputations for sales via the Internet (by email order) before record companies or retailers even started to sell online in any quantity. For any online-seller, brand recognition is essential: as mentioned above, Universal Music and Sony Music recently sold their shares in their online portal Pressplay to Roxio. The latter will relaunch the digital music service under the name “Napster” and will benefit from the still highly recognized brand for digital downloading, although even the application will have changed.

Offering all repertoire out of one hand

For quite some time it was nearly impossible to enter a cyber store and browse through repertoire from multiple record companies like in a brick-and-mortar store: Germany’s Popfile offers only Universal’s repertoire; Pressplay began as a joint venture between Universal and Sony but partnered with other major record companies; MusicNet partnered with Sony and Universal Music; OD2 has collected licenses from various record companies;²³¹ and Apple clearly demonstrated with its iTunes Music Store how effectively a third party can sell music online by aggregating all the Majors’ content.

The impact of technological developments on licensing: E- and M-Commerce

While CD sales are declining, sales of newly developed audio and audio-visual carriers such as DVD and SACD are increasing. The most important technological development, however, is the ability to deliver content compressed and converted into bits and bytes via global or local networks from one user to another within seconds. The best example of this development is the exploitation of music on the Internet.

Today the music industry faces “electronic music piracy,”²³² especially in the form of its repertoire being compressed in the so called MP3 format²³³ and posted, transmitted and downloaded globally via the Internet – without the right owners’ authorization and, therefore, without payment of royalties to any of the above-mentioned contributors to the creation of the sound recording. Billions of songs are “swapped” every month via peer-to-peer network services.²³⁴ This is one of the reasons why physical sales are declining, as demonstrated in the (P2P) chart above. This is also the reason why record companies and other players are now rolling out business models to attract users to conveniently download songs against payment in a secure environment: secure for both consumers and right holders. These models compete with the illegal peer-to-peer file sharing by



offering added value that illegal file sharing operators do not and cannot offer: e.g., direct contact with the marketing team of the record company in order to be informed about the artists, access to chat rooms with the artist, concert tours, cheaper concert tickets, high-quality recordings, no risk of downloading fake or even infected files or having to face timed-out transfers etc. Such convenient and advanced download portals include: MusicNet, *E-Compil.fr*, operated by Universal Music France and *Popfile.de*, operated by Universal Music Germany, United States-based Listen.com (the first subscription service offering various webcasting genre channels and downloads of content from all majors) and, finally, Apple's iTunes Music Store.

In addition, the M-Commerce market is growing in the music sector with sales of ring tones, logos, screen savers, voice cards, MMS and artists' images etc. Streamed content will in future be available in cars as well as via mobile phones,²³⁵ hand-held organizers etc. The third generation of mobile phones (3G) will offer multimedia services that are unknown today. Wireless streaming of music against payment is already growing, for instance, in the United States of America via "My Music" and "Sound Market" and in Japan via "M-Stage" but it is still suffering from slow data transmission. The United States company RealNetworks presented at the GSM World Fair in Cannes in 2002 a software that enables users to access audio and audio-visual files via their mobile phone in high quality, and Finnish, Spanish and German companies are now testing the compatibility of this technology with the UMTS mobile phone standard.

The emergence of new business and licensing models

The Internet P2P services demonstrate the global community's willingness to consume music via the Internet. During the early dotcom boom, right owners and technology companies dreamed of a flourishing online market. Bullish predictions were made as far as the representation of digital downloads in the share of soundcarrier sales were concerned. But at that time neither the technological nor the licensing infrastructure that would enable an online music market to develop was in place.²³⁶ In order to meet the demand for music online, but in a secure environment, right owners need to consider various business and licensing models:

- Unrestricted *à la carte* download: a company makes downloads of entire sound recordings available for a per-recording or per-album charge. A customer may use the recording at any time, and there is no copy protection.
- Copy protected *à la carte* download: a customer may use the downloaded recordings at any time but is limited in his ability to make copies (e.g., copying is permitted only to a personal device²³⁷). One-time downloads might be reflected in the price, and companies are now experimenting with limited burns and downloads.²³⁸
- Time-Out: a customer may use the downloaded recording any number of times for a limited period of time, and as he does not want "to own" it forever, he therefore pays less.
- Subscription Distribution: a customer receives downloads for a periodic fee irrespective of the number of downloads actually made. Alternatively, for a periodic fee, a customer might receive a daily featured selection via email. The copies could be unrestricted, copy protected or time limited. Pressplay.com, for instance, provides three schemes: "unlimited" for US\$9.95 provides for unlimited streaming and downloads per month. "Unlimited plus" for US\$17.95 provides for unlimited streaming and downloads and 10 portable downloads. "Annual Plus" for an annual fee of US\$179.40 (i.e., US\$14.95 per month) provides for unlimited streaming and downloading and 120 portable downloads on day one of membership. There is even a legal P2P service called "Wippit" based on a subscription service and licensed by various record companies. This model does not seem to be

popular with users. Apple's comparably unrestricted iTunes Music Store demonstrated with one million downloads within the first week after its launch the immense popularity of pure à la carte download models without any subscription. Shortly after its launch, Universal and Sony sold their shares in Pressplay to Roxio.²³⁹

- Download of Bonus Track: the record company distributes a recording in physical form. A download of an additional track is available over the Internet to customers who verify that they have bought it. The copies could be unrestricted, copy protected or time limited.²⁴⁰
- Superdistribution: the usage rules associated with the downloaded track permit a customer to send a copy or a link to that song to a friend. The friend's copy can be tried out before he buys it.

From this non-exhaustive list of business models it appears that any licensing scheme that regulates these models depends very much on DRM-technologies in order to enforce the licensing conditions set by the licensor.²⁴¹ In the past, the user "had to buy" at least a single or even an album, in order to listen to his/her favorite artist – although he only may like one particular song on that album. The sound carrier clearly states: "Unauthorized copying, public performance and broadcasting of this recording prohibited." With the emergence of DRM, providers are now prepared to set out convenient (end user) licensing schemes that meet his/her demands more specifically.

Internet Exploitation Agreements

Taking into account the above considerations, what would such an agreement look like? Any licensing agreement relies very much on the business model adopted by the exploiter. It is therefore essential for the licensor to carefully study the model and adapt his licensing scheme to it. It should be noted that, although Internet exploitation is a fairly new way of using music, there is no need to invent completely new Internet licensing agreements. On the contrary, parties are advised to base these agreements on the structure of the above-mentioned conventional license agreement structure and to add whatever new terms are necessary. The main issues to be dealt with are the following:

Based on the above-mentioned standard licensing agreement the main issues are as follows:

- Is the license an exclusive or non-exclusive one?
- Does the licensee need global rights or is the Internet exploitation by technical means restricted to exploitation in a certain country (e.g., IP address look-up, nationality of credit card issuing bank, self-registration on the website, other technical geographic restrictions)?
- Is the license fee calculated on a track-by-track basis and triggered by each download of the recording? In this case, the above-mentioned financial considerations apply. The license fee is likely to be calculated as a percentage of the end consumer price, or if the licensor actually sells his recordings to the licensee who then sells them to his customers, the above-mentioned traditional "PPD model" might apply. Are "cyber-freegoods" (i.e., free downloads/promotional 30 seconds clips) included in the business model and are they accounted for? Please note that "returns" obviously do not appear in any online model.
- For subscription services, the license fee can be calculated as a percentage of all net revenues (especially subscription fees) received by the licensee.
- The advances to be paid and when?



- (a) The licensor will require use of his recordings in a secure environment and therefore the license agreement, includes a provision requiring use of a particular DRM-technology.
- (b) Furthermore it should be clarified whether the licensee is allowed to grant sub-licenses. This is a tricky point, as the licensor might wish to control his repertoire in a “young marketplace” in order to gain more experience in the exploitation of rights on the Internet.
- (c) The licensor might wish to ask for server-logs that enable him to evaluate how many individuals per month, at what time of the day and from what country his tracks are downloaded. This data can provide valuable information for further marketing.
- (d) Finally, the licensor might insist on the delivery of end consumer data as it is registered on the licensee’s website (i.e., email and physical addresses, preferences, taste of music etc.) in order to prepare a customer profile for direct communication with that customer. It is essential to agree that the licensee shall be responsible for meeting any requirements of local data protection laws and in particular that any violation of the latter shall be the responsibility of the licensee and not the licensor.

Examples of advanced licensing mechanisms to cover global exploitation

The Internet as a global network enables the sale of music globally to any consumer who has access to the Internet. In reality, however, this possibility has yet to be fully realized in part as a result of the complexity of the licensing situation in such an environment.²⁴² Any right owner who considers establishing a licensing mechanism to license his rights for exploitation on global networks, whether individually or collectively, faces the following issues:

- *Applicable law.* In general, right owners depend on the protection granted by the respective national laws in order to control and license the copyright-relevant elements.
- *Right owners do not have a single world-wide copyright* but have to rely on a bundle of national copyrights and, therefore, either suffer or benefit from the weakness or strength of the respective local copyright law. It is here that the global harmonization of copyright laws, via the above-mentioned international treaties, comes into play.
- *Rights clearance is generally necessary in all territories* where the exploitation is taking place. This proposition was recently supported by the Canadian Federal Court of Appeal, which held in its decision of May 1, 2002, that Internet transmissions of music to end users in Canada qualify as “communications to the public” and were covered by Canadian copyright law even if they originate outside Canada.²⁴³ Consequently, in international networks, a license is necessary that covers not only the exploitation in the country of origin, but also the making available in third countries.
- *Right owners’ internal licensing arrangements are typically organized on a national basis.* As a result of the intra-record company matrix licensing structure and sub-publishing agreements, national affiliates of record companies and publishers typically hold their rights for exploitation in their national territory only, and are thus unable to issue a global license.



Established collective global licensing systems

Aside from the fact that record producers in particular are now designing various systems to adapt their individual licensing schemes to the reality of the Internet, two major developments with respect to international collective licensing via collecting societies shall be discussed:

Publishers and authors

Some authors collecting societies have amended their reciprocal agreements dealing with performing rights²⁴⁴ by the so-called Santiago Agreement:

In September 2000, BMI (United States of America), BUMA (Netherlands), GEMA (Germany), PRS (United Kingdom) and SACEM (France) established that global licenses for the use of musical works on the Internet are granted to exploiters by the author's society in the country where the exploiter has its activity and economic residence.²⁴⁵ In September 2001, the societies administering the mechanical rights adopted a similar amendment to their standard reciprocal agreements, called the Barcelona Agreement.²⁴⁶ Such agreements will become essential for the international roll-out of nationally operating cyber stores, such as Apple's iTunes Music Store in the United States of America.

Record producers

Supported by the Secretariat of the International Federation of the Phonographic Industry in London (IFPI), the collecting societies administering record producers' performance rights established their first set of international reciprocal agreements²⁴⁷ and presented it publicly in September 2001.²⁴⁸ This experimental license agreement covers the simultaneous transmission of terrestrial single-channel TV and radio broadcasts via the Internet and was signed by 31 collecting societies from Eastern and Western Europe, Asia, Australasia and Latin America. In general terms, this system allows broadcasters to obtain record producers' rights in order to simulcast their programs over the Internet into numerous countries on the basis of a single, multi-territorial license. In its decision of October 8, 2002, the European Commission granted an anti-trust exemption as the intended "single one stop shop license boosted competition among the collecting societies."²⁴⁹

Conclusion

New technologies have already changed the way music is delivered to consumers. Traditionally, what were secondary forms of use have become primary forms of use, which in effect can replace retail sales. The traditional licensing models are facing various challenges caused by these new ways of exploitation. Regional/global exploitation in particular requires the development of quick and easy mechanisms that enable right owners to adapt their licensing schemes to new forms of global exploitation. In an E- and M-Commerce environment, the enforcement of licensing conditions by robust DRM-technologies and digital asset management becomes a key issue. The consolidation of online services with its aggregation of repertoire on various single platforms and, finally, the success of Apple's iTunes Music Store with its high name recognition among IT fans begin to demonstrate a realistic commercial proposition and the viability of an emerging legal online market. Downloading and CD burning will be central to this business model. This success suggests that many consumers are willing to pay US\$1 per track if the interface is quick and easy to use, and if there are few licensing restrictions placed on the copying and portability of downloads. Music sales can be tailored in a way that has never existed before. The development of new and flexible license agreements also meets the demands of many exploiters for quick and easy mechanisms to obtain instant (world-wide) Internet licenses. The introduction of statutory licenses become



unnecessary as the players organize themselves. With the ratification of the WIPO Internet Treaties by a growing number of adhering countries, the basic legal framework will have been established.

The new opportunities for music content creators, such as video games, mobile phone ring tones, synchronization and the online music market, lie mostly outside the traditional route from record company to consumer, via physical sound carriers. The music industry is now in the process of finding commercially viable new revenue streams to equal physical sales. In the future, right owners will reach out for new business models and licensing structures. These new models might dismantle parts of the present infrastructure or even create new ones. Certainly, brick-and-mortar distribution of music will continue for the foreseeable future, and hybrid models that combine traditional and new distribution models are likely to be the most successful ones. More flexible online-licenses will reflect the more flexible use of music in the online-world. We will see more consumer packaging on the physical product and special inserts that people cannot download or burn. The recent support and success of TV-backed talent shows in many countries has also provided the record companies with the opportunity to adapt their business models in order to tap into new income streams in which they have not traditionally participated.

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Footnotes

Chapter I

- 1 The use herein of the terms “copyright” and “copyrights,” etc., shall include within its/their meaning not only copyright works, but also objects of related rights, such as sound recordings; this is done so only in the interests of efficiency and brevity.

Chapter II

- 2 For certain types of publishing, the true “author” may be the publisher itself. An educational publisher, for example, preparing materials to be used in an elementary school curriculum will be designing a multi-volume work pursuant to state or locally mandated “frameworks” that define, in great detail, the materials to be included and the pedagogy to be utilized in presenting those materials. In that circumstance, the publisher will be identifying the specific contributions required, will be identifying and hiring (as employees or on a free-lance basis) the individual contributors, will be coordinating the efforts of all of those contributors and will be making final decisions about the content, design, form, presentation, media and all other elements of the final product.
- 3 The countries are usually not identified in agreements as “the British Commonwealth.” Instead, they are listed individually on an attachment to the agreement. Australia is sometimes treated differently because of changes it made in its domestic copyright law in the 1991 out of apparent frustration with the fact that English language materials were not distributed in Australia until long after they were originally published in the U.S., because those works were included in the licenses to U.K. publishers. To avoid a possible loss of copyright exclusivity in Australia due to delayed availability of a title there, U.S. publishers sometimes retain rights to Australia. The matter is usually decided in case-by-case negotiations.
- 4 Database publishers are an important part of the industry, however, and for those publishers the significant differences between the legal protection offered for databases in the European Union (where databases are given sui generis protection under the laws of Member nations in compliance with the EU Database Directive), and in the U.S. (where most databases were protected by copyright until the Supreme Court’s decision in *Feist v. Rural Telephone Service Company*, 499 U.S. 340 (1991), and where attempts to create legal protection for non-copyright protected databases have not yet been successful) are a significant business and legal problem.
- 5 In countries with strong “moral rights” regimes, like France and Germany, an author’s rights to have her work attributed to her and to protest any violations of the integrity of her work often cannot be waived or assigned by contract.
- 6 To give a specific example of how this has had an impact on the licensing of literary works, it has been argued that the time-honored practice in trade publishing of giving exclusive British Commonwealth rights to U.K. publishers but excluding other countries from the granted territory may violate EU non-competition law. The British publishers have argued that they therefore have to be granted exclusive English language rights throughout the EU. American publishers, who are themselves selling English language versions of their works into the EU, strongly disagree. The practical solution has often been for U.K. publishers to maintain exclusive rights in the U.K., but to permit both U.K. and U.S. publishers to sell English language books elsewhere in the EU on a non-exclusive basis.
- 7 Materials for the elementary and secondary education markets are often prepared under “work-made-for-hire” agreements or are the subject of outright assignments. Assignments of all rights are also common in the publication of college textbooks and journal articles.
- 8 The preparation of basic educational materials for use in elementary and secondary education is conceptually at the opposite end of the scale. The content, structure, format, organization and other aspects of elementary educational materials are often determined by the need to comply with specific sets of requirements established by governmental or local authorities, which leaves little room for individual creativity. These works are often created by employees, or by individuals under contract to educational publishers that vest the authors’ rights (through “work-for-hire” or another mechanism as permitted by local law), in the publisher, who combines those contributions into the final work. Since these basic education materials are therefore not created under a “license” to the publisher, the discussion below will focus on other types of publishing.
- 9 For an example from the United States, see *Random House, Inc v. Rosetta Books LLC*, 150 F.Supp2d 613 (SDNY 2001), *aff’d* 283 F.3d 490 (2d Cir 2002).
- 10 “Electronic Rights” are discussed in more detail below.
- 11 In trade publishing agreements, “electronic rights” are often divided between “Electronic Book” rights and “Electronic Version” rights. The terminology varies, but the concept is that the “e-book” right to deliver the text of the work digitally, through various technologies such as on-line distribution, hand-held e-book readers, etc., will stay with the original publisher to be exploited as a primary or subsidiary right, while the ability to license the text for inclusion in a new work with substantial additional content (so-called “multimedia versions”) will be a subsidiary right either granted to the original publisher or retained by the author.
- 12 The trade publishing industry in the U.S. seems to have moved to a 50/50 split of net proceeds as the standard for compensating authors for e-book sales.
- 13 Giving the author approvals was a compromise offered by some publishers, to conquer author reluctance to part with rights that were of uncertain value at the time of the agreement. Such compromises are becoming less common as the market for electronic versions is beginning to mature.
- 14 In college and professional publishing, rights grants will also specify the particular edition being licensed. The local publisher may be given an option on rights to subsequent editions, but the grant will clearly apply only to the edition specified in the agreement.
- 15 In certain disciplines, particularly science and mathematics, English is widely understood and cultural differences are unimportant. So works can be sold internationally without the need for translation or “localization.”
- 16 “New Premise in Science: Get the Word Out Quickly, Online,” *New York Times*, December 17, 2002, page D1.



- 17 A great deal of information about RROs and the national laws of the countries in which they exist can be found at the web site maintained by International Federation of Reproduction Rights Organizations (IFRRO) at <http://www.ifrro.org/>.
- 18 Information about CCC is available at <http://www.copyright.com>.
- 19 *Boosey & Hawkes Music Publishers, Ltd. v. Walt Disney Co.*, 145 F.3d 471 (2d Cir. 1998) (video distribution was held to be included in the grant).
- 20 *Bartsch v. Metro-Goldwyn-Mayer, Inc.*, 391 F.2d 150 (2d Cir. 1968) (motion picture rights included the right to do television broadcasts).
- 21 *Rey v. Lafferty*, 990 F.2d 1379 (1st Cir. 1993) (video cassette rights not included in the television viewing grant).
- 22 *Random House, Inc v. Rosetta Books LLC*, 150 F.Supp2d 613 (SDNY 2001), *aff'd* 283 F.3d 490 (2d Cir 2002) (e-books not included in grant).
- 23 The Court of Second Instance of Munich recently rejected such a claim when advanced in connection with the distribution on DVD of a 1983 film version of the "The Magic Mountain." *Lüdi v. Kinovelt* (October 10, 2002), *Zeitschrift Für Urheber Und Medienrecht* 922 (2002).
- 24 These concerns are addressed by commercial and learned society publishers by (for most journals) subjecting submitted articles to a rigorous peer review process as, apparently, would the new "open access" journal publishers.
- 25 There is more information about the "open access" movement available at <http://www.publiclibraryofscience.org>, <http://www.pubmedcentral.gov>, and <http://www.biomedcentral.com>.
- 26 These comments were filed in connection with a rule-making proceeding being conducted by the Copyright Office to determine if exceptions to the prohibitions on circumvention of access controls should be created. A copy of AAP's comments can be reached through its web site, <http://www.publishers.org>.
- 27 A joint "White Paper" discussing the issue of developing "user-friendly" DRM for e-books, prepared by the AAP and ALA, was released on March 21, 2003. It can be found through the AAP web site, <http://www.publishers.org>.
- 28 See 17 U.S.C. 108.
- 29 *Princeton University Press v. Michigan Document Services, Inc.*, 99 F.3d 1381 (6th Cir. 1996); *Basic Books v. Kinko's Graphics Corporation*, 758 F.Supp1522 (SDNY 1991).
- 30 Under Section 107, the determination of whether a use of a copyrighted work which made for such purposes as criticism, comment, news reporting, teaching, scholarship, or research is a "fair use" and therefore non-infringing, is based on a consideration of four factors: (i) the purpose and character of the use, including whether it is for commercial or nonprofit educational purposes; (ii) the nature of the copyrighted work (i.e. fiction or nonfiction); (iii) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (iv) the effect of the use on the potential market for or value of the copyrighted work.
- 31 "Fair use" is the most important, but definitely not the only, statutory limitation on the exclusive rights of copyright proprietors included in the Copyright Act. Sections 108 – 121 of the Act set forth numerous other specific limitations for, among other purposes, of permitting certain uses of copyrighted works by libraries and archives, in teaching activities, in broadcasting, and by the visually impaired.
- 32 17 U.S.C 1201
- 33 EU Copyright Directive, Article 5(1).
- 34 The exceptions are listed in Article 5(2) and 5(3).
- 35 EU Copyright Directive, Article 5(4).

Chapter III

- 36 17 U.S.C. § 101.
- 37 WIPO maintains a list of treaty signatories at: <http://www.wipo.org/treaties/ip/index.html>.
- 38 Signed December 17, 1992.
- 39 WIPO Copyright Treaty Art. 1(2), December 20, 1996.
- 40 See *Random House, Inc. v. Rosetta Books LLC*, 283 F.3d 490 (2nd Cir. 2002).
- 41 See *New York Times v. Tasini*, 533 U.S. 483 (2001) (print publishers held to have infringed independent contractors/freelance authors' rights by making available the authors' individual articles in electronic databases without authorization to do so, despite rights held by the publishers in other aspects of the authors' works).
- 42 17 U.S.C. § 107.
- 43 Such new schemes include the music industry's own MusicNet, PressPlay and MP3.com, as well as the emergence of other independent companies such as Listen.com, among others.
- 44 See *New York Times v. Tasini*, 533 U.S. 483 (2001) (print publishers held to have infringed independent contractors/freelance authors' rights by making available the authors' individual articles in electronic databases without authorization to do so, despite rights held by the publishers in other aspects of the authors' works).
- 45 280 F.3d 934 (9th Cir. 2002).



- 46 See *Universal City Studios, Inc. v. Reimerdes*, 111 F. Supp. 2d 294 (S.D.N.Y. 2000); *RealNetworks, Inc. v. Streambox, Inc.*, 2000 U.S. Dist. LEXIS 1889 (W.D. Wa 2000).
- 47 17 U.S.C. § 109(a).
- 48 Mr. Sugayan expresses his appreciation to Jim Mitchell, David Green and David Weiskoff of Corbis Corporation for their assistance in the preparation of this chapter.

Chapter IV

- 49 Louis Menand, *Paris, Texas*, *The New Yorker*, February 17, 2003, at p. 169.
- 50 Lewis Jacobs, *The Rise Of The American Film: A Critical History*, Harcourt, Brace And Company (1939), at p. 287.
- 51 The average film released during 2002 by one of the seven major studios had a negative cost of US\$58.8 million. Jack Valenti Press Release, Valenti Announces Dramatic Box Office And Admissions Increases In Decades In Showest Address, March 4, 2003. Also see Motion Pictures Association Worldwide Market Research, U.S. Entertainment Industry: 2002 MPA Market Statistics (2002 MPA Market Report), at p. 19.
- 52 Five studio pictures alone generated over US\$1.2 billion in US theatrical receipts during 2002—14% of the total annual US box office source, 2002 MPA Market Report, at p. 11.
- 53 AFMA's official definition of an "independent" is: "Those companies and individuals apart from the major studios that assume the majority of the financial risk for a production, and control its exploitation in the majority of the world."
- 54 AFMA 2000 Membership Sales Survey, for Calendar Year Ending December 31, 2000.
- 55 The MPAA has reported that its members' worldwide cash revenue from their films during 2002 was US\$37.3 billion. Of this sum, US\$6.7 billion was theatrical revenue, with US\$16.3 billion from home video (an increase of 31% over the prior year). See Hy Hollinger, MPAA reports robust '02 earnings, *The Hollywood Reporter*, April 15-21, 2003, at p. 10.
- 56 For a discussion about the use of pre-sales, see Arnold Kopelson, *One Producer's Inside View of Foreign and Domestic Pre-Sales in the Independent Financing of Motion Pictures*, 12 *Loy. L.A. Ent. L.J.* 1 (1992), at p.p. 1-18.
- 57 "According to the MPAA, piracy costs the studios over US\$3 billion a year worldwide (figure is based on estimates of the value of illegal videocassettes and DVD sales)." Paul Sweeting, *Newer piracy methods scramble legal picture*, *Variety*, March 3, 2003, at p. A4. (See www.mpaa.org for more information.)
- 58 AFMA International Schedule of Suggested Territories and Regions in The AFMA Model International Licensing Agreements, 3rd edition, 2000. (See www.AFMA.com for AFMA documents and information.)
- 59 For example, see *Woods vs. Universal City Studios, Inc. et al*, 920 F. Supp. 62 (U.S. District Court, Southern District of New York, 1996), where the Court granted a motion for a preliminary injunction against Universal's continuing theatrical release of "12 Monkeys" for having designed and used a set in the picture which was based on a copyright protected drawing.
- 60 Patrick Frater, *Video Rental Windows Face Extinction*, *ScreenDaily.com*, March 14, 2003.
- 61 See AFMA International Schedule of Definitions in The AFMA Model International Licensing Agreements, 3rd Edition, 2000.
- 62 Paul Goldstein, *International Copyright—Principles, Law, and Practice*, Oxford University Press (2001), at p.285, citing WIPO, *Guide to the Berne Convention for the Protection of Literary and Artistic Works (Paris Act, 1971)*, at p. 41 (1978).
- 63 Goldstein, *Ibid*, at p. 292.
- 64 *Gardner, et al. vs. Nike, Inc.*, 279 F3d 774 (U.S. Court of Appeals, 9th Circuit, 2002).
- 65 AFMA's arbitral agent reports that over 350 AFMA arbitration claims were initiated between 2000 and 2002, including 258 in 2001-2002.

Chapter V

- 66 Created by Taito Corporation in 1978; (visited March 17, 2003) <http://www.watch.impress.co.jp/game/>.
- 67 Created by Namco Ltd. in 1980; (visited March 17, 2003) <http://www.zaurusworld.ne.jp/>.
- 68 "Rental revenue" is revenue which the distributor receives from box office earnings. Depending upon the strength of the motion picture concerned, theatres generally keep approximately 40%-50% of revenue intake and remit the remainder to distributors.
- 69 "Pokémon Story," Kenji Hatakeyama and Masakazu Kubo, Nikkei BP, 2000.
- 70 Figures based on currency exchange rate of 120 yen for US\$1.
- 71 Figures taken from 2002 Computer Entertainment Software Association (July, 2002) *Games White Paper*, at: <http://www.cesa.or.jp/>.
- 72 *Id.*
- 73 *Id.*
- 74 *Id.* As taken from *The Multimedia Markets in North America and Europe (March 2002)* (International Development Group, Inc.).
- 75 Date from NPD Funworld quoted in Joseph Moran, *Sales of Console and Computer Video Game Software Set New Record in 2002*, January 30, 2003 (visited March 17, 2003), at: <http://www.gamemarketwatch.com/news/item.asp?nid=2635>.



76 Article 2 (paragraph 10-2), Article 10, (paragraph 9) of the Copyright Law of Japan.

77 PacMan Case (Tokyo District Court, September 28, 1984).

78 Tokyo District Court 1998 (wa) 22568, (May 22, 1999).

79 Osaka District Court 1998 (wa) 6979 and 9774 (October 7, 1999).

80 Tokyo High Court 1999 (ne) 3355, (March 27, 2001).

81 Osaka High Court 1999 (ne) 3484, (March 29, 2001).

82 Supreme Court of Japan 2001 (uke) 952, (April 27, 2002).

83 See e.g., *Apple Computer Inc. v. Franklin Computer Corp.*, 714 F.2d 1240 (3d Cir. 1983) where the Court held that a computer program's source and object codes are "literary works" under the Copyright Act of 1976. The Court further stated that "Copyright extends to works in any tangible means of expression from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of machine or device." See also, *Atari Games Corp. v. Oman* 888 F.2d 878, 884 (D.C. Cir. 1989) where the Court held that interactive works, where sequence of action is altered by each user are also protected (deemed to be fixed in a tangible medium).

84 See 17 U.S.C. Section 102(a). See also, *Computer Assoc. Int'l, Inc. v. Altai, Inc.*, 982 F.2d 693, 702 (2nd. Cir. 1992) which held that the literal elements of computer programs, i.e., their source and object codes, are the subject of copyright protection.

85 17 U.S.C. Section 102(b).

86 979 F.2d (1992).

87 *Feist Publications, Inc. v. Rural Tel. Serv. Co.*, 499 US 340 (1991), as quoted by *Atari Games Corp. v. Oman* 979 F.2d 242, 243 (1992); also, the Court of Appeals did not object to the Register of Copyrights' indication that the Copyright Office is applying the same creativity standard to the videogame "Breakout" as it would to any other type of work, be it a pictorial, graphic, dramatic, musical, or literary work, etc."

88 17 U.S.C. Section 106.

89 Generally, a "patent may not be obtained...if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which the subject matter pertains." 35 USC Section 103.

90 Forms may be obtained online (visited March 17, 2003), at: <http://lcweb.loc.gov/copyright/circs/>.

91 See 17 U.S.C. Section 106(2).

92 See *Whelan Assoc. v. Jaslow Dental Lab*, 797 F.2d 122, 1231 (3d Cir. 1986).

93 See *Apple Computer, Inc. v. Microsoft Corp.* 35 F.3d 1435, 1442 (9th Cir. 1994).

94 872 F.2d 907, 913 (9th Cir. 1989).

95 Section 107 of the Copyright Law codifies the fair use defense: "In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include—(1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyright work; (3) the amount and substantiality of the portion used in relation to the copyright work as a whole; (4) the effect of the use upon the potential market for or value of the copyright work." The factors are nonexclusive, see *Fisher v. Dees*, 794 F.2d 432, 435 (9th Cir. 1986). See also *Narell v. Freeman*, 872 F.2d 907, 913 (9th Cir. 1989) where the Court stated fair use is also "for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research."

96 203 F.3d 596 (9th Cir. 2000).

97 *Sony Entertainment v. Connectix Corp.*, 203 F.3d 596, 603 (9th Cir. 2000).

98 75 FCR 8.

99 IPD 25030.

100 Commission Regulation (EC) No 240/96 of 31 January 1996 on the Application of Article 85 (3) of the Treaty to certain categories of technology transfer agreements (Text with EEA relevance).

101 See *Sega Enterprises Ltd. v. Accolade, Inc.* 977 F.2d 1510 (9th Cir. 1992).

102 17 U.S.C. Section 106(3) of the Copyright Act provides in applicable part: "Subject to Sections 107 through 120 [sic], the owner of a copyright under this title has the exclusive rights to do and to authorize any of the following: [...] (3) to distribute copies or phonorecords of the copyright work to the public by sale or other transfer of ownership, or by rental, lease, or lending;"

103 839 F. Supp. 1552 (M. D. Fla. 1993).

104 983 F. Supp. 1167 (N.D. Ill. 1997).

105 Council Directive 2001/29.

106 Council Directive 2001/29.

107 See (visited on March 18, 2003) <http://www.sonypictures.com/movies/residentevil/flash/index.html>.

108 33 F.3d 518 (5th Cir.).

109 Copy L. Rep. (CCH) 26,934 (SDNY August 7, 1992).

110 For an excellent introductory discussion on these and other cases, see *Multimedia Law: Forms and Analysis* by Richard Raysman, Peter Brown and Jeffrey D. Neuburger (1997 Law Journal Seminars-Press).

111 These numbers are taken from certain licensing agreements based on the author's experience and should not be interpreted as to indicate any typical industry figures.



- 112 Nagoya District Court 1998 (wa) 527 (January 19, 2000).
- 113 Based on interviews with Mr. Tetsu Kayama, Representative Director and Chief Operating Officer of Sega Corporation in March 2003.
- 114 Based on interview with both Mr. Tetsu Kayama of Sega and Mr. Kenzo Tsujimoto, President and CEO of Capcom Col. Ltd. in March 2003.
- 115 Irene M. Kunii, A Video-Game War That's Just Dandy for Everyone, March 4, 2002, Business Week Online, (visited March 17, 2003), at http://www.businessweek.com/magazine/content/02_09/b3772075.htm.
- 116 The Cincinnati Enquirer, December 31, 2002—David Germain, The Associated Press.
- 117 Joseph Moran, Sales of Console and Computer Video Game Software Set New Record in 2002, January 30, 2003, (visited March 17, 2003) <http://www.gamemarketwatch.com/news/item.asp?nid=2635>.
- 118 <http://www.emuunlim.com/doteaters/play1sta1.htm>; see also Bob Low Still Game at Forty, October 17, 2002, Scottish Daily Record & Sunday Mail Ltd.
- 119 <http://lcs.www.media.mit.edu/groups/el/projects/spacewar/>.
- 120 <http://www.pong-story.com/>.
- 121 <http://www.emuunlim.com/doteaters/play1sta2.htm>.
- 122 See (visited March 17, 2003) <http://www.emuunlim.com/doteaters/play2sta2.htm>.
- 123 See (visited March 17, 2003) <http://www.atari-history.com/>.
- 124 See <http://www.msnbc.com/news/883701.asp>.
- 125 Far Eastern Economic Review, March 20, 2003, Nokia's Game: The world's top mobile phone maker is poised to play Nintendo for the videogame market, by Geoffery A. Fowler, quoting Informa Media Group research.
- 126 The author is grateful to the following persons who provided valuable assistance in the drafting and research of this paper: Yoshiro Masumoto, Esq., Toshifumi Onuki, Esq., Atsushi Isagarashi, Esq., Takeo Yamada, Esq., Noah Shaikh Esq. of TMI Associates, and Ryo Okamura, Esq. of Simmons & Simmons, Tokyo office.

Chapter VI

- 127 For related information see generally http://www.leonine.com/~lion/pub_papers/itphil/node3.html, visited on 03.04.2003.
- 128 Bill Gates, *the Road Ahead*, Viking (1995) 20.
- 129 All statistics courtesy NASSCOM (National Association of Software and Service Companies) Indian IT Software and Services Directory, 2002.
- 130 Even within a relatively new field such as software licensing, a traditional and modern perspective has clearly emerged. The traditional type of licenses allow only use of a software.
- 131 Under the Open Source Model, which is a recently developed view of software licensing, a license is seen as not merely a right of possession but also a kind of title in the software itself, albeit subsidiary to the primary title of the owner of the software.
- 132 Robert Bond, *E-licenses and Software Contracts – Law, Practice and Precedents*, Butterworths (2000) 4.
- 133 "A Mainframe Computer is the primary framework of a large computer's central processing unit (CPU)", c.f. Brad Hansen, *the Dictionary of Computing and Digital Media – Terms and Acronyms*, BPB Publications (2000) 191.
- 134 Nilima Bhadbhade (ED.) Pollock and Mulla, *Indian Contract and Specific Relief Acts*, 1 Butterworths (2001) 153.
- 135 No 95-C-0671-C (US 7th Cir CA, 20 June 1996). The defendant, Zeidenberg, purchased copies of the software 'Select Phone', marketed by PRO CD Inc, and made available the information in the software relating to phone numbers on the Internet. This was in spite of the shrink-wrap license that came along with the software and a similar notification at the time of installation. The defendant's claim that the license is not binding was rejected. The Court held that unless some terms are objectionable on grounds applicable to contracts in general, a shrink-wrap license is binding upon the parties to the license. In its analysis, the court gave numerous examples of standardized contracts where the "exchange of money precedes the communication of detailed terms" such as the situation in ProCD. For example, when a buyer purchases insurance, the insurance agent speaks with the buyer first, then the buyer pays the agent, and, lastly, the policy and its terms are sent to the buyer. The court also described other types of situations with similar agreements, such as the purchase of airline tickets, concert tickets and consumer goods, including radio sets and over-the-counter drugs. Beside the obvious benefit to vendors, the use of standardized contracts "serves buyers' interests [as well] by accelerating effectiveness and reducing transaction costs." Moreover, the Seventh Circuit noted that the customer's right to return the product for a refund if the customer finds the "terms. . . unacceptable. . . may be a means of doing business valuable to buyers and sellers alike."
- 136 [1996] FSR 367.
- 137 *Supra* note 9.
- 138 *Supra* note 10.
- 139 Michael D. Scott, *Scott on Computer Law*, 2 Aspen Law and Business (2001) 12-12.
- 140 Original Equipment Manufacturer.
- 141 Personal Digital Assistants.
- 142 Value Added Resaler.



- 143 Robert Bond, *E-Licenses and Software Contracts – Law, Practice and Precedents*, Butterworths (2000) 19.
- 144 Trusted Third Party.
- 145 Open Source Software, will be dealt with at a conceptual level in a later segment, but its inclusion at this stage under the various classes of licenses was imperative.
- 146 As we shall see later, this naturally means that you have to provide some value addition, instead of merely selling the software by itself, since if you do so, nobody will buy software that they can get completely free elsewhere.
- 147 There is a standard definition of the term “open source,” and software licenses must meet the requirements (as given above) of the Open Source Definition (OSD) before they are eligible to be called open source licenses.
- 148 For the purposes of this paper, the copy of the GNU GPL studied was the one distributed with the open source Web Browser known as K-Meleon, available at <http://kmeleon.sourceforge.net>, (visited on 03.04.2003).
- 149 Choice of forum clauses though valid per se may be against public policy in specific instances on account of the equitable ground of the relative bargaining powers of the parties, as was the case in *Horning v. Sycam* [556 F. Supp. 819 (E.D. Ky. 1983) at 821, where the court said: “the plaintiff, a solo dental practitioner, would be seriously inconvenienced by being required to litigate this matter in Wisconsin, whereas the defendant would not be inconvenienced by being required to litigate here. ...In the opinion of the court, there was a disparity of bargaining power with regard to the particular clause of the contract in question. The forum selection clause is one of the many clauses in the form contract that together represents the best job of boiler plating since the building of the Monitor.”
- 150 L.J. Kutten, *Computer Software – Protection/ Liability/ Law/ Forms*, 2 WESTGROUP (2001) 8-11.
- 151 The importance of this term is evident from the fact that most of the litigation pertaining to breach of software licenses revolves around the interpretation of this clause. *Geoscan, Inc. of Texas v. Geotrace Technologies, Inc.*, c.f. <http://laws.findlaw.com/5th/9920744cv0.html>, is a classic instance of this. *Geoscan, Inc.* develops and sells software used in the oil and gas exploration industry for plotting seismic data. *Geoscan* sold four software licenses to *Geotrace Technologies*. *Geotrace* then installed the software, without permission, in numerous offices and on numerous CPUs far in excess of the original licensing agreements. *Geoscan* sued *Geotrace* for breach of contract, copyright infringement, and unfair trade practices. The district court granted *Geotrace*'s motion for summary judgment, concluding that, the contract allowed *Geotrace* to have unlimited use of the software as the section designating specific CPUs and locations was left blank by *Geoscan*, the drafter of the contract. Although the United States Court of Appeals, Fifth Circuit went on to reverse the judgment in part, and permitted *Geoscan* to try its breach of contract claim before a jury, the ambiguity of the impugned clause could prove costly in what seemed otherwise to be an open and shut case.
- 152 In *Pollstar v. Gigmania, Ltd.*, 170 F. Supp. 2d 974 (E.D. Cal. 2000), although the federal district court in the Eastern District of California upheld the validity of click-wrap agreements, it expressed concern that an action for breach may not lie against the defendant although there was a violation of the terms of the license, as the users of the plaintiff's website may not be aware of its terms because the notice of the license agreement was in small gray text on a light gray background and the link to the terms was not underlined. In *Register.com, Inc. v. Verio, Inc.*, 126 F. Supp. 2d 238 (S.D.N.Y. 2000) a district court in the Southern District of New York declared that browse-wrap agreements are enforceable as long as users receive clear notice of the terms. The Plaintiff, a registrar of Internet domain names, sought an injunction against defendant *Verio*, a competitor and Internet service provider, for using automated software to access information on its Web site about its customers and compiling the information for mass marketing purposes, such as sending “spam.” *Register.com* alleged that this process constituted a breach of contract because its Web site contained a browse-wrap agreement that prohibited commercial use of any information obtained from its site. FN;F167 Like the Web sites at issue in *Pollstar*, *Register.com*'s Web site stated that using the site demonstrated assent to be bound by the terms and conditions of the agreement. *Register.com* argued that the defendant had formed a contract when it submitted a query on *Register.com*'s database. The defendant dismissed this argument by maintaining that merely submitting a query did not adequately indicate assent to the terms; an independent act demonstrating agreement to be bound by the terms of the browse-wrap was required. The court agreed with *Register.com* that the “terms of use are clearly posted on [the] Web site. The conclusion of the terms paragraph states, ‘By submitting this query, you agree to abide by these terms.’” Therefore, the court concluded, “there can be no question that by proceeding to submit a . . . query, *Verio* manifested its assent to be bound by *Register.com*'s terms of use, and a contract was formed and subsequently breached.”
- 153 It was not until ProCD (Supra n. 9) that the precarious ground of shrink-wrap agreements was given any standing. ProCD involved a compilation of telephone directories offered on a computer database. For nonretail buyers, ProCD offered this information as a way to avoid calling long-distance information. The general public could get this information at a low price, while retailers, manufacturers and others using the information for business uses had to pay a higher price. To assure that this price discrimination practice was enforced, ProCD used a shrink-wrap license. The defendant, Matthew Zeidenberg, purchased the product and then made the information available over the Internet for a price cheaper than ProCD was charging—in direct violation of the terms of the shrink-wrap. In finding the shrink-wrap license enforceable, the court applied the Uniform Commercial Code (hereinafter “UCC”) and basic contract principles. FN;F35 The court found that “ProCD proposed a contract that a buyer would accept by using the software after having an opportunity to read the license at leisure.” Consistent with contract law, Zeidenberg had the ability to reject the contract by sending back the product after having read the terms. Zeidenberg's failure to send the product back after reading the terms indicated his acceptance to the court and bound him to the terms of the agreement. The ProCD court also discussed market competition as a safeguard for consumer protection concerning shrink-wrap. Under this theory, the terms and conditions offered by contract reflect private ordering and a decision on behalf of consumers and sellers as to what are the most important and essential terms. This prioritizing is essential to the efficient functioning of markets and reflects the court's traditional separation from any business judgment decisions. C.f. JENNIFER FEMMINELLA, “Online terms and conditions agreements: bound by the Web,” 17 ST. JOHN'S J. LEGAL COMMENT 87
- 154 In the case of *Harbinger UK Ltd. v. GE Information Services Ltd.*, [2000] 1 All ER (Comm) 166, the Court of Appeal had to consider the effect of a support and maintenance obligation provided in perpetuity. The licensor in this case had granted a distribution agreement together with support and maintenance obligations which were expressed to be ‘in perpetuity’. The licensor terminated the distribution agreement and believed that its obligations to support and maintain were also thereby extinguished. The court, however, held that the said obligation would exist for so long as the distributor was also obliged to maintain the software for its own customers.

- 155 § 2-313. Express Warranties by Affirmation, Promise, Description, Sample:
 (1) Express warranties by the seller are created as follows:
 (a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
 (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
 (c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.
 (2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.
- 156 489 N.E.2d 380 (Ill. App. 1986) c.f. Supra n. 23 at 10-9.
- 157 Ibid.
- 158 Quinn v. City of Detroit, 23 F. Supp. 2d 741 (E.D. Mich 1998).
- 159 17 U.S.C. 117.
- 160 547 F. Supp. 999 (N.D. Ill. 1982)
- 161 Scott, supra n. 13 at 15-52.
- 162 Northern Pacific Railway v. United States, 356 US 1, 4 (1958).
- 163 § 4 of the Clayton Act reads: "Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of the suit, including a reasonable attorney's fee."
- 164 15 U.S.C. § 13 (1982).
- 165 For a full text of the judgment see <http://www.usdoj.gov/atr/cases/f200400/200457.htm> visited on 05.04.2003.
- 166 For a case update see <http://techupdate.zdnet.com/techupdate/stories/main/0,14179,2853802,00.html>, visited on 05.04.2003.
- 167 At the time of writing this paper, the arguments of Microsoft and Sun have been heard by the U.S. Court of Appeals for the Fourth Circuit, in Richmond, Virginia, and a judgment is awaited. Sun has argued that Microsoft tried to derail a competitive threat posed by Java by offering a version of the technology that is incompatible with Sun's specifications. Its lawyers argued before Motz that Microsoft's behavior, if allowed to continue, would unfairly drive developers to Microsoft's competing .Net platform. Microsoft has argued that other issues, such as Java's performance and quality, have hampered developer adoption of Java, not Microsoft's actions. Its lawyers have argued that the "must-carry" Java order is an extreme solution to Java's competitive disadvantage, and that Motz's order is unprecedented in antitrust law. On February 3, Microsoft took the first step to comply with Motz's order, by replacing the service pack Windows XP SP1 with a new service pack, XP SP1a, which is identical to the previous service pack but excludes Microsoft's Java virtual machine. (See generally, <http://pcworld.shopping.yahoo.com/yahoo/article/0,aid,110124,00.asp#> visited on 04.04.2003)
- 168 Uniform Computer Information Transactions Act.
- 169 Uniform Commercial Code.
- 170 Michael L. Rustad, "Making UCITA More Consumer-Friendly", 18 J. Marshall J. Computer & Info. L. 547.
- 171 See Carlyle C. Ring, Jr. & Ray Nimmer, Series of Papers on UCITA issues 11 (1999), at <http://www.ucitaonline.com/docs/q&apmx.html>.
- 172 The UCITA Prefatory Note elaborates: UCITA is the first uniform contract law designed to deal specifically with the new information economy. Transactions in computer information involve different expectations, different industry practices, and different policies from transactions in goods. For example, in a sale of goods, the buyer owns what it buys and has exclusive rights in that subject matter (e.g., the toaster that has been purchased). In contrast, someone that acquires a copy of computer information may or may not own that copy, but in any case rarely obtains all rights associated with the information. What rights are acquired or withheld depends on what the contract says. This point only is implicit in Article 2 for goods such as books; UCITA makes it explicit for the information economy where, unlike in the case of a book, the contract (license) is the product.
- 173 U.C.I.T.A., Prefatory Note (1999 Draft), at <http://www.law.upenn.edu/bll/ulc/ucita/citam99.htm>. This language was edited from the final draft but presumably it remains true.
- 174 U.C.I.T.A. § 103 (2000).
- 175 Ibid.
- 176 Supra n. 30.
- 177 As under the UCC, a contract under the UCITA "may be formed by any manner sufficient to show agreement." Shrinkwrap validation involves not the formation of a contract, but what the terms of that contract are (i.e., the terms of the agreement). Shrinkwrap contracts get in under the UCITA because it allows the terms of mass-market licenses to constitute the terms of the agreement. A mass-market license is a license marketed to the public on an un negotiated basis. A corollary to this acceptance of mass-market licenses is the validation of shrinkwrap terms. Shrinkwrap licenses are really just mass-market license terms that are contained within the wrapping of the product. Thus, the UCITA validates shrinkwrap licenses by allowing for parties to manifest their assent to the terms after forming the contract and unwrapping the product. The license part of mass-market and shrinkwrap licenses are considered the "Terms of Record." These terms of record become part of the contract if the party adopts the terms, such as by manifesting assent. Two key ideas underlie the manifestation of assent in the UCITA. First, the person must have an opportunity to review the terms. Section 112 requires, for manifestation of assent, that the person be either "acting with knowledge of, or . . . ha(s) an opportunity to review the record or term or a copy of it." Second, the manifestation of assent may be by either



direct assent or conduct that indicates assent. Section 112 indicates that a person may manifest assent by either authenticating the term or “engag(ing) in conduct . . . with reason to know that the other party . . . may infer from the conduct or statement that the person assents to the record or term.” C.f. Sean F. Crotty “The how and why of shrinkwrap license validation under the Uniform Computer Information Transactions Act”, 33 RUTGERS L.J. 745.

178 Eric S. Raymond, “The Cathedral and the Bazaar”, <http://www.tuxedo.org/~esr> visited on 05.02.2003.

179 OSS survives because of the reputational gains for programmers who write or contribute to successful OSS projects – for this model to survive, even the smallest contributions must be publicly acknowledged. On the contrary, try and find the names of the programmers of, say, Microsoft Word – your classic closed source program – and you will find it’s pretty much impossible.

Chapter VII

180 The concept of “performing rights” broadly corresponds to the definition of “public performance” in Article 1 of the CISAC Model Contract concerning “public performance” rights presented below (see pp 104-105). It reads as follows: “Under the terms of the present contract, the expression ‘public performances’ includes all sounds and performances rendered audible to the public in any place whatever within the territories in which each of the contracting Societies operates, by any means and in any way whatever, whether the said means be already known and put to use or whether hereafter discovered and put to use during the period when this contract is in force. ‘Public performance’ includes in particular performances provided by live means, instrumental or vocal; by mechanical means such as phonographic records, wires, tapes and sound tracks (magnetic and otherwise); by processes of projection (sound film), of diffusion transmission (such as radio and television broadcasts, whether made directly or relayed, retransmitted etc...) as well as by any process of wireless reception (radio and television receiving apparatus, telephonic reception, etc... and similar mean and devices. etc...)”

181 For this, see Dr. Mihály Ficsor: “Collective Management of Copyright and Related Rights,” WIPO publication, Geneva, 2002.

182 Hereinafter, in this paper, unless the contrary follows from the given context, “copyright” means also related rights, and “work” also means objects of related rights.

183 Under paragraph (1) of the same Article “[a]uthors of literary and artistic works shall enjoy the exclusive right of authorizing: (i) the broadcasting of their works or the communication thereof to the public by any other means of wireless diffusion of signs sounds or images; (ii) any communication to the public by wire or by rebroadcasting of the broadcast of the work, when this communication is made by an organization other than the original one; (iii) the public communication by loudspeaker or any other analogous instrument transmitting, by signs, sounds or images, the broadcast of the work.”

184 For the expression “Article 12 rights,” see the section on the “Rights of performers and producers of phonograms,” *intra*.

185 Article 9(2) – “the mother of all ‘three-step test’ provisions” – uses the expression “to permit the reproduction of... works.” This may mean – subject to the said test – either free uses or, as it is clarified in the report of Main Committee I of the 1967 Stockholm revision conference (see paragraph 85), the reduction of the exclusive right to remuneration to a mere right to equitable remuneration. It is on this basis, that, in case of widespread and uncontrollable private copying, in certain countries, a right to remuneration is applied (usually in the form of a levy on recording equipment and material).

186 As regards “residual rights,” the best example is the “unwaivable right to remuneration” under Article 4 of Council Directive 92/100/EEC of 19 November 1992 “on rental right and lending right and on certain rights related to copyright in the field of intellectual property” (the “Rental Directive”).

187 The “three-step test” providing the conditions for exceptions was included originally in Article 9(2) of the Berne Convention concerning the right of reproduction of copyright owners. Later, it was extended to all economic rights of copyright owners by Article 13 of the TRIPS Agreement and then by Article 10 of the WCT, and also to the economic rights of performers and producers of phonograms by Article 16 of the WPPT. The three conditions (three “steps”) are as follows: (i) an exception may only be granted in certain special cases; (ii) it must not conflict with a normal exploitation of works or objects of related rights; and (iii) it must not unreasonably prejudice the legitimate interests of owners of rights.

188 The expression “Article 12 rights” refers to Article 12 of the Rome Convention which provides as follows: “If a phonogram published for commercial purposes, or a reproduction of such phonogram, is used directly for broadcasting or for any communication to the public, a single equitable remuneration shall be paid by the user to the performers, or to the producers of the phonograms, or to both. Domestic law may, in the absence of agreement between these parties, lay down the conditions as to the sharing of this remuneration.” (It is to be noted, however, that, under Article 16 of the Convention, Contracting States may make various reservations; *inter alia*, they may declare that they do not apply Article 12 or may make its application conditional on reciprocity.)

189 The expression “if any” refers to the possibility of performers’ organizations of choosing between so-called “category A” and “category B” agreements. In the case of a “category B” agreement, no payments are transferred between the contracting organizations; all the income remains in the country where it is collected, and is used in accordance with the rules of the organization of that country (it is either used for social or cultural purposes or is distributed to the performers of the country in order to “compensate” them for the remuneration they are entitled to in other countries but do not receive). Under a so-called “category A” agreement, the shares due to performers of the other country are transferred in one sum and the distribution is completed by the organization of that country according to its own distribution systems. There seems to be a certain trend towards an increase of cases where category A agreements are concluded; and also a third type of agreements has been introduced recently, called the “category C” agreements (which combine the elements of category A and category B agreements in the sense that, at least, a part of the remuneration is distributed according to the principles of category A agreements.) As regards “category B” agreements, they are mainly justified by the problems of identification and the related high costs, on the one hand, and the need for mutual solidarity among performers, on the other.

190 See “WIPO International Forum on the Exercise and Management of Copyright and related Rights in the Face of the Challenges of Digital Technology” (Seville, May 14 to 16, 1997) WIPO publication No. 756 (E).

191 The Sydney addendum provided for three alternative formulas:

- first formula (the “Contract’s direct application formula”): “With regard to direct broadcasting by satellite, the contracting Societies agree that the rights conferred by virtue of Article 1 of this Contract are not limited to the territories of operation but are valid for all countries within the footprint of the satellite of which the transmissions are effected from the territory/ies in which a contracting Society operates.”
- second formula (the “prior agreement” formula): “With regard to direct broadcasting by satellite, the contracting Societies agree that the rights conferred by virtue of Article 1 of this Contract are not limited to the territories of operation but are valid for all countries within the footprint of the satellite of which the transmissions are effected from the territories in which a contracting Society operates, subject to having acquired the other contracting Society’s agreement beforehand as to the conditions under which the authorizations required for such transmissions may be delivered, insofar as the territories in which it operates are situated within the satellite’s footprint.”
- third formula (the “prior consultation” formula): “With regard to direct broadcasting by satellite, the contracting Societies agree that the rights conferred by virtue of Article 1 of this Contract are not limited to the territories of operation but are valid for all countries within the footprint of the satellite of which the transmissions are effected from the territories in which a contracting Society operates, subject to having consulted the other contracting Society beforehand as to the conditions under which the authorizations required for such transmissions may be delivered, insofar as the territories in which it operates are situated within the satellite’s footprint.”

Point 3 of the Sydney addendum also provides that, in the case of the second and third formulae, the prior agreement or prior consultation should necessarily concern the following points: (i) tariffs (“it is desirable to come to a harmonization of tariffs so as to avoid outrageous imbalances; such harmonization should be established at a level which will secure, in any event, a just remuneration for authors”); (ii) sub-right owners (such as sub-publishers; “the conditions for a possible participation of the sub-right owners should be determined pursuant to terms to be settled by bilateral agreement between the Societies concerned”); (iii) deduction for social and/or cultural purposes (“the conditions under which this deduction could be effected and, in conformity with the confederal Rule, within the limit of an effective maximum of 10% applied to the net distributable income, should also be determined according to terms to be settled by bilateral agreement between the Societies concerned”).

- 192 Since the adoption of the model of the Santiago agreement, also other similar global licensing systems have been worked out; in particular the Barcelona agreement of BIEM for mechanical reproduction rights, and the IFPI agreement to authorize simulcasting through the global network.
- 193 Views differ concerning the legal characterization of such kinds of downloading; and owners of copyright (such as publishers) which hold rights of reproduction and distribution tend to favor recognition and application of these rights (which, in certain countries, such as in the United States of America, are recognized in the case of such kinds of downloading; something that is allowed under the WCT as stated and recognized in the Records of the 1996 Diplomatic Conference). In order that the Santiago agreements – after their experimental period – may continue being applicable without any major conflicts, inter alia, there seems to be a need for settling somehow the question of possible parallel or alternative application of “performing rights” (in particular, the right of communication to the public) and copy-related rights in respect of the above-mentioned kinds of downloading.

Chapter VIII

- 194 For further details on collective licensing, see Chapter VII of this Guide. See also Bortloff “Collective Management of Rights in Musical, Literary and Dramatic Works” (speech delivered at the Regional Seminar for the Central Asian Countries on Copyright and Neighbouring Rights, organized by WIPO in cooperation with the government of the Republic of Kazakhstan (Almaty, Kazakhstan, June 28 to 30, 1995; WIPO-Documents WIPO/CNR/ALM/95/12).
- 195 WIPO Performances and Phonograms Treaty (hereinafter referred to as “WPPT”) of December 20, 1996, and available at <http://www.wipo.int/treaties/ip/wppt/index.html>.
- 196 In its “2002 Global Sales Report.” See IFPI’s press release at <http://www.ifpi.org/site-content/press/20030409.html> of April 9, 2003.
- 197 Music Week “Collection Societies Report 2002” of September 28, 2002, at p. 6.
- 198 See IFPI’s press release at <http://www.ifpi.org/site-content/press/20030409.html> of April 9, 2003.
- 199 See Ibid Bortloff “The author in the digital age,” in: GEMA-News Vol. 153 (July 1996) 20 (published speech held during the Frankfurt Music Fair in Spring 1996; in German and English); Schonning, ALAI Nordic Study Days, June 18 to 20, 2000 in Stockholm, in ALAI Report following “Copyright, related rights and media convergence in the digital context”, at p. 137.
- 200 Apple already has had to restrict the file-sharing capabilities of its service due to misuse.
- 201 Music & Copyright No. 243, January 2003, at p. 3.
- 202 Financial Times Business Section, June 18, 2002. Consumers in Japan order 80m new ring tones each month, whereas in Europe 60m are ordered each month (Music & Copyright No. 243, January 2003, at p. 3.).
- 203 Music and Media, December 2002, at p. 13.
- 204 It is noted that, for instance, an artist improvising during his performance might create a new work and therefore also benefits from an author’s right as a composer.
- 205 Available at <http://www.unesco.org/culture/laws/copyright/images/copyrightconvention.rtf>.
- 206 Available at <http://www.wipo.int/clea/docs/en/wo/wo001en.htm>.
- 207 Available at <http://www.wipo.int/clea/docs/en/wo/wo024en.htm>.
- 208 Available at <http://www.wipo.int/clea/docs/en/wo/wo023en.htm>.
- 209 Available at http://www.wto.org/english/docs_e/legal_e/27-trips.pdf.



- 210 Available at http://www.wto.org/english/docs_e/legal_e/26-gats.doc.
- 211 Available at <http://www.wipo.int/clea/docs/en/wo/wo033en.htm>.
- 212 Directive 2000/31/EC of June 8, 2000; available at http://europa.eu.int/ISPO/ecommerce/legal/documents/2000_31ec/2000_31ec_en.pdf.
- 213 Directive 2001/29/EC of May 22, 2001; available at http://europa.eu.int/information_society/topics/multi/digital_rights/doc/directive_copyright_en.pdf.
- 214 It shall be focussed here on the rights provided by the most recent WIPO Treaties complemented, where necessary, by the other above mentioned conventions.
- 215 See the non-exhaustive list at <http://www.ifpi.org>. There are separate societies that only collect for producers or for performers, or joint societies that collect for both.
- 216 Financial Times, Business Section, June 18, 2002.
- 217 Financial Times, Business Section, June 18, 2002.
- 218 In the case of performance rights the so called "grand rights" describing the dramatico-musical performance of the work on stage (see also BC, Art. 11) are neither transferred to a collecting society nor to a publisher.
- 219 Billboard, April 5, 2003, at p. 66.
- 220 See, for instance, the typical soul and jazz sound recordings produced by the labels Motown and Blue Note.
- 221 See the announcement at <http://www.emimusic.com/news/pr180.html>.
- 222 Not all record companies account on this basis: for instance, BMG's accounting model up to the end of 2002 was based on the suggested retail price.
- 223 Under the terms of the cash-and-stock transaction the two majors receive shares and cash. Additionally, both companies have representatives on Roxio's board of representatives.
- 224 See the announcement at http://www.bmg.com/news/articles/artists_article_021120.html.
- 225 Music & Copyright, No. 241, December 11, 2002, at p. 13.
- 226 Billboard, April 5, 2003, at p. 3.
- 227 See the statement of the European Digital Media Association (EDiMA) representing Internet webcasters at a hearing with the European Commission on November 13 and 14, 2000, at http://www.edima.org/news_hearing.html.
- 228 Available at http://www.house.gov/cannon/bills2001/online_music.pdf.
- 229 See the Canadian government's consultation paper of June 22, 2001, available at <http://strategic.gc.ca/SSG/rp00008e.html>.
- 230 See the press release at http://www.echo.com/press/releases/03_01_27.html.
- 231 See for example the European-wide licenses granted by several major record companies to the online-Service OD2 (see details at <http://www.od2.com>).
- 232 See Bortloff, Report for WIPO on "Notice and take-down agreements in practice in Europe" WIPO Document OSP/LIA/3 of 01/12/1999 available at <http://www.wipo.int/eng/meetings/1999/osp/index.htm>; Bortloff "Infringement – The IFPI perspective," in co-operation with Mike Edwards in: Legal and Commercial Effects of Digitisation in the Music Industry (Reports presented at the meeting of the International Association of Entertainment Lawyers, MIDEM 2000), at p. 62 et seq.; Bortloff "Notice and take-down procedures – Views from the recording industry," in: Entertainment Law Review 2000, at p. 153 et seq. Bortloff "Experiences in the fight against electronic music piracy on the Internet," in: 2000, Gewerblicher Rechtsschutz und Urheberrecht (Industrial Property and Copyright, international edition, published by the Max-Planck-Institute (Munich)) at p. 665 (in German).
- 233 Audio compression (rate 1: 12) standard formally called MPEG-1 Audio Layer III and developed by Fraunhofer Institute in Germany.
- 234 According to a study published by Forrester Research in January 2003, one in seven Europeans downloads music. Around one-third of the Internet population, or 13% of all Europeans, uses the Net to download music, and 38% of these download more than seven tracks per month, of frequent downloaders, 63% burn CDs.
- 235 See Ericsson <http://www.computingsa.co.za/2001/03/26/Topnews/top01.htm>.
- 236 Additionally, new EU-rules to be implemented by July 1, 2003 on VAT on E-Commerce follow the principles agreed within the framework of the OECD and have diminished legal uncertainties as to who pays where which applicable VAT on online sales – between EU member states or between the latter and foreign countries (especially the US). EU suppliers will no longer be obliged to levy VAT when selling on markets outside the EU. Non-EU suppliers will have to charge VAT on sales to private consumers based in the EU, just as EU suppliers have to do. For further details about the respective Council Directive and Regulation see http://europa.int/comm/taxation_customs/taxation/ecommerce/vat_en.htm.
- 237 Downloads to a personal device such as an mp3-player is of high importance. Apple combines its successful iTunes Music Store with the popularity of its iPod (the new version introduced simultaneously offers enough storage for 7,500 songs). According to the market research company IDC the compound annual worldwide growth rate for the market for compressed audio players will be 30% pa until 2007 (see press release of June 12, 2003, at www.idc.com).
- 238 Universal Germany's portal Popfile.de and United States-based Apple's iTunes Music Store offer tracks for burning and transferring onto portable devices for €0.99/\$0.99 per track without any subscription and only few restrictions.
- 239 Roxio plans to retool Pressplay before re-releasing it as Napster by March 2004 and it expected to make à la carte downloads a feature of its service.
- 240 In 2001, Virgin Spain entered into a partnership with United Kingdom digital technology company OD2 and a mobile phone operator to promote Bonustrax, a system that allows extra album tracks to be downloaded online, following the purchase of a CD.

- 241 This is why the anti-circumvention rules of the WIPO Treaties and the EU Copyright Directive play such an important role.
- 242 Apple and Music Net, for instance, only deliver to customers based in the United States of America and Popfile only to customers based in Germany.
- 243 SOCAN . / . Canadian Association of Internet Providers et al. 2002 FCA 166, available at http://www.ftc-cf.gc.ca/bulletins/whatsnew/a-764_99_e.pdf. The underlying theory, in various forms, for also clearing the rights in the country of reception is also called Bogsch–Theory (named after the former Director General of WIPO, Arpad Bogsch).
- 244 Agreements that enable each participating society to administer and license the other society’s national repertoire in its territory.
- 245 This agreement has been notified to the European Commission (DG Competition) see OJ C 145, 2 of May 17, 2001.
- 246 Available in English and French from <http://www.biem.org>.
- 247 Sometimes informally named after its designer and author of this Chapter “Bortloff Agreement”, see Dixon, “Issues and Policies in licensing music for Digital Services”, 9th Annual Conference on International Intellectual Property Law & Politics, Fordham School of Law, New York on April 19 and 20, 2001; Grosheide, IIC 2002 Vol. 33, 698, at p. 709; Vinje, “Digital Music Delivery: Navigating one’s way through a legal minefield” speech delivered on November 20 and 21, 2001, during the Softic Symposium 2001, in Tokyo (available at www.softic.or.jp/symposium/open_materials/10th/en/vinje_slides2-en.pdf).
- 248 The author of this Chapter presented the system in an interview with BBC World Service in September 2001. See also the press articles in: International Herald Tribune on September 12, 2001, 16; Music & Copyright No. 213 on September 26, 2001, at p. 5 and 14; MBI special supplement on collecting societies, October 2001, at p. 9; Webnoize.com online edition of September 12, 2001; South China Morning Post (Hong Kong) on September 17, 2001; Billboard Bulletin online edition of September 12, 2001; Billboard on November 22, 2001, at p. 6; Music & Media on September 29, 2001, at p. 1 and 21; Bloomberg News on September 11, 2001; IFPI press release of September 11, 2001 available at <http://www.ifpi.org/site-content/press/20010911.html>.
- 249 See the Commission’s press announcement IP/02/1435 at www.europa.eu.int, and its decision at <http://europa.eu.int/comm/competition/antitrust/cases/decisions/38014/en.pdf> as well as the press announcement by the IFPI Secretariat at www.ifpi.org/site-content/press/20021008b.html; Bloomberg News of October 9, 2002; Communications Daily Vol. 22, Issue 196 of October , 2002; Agence Europe.



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